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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 12 July 2007

Inflation Developments

1. Consumer prices fell by 0.24% in June, bringing 12-month cumulative inflation down by 0.63 percentage points to 8.60%. Accordingly, annual inflation registered a total decline of 2.26 percentage points in the past 3 months and stayed within the uncertainty band.

2. Unprocessed food prices remain volatile. Last month's Summary of the Monetary Policy Committee Meeting mentioned the possibility of more limited price declines of unprocessed food this summer due to early harvest of some vegetable items. Indeed, the decline in vegetable prices in June was less than last year's levels and thus the annual inflation of unprocessed food prices increased, notwithstanding the partial correction in fruit prices. Volatility in fruit and vegetable prices continue to pose risks to the course of headline inflation. Moreover, bad crop of wheat may have adverse effects on consumer prices through bread and grain products.

3. The rise in oil prices had adverse effects on inflation via fuel prices in the past couple of months. Utility prices and non-oil energy items however, continued to display a benign course.

4. Durable goods (excl. gold) inflation fell to 0.32%, per annum, in response to both the strong Turkish lira and the easing demand. On the other hand, the annual inflation in clothing and footwear prices rose to 7.15%.

5. Although the services inflation ceased to decline in June, developments in sub-items suggest a continued downward trend: The main driver of services inflation in June was the rise in mobile phone call rates. The delayed effects of rising oil prices on transportation services also somewhat restrained the decline in services inflation. On the other hand, monthly inflation in other services items remained below last year's levels. In fact, the cumulative rise in service prices was only 4.61% in the first half of the year, the lowest 6-month figure since the 2003-based CPI index was introduced. Annual services inflation is expected to further decline in the forthcoming period.

6. Special CPI aggregates also respond to last year's monetary tightening. The favorable course of services and durable goods prices in the last three months significantly curbed the inflation in special CPI aggregates. Inflation is expected to

come further down in the next couple of months, on the back of the lagged effects of monetary tightening and the high base of the second half of 2006.

Factors Affecting Inflation

7. The Monetary Policy Committee (the Committee) assesses that the recent data on economic activity is broadly consistent with the outlook presented in the April Inflation Report.

8. Although the GDP grew by 6.8% in annual terms during the first quarter of 2007, seasonally adjusted growth was only 0.4%, indicating an ongoing slowdown in economic activity.

9. Contribution of domestic demand to GDP growth was limited during the first quarter of 2007. Seasonally adjusted data suggest that private consumption and private investment expenditures displayed a moderate increase over the previous quarter, while construction investment continued to grow steadily.

10. Consumption spending continued to moderate in the second quarter. The pace of growth in total consumer loans was low during the second quarter compared to the first half of 2006, although personal expenditure loans gained momentum in this period. While automobile loans continued to decrease in the second quarter, other leading indicators on domestic demand such as domestic sales of white goods and imports of consumer goods declined slightly on seasonally adjusted terms during April-May period. Taking into account the significant base effect driven by the strong demand of the last year, the annual growth in private consumption demand is expected to turn to negative in the second quarter.

11. Indicators of investment demand point to a modest recovery. While imports of capital goods displayed a recovery during April-May, the decline in commercial vehicle sales continued to restrain machinery and equipment investment. Construction investment, on the other hand, keep growing, albeit at a moderate pace compared to the previous two years.

12. In the first quarter, annual real growth rate in total government spending was 9.1%, moderating the slowdown in aggregate demand. Primary spending increased by 29.3% in nominal terms, per annum, during the April-May period, indicating that government spending continued to rise at a high pace in the second quarter. This observation is also supported by the January-June figures of the Treasury's primary cash balance.

13. External demand continues to support the economic activity. Industrial production was strong in May with the stimulus of exports. Leading indicators

suggest that export growth remained robust also in June and July. Strong external demand and ongoing productivity gains should support the export growth in the forthcoming period. However, considering the strong second-half figures of last year, the annual rate of growth in exports is expected to moderate in the upcoming period.

