No: 33

27 December 2007

SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting date: December 13, 2007

Inflation Developments

1. Consumer prices rose by 1.95 percent in November, bringing the annual inflation to 8.40 percent. Administered prices accounted for about 1 percentage point of the month-on-month increase in headline inflation. The upward trend in the prices of processed food and catering services group suggest that the drought continued to be effective on food inflation in November as well.

2. Energy prices edged up sharply in November by 6.78 percent, raising the annual inflation in this group to 11.02 percent. This was mainly attributable to the rise in the prices of fuel oil and LP gas, driven by hikes in the Special Consumption Tax, as well as to the new municipal water tariff in İstanbul. Aside from adjustments in administered prices, the recent increase in international oil prices was also instrumental in the rise of energy prices. The planned hikes in electricity and natural gas prices in the upcoming period, together with the future course of oil prices, pose a significant risk to energy prices.

3. Despite the decline in the prices of clothing and footwear, the year-on-year inflation in goods excluding energy and unprocessed food posted an increase in November due to significant price hikes in processed food, tobacco products and gold. The prices of consumer durables, on the other hand, maintained its downward trend in November. Following the tax hikes on tobacco products, the prices of alcoholic beverages and tobacco group increased by 6.51 percent month-on-month, bringing the annual inflation rate for this group to 17.21 percent. In other words, nearly 0.85 percentage points of the annual CPI inflation stems from the tobacco prices.

4. Annual services inflation slightly increased in November due to the rise in the prices of recreational and cultural services, and restaurants and hotels group. In line with sustained increases in food prices, catering services inflation has been accelerating recently. The Monetary Policy Committee noted the continued slowdown in rents and transportation services inflation and assessed that recent developments in services inflation were favorable except for food price-driven increase in catering services inflation.

5. Adverse developments in food prices due to drought and global factors have put an upward pressure on core inflation indicators via higher prices of processed food and catering services. Yet, the Committee assessed that readings on inflation do not present an unfavorable outlook when food-related items and administered prices are excluded. Therefore, inflation is expected to decelerate further despite the upside risks related to food and energy prices.

Factors Affecting Inflation

7. Gross Domestic Product (GDP) increased by 1.5 percent in the third quarter of 2007 compared with the same period of last year. Seasonally adjusted figures, on the other hand, pointed to a 0.6 percent decline over the second quarter. Domestic demand gave a strong boost to GDP, while the public sector contributed to growth at a slower rate; the contribution of net foreign demand, however, was noticeably negative. While the lagged effects of the monetary tightening have continued, albeit at a weaker rate, temporary supply shocks in the agricultural sector have accentuated the slowdown in economic activity.

8. The contribution of private consumption demand to growth improved significantly over the third quarter, consistent with the leading indicators reported in previous reports. In seasonally adjusted terms, private consumption demand, which has grown modestly since mid-2006, increased by 2.3 percent in this period compared to the previous quarter, mainly on the back of spending on durables and semi- or non-durables.

9. Despite the rebound in private consumption demand, the pace of public consumption showed little change from previous quarters, whereas restrictive measures on the fiscal side has shown its impact on public investments. The recovery in domestic demand was mainly driven by private consumption, whereas private investments lost momentum on a quarterly basis.

10. Leading indicators for the fourth quarter points to a moderate recovery in economic activity. Industrial production grew by 7.9 percent year-on-year in October and was up markedly from September in seasonally adjusted terms. Indicators for private consumption and investment demand also suggest a similar outlook. According to the seasonally adjusted data, following a downbeat reading in September, domestic sales of automobiles grew rapidly in the October-November period compared to the third quarter. The CNBC-e consumption index also exceeded its third-quarter average. Moreover, imports of consumer goods jumped in October compared to the same month last year. Seasonally adjusted domestic sales of white goods also rebounded in October but remained below the third-quarter average.

11. Consumer loans also continue to increase at moderate rates. The Committee assessed that, in addition to the lagged effects of monetary tightening, ongoing problems in global credit markets were restrictive on the growth of consumer loans in the fourth quarter of 2007.

