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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: November 14, 2007

Inflation Developments

1. Consumer prices rose by 1.81 percent in October, bringing annual inflation to 7.70 percent. The main source of increase in annual inflation rate was the prices of food and non-alcoholic beverages, which posted a month-on-month increase of 3.41 percent.

2. The recent run-up in food prices has continued to have an adverse effect on consumer prices, in Turkey as well as the rest of the world. Both processed and unprocessed food inflation maintained its upward trend in October due to drought-related supply shortfalls. The year-on-year increase in the prices of food and non-alcoholic beverages reached 14.71 percent. Meanwhile, non-food inflation continued its downward trend and declined to 5 percent.

3. The annual inflation in energy group dropped to 4.82 percent in October. Continued strength of the New Turkish lira limited the impact of the sharp rise in crude oil prices on domestic fuel prices. The increase in the prices of energy items for housing group was also limited. However, the Monetary Policy Committee (the Committee) noted that the prices of energy group would increase in November due to new municipal water tariffs in Istanbul, the hikes in the Special Consumption Tax levied on fuel products, and the record-high oil prices in global markets.

4. The slowdown in the annual inflation of goods excluding energy and food has continued in October. The decline in the annual inflation rate of consumer durables and clothing-footwear group in particular has lowered the year-on-year increase in the prices of goods excluding energy and food to 2 percent.

5. Annual services inflation did not display a significant change in October. The increase in the annual growth rate of prices of restaurants-hotels and communication services suspended the downtrend in annual services inflation. Recently, prices of restaurants-hotels have been under pressure from the rapidly rising food prices. Prices in other services, on the other hand, maintained their moderate course.

6. The Committee assessed that the hikes in administered prices might delay the disinflation process in the short run. The impact of these adjustments will be observed mostly in November. The tax hikes in fuel and tobacco products and the new water tariffs are likely to contribute around 0.8 points to monthly inflation in November. In

addition, the expected adjustments to electricity and natural gas prices may delay the downward trend in inflation. On the other hand, a partial correction in the prices of unprocessed food group is likely to offset some of the pressure on November inflation.

7. Notwithstanding the risks related to energy and food prices, inflation is expected to decelerate in the medium term owing to the lagged effects of strong monetary tightening.

Factors Affecting Inflation

8. Readings on recent economic activity are in line with the outlook presented in the October Inflation Report. While private consumption and investment demand shows signs of recovery, external demand has been moderating and aggregate demand conditions have continued to support the disinflation process.

9. Indicators for the third quarter economic activity point to a recovery in private consumption. During this period, domestic sales of automobiles and white goods as well as imports of consumer goods recorded noticeable growth in seasonally adjusted terms, compared to the second quarter. The CNBC-e consumption index and the October figures for domestic sales of automobiles suggest that the recovery in private consumption continues in the fourth quarter. Recent data on consumer loans also display a similar pattern. The Committee noted that, despite the recent recovery, the quarterly growth rate in consumer loans still remains below the levels recorded in the first half of 2006 when the domestic demand was strong.

10. Import figures of capital goods indicate that the recovery in investment has continued in the third quarter. October figures of domestic sales of light commercial vehicles suggest a similar trend in investment demand in the fourth quarter. The recovery in investment demand is mostly import-driven, which contains the capacity pressures on economic activities. Moreover, it should be noted that the domestic sales of commercial vehicles is still at low levels compared to the episodes when the domestic demand was strong. Under the current policy stance envisaging a measured and cautious rate cut cycle, the domestic demand is expected to continue to recover at a moderate pace.

11. Industrial production figures also point to an ongoing modest growth in economic activity in the third quarter of 2007. Industrial production for this period increased by 4 percent compared to the same quarter of the previous year, but it remained nearly flat in seasonally adjusted terms, with a slight increase of 0.4 percent over the preceding quarter. The Committee assessed that the slowdown in industrial production observed in September would be temporary. Leading indicators for the fourth quarter signal a relatively stronger industrial production in October.

12. External demand and productivity gains continue to support exports. On the other hand, the recovery in domestic demand and the relative price effect raised the demand for imported goods, reducing the contribution of net exports to GDP. In fact, the quarter-on-quarter growth in import surpassed that of exports in real terms in 2007 Q3. Therefore, the contribution of net foreign demand to GDP growth is likely to be negative in the second half of 2007.

13. Turning to cost pressures on inflation, crude oil prices have been on the rise since August. In addition, agricultural commodity prices have continued to follow an upward trend due to drought-related supply shortfalls and increased demand for agricultural products in bio-fuel production. However, strong New Turkish Lira has partially offset the adverse effects of rising commodity prices on domestic inflation.

14. Unit labor costs declined in the first half of the year thanks to ongoing productivity gains in the manufacturing industry, albeit at a slower rate. Recent increases in industrial production as well as current trends in employment and wages suggest that unit labor costs maintained their downward trend in the third quarter.

Monetary Policy and Risks

15. In light of these assessments, the Committee maintained the policy stance in the October Inflation Report, assessing that the risks against attaining the inflation target in the medium run are balanced under a measured and cautious rate cut cycle. It should be underlined that the current level of short-term interest rates remains restrictive even after the recent rate cuts. As a matter of fact, inflation in durable goods and services—CPI sub items sensitive to monetary policy stance—display a benign course. The Committee underscored the need for close monitoring of services inflation in assessing the medium term outlook, as it represents the nontradable component of inflation that is more sensitive to demand and less sensitive to exchange rates.

16. The timing and extent of further easing will depend on incoming information regarding global liquidity conditions, external demand, public expenditures and other determinants of the medium term inflation outlook. There are both upside and downside risks to the medium term outlook:

17. Market interest rates came down significantly in the past couple of months, partly owing to the increased accommodation in monetary policy. However, ongoing uncertainty in mature credit markets limits the impact of monetary easing on domestic demand. Yet, the lagged impact of recent rate cuts on credit and consumption growth remains to be seen. On the other hand, the possibility of a sharper-than-expected slowdown in global growth poses a downside risk on aggregate demand. The Committee thus underlined that both domestic and external demand conditions should be monitored closely.

18. There is still uncertainty as to the impact of difficulties in credit markets on global financial flows. The Central Bank of Turkey (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.

19. The contribution of food prices on annual inflation reached to 4 percentage points in October. Food prices continue to pose risk on inflation forecasts. Lower food production due to adverse weather conditions and ongoing uncertainties on crop yields has been affecting food inflation all over the world. On the other hand, past cumulative hikes have created a high base in food prices, increasing the possibility of a downward correction. Besides the food prices, recently crude oil prices have also followed a higher course than the level assumed in our baseline scenario in the October Inflation Report. The rise in the price of oil affects inflation not only through energy prices but also through food prices, as the increased demand for bio-fuels drives up world prices for many farm products.

20. The Committee considers the impact of administered price hikes on inflation as temporary. Survey respondents appear to agree with this view, as the medium term inflation expectations have not deteriorated after the announcement of price hikes. Nonetheless, it should also be added that possible increases in electricity and natural gas prices have compelled the Committee 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.

21. To sum up, energy and food prices continue to pose risks to the inflation outlook. The CBT will not react to first round impacts of these developments. Potential second round effects of rising food and energy prices, however, will be closely monitored.

22. Finally, it should be emphasized that the support of fiscal policy and structural reforms are critical in achieving price stability. In this respect, the European Union accession process and the implementation of structural reforms envisaged in the economic program, which will ensure the sustainability of productivity gains, 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.