

PRESS RELEASE

**JULY INFLATION, FORWARD LOOKING EXPECTATIONS AND INTEREST
RATES**

I. GENERAL EVALUATION

1. In July, consumer prices and wholesale prices increased by 1.4 percent and 2.7 percent, respectively. While the increase in consumer prices stayed within the expected range, the wholesale prices increased beyond the expected level. Annual inflation sustained its downward trend and CPI (Consumer Prices Index) inflation came down to 41.3 percent and WPI (Wholesale prices Index) inflation to 45.9 percent.
2. Disregarding the seasonal factors, deseasonalized CPI and WPI increased by 2.6 and 3.4 percent, respectively in July.
3. Despite the decline in food and textile prices in July, the rise in the prices of consumer durables and communication services played an important role in the course of the consumer prices in July. Notwithstanding the favorable developments in the agricultural sector, wholesale price inflation accelerated due to upward movements in public prices and the depreciation of Turkish lira. In July, CPI excluding food rose by 2.2 percent and WPI excluding agriculture by 4.2 percent.
4. The annual inflation trend, computed using 3 month moving average of deseasonalized CPI and WPI, was 30,2 and 33,6 respectively. On the other hand, using the same method, the WPI inflation trend excluding agriculture prices was 45.4 percent and CPI inflation trend excluding food was 32.8 percent.

Table 1: General CPI and WPI and sub-items

	Yearly Change %		Monthly Change %		
	2001	2002	2002		
	July	July	May	June	July
CPI	56,3	41,3	0,6	0,6	1,4
Goods	61,4	43,9	0,1	0,2	0,6
Services	47,8	36,5	1,6	1,4	3,1
Excluding Food	58,7	41,0	2,0	2,2	2,2
WPI	65,4	45,9	0,4	1,2	2,7
Public	78,6	44,5	2,7	4,3	4,3
Private	60,5	46,5	-0,4	0,0	2,0
Private					
Manufacturing	69,2	45,8	1,5	2,8	4,1
Excluding					
Agriculture	72,6	45,6	1,9	3,4	4,2
Excluding					
Agriculture and					
Energy	71,1	45,8	2,0	3,5	4,4

Source: CBRT, SIS

Developments in Consumer Prices:

5. The adverse effect of the increase in public prices and the depreciation of Turkish lira on consumer prices manifested itself in July. An accelerated increase was observed in the sub-items excluding food and textiles -- especially in consumer durables and services group.

6. The decline in food and textile prices was the most prominent factor containing further increase in CPI. However, the prices of consumer durables comprised of electrical and non-electrical devices, cultural and recreational activities and private transportation vehicles increased by 5.1 percent due to recent depreciation of Turkish lira. Moreover, the rise in the prices of communication services, transportation services, health services and energy, which are under government control, have had an adverse effect

