No: 2011 – 57 **30 November 2011**

SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: November 23, 2011

Inflation Developments

1. In October, consumer prices were up 3.27 percent and annual inflation climbed to 7.66 percent. October price developments were highlighted by increases in administered prices, which contributed to the monthly inflation by 1.35 percentage points. While core goods inflation continued to increase parallel to the exchange rate movements, the prices of services maintaineda moderate course in this period.

2. Administered prices went up due to the tax hikes and adjustments in energy prices. In this period, the Special Consumption Tax (SCT) rates were raised on some motor vehicles, mobile phones, alcoholic beverages and tobacco products. As foreseen, the largest contributor to inflation within SCT hikes became tobacco products with 0.8 percentage points. Price adjustments in energy due to the increases in electricity and natural gas tariffs added 0.5 percentage points to inflation. Moreover, it should be noted that the adjustments in tobacco products will further contribute around 0.2 percentage points to November inflation.

3. Despite an increase by 4.04 percent in the prices of food and alcoholic beverages in October, annual inflation in this group continued to decline due to the base effect in unprocessed food prices. Owing to the price increases in fresh fruits and vegetables amid adverse weather conditions, unprocessed food prices rose by 7.56 percent. On the processed food front, the rise in annual inflation came to a halt in October. Due to the rapid increases in unprocessed food prices and the base effects, annual food inflation is expected to rise markedly during the last two months of the year.

4. Prices of services rose by 0.56 percent in October, and annual services inflation went up to 6.63 percent. Seasonally adjusted data point to a deceleration in services inflation. Annual core goods inflationcontinued to increase in this period due to the ongoing exchange rate pass-through, reaching 8.77 percent in October. This rise was attributed to durable goods prices in particular. Meanwhile annual inflation went up in theclothing group as well. Thus, the annual inflation of the core price indicators displayed an increase, while the seasonally adjusted data exhibited a relatively milder trend.

Factors Affecting Inflation

5. Recent data releases point to a notable reduction in economic growth in the second half of the year. Industrial production displayed a modest growthconsistent with the slowing domestic demand and deteriorating global outlook. Capacity utilization rates remained below the pre-crisis levels. The Committee noted that global problems would continue to put a cap on the industrial activity in the forthcoming period.

6. The final domestic demand continues to slowdown. The depreciation in the Turkish Lira and recent tax adjustments coupled with the uncertainties regarding the global economy, are expected to weaken the demand for durable goods, particularly the sales of vehicles, in the forthcoming period. Besides, the decline in consumer and investor confidence feed into this downtrend.Moreover, the recent and notable slowdown in consumer loans also supports this outlook.

7. The Committee indicated that the lagged effects of the policy measures undertaken since November 2010 to rebalancethe domestic and external demand would be more pronounced in the last quarter of the year. Additionally, the restrictiveimpact of global problems on the externalfinancing may contribute to the tightening in domestic lending conditions in the forthcoming period. Besidesthe developments in credit conditions, thelow levels in capacity utilization rates coupled with the mounting uncertainties in demand pose a downward risk on investments. All these indicators signal that the deceleration in domestic demand will continue.

8. External demand remains weak. Recent downward revision of medium-term growth forecasts for the U.S. and the euro area points to a steadily worsening outlook for the global economy. The Committee underlined that the outlook for the world economy noticeably deteriorated compared to the first half of the year and that global problems would continue to restrain foreign demand notwithstanding the competitive advantage provided by the exchange rate movements.

9. Parallel to the economic activity, the slowdown in seasonally adjusted non-farm employment continued in August. Meanwhile, unemployment rates declined owing to the fall in the labor force participation rate. Contrary to the robust course in the construction sector, employment in services slowed down, driven by trade, restaurants, hotels, transport and communication. Employment in the industrial sector declined in this period, whereas leading

indicators point that global problems will continue to put a cap on the employment conditions in the sector.

Risks and Monetary Policy

10. In light of these developments, the Committee has indicated that the rebalancing between the domestic and external demand is ongoing as envisaged. The rebalancing takes place through imports, as the external demand remains weak due to prevailing problems regarding the global economy. In fact, seasonally adjusted real imports data suggest to a slowdown since the second quarter.

11. The Committee has underscored the key role of credits in the rebalancing process. Recent slowdown in credit growth has been restraining the amount of expenditures financed through borrowing. With the credit growth decelerating to more reasonable levels, the desired increase in private savings has already started to take place. Accordingly, the improvement in the current account balance is expected to become more significant in the final months of the year.

12. The Committee has noted that inflation will display a rapid increase in the short-term due to the base effects from unprocessed food prices. Base effect will be stronger in November and inflation is expected to exceed the target significantly at the end of the year. The Central Bank has delivered a strong tightening in October in order to prevent the potential second round effects of this development. The tightening is having an impact on credit and domestic demand as of the final quarter. In this respect, domestic demand is expected to follow a moderate path and second round effects of the temporary price movements will be contained in the forthcoming periods.

13. The Committee members have emphasized the importance of having a flexible monetary policy framework against the exceptionally high level of uncertainty across global financial markets. Currently, active use of the interest rate corridor through effective liquidity management provides the required flexibility. In this context, monetary policy stance can be changed at a daily frequency by adjusting the liquidity operations. The impact of the measures undertaken on credit, domestic demand, and inflation expectations will be monitored closely and the amount of Turkish lira funding via one-week repo auctions will be timely adjusted on both sides, if needed.

14. Developments in the financial markets are monitored closely because of the persisting uncertainty regarding global economy. Especially, ongoing concerns on the sovereign debt dynamics in the euro area and the possibility of a contagion to financial markets which would further deepen the global problems emerge as a main risk factor. In line with the strategy formulated at the interim

meeting of August 4, 2011, the Committee will continue to monitor global developments closely and take the needed measures promptly to maintain the stability in the domestic financial markets.

15. Monetary policy will continue to focus on price stability while preserving financial stability as a supplementary objective. To this end, the impact of the macroprudential measures taken by the CBRT and other institutions on the inflation outlook will be assessed carefully. Strengthening the commitment to fiscal discipline and the structural reform agenda in the medium term would support the relative improvement of Turkey’s sovereign risk, and thus facilitate macroeconomic and price stability. Sustaining the fiscal discipline will also provide more flexibility for monetary policy and support the social welfare by keeping long term interest rates permanently at low levels. In this respect, timely implementation of the structural reforms envisaged by the new Medium Term Program remains to be of utmost importance.