

OCTOBER INFLATION AND OUTLOOK

I. GENERAL EVALUATION

1. In October 2002, the prices increased in line with market expectations. CPI increased by 3.3 percent, while WPI increased by 3.1 percent. Thus, the overall increase in January-October period became 24.0 percent in CPI and 25.5 percent in WPI. The downward trend in annual inflation continued, CPI and WPI rose by 33.4 percent and 36.1 percent respectively on a year on year basis.

2. The relative stability in exchange rate in the last three months, and the sluggish domestic demand continued to have a favorable effect on the course of inflation also in October 2002.

3. High increases in food and clothing prices due to seasonal factors have been the main determinants of the increase in consumer prices in October. WPI was affected adversely due to an increase of 8.1 percent in agricultural prices, being the highest October rate in the last 5 years. However, being the lowest October rates since 1983, the rate of increase in manufacturing industry and energy prices limited the increase in WPI. In October, CPI excluding food rose by 2.9 percent while WPI excluding agriculture rose by 1.8 percent.

Table 1: CPI, WPI and Sub-items

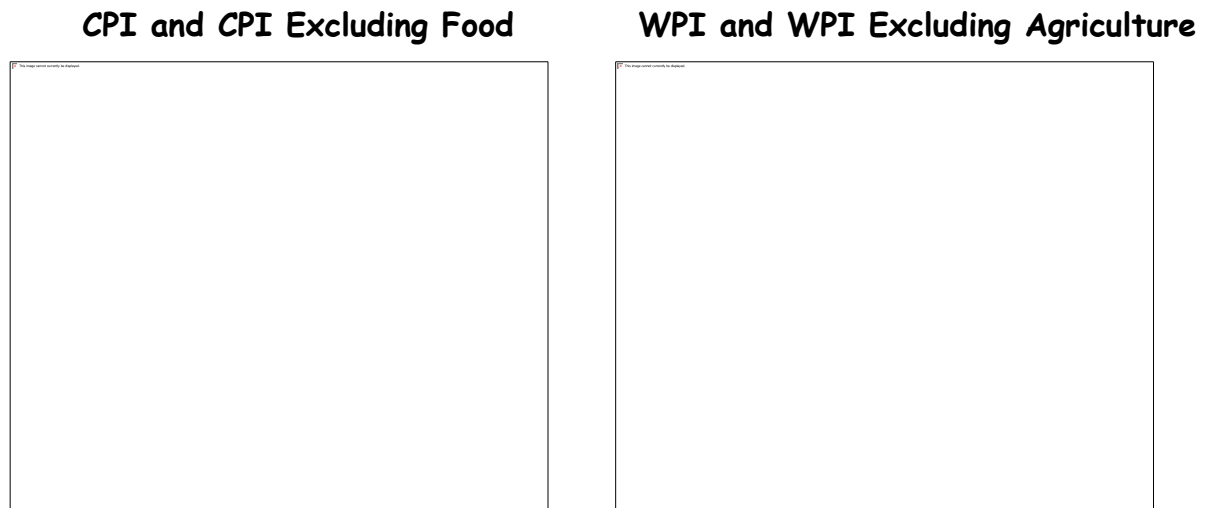
	Year-on-Year % Change		Monthly % Change		
	2001	2002	2002		
	October	October	August	September	October
CPI	66,5	33,4	2,2	3,5	3,3
Goods	77,0	34,0	1,2	4,0	4,2

Services	49,2	32,5	4,1	2,6	1,5
Excluding Food	67,1	33,7	2,7	3,0	2,9
WPI	81,4	36,1	2,1	3,1	3,1
Public	100,4	33,8	2,7	3,3	1,7
Private	74,5	37,1	1,9	3,0	3,7
Public Manufacturing	98,8	35,2	2,5	3,4	1,6
Private Manufacturing	88,7	31,1	2,3	2,5	1,8
Excluding Agriculture	92,9	32,3	2,5	2,9	1,8
Excluding Agriculture and Energy	91,6	32,5	2,5	2,9	1,9

Source: CBRT, SIS.

4. The inflation measure, which is calculated by using 3-month moving averages of seasonally adjusted CPI and WPI decreased in October as in September and reached 31.4 percent in WPI and 28.4 percent in CPI. The annual inflation became 32.7 percent in WPI excluding agriculture, and 27.0 percent in CPI excluding food.