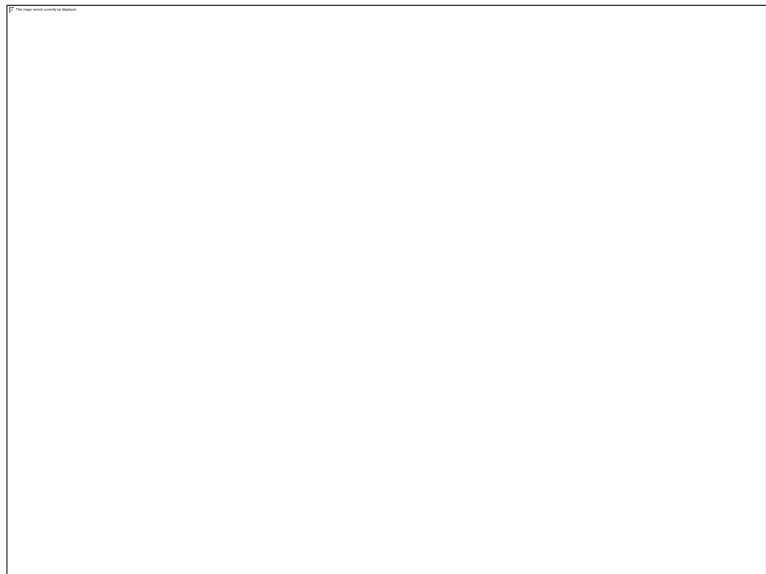
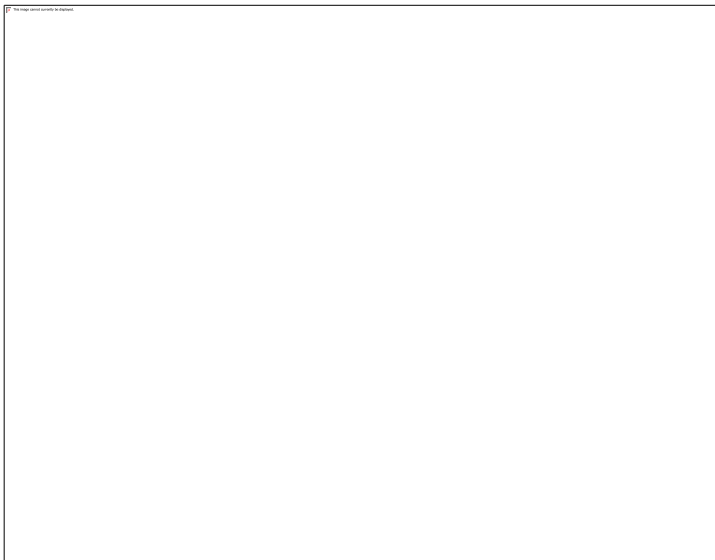
on consumer inflation. The decline in the food and textile prices, however, has helped to contain the increase in CPI at 1.4 percent level.

7. The 1.1 percent and 3.5 percent decrease in food and textile-shoes sectors, respectively, have helped to contain the goods price inflation at 0.6 percent level. Induced by the 15.6 percent rise in communication services prices, 7.5 percent in hospital services prices and 4.8 percent in transportation prices, services prices rose by 3.1 percent. As of July, the annual increase in prices of goods and prices of services scored 43.9 percent and 36.5 percent, respectively.

