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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 16 April 2013

Inflation Developments

1. In March, consumer prices were up by 0.66 percent and annual inflation increased to 7.29 percent. This rise was attributed to unprocessed food prices, while core inflation indicators remained on a mild track.

2. On the food and non-alcoholic beverages front, annual inflation went up to 8.10 percent. Mainly driven by the prices of fresh fruits and vegetables and the base effect, annual unprocessed food inflation jumped by around 5 percent and stood at 6.79 percent in March. In addition to the persisting price increases in the bread and cereals group, annual processed food inflation went up owing to the rising processed meat prices as well. On the other hand, leading indicators for April point that following the upsurge in the first quarter of the year, unprocessed food prices will be subject to a correction.

3. Energy prices maintained their favorable course in March. First-quarter price increase, which was 4.1 percent on average in the 2010-2012 period, stood at 0.86 percent this year owing to the stable courses of oil prices and the Turkish lira. On account of the base effect, group's inflation is projected to fluctuate in the forthcoming period.

4. Prices of services went up by 0.42 percent in March and annual services inflation increased to 7.32 percent. Across subcategories, rents and prices of transport services explain the rise in annual inflation. Meanwhile, both the seasonally adjusted rate of increase of the prices of services and the diffusion index edged up in March.

5. Annual inflation in core goods group went down to 4.29 percent in March. Annual inflation in the clothing group further decelerated following February, and inflation in core goods excluding clothing and durable goods also continued with its downward track. On the other hand, annual inflation in durable goods group saw increases due to automobile and furniture prices in March as well. Overall, seasonally adjusted data indicates that the underlying trend of core inflation indicators maintained on a relatively mild track.

Factors Affecting Inflation

6. Data regarding the first-quarter of 2013 point that final domestic demand follows a healthy recovery. Having increased both in January and February subsequently, industrial production compensated the sharp decline in December and posted a quarterly increase. In the same period, production and imports of both consumption and investment goods registered increases. Domestic sales of automobiles and white goods besides the credit data regarding the first quarter also display a similar outlook. Against this background, the Monetary Policy Committee (the Committee) has assessed that final domestic demand would have a sizeable contribution to growth in the first quarter.

7. Data pertaining to foreign trade and the current account balance are evolving in line with expectations. Exports slow down due to weak global economic activity. As for imports, an increase was recorded upon the revival in domestic demand, which led to a rise in the current account deficit. The Committee has assessed that current account deficit may continue to increase, yet the current policy framework and the decline in commodity prices would contain the widening in the current account deficit.

8. Seasonally adjusted non-farm employment continued to increase in January 2013, and unemployment rates receded. This fall in unemployment was attributed to the rise in the non-farm employment. The increase in the non-farm employment rate was mainly driven by the industrial sector, which settled on a trend of recovery in the last quarter of 2012. Survey indicators suggest that industrial employment remained on an upward track. Total employment is expected to register mild increases in the forthcoming period. Nevertheless, uncertainties regarding the global economy may restrain investment and employment growth in the forthcoming period.

Risks and the Monetary Policy

9. The Committee has indicated that domestic and external demand have been evolving in line with expectations. Domestic demand follows a healthy recovery while exports slow down due to weak global economic activity. Increases in the non-farm employment support the demand through disposable income growth. Moreover, financial and monetary conditions continue to support domestic demand. Therefore, the contribution of domestic demand to economic growth is expected to increase gradually. In fact, developments for first quarter economic activity suggest a marked recovery in domestic demand, especially through investment demand: However, ongoning global uncertainty and weak external demand still pose downside risks regarding the recovery in economic activity.

10. Recently, the current account deficit has increased slightly following the revival in domestic demand. However, the current policy framework and the decline in commodity prices are expected contain the widening in the current account deficit. Current policy strategy contains the deterioration in the current account by weakening the impact of capital inflows on the credit growth and exchange rate

11. Recently, there is a re-acceleration in capital inflows and credit growth hovers above the reference rate. Both the improved risk perceptions towards Turkey and the monetary stimulus package announced by the Bank of Japan suggest that capital inflows may remain strong in the forthcoming period. On the other hand, uncertainties regarding Euro area may lead to fluctuations in the risk appetite. All these developments once again point to the importance of having a flexible and multi-instrument monetary policy framework.

12. The Committee indicated that, in order to balance the risks on financial stability, the proper policy would be to keep interest rates low while increasing foreign currency reserves via macroprudential measures. Accordingly, it was deemed appropriate to further increase the reserve options coefficients, while delivering a cut in the short term interest rates. The Commitee has reiterated that more efficient use of reserve option mechanism reduces the need for a wide interest rate corridor.

13. Ongoing uncertainties regarding the global economy and the volatility in capital flows 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.

14. The Committee has indicated that the weak global demand and the commodity price outlook contain the upward pressures on inflation. Although unprocessed food prices pose upside risk regarding inflation forecasts, the fall in commodity prices partly offset this risk. 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, implementation of the structural reforms envisaged by the Medium Term Program remains to be of utmost importance.