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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 17 September 2013

Inflation Developments

1. In August, consumer prices edged down by 0.10 percent and annual inflation receded to 8.17 percent, which was attributed to unprocessed food and energy prices. Food and energy groups added 0.9 percentage points less to the annual inflation compared to July. Due to the recent depreciation in the Turkish lira, core inflation indicators exhibited a slight increase.

2. Annual inflation in the food group went down to 10.25 percent. The unprocessed food group saw falling inflation amid plunging prices of fresh fruits and vegetables. On the processed food front, despite the decelerating course of the prices of bread and cereals, annual inflation reached 8.32 percent upon rising prices of other processed food products. Leading indicators point to a further downward movement in the annual unprocessed inflation in September.

3. Energy prices went up owing to the depreciation of the Turkish lira coupled with increasing oil prices. Nevertheless, the annual energy inflation declined due to the base effect in August. Similarly, the annual energy inflation is envisioned to decline further in September, despite the persisting rise in fuel and bottled gas prices.

4. Prices of services edged up by 0.61 percent, and the annual services inflation reached 8.18 percent in August. Seasonally adjusted data suggest that the underlying trend of services inflation remained on a high track as well. Annual inflation in the core goods group climbed to 4.58 percent in August. Durable goods prices continued to rise, while the seasonal price reduction in the clothing group remained below that in past years. In this framework, due to the depreciation of the Turkish lira, the seasonally-adjusted trend of increase in core goods prices followed an upward course.

5. In sum, inflation is expected to fall further in the upcoming period; yet core inflation indicators are foreseen to remain above the target for a while.

Factors Affecting Inflation

6. GDP exhibited a stronger-than-expected growth in the second quarter of 2013. Final domestic demand, which surged in the first quarter in seasonally-adjusted terms, remained flat in the second quarter. Meanwhile, the change in stocks contributed greatly both to the quarterly and annual growth. On the other hand, exports followed a milder course amid the weakening global demand. Thus, aggregate demand conditions did not exert an upside pressure on inflation.

7. Recent data suggest that final domestic demand and exports continue to grow at a moderate pace. Production and imports of consumption goods registered increases in July on a quarterly basis, while available data on the sales of white goods and automobiles and credit utilization of the third quarter indicate an uptick in consumption demand. Imports of capital goods and production of capital goods excluding vehicles besides the production of other non-metallic minerals display a sluggish outlook in investments. Industrial production in July posted higher figures compared to the average of the previous quarter. Indicators of the PMI, the Business Tendency Survey and leading exports data reveal a mild recovery across the third quarter.

8. Data regarding foreign trade and the current account balance are in line with expectations. Despite an expected increase in the annual cumulative current account deficit due to the base effect from the gold trade in the short term, it is anticipated that gradual improvement in the current account balance excluding gold trade will continue.

9. Due to the slowdown in non-farm employment, the seasonally adjusted unemployment displayed an increase in the June 2013 period. Most of the subcategories, primarily the industrial sector employment, exhibited a decline in this period. Total Employment Expectation, among the CBRT Business Tendency Survey indicators, and the PMI Employment Index signal that industrial employment may remain weak. In addition, uncertainty regarding the global economy remains as a risk factor that may restrain investment and employment growth in the forthcoming period.

Monetary Policy and Risks

10. Inflation is expected to fall further in the forthcoming period. The Committee indicated that, under the assumptions of no additional adjustments in administered prices and the continuation of benign trend in unprocessed food prices, year-end inflation is likely to be close to the forecast presented at the July

Inflation Report. However, core inflation indicators are likely to hover above the inflation target for some time due to the exchange rate volatility observed during the recent months. The impact of these developments on the pricing behavior is closely monitored. Therefore, the Committee stated that the cautious monetary policy stance will be maintained and additional monetary tightening will be implemented at the appropriate frequency until the medium term inflation outlook is in line with the medium term targets.

11. The current policy framework is improving the current account balance. The weakness in capital flows, cautious monetary policy stance and the macroprudential measures undertaken will gradually bring down the loan growth rates to more reasonable levels. Accordingly, gradual decline in the current account deficit excluding gold trade is expected to continue.

12. According to the Committee, increasing the predictability of the Turkish lira liquidity policy is important in order to contain the repercussions of uncertainties in global monetary policies on the domestic economy. It was underlined that fluctuations in financial markets in this period largely reflect a “re-pricing” effect. Thus, the strategy to reduce policy rate uncertainty contributes greatly to the prevention of the economy from being dragged into a vicious circle that is not driven by economic fundamentals. In fact, it was expressed that, following a clearer signal regarding the monetary policy, the sensitivity of domestic policy rates to global rates has weakened to a large extent and recently market rates rather respond to domestic macroeconomic developments, as they should.

13. Recent developments have shown that global economy continues to be fragile. Therefore, developments regarding price stability and financial stability will be closely monitored and necessary adjustments will continue to be made in the composition of Turkish lira liquidity provided by the Central Bank.

14. The Committee monitors fiscal policy developments and tax adjustments closely with regard to their effects on the inflation outlook. The baseline monetary policy stance takes the fiscal framework outlined in the Medium Term Program as given. Accordingly, 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.

15. 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 will ensure the sustainability of the fiscal discipline and reduce

the savings deficit will 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, implementation of the structural reforms outlined by the Medium Term Program remains to be of utmost importance.