Figure 1: CPI and CPI Excluding Food

Annual Percentage Change

**Monthly Percentage Change
(Deseasonalized)***

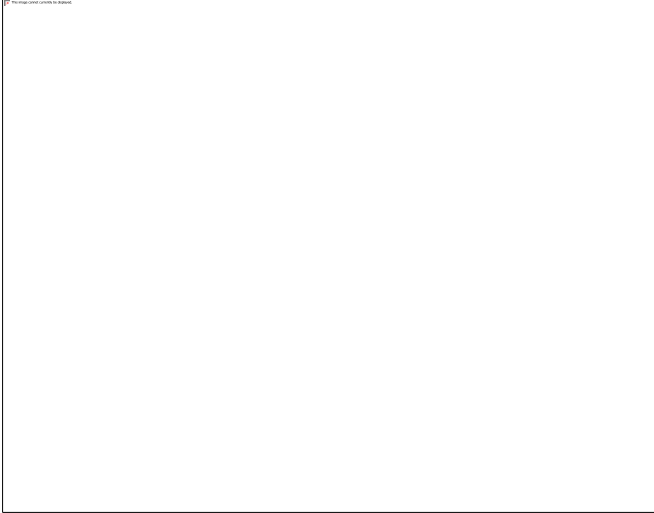


Source: CBRT, SIS

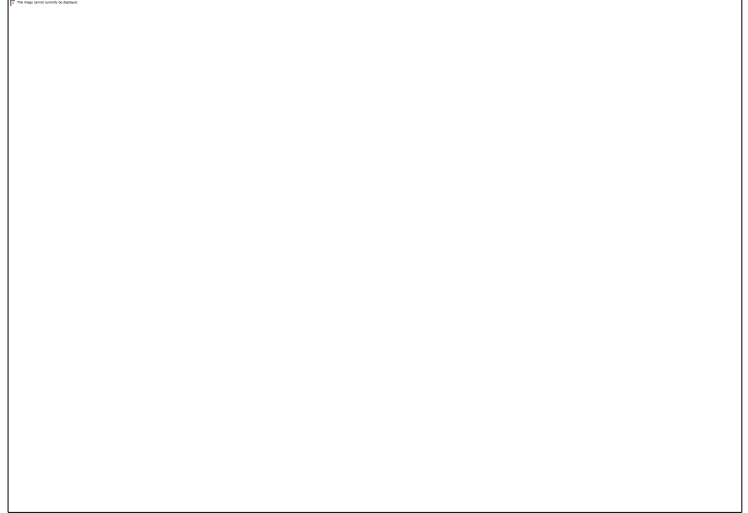
*TRAMO/SEATS Method has been employed for deseasonalization.

Figure 2: Prices of Goods and Services

Annual Percentage Change



Monthly Percentage Change (Deseasonalized)*



Source: CBRT, SIS

*TRAMO/SEATS Method has been employed for deseasonalization.

Developments in Wholesale Prices Index

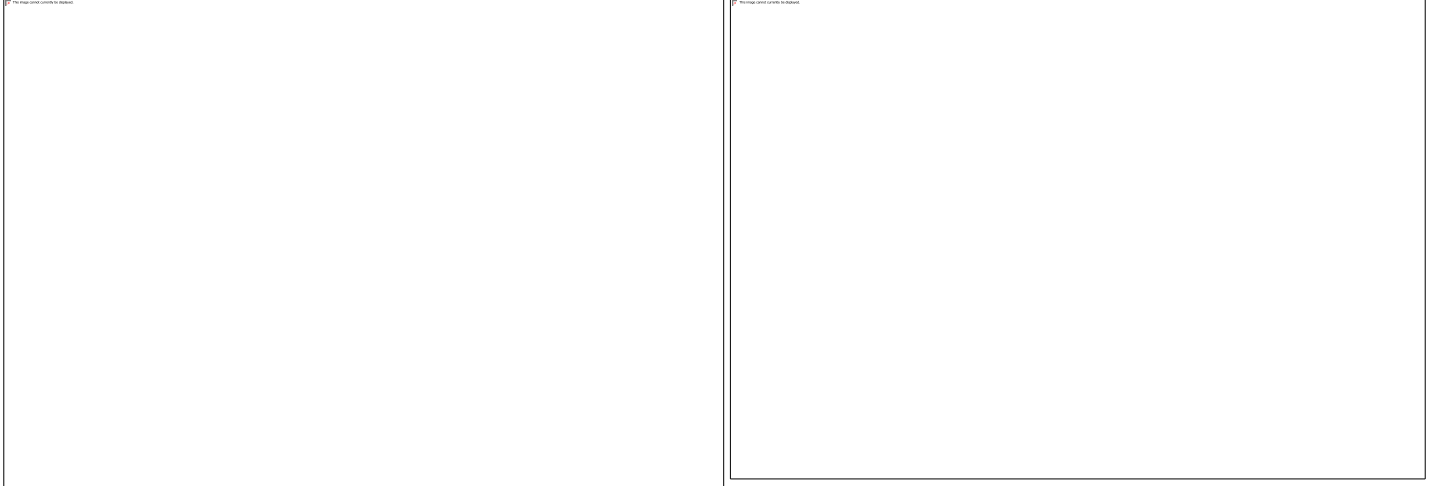
8. In July, the rise in manufacturing industry prices was the main determinant of the increase in WPI. The fact that Turkish lira depreciated nominally against the foreign currency basket by 11.5 and 10.4 percent respectively in June and July has underlined the increase in manufacturing industry prices. Moreover, the rise in the public sector manufacturing industry prices led to an increase in private manufacturing industry prices by 4.1 percent.

9. As was the case in June, the main factor restraining further increase in WPI prices other than seasonal factors in July was again the agricultural prices that dropped by 2.9 percent. The main reason behind the decrease in agricultural prices was low domestic demand and excess agricultural supply due to seasonal factors. While deseasonalized WPI increased by 3.4 percent in July, increase in deseasonalized WPI excluding agriculture was 4.2 percent.