14. The marked decline in inflation had a favorable impact on inflation expectations. Improvement in the expectations should continue in the upcoming period as the inflation keeps declining. However, the Committee reads the existing gap between medium-term inflation expectations and targets as a factor requiring caution.

15. In sum, while the developments in energy and food prices, public expenditures, and external demand since the last quarter of 2006 restrain the disinflation process, domestic demand and inflation continue to decelerate thanks to the lagged effects of strong monetary tightening.

Monetary Policy and Risks

16. Recent developments are broadly in line with the April Inflation Report. Therefore, adhering to the outlook presented in the Report, the Committee envisions a measured easing starting from the last quarter of 2007. However, the exact timing and extent of the easing may vary depending on the incoming information regarding external demand, public expenditures and other determinants of medium term inflation outlook.

17. It should be stressed that this policy stance is based on the current information set and thus it should by no means be interpreted as a commitment on behalf of the Committee. The Committee highlighted the following uncertainties that could necessitate a significant revision in the monetary policy outlook in either direction:

18. Inflation expectations remain sticky, partly owing to the elevated headline inflation figures of the past year. Uncertainties regarding the food and oil prices and the incomes policy in 2007 further add to the stickiness in inflation expectations. The present gap between medium term expectations and targets suggests that the target inflation may have been serving less of an anchor recently. This constitutes a risk for wage setting behavior, and hence, for services inflation. Realization of such a risk would slowdown the pace of disinflation, possibly requiring a tighter-than-envisaged monetary policy.

19. There are certain services items, of which, inflation inertia is driven by structural factors and thus, cannot simply be explained by backward indexation. Needless to say, these prices can hardly be influenced by monetary policy. For example, annual rent inflation have remained sticky around 20 percent in the past three years, contributing to annual headline inflation by about one percentage

points each year. Rent inflation is expected to moderate in the next couple of months, and further stabilize in the medium to long term, as the housing supply keeps rising. Nevertheless, the possibility that rent inflation will continue to exceed the other services inflation is considered as a risk factor against the disinflation process.

20. The monetary transmission mechanism has proven to be effective during the past year. Despite the increase in non-interest government spending and the robust external demand that have restrained the speed of disinflation, monetary tightening has been successful to bring inflation back to the projected path heading towards the medium term targets. However, in order to reach the medium term target of 4 percent, the domestic demand needs to stay under control for a while. However, domestic demand conditions may turn less supportive for the disinflation process, once the prevailing uncertainties fade out and the long-term interest rates continue to decline during the second half of the year. Such a situation could lead monetary policy to stay more cautious than implied by the baseline scenario. Nonetheless, such an outcome would be less likely, should the cautious monetary policy stance backed by fiscal discipline.

21. Possible fluctuations in the global liquidity conditions continue to pose risks to the inflation outlook. The inflation and growth outlook for the developed economies are still not clear, and thus, international financial markets continue to be sensitive to new data releases. Ongoing uncertainties over the global imbalances stand out as another risk factor that might lead to abrupt changes in portfolio preferences and liquidity conditions. The Central Bank of Turkey will limit the potential inflationary effects of a possible shift in risk perceptions by pursuing an active liquidity management strategy.

22. In this respect, the Committee, considering the current levels of liquidity, assessed that the Central Bank Liquidity Bills could be used, in addition to the current tools used in open market operations, to enhance the effectiveness of liquidity management when necessary.

23. Prudent monetary policy is necessary but not sufficient for achieving price stability. The role of fiscal policy and structural reforms are also critical in this process. In this respect, the European Union accession process and the implementation of the structural reforms envisaged in the economic program remain to be important for long-term stability. Particularly, advances in structural reforms that would enhance the quality of fiscal discipline are monitored closely with regard to their effects on both macroeconomic and price stability.