Figure 1: Annual Percentage Change and 3-Month Moving Averages



(*) 3-Month moving averages (Annual, Seasonally Adjusted)

Source: CBRT, SIS.

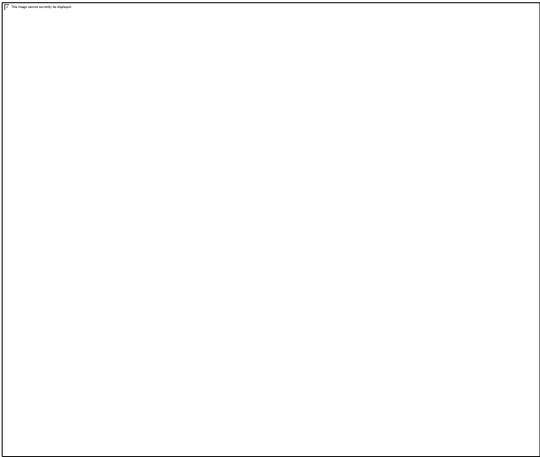
Developments in Consumer Prices

5. The increase of 3,3 percent in CPI mainly stemmed from the rise in food and clothing prices due to seasonal factors. When food and clothing items are excluded from the CPI, the rate of increase falls down to 1,7 percent. Seasonally adjusted price increase in CPI continued to decline in October and realized at 1,7 percent dropping by 0,3 percent compared to the previous month. Especially the limited increases in housing and households had an effect on this decline. Both sectors experienced the lowest October price increases throughout the last nine years. There was no significant increase in seasonally adjusted food, beverages and tobacco prices, which had showed an upward trend starting from June. The highest increase was in clothing and shoe sub-item.

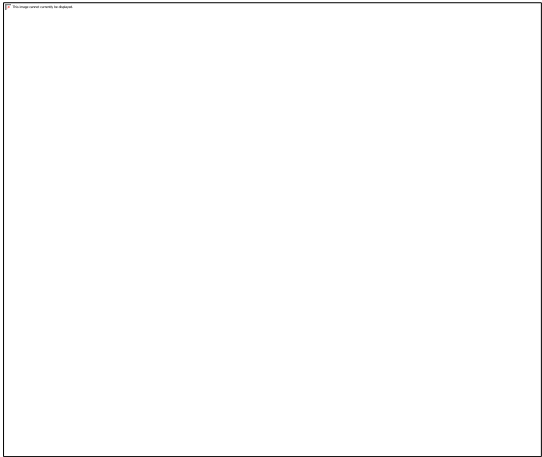
6. Seasonal price increases in food and clothing groups led to an increase by 4,2 percent in the prices of goods in October. The rate of increase in the rents slowed down compared to September, being realised as 2,6 percent. Due to considerably lower increases in the prices of services excluding rents, inflation remained at level of 1,5 percent in services group in general. Seasonally adjusted rate of increase of goods and services prices were realised as 1.8 percent in October, showing a slowdown compared to the previous month. As of October, the annual inflation dropped to 34 percent for goods prices and to 32,5 percent for service prices.

Figure 2: Prices of Goods and Services

Year-on-Year % Change



**Monthly % Change
(Seasonally Adjusted)***



Source: CBRT, SIS.

*TRAMO-SEATS method has been used in deseasonalization.

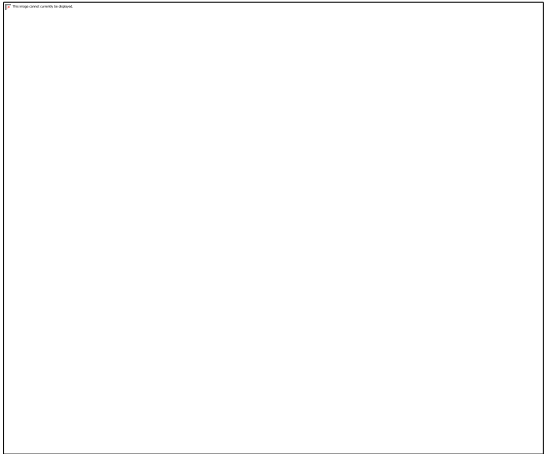
7. CPI excluding food rose by 2,9 percent due to the increase in clothing prices by 12,7 percent. The said increase in clothing prices led to an acceleration of seasonally adjusted CPI excluding food compared to the previous month. Nevertheless, the increase on a yearly basis continued to decline and the annual increase in CPI excluding food dropped to 33,7 percent (Figure 3).