Figure 3: WPI AND WPI Excluding Agriculture

Annual Percentage Change

Monthly Percentage Change (Deseasonalized)*



*TRAMO/SEATS Method has been employed for deseasonalization.

II. FORWARD-LOOKING EXPECTATIONS

10. As will be recalled, in the Central Bank's Press Release dated June 28, 2002, it was stated that:

- a) During the period from last autumn up until the emergence of political uncertainty, the program had started to produce positive results and the general acceptance that this program was the right one to bring stability to the Turkish economy became prevalent,
- b) The structural reforms carried out recently had decreased the vulnerability of the economy against political uncertainties and external shocks,
- c) There is no option other than strictly adhering to the fundamental principles of the current program which is bringing the stability Turkish Economy was longing for,
- d) The structural and operational measures have been taken in line with the economic program,
- e) Fundamental institutional arrangements have been made owing to the structural reforms so as to minimize election-oriented economic policies that may jeopardize the sustainability of economic stability,

- f) The Central Bank did not expect the economic program to be interrupted by exogenous shocks,
- g) Market sentiment was expected to keep up its positive trend with the elimination of political uncertainties,
- h) The Central Bank was maintaining its positive outlook for the period ahead,

and it was stated that the perceptions of political uncertainty affected the economic expectations and also the foreign exchange rates and interest rates adversely.

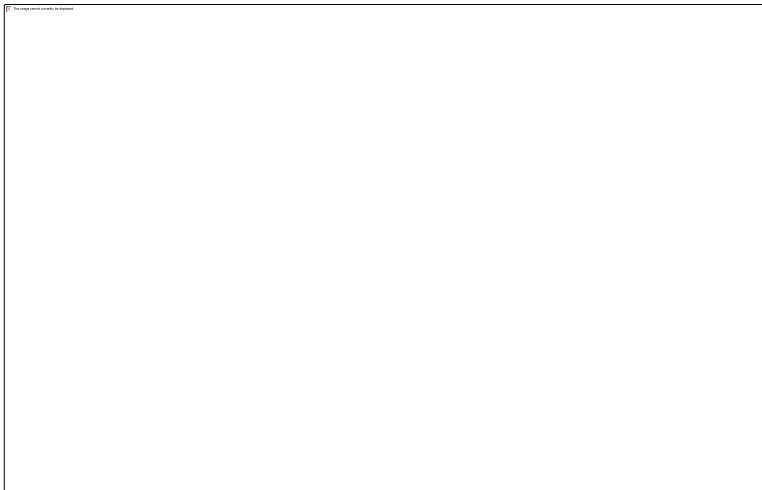
11. Since May, when the political uncertainty emerged, both the interest rates and foreign exchange rates have risen and there has been a standstill in the improvement of economic expectations. While the interest rates of the benchmark Government security in the secondary market due April 9, 2003 decreased to 52 percent at the end of April, it soared to 77 percent in June and floated around 75 percent until the end of July. Compared to end-April figures, US dollar appreciated by 27 percent and Euro by 38 percent against Turkish lira in July. With the deteriorating expectations, the reverse currency substitution that started at the end of 2001 came to halt which also supported the increase in foreign exchange rates. The interest rates at the Central Bank's Turkish lira deposit buying auctions with 4 weeks maturity provide important hints about the market risk perception. While the average compound interest rate of the Turkish lira deposit buying auction held on May 8, 2002 was 61.00 percent, the average interest rate in the auction dated July 12, 2002 became 67.47 due to the recent uncertainties.

12. According to the CBRT expectations survey, the accelerated downward trend in forward-looking inflationary expectations since December 2001, has stopped due to the recent developments not directly related to the implementation of the economic program. However, recently, despite the depreciation of the Turkish lira and the rise in interest rates, which worsened short-term inflationary expectations, the fact that there is no deterioration in the long-term expectations suggests that the points highlighted in our press release dated June 28, 2002 have been acknowledged by the markets. The results of the public surveys conducted in the second half of July indicate that the expectations are still consistent with the end-year targets and there will be no

difficulty in attaining these. Expected inflation for the next 12 months stayed around 32 percent level in the last two months, exhibiting a flat trend.

