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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: July 21, 2011

Inflation Developments

1. In June, consumer prices decreased by 1.43 percent, and annual inflation went down to 6.24 percent. As foreseen in the summary of the June Monetary Policy Committee (the Committee) meeting, this decline was largely driven by the developments in unprocessed food prices due to correction in fresh fruit prices. Hence, annual inflationreverted back to theprojected path in the April Inflation Report.

2. Prices of food and nonalcoholic beverages decreased by 6.40 percent following the downward correction in theunprocessed food price index, and the group's annual inflation went down by 4.48 percentage points to 8.13 percent. On the processed food front, prices of fats and oilscontinued to rise in June, while ongoing decreases in meat and dairy prices contained the increases in processed food prices.

3. Prices of services rose by 0.76 percent in June, while annual services inflation increased by 0.58 percentage points to 5.02 percent. This rise in annual inflation was driven by prices of tour packages.Due to lagged effects of rising fuelprices,the rate of increase in transport prices gained a slight momentum. Rentscontinued to rise moderately. On the other hand, seasonally adjusted figures indicate that prices ofservices posted a slower quarter-on-quarter increase in the second quarter.

4. Annual core goods (excluding food, energy, alcoholic beverages, tobacco and gold) inflation continued to risedue to cumulative increases in import prices,to 5.56 percent in June.Among durable goods (excluding gold), automobile and furniture prices surged, whereas prices of white goods fell. The rate of increase in clothing prices continued to rise year-on-year.However, seasonally adjusted data indicate a deceleration in the core goods inflation.

5. While core inflationindicators increased in June owing to the developments in prices of services and core goods, theirunderlying trend followed a downward path. TheCommittee anticipates that core inflation is likely to display some upward movement over the short term, but the increase is expected to be limited due to the slowdown in economic activity.

Factors Affecting Inflation

6. Recent data releases are broadly consistent with the outlook presented in the April Inflation Report. Second-quarter data indicate a pronounced slowdown in economic activity. In fact, seasonally adjusted industrial production was down for four consecutive months since February,and materialized below the first-quarter average in the April-May period. Similarly, the manufacturing industry capacity utilization rate, which has been declining since the turn of the year, remained flat in June, pointing thatrecently economic activityremains weak.

7. Private consumption shows signs of slowdown, while investment growth is moderating. Production and imports of consumption goods remained below first-quarterfigures in the April-May period.Indicators on investment demand suggest a deceleration as well. Meanwhile, the sales data also confirm the slowdown in domestic demand.

8. External demand outlook remains weak. Recent data indicate a limited recovery in exports for the second quarter. Both global PMI indices and recent figures for new orders suggest that external demand conditions would remain weak in the third quarter. In fact, low levels of capacity utilization rates persist due to weak external demand. Considering the mounting uncertainty regarding the global economy, the Committee has reiterated that exports would recover slowly and gradually.

9. Employment conditions continue to improve, with unemployment rates back to pre-crisis levels.After the first quarter’s faster-than-expected growth, non-farm employment continued to risein April. Leading indicators suggest that thisuptrend in non-farm employment would continue at a slower pace in the short term. The Committee has stated that,despiteimproved employment conditions, unit labor costs decreased due to strong productivity gains.

Monetary Policy and Risks

10. The Committee has indicated that, due to the measures taken so far, the domestic demand is now under control and reiterated that the current account balance will start to improve in the final quarter of the year. It was stated that the recent measures taken by the Banking Regulation and Supervision Agency and the tight fiscal policy stance support the policy mix implemented by the Central Bank, and thus contribute to the rebalancing of domestic and external demand. Although the rate of credit growth has yet to decline to the levels compatible with the financial stability, the Committee members expect

further deceleration in the second half of the year owing to the lagged impact of tightening policies.

11. In light of these assessments, combined with the heightened uncertainty regarding the global economy and the slowdown in domestic economic activity, the Committee has decided to maintain the current policy mix.

12. The Committee has also assessed the forecasts prepared for the July Inflation Report. It was concluded that inflation forecast path would remain largely unchanged, since there has been no significant revision in the underlying assumptions compared to the April Inflation Report. Nevertheless, the Committee members underscored that developments since the April Inflation Report have increased the downside risks regarding the global economy; and therefore, this view should be emphasized in the Inflation Report and other communication documents regarding monetary policy.

13. Problems in credit, real estate and labor markets in advanced economies are yet to be solved. Moreover, concerns on fiscal dynamics in these economies still persist. Especially, mounting problems regarding sovereign debt of the euro area peripheral economies have increased the downside risks on the global economy. The Committee members indicated that it would be appropriate to narrow the interest corridor gradually should the sovereign debt problems regarding some European economies and the concerns on global growth continue to have adverse impact on the risk appetite. Moreover, the Committee stated that all policy instruments may be eased, should global economic problems intensify and lead to a contraction in domestic economic activity.

14. Even if the debt problems in the euro area are resolved before they turn into a global crisis, it is still likely to experience an extended period of weak economic activity in advanced economies coupled with continued growth in emerging markets driven by domestic demand. In such a case, there may be a resurge in short term speculative capital inflow to emerging markets. This would also mean weak external demand and elevated commodity prices, feeding into macro-financial risks for the domestic economy, fueled by the rising capital inflows. The Committee stated that, should this scenario materialize, low policy rates and high reserve requirements may be preserved for an extended period to contain the risks against price and financial stability.

15. Developments in exchange rates and import prices have been putting pressure on core inflation since the last quarter of 2010. The hike in customs duties on fabric and apparel imports is another factor that could lift up the core inflation indicators. Under current circumstances the increase in core inflation reflects relative price movements, as the existing output gap contains the second round effects of relative price movements. However, the core inflation

is expected to further increase in the forthcoming period, posing upside risks regarding inflation expectations and price setting behavior. The Committee will not hesitate to tighten monetary policy, should such a risk materialize and threaten the achievement of medium term inflation targets. The exact mix to be used for policy tightening in such a case will depend on developments regarding domestic demand, capital flows, current account and credit growth.

16. The Committee expects the impact of the ongoing tightening measures on credit volume and domestic demand to be more significant during the second half of the year. However, the extent and the timing of the impact may vary depending on the developments beyond the control of monetary policy. The lagged effects of the policy measures on price and financial stability will be closely monitored and additional measures will be taken if deemed necessary.

17. The Committee will continue to monitor fiscal policy developments closely while conducting monetary policy. Sustaining the fiscal discipline under current circumstances is essential to limit the risks posed by the current account deficit driven by the disparity between domestic and external demand. Saving the extra revenues acquired throughthe tax amnesty and strong economic activity would not only reduce price and financial stability risks, but also increase the efficiency of the new policy mix. In this respect, inflation forecasts presented in the baseline scenario of the July Inflation Report assume that the extra budget revenues will be saved to a large extent. 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.

18. 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 Central Bank 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 interest rates permanently at low levels. In this respect, timely implementation of the structural reforms envisaged by the Medium Term Program and the European Union acquis communautaire remains to be of utmost importance.