Figure 3: CPI and CPI Excluding Food

Year-on-Year % Change



**Monthly % Change
(Seasonally Adjusted)***



Source: CBRT, SIS.

*TRAMO-SEATS method has been used in deseasonalization.

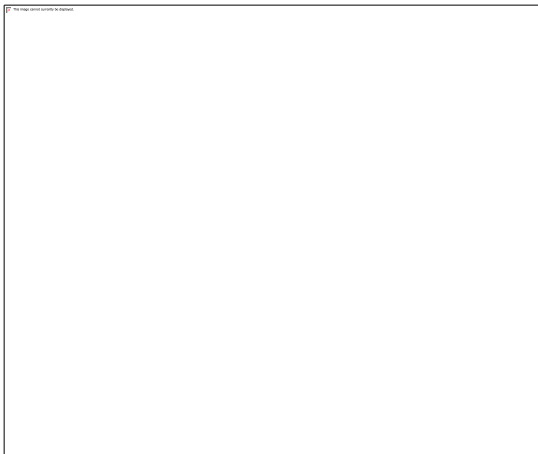
Developments in Wholesale Prices

8. In October, seasonal factors have affected the rate of increase in WPI by 1,2 percentage points. Moreover, seasonally adjusted wholesale prices that had showed an upward trend starting from May turned into a downward trend in July and maintained this tendency in October as well. Despite the negative impact of 8,1 percent increase in agricultural prices on WPI, the 1,8 percent increase in manufacturing industry prices has limited WPI. The slowdown in agricultural prices by 10,7 percent in April-August period has reversed and agricultural prices contributed to WPI inflation by 0,1 percent and 1,8 percent in September and October, respectively.

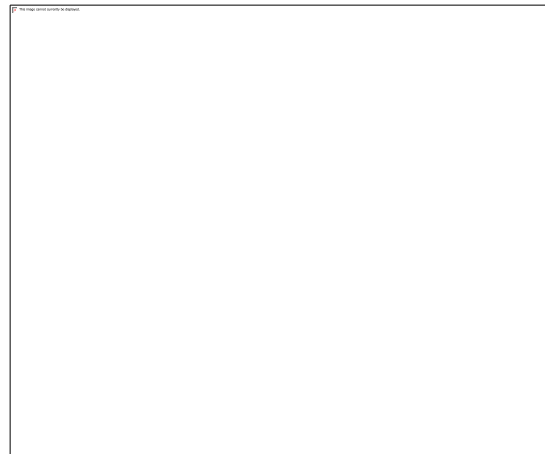
9. Public manufacturing industry prices recorded its lowest rate of increase since February. The slowdown in the rate of increase in public prices and the stability of the Turkish lira in the last months also limited the rate of increase in private manufacturing industry prices, which dropped to its lowest level in the last seven months. Owing to these developments, seasonally adjusted WPI increase, which began slowing down starting from August, maintained this trend in October as well, and realized at 1,9 percent. Meanwhile, increase in WPI excluding agriculture declined from 2,9 percent in September to 1,8 percent in October.

Figure 4: WPI and WPI Excluding Agriculture

Year-on-Year % Change



**Monthly % Change
(Seasonally Adjusted)***



Source: CBRT, SIS.

*TRAMO-SEATS method has been used in deseasonalization.

II. OUTLOOK

10. Success in the fight against inflation in 2002 was achieved together with favorable developments in the other economic data. At first, a 3 percent GNP growth that was predicted for 2002 in the beginning of the year seemed unattainable to markets. As a matter of fact, while the expected growth in GNP for 2002 was 2,7 percent in January, it dropped to 2 percent in April. However, the rate of growth in the first half of the year reached 4,7 percent. Taking this recovery in account, GNP growth projection for 2002 was revised up to 4 percent in October. In addition, improvement in expectations for capacity utilization ratio, industrial production index and general outlook in the economy points out that the growth rate will even raise above 4 percent at the end of the year. In fact, according to CBRT Expectation Survey published in November, markets raised their growth expectations for 2002 to 4,3 percent.

