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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: October 16, 2007

Inflation Developments

1. Consumer prices increased by 1.03 percent in September, bringing year-on-year inflation rate down to 7.12 percent. As foreseen in the summary of the previous Monetary Policy Committee (the Committee) Meeting, annual inflation continued to decelerate in September, following a temporary rise in August.

2. The volatility in the prices of fresh vegetables and fruits impede the predictability of monthly inflation figures. Moreover, processed food prices have displayed sharp increases over the last several months, due to temperatures above seasonal averages and drought conditions as well as the Ramadan effect. The course of food prices has increased the importance of core indicators excluding the food group. Therefore, the Committee noted that it would be useful to underscore the ongoing deceleration in non-food inflation.

3. Although energy prices continued to rise in September, at a much higher rate than the past few months due to soaring crude oil prices, they still supported the disinflation process in the first nine months of the year. There may be some price increases in certain energy group items such as electricity and water in the upcoming period. The Committee assessed that the impact of these rate hikes on inflation would be temporary.

4. The slowdown in services prices, which has become evident since July, was quite strong in September, bringing annual services inflation down by 2.5 percent in the past three months. Although the pace of disinflation process is particularly noteworthy in rents and restaurants-hotels group, the deceleration in services inflation is quite visible in other items as well. Since the beginning of the year, annual inflation rate has declined by 3 percentage points in rents and 5 percentage points in transportation services.

5. The effect of monetary tightening on special CPI aggregates has been quite visible. The slowdown in seasonally adjusted monthly increases in the widely cited core indicator, H-index (CPI excluding energy, unprocessed food, alcohol-tobacco and gold), confirms the downward trend in inflation.

6. All in all, notwithstanding the risks related to energy, food and administered prices, inflation is expected to decelerate owing to the lagged effects of strong monetary tightening.

Factors Affecting Inflation

7. The Committee assesses that the second-quarter Gross Domestic Product (GDP) data point to a moderate growth in domestic demand and economic activity. In this period, private and public investments were the main drivers of domestic demand growth, whereas the increase in private consumption demand was rather limited.

8. Leading indicators for the third quarter point to an ongoing recovery in private investment expenditures. Domestic sales of commercial vehicles recorded high growth rates in both annual and quarterly terms. While the machinery-equipment production for the July-August period remained below the second quarter levels, electrical machinery production continued to increase in the same period, albeit at a slower pace. In the July-August period, imports of capital goods, an indicator of investment demand, displayed a noticable rise compared to the second quarter. To sum up, initial readings in the third quarter indicated a strong recovery in investment demand, although that demand is mainly for imported goods.

9. Consumption demand has started to recover in the third quarter. The composition of the aggregate demand has been shifting in favor of domestic demand. According to seasonally adjusted figures, domestic sales of white goods, imports of consumer goods for the July-August period, and domestic sales of automobiles for the third quarter grew significantly over the preceding quarter. Third-quarter average of the CNBC-e consumption index is above its second-quarter level, and consumer confidence indices confirm the modest recovery in consumption demand.

10. The Committee assesses that the aforementioned developments indicate a modest recovery in domestic demand, rather than an overheating in the economy, following the slowdown since the second half of 2006. Although quarterly growth rates of real consumer credit have been somewhat rising recently, they still remain below the periods where domestic demand was more robust. Likewise, domestic sales of automobiles, despite the recent recovery in the third quarter, remains at modest levels.

11. Industrial production figures in August and estimates for September also confirm the moderate growth in domestic production. Industrial production for the July-August period increased by 5 percent compared to the same period

last year, while seasonally adjusted figures indicate a slight increase over the preceding quarter. Despite the recent recovery, furniture manufacturing, a sub-sector believed to reflect consumer demand, is still below the level it reached during the first half of 2006, when the domestic demand was strong.

12. While growth in exports has maintained its strong pace, the rate of increase in imports has surpassed that of exports in the June-August period due to the recovery in domestic demand and the appreciation of the Turkish lira. Therefore, it is projected that the contribution of net exports to GDP growth in the second half of the year will be negative.

13. To sum up, readings on recent economic activity are in line with the outlook presented in the July Inflation Report. While private consumption and investment demand exhibits signs of recovery, external demand moderates and aggregate demand conditions continue to support the disinflation process. This trend is likely to continue in the upcoming period as well.

14. The upward trend in crude oil prices persisted in the recent period. In addition, other commodity prices also continued to be on the rise. Prices of agricultural products used as main inputs for processed food, such as wheat and corn, continue to rise. However, the strong domestic currency partially offsets the rise in crude oil and other commodity prices and curbs input costs.

15. Lagged effects of monetary tightening since the second half of 2006 seems to have curtailed the unit labor costs in the overall economy, primarily in the services sector. Downward trend in unit labor costs in the manufacturing industry confirms this view. Although no wage data for the services sector is available, a similar conclusion might well be drawn for this sector in view of the slowdown in the growth rate of employment and prices.

