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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 16 May 2013

Inflation Developments

1. In April, consumer prices increased by 0.42 percent and annual inflation receded to 6.13 percent. This fall was attributed to the base effect in energy prices besides the developments in unprocessed food prices. Total contribution of the food and energy groups to the annual inflation posted a monthly decline by around 1 percentage point in April. Meanwhile, core inflation indicators remained on a mild track.

2. On the food and non-alcoholic beverages front, annual inflation went down to 6.83 percent. Mainly driven by the prices of fresh fruits and vegetables, unprocessed food prices fell by 2.79 percent in April. In the meantime, price hikes in meat restrained the fall in the group's prices. Annual processed food prices did not post a noticeable month-on-month change in April, while the group's annual inflation decreased to 8.26 percent. Prices of bread and cereals besides processed meat continued to rise, in contrast to the mild course of other processed food prices.

3. Energy inflation maintained its favorable course owing to the decline in international oil prices, and the group's prices fell by 0.98 percent in April. Being also driven by the high base in the same period of the last year, annual energy inflation went down by 4.28 percentage points to 4.94 percent. The base effect led by energy prices will remain as the determinant on the course of annual inflation in the period ahead. The said effect is estimated to push inflation up in the May-July period, and pull it down later on.

4. Prices of services edged up by 0.54 percent in April, while annual services inflation remained flat with 7.26 percent on a monthly basis. Annual inflation in transport and restaurant-hotel services decreased in contrast to the increase in other subcategories. The uptrend in rent inflation has accelerated recently. Meanwhile, both the seasonally adjusted rate of increase of the prices of services and the diffusion index registered an increase in April.

5. Annual inflation in core goods group went down to 3.61 percent in March. All the subcategories of core goods saw a decline in annual inflation, and the seasonally adjusted figures settled on a downward track.

Factors Affecting Inflation

6. Data regarding the first-quarter of 2013 point that final domestic demand follows a healthy recovery. Notwithstanding the weak course in March, the industrial production index recorded a quarter-on-quarter increase. In the same period, production and imports of both consumption and investment goods registered increases. Among the data regarding the second quarter, domestic sales of automobiles besides the credit data of April also point that the recovery of first quarter will continue. The consumer confidence index also displays a similar outlook. Against this background, the Monetary Policy Committee (the Committee) assessed that final domestic demand would have a sizeable contribution to growth in the first half of the year. Nevertheless, uncertainties regarding the global economy may restrain investment growth in the forthcoming period.

7. Data pertaining to foreign trade and the current account balance are evolving in line with expectations. Exports slow down due to weak global economic activity. As for imports, an increase was recorded upon the revival in domestic demand, which will bring a rise in the current account deficit. However, the Committee assessed that the current policy framework and the decline in commodity prices would contain the widening in the current account deficit.

8. Seasonally adjusted data suggest that unemployment rates went down on account of the rise in employment in February 2013. The increase in non-farm employment was mainly driven by the services sector besides the industrial sector, which settled on a trend of recovery in the last quarter of 2012. Meanwhile, employment in the construction sector remained flat. Survey indicators suggest that industrial employment will decelerate in the second quarter. The Committee expects that total employment will register mild increases in the period ahead.

Risks and the Monetary Policy

9. Capital inflows remain strong and credit growth hovers above the reference rate. The Committee indicated that, in order to balance the risks on financial stability, the proper policy would be to keep interest rates low while increasing foreign currency reserves via macroprudential measures. Accordingly, it was deemed appropriate to implement a measured tightening via reserve requirements and reserve options coefficients, while delivering a cut in the short term interest rates.

10. The Committee has continued its strategy to increase the effectiveness of the Reserve Options Mechanism (ROM) gradually in response to the heightened volatility in capital inflows. The Committee indicated that, in order to enhance the automatic stabilizer effect of the mechanism, the coefficients should be adjusted

upwards and a new tranche should be added to the existing scheme. The Committee has underscored that more effective utilization of the ROM reduces the need for a wider interest rate corridor.

11. Ongoing uncertainties regarding the global economy and the volatility in capital flows necessitate the monetary policy to remain flexible in both directions. Therefore, the impact of the measures undertaken on credit, domestic demand, and inflation expectations will be monitored closely and the funding amount will be adjusted in either direction, as needed.

12. The Committee has indicated that the weak global demand and the commodity price outlook contain the upward pressures on inflation. In the meantime, the impact of increases in credit and domestic demand on the pricing behavior will be monitored closely.

13. The Committee monitors fiscal policy developments and tax adjustments closely, with regard to their effects on the inflation outlook. In the setting of monetary policy, the framework outlined in the Medium Term Program is taken as given. In this respect, it is assumed that fiscal discipline will be sustained and there will be no unanticipated hikes in administered prices. A revision in the monetary policy stance may be considered, should the fiscal stance deviate significantly from this framework and consequently have an adverse effect on the medium-term inflation outlook.

14. Prudent fiscal and financial sector policies are crucial for preserving the resilience of our economy against existing global imbalances. Strengthening the structural reform agenda that would ensure the sustainability of the fiscal discipline and reduce the savings deficit would support macroeconomic stability in the medium-term. This will also provide more flexibility for monetary policy and improve social welfare by keeping interest rates of long-term government securities persistently at low levels. In this respect, implementation of the structural reforms envisaged by the Medium Term Program remains to be of utmost importance.