11. It is evident that the main reason of favorable developments both in inflation and in other economic variables, despite the perception of political uncertainty that intensified in May, is the elimination of economic fragility through structural reforms as well as tight fiscal and monetary policies. In fact, despite political uncertainty, the Central Bank announced clearly by press releases of 28 June 2002 and 5 August 2002 that the outlook for future was favorable for two reasons. First, the fulfillment of the majority of structural reforms would decrease the fragility of economy against uncertainties and external shocks. The second reason was the high probability of implementing the program uninterruptedly, taking its successful results into account which had put an end to concerns on its sustainability, by bringing stability in the markets. However, a slight deterioration was observed in the public finance and delays occurred in some structural adjustments due to political elections.

12. 2002 fiscal and monetary policies and structural reforms made under the current program were crucial in making progress on the way to price stability and the inflation has rapidly come down. CPI inflation, which was 68,5 percent at the end of 2001, came down to 33,4 percent in October, which is the lowest

level of the January 1988 - October 2002 period. Current developments indicate that CPI inflation will remain below the target of 35 percent.

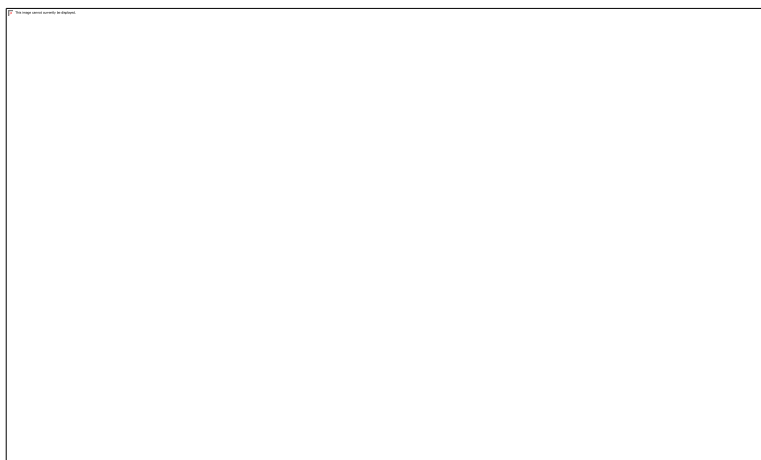
13. According to the results of Expectation Survey, markets are expecting the annual inflation figure to drop to 32,3 percent in the first period of November (Figure 5). In addition to favorable inflation expectations for 2002, the expectations for the next 12 months also displayed a stable downturn. According to the results of first period of November, inflation expectation for the next 12 months declined to 26,5 percent.

14. Continuation of success achieved in lowering inflation in 2002 will depend on taking urgent measures for recovering the recent deterioration in public finance and delays in structural reforms, and will depend also on the strict determination in pursuing structural reforms and fiscal discipline in 2003. Determination in these areas will further improve expectations and will have a positive effect on the determinants of inflation. Considering that short-term interest rates will continue to be set only within the framework of price stability target, complying with the basic principles of the current program will facilitate the fight against inflation and ease its pressure on the economic growth.

15. It will be helpful to underline a number of risks that might adversely affect the inflation developments in the short-term. It is probable that especially food and agricultural prices might increase due to Ramadan and religious holiday, in contrast to the downward trend observed in the previous period. In addition, the highest increase recorded in agricultural prices in October since February and the fact that the increase in agricultural prices has not yet been reflected on food prices can be considered as a development that might lead to rapid rise in food prices. Another factor that may have an unfavorable impact on inflation is the probability of a relative acceleration in public prices.

16. Meanwhile, in addition to the policies of the public sector, the incomes and pricing policy of private sector also will continue to bear importance on the fight against inflation as in the past. Therefore, private sector should formulate its incomes and pricing policy in line with the inflation target. The increase in demand that might arise as result of removal of uncertainties and restored confidence must not be considered by private sector as an opportunity to increase profit margins. It is very important for reducing the cost of disinflation.

Figure 5: Inflation Expectations According to CBRT Expectations Survey



Source: CBRT