Monetary Policy and Risks

16. The Committee assessed that the September rate cut decision led to a significant fall in both the medium and long-term interest rates, reducing the downward risks on medium term inflation posed by global economic developments.

17. In light of these developments, the Committee decided to continue the measured rate cuts. The Committee underlines that the current level of the short-term interest rates remains restrictive even after the recent policy rate cuts. The Committee assesses that, under the current policy stance envisaging a measured and cautious rate cut cycle, the risks on attaining the inflation target in the medium term are balanced.

18. Considering the downward trend in interest rates, the Committee decided to narrow the gap between borrowing and lending rates in order to limit the extent of potential upside fluctuations in overnight interest rates. In this regard, borrowing rates are reduced by 50 basis points, while lending rates are cut by 75 basis points. It should be noted, however, that main policy instrument of the Central Bank is the overnight borrowing rates, and thus the additional cut in lending rates is merely a technical adjustment.

19. The Committee stated that the timing and extent of further easing would depend on the incoming information regarding global liquidity conditions, external demand, public expenditures and other determinants of the medium term inflation outlook. In other words, the future monetary policy decisions will be data dependent. Main risks to the inflation and monetary policy outlook can be summarized as follows:

20. The Committee closely monitors the developments in international liquidity conditions and credit markets. As of today, a sharp slowdown on global economic growth is not perceived as the most likely scenario, leading to continued capital flows to emerging markets. However, that the risks in the financial markets have not yet been adequately priced necessitates caution. The CBT, in case of a heightened risk aversion and a decline in risk appetite towards emerging financial markets, will aim at limiting the effects of possible market fluctuations on inflation outlook by pursuing an active liquidity management strategy, as well as by utilizing other policy instruments if needed.

21. Recent volatility in credit markets has partially offset the upside risks to the aggregate demand mentioned in the July Inflation Report. However, there are some remaining risks to the demand outlook. On one side, the extent to which the recent decline in longer-term rates will stimulate the domestic demand is yet to be observed. On the other side, a sharper-than-envisaged slowdown in global growth will ease both the external demand and, through the tighter credit conditions, the domestic demand. Financing conditions and credit developments will continue to be closely monitored in the face of these upside and downside risks. If credit conditions turn out to be more favorable than expected and the domestic demand accelerates, this may lead to a more cautious policy stance than implied by the baseline scenario, as well as the use of policy tools other than short term interest rates, such as required reserves and alike. Likewise, materialization of downside risks would lead to a downward adjustment in the policy stance.

22. As of the meeting date, medium term outlook is based on the assumption that government expenditure targets will be met in 2008 and incomes policy will be set in line with inflation targets. On the other hand, the fact that efforts to

readjust the primary budget balance are more focused on increases in indirect taxes as opposed to expenditure cuts poses a risk to the predictability of inflation.

23. The sustained rise in food prices is considered as an important risk to the inflation outlook. Our medium term projection envisages a gradual correction in which food inflation converges to headline inflation in the medium term. However, low crop yields in 2007 and recent global trends have increased upside risks to the food inflation. On the other hand, past cumulative hikes have created a high base in food prices, increasing the possibility of a downward adjustment. Potential volatility in food prices continue to pose risks to the inflation outlook on both sides, since food prices constitute a large fraction of the CPI index. The Committee will not react to the developments in food prices as long as the second round effects are contained.

24. There are some uncertainties over the medium term impact of the recent developments in energy prices. Owing to cumulative increases in international oil and natural gas prices, recently the need to make a sizeable adjustment in electricity prices has been on the agenda. The price of water, classified as an energy item in the CPI, may also display a significant rise in the last quarter of 2007, although the rate of increase may differ across regions. Moreover, international crude oil prices have continued its upward course. Medium term impact of the rise in energy prices on inflation will be limited, as long as the inflation expectations and the price setting behavior remains intact. However, since the energy price is an important factor of production, it should also be added that recent developments in energy prices have compelled the CBT to be relatively more cautious. On the other hand, switching to a cost-based automatic pricing mechanism in electricity would reduce the risks on shortage of supply as well as on price stability.

25. Turkey has taken significant steps towards price stability in recent years. However, it is not yet possible to define the current state as price stability. The CBT will continue to exercise its policy instruments to attain price stability and thus to improve welfare of the society in the medium term. During this process, it is particularly important not to sacrifice long-term permanent gains in favor of temporary benefits.

26. The support of fiscal policy and structural reforms are also critical in achieving price stability. In this respect, the European Union accession process and the implementation of structural reforms envisaged in the economic program remain to be of concern. Particularly, advances in structural reforms that would enhance the quality of fiscal discipline are monitored closely with regard to their implications on macroeconomic and price stability.