13. Establishing confidence in the economic program, stability in foreign exchange and Turkish lira markets, appreciation of Turkish lira and implementation of tight monetary and fiscal policies as planned have been the key determinants of the price developments in the January-May period. On the other hand, starting from the second half of May, depreciation of Turkish lira has adversely affected the prices in the sectors that are relatively more sensitive to developments in foreign exchange prices.

Figure 4: Inflationary Expectations according to the Expectations Survey conducted by the Central Bank



Source: CBRT

14. Increases in manufacturing industry prices sensitive to exchange rate depreciation and the increases in prices of administered goods can indirectly affect the prices in other sectors. Therefore, in

case that the political uncertainty perception prevails and that the foreign exchange and Turkish lira markets cannot be stabilized in the short run, the above-mentioned price increases may pose a risk to the success of disinflation.

15. Nevertheless, during last week, there have been some developments that would decrease the uncertainties to a great extent. Passing by the Turkish Grand National Assembly of the European Union Harmonization Laws that would accelerate Turkey's accession to EU is a development that would provide momentum to Turkey's economic development and affect the expectations of the markets in a positive way. Setting the early election date as November 3, 2002 has already decreased the

perception of political uncertainty. Following these two developments that were received positively by the markets, both the interest rates on Government Securities and the foreign exchange rate have dropped considerably. While the compound interest rate of the Government Securities due April 9, 2003 was around 76 percent at the end of July, it dropped down to 68 percent in the operations on August 2, 2002 with value date August 5, 2002. Similarly, while exchange rate for 1 US dollar was 1.690.000 Turkish liras at the end of July, it declined to 1.650.000 on August 2, 2002.

16. While the compound interest rate at the Central Bank's Turkish lira Deposit Buying Auctions with 4 weeks maturity-- one of the risk perception indicators in the markets-- was 67.47 percent on July 12, 2002, this rate declined to 64.56 percent on August 2, 2002. These favorable developments are expected to improve forward-looking expectations for the economy and to have positive reflections on inflation in the next period.
17. On the other hand, the fiscal and monetary policies as well as structural reforms and arrangements are carried out as per the economic program with no hitches whatsoever. Indeed, the IMF Board of Directors is expected to convene on August 7, 2002 and take up the release of the credit tranche projected to be extended to Turkey.
18. Consequently, as it was stated in our press release dated June 28, 2002, it is obvious that the implementation of structural reforms alleviated the vulnerability of the Turkish economy against uncertainties and external shocks. In addition, in light of the following positive developments, it is envisioned that the end-year target of 35 percent CPI inflation will be attained: (i) the determination of the election date would decrease the political uncertainty perceptions; (ii) the recent important steps towards accession to the European Union would be welcomed by the markets; (iii) the recent upward trend in inflation is just a temporary one; (iv) despite the distortion in short-term inflationary expectations, the long-term inflationary expectations would remain intact; and (v) the sizable price increases in most of the goods and services produced by the public sector have reduced the State Economic Enterprises gaps, and (vi) inflationary developments to date and forward looking expectations continue to be in line with the

end-year inflation target. Within this framework, Central Bank's positive view explained in the Press Release dated June 28, 2002 still holds.

III. INTEREST RATES OF THE CENTRAL BANK

19. Under the light of the above assessments, Interbank Money Market and İstanbul Stock Exchange Repo-Reverse Repo Market short term interest rates have been changed as follows as of August 5, 2002:

a) Overnight Interest rates: Borrowing interest rate has been decreased from 48 percent to 46 percent, and lending rate has been decreased from 55 percent to 53 percent.

b) Other Maturities: Borrowing interest rate for one week has been decreased from 49 percent to 46 percent.

c) Late Liquidity Window Interest Rates: Within the framework of the Late Liquidity Window Facility, the overnight lending interest rate between 16:00-16:30 at the Interbank Money Market has been decreased from 65 percent to 63 percent and our borrowing rate of 5 percent remained the same.