12. The Committee underlined the essence of investments for the sustained productivity gains. Despite a slowdown in machinery-equipment production, imports of machinery-equipment gained speed in October over September and also the preceding quarter. In addition, both production and imports in the electrical machinery industry increased significantly on a year-on-year and per quarter basis. Following a rebound in the third quarter, domestic sales of light commercial vehicles recorded high growth rates during the October-November period compared to the previous quarter. Imports of capital goods grew sharply by 41.3 percent in October on a year-on-year basis and seasonally adjusted figures point to a continued acceleration. In sum, leading indicators except for machinery-equipment production suggest that investments picked up in the fourth quarter on a yearly and quarterly basis.

13. Exports continue to expand owing to productivity gains and on the back of strong external demand. Preliminary data indicate that exports recorded a high growth rate in November in dollar terms. Nevertheless, according to quantity indices that exclude the price effect, real exports grew at a lower pace than real imports in the second half of the year. The strengthening demand for imported goods, particularly automobiles and commercial vehicles and other capital goods, signal that the contribution of net foreign demand to growth will continue to be negative in the last quarter.

14. To sum up, the modest recovery of the private demand continues, while aggregate demand conditions continue to support the disinflation process on the back of slowdown in public expenditures and net external demand.

15. The Committee noted that the recent labor market developments also contain valuable information on the current state of the economy. Readings on seasonally adjusted figures showed that the growth rate of services employment, particularly in wholesale/retail trade and in restaurants/hotels, has been slowing down since mid-2006. This trend became more pronounced in the third quarter of 2007. Accordingly, the decline in non-farm unemployment rate came to a halt in the past year. Looser labor market is likely to restrain wage inflation in the overall economy.

16. While employment in the industrial sector posted a year-on-year decrease in the third quarter of 2007, labor productivity has maintained its upward trend. Current trends in employment and production suggest that unit labor costs will slightly decline in the fourth quarter of 2007 owing to continued rise in productivity.

Monetary Policy and Risks

17. Drought and energy related supply shocks not only increase inflation temporarily but also have short term adverse effects on growth. In fact, the contraction in the agricultural output in 2007 explains much of the recent dynamics in inflation and output. The Committee underlined that the primary goal of the Central Bank of Turkey (the CBT) is to achieve price stability, and noted that monetary policy remains restrictive even after the recent rate cuts.

18. The CBT is focused on attaining the medium term inflation target of 4 percent, in a framework where monetary policy does not react to temporary and exogenous shocks. The Committee, judging the recent rise in inflation as temporary, maintained the policy stance presented in the October Inflation Report, and assessed that, under a measured and cautious rate cut cycle, the risks against attaining the inflation target in the medium run are balanced. The timing and extent of further easing will depend on incoming information regarding global liquidity conditions, external demand, fiscal policy implementation and other factors affecting the medium term inflation outlook. Risks to the inflation and monetary policy outlook can be summarized as follows:

19. Ongoing uncertainties in global financial markets had an adverse impact on consumer and investor confidence. It has also tightened credit conditions, laying the ground for measured and cautious rate cuts. Nonetheless, there are still difficulties in assessing the overall risk. Uncertainties on global risk appetite and the extent of slowdown in global growth persist, which poses risks on the outlook for monetary policy.

20. Food prices remain as an important risk factor for inflation. Besides the drought-related factors, increased demand for bio-fuels drives up world prices for many farm products such as corn and wheat. Although there is some chance of a downward correction in unprocessed food prices, the processed food prices are likely to follow an elevated course in the short term. Yet, food inflation is expected to normalize in the medium term.

21. Although administered prices led to a rise in headline inflation recently, the impact on medium term expectations was rather limited. However, potential second round impacts of the planned hikes in electricity and natural gas prices compels the Committee to be cautious.

22. Accordingly, potential effects of rising food and energy prices on overall price setting behavior in the economy will be closely monitored.

23. Finally, it should be emphasized that the support of fiscal policy and structural reforms are critical for achieving and maintaining price stability. 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. Sustaining the productivity gains is essential for attaining price stability while preserving high growth rates. 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 critical.