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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 26 March 2013

Inflation Developments

1. In February, consumer prices were up by 0.30 percent and annual inflation decreased to 7.03 percent, which is attributed to food prices. Meanwhile, core inflation indicators and prices of services remained on a mild track.

2. On the food and non-alcoholic beverages front, annual inflation went down to 5.60 percent. Annual unprocessed food inflation fell to 1.87 percent particularly due to vegetable prices. Moreover, the deceleration in the monthly rate of increase in processed food prices got more pronounced in this period. Although bread and cereals group maintained rising prices in line with the domestic wheat prices outlook, annual processed food inflation went down by 0.5 percentage points to 8.39 percent owing to the favorable course of other processed food products in February. On the other hand, leading indicators point that annual unprocessed food inflation will rise in March.

3. Energy prices increased by 0.64 percent in February, while the annual energy inflation went down to 11.75 percent. Domestic fuel prices rose by 1.85 percent upon the surge in international oil prices. Meanwhile, international oil prices in March went back to the level projected in the January Inflation Report.

4. Annual services inflation crept up to 7.21 percent. Across subcategories, annual inflation increased in communication and transport services; but remained unchanged in rents, restaurants, hotels and other services. Meanwhile, both the seasonally adjusted underlying trend and the diffusion index of the prices of services edged up; yet the group’s prices remained on a mild track in February.

5. Inflation in core goods group rose by 0.14 percentage points to 4.46 percent. Prices fell at a higher rate than seasonal averages in the clothing group; while durable goods prices saw increases due to automobile and furniture prices. Thus, annual durable goods inflation, which has been recently decreasing, went up in February. Meanwhile, annual inflation in core goods excluding clothing and durables maintained the downward trend. Overall, seasonally adjusted data indicates that the underlying trends of core inflation indicators maintained their relatively mild track.

Factors Affecting Inflation

6. Data regarding the first quarter of 2013 suggests that economic activity continues to improve. Industrial production increased on a monthly basis in January, partially compensating the decline in December. Both the course of automobiles and white goods sales and credit data indicate that the domestic demand is on an upward track. Survey indicators signal that a healthy recovery has started in final domestic demand due to a revival in both investment and consumption demand.

7. Recent data pertaining to the current account balance and foreign trade are as envisaged. Notwithstanding the sluggish global growth, the underlying trend of exports displays a relatively positive outlook owing to the product and market diversification. On account of the rebound in domestic demand, imports exhibit a marked increase. This leads to some widening in the current account deficit. The Monetary Policy Committee (the Committee) has assessed that the current policy framework will contain the deterioration in the current account balance.

8. Seasonally adjusted non-farm employment continued to increase, albeit at a slower pace, in December 2012. However, unemployment rates edged up due to higher labor force participation rates. The rise in the non-farm employment in this period was triggered mainly by the industrial sector, which settled on a trend of recovery in the last quarter of 2012. In line with the rebound in economic activity, employment is expected to increase gradually in the forthcoming period. Nevertheless, uncertainties regarding the global economy may restrain investment and employment growth in the forthcoming period.

Monetary Policy and Risks

9. During the early months of the year, financial conditions have improved markedly with the impetus from strong capital inflows, and consequently credit growth has hovered above the reference rates. The Committee has assessed that first quarter credit growth suggests a trend faster than the reference rate of 15 percent which is deemed as healthy for Turkey.

10. Following the heightened global uncertainty, capital inflows have decelerated in the recent period. Ongoing policy uncertainty in advanced economies and problems in the Euro area have led to a slowdown in capital inflows, once again increasing the volatility.

11. The Committee has decided 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. More effective

utilization of the ROM reduces the need for a wider interest rate corridor. In this respect, the interest rate corridor was made more symmetric by cutting the overnight lending rates by 100 basis points.

12. Ongoing uncertainties regarding the global economy 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. The Committee stated that liquidity management will be more important in the forthcoming period. Accordingly, the share of one-month funding was decreased in order to tighten the liquidity conditions to some extent.

13. The Committee foresees that tighter liquidity policy along with the weaker capital inflows will slow down the credit growth. Necessary measures will be taken through liquidity policy, ROM, and reserve requirements should the capital inflows re-accelerate.

14. Weakening global demand and the commodity price outlook contain the upside risks on inflation. The fragile outlook of global economy exerts downward pressures on energy and base metal prices. Moreover, recent developments suggest that the recovery in the Euro area—our largest trade destination, may be weaker than expected. All these developments 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.

15. 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.

16. 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, steps towards implementation of the structural reforms envisaged by the Medium Term Program remain to be of utmost importance.