

## AUGUST INFLATION AND FORWARD LOOKING EXPECTATIONS

### 1. GENERAL EVALUATION

1. In August, consumer prices increased by 2.2 percent and wholesale prices by 2.1 percent, in parallel with the market expectations. With the figures of August, increase in CPI reached 16.1 percent and WPI reached 19.0 percent in the January-August period. The downward trend in annual inflation continued and annual increases in CPI and WPI came down to 40.2 and 43.9 percent, respectively.
2. Following the upward trend observed in interest rates and depreciation of the exchange rate since May, foreign exchange and Turkish lira markets gained a relative stability in August. Meanwhile, the adverse effects on inflation of the deterioration in the financial indicators, which occurred in the last three months, have been limited as the public price increases were mostly completed in the June-July period.
3. The high rates of price increases in education and health services due to seasonal factors as well as rise in transportation prices became the main factors instigating increase in consumer prices. As the exchange rate has stabilized and public price adjustments have slowed down, the increase in prices of manufacturing industry have been limited and increase in wholesale prices stayed below the July figures. In August, CPI excluding food increased by 2.7 percent while WPI excluding agriculture increased by 2.5 percent.
4. In August, the annual inflation trend, which is calculated by using 3-month moving averages of deseasonalized CPI and WPI, continued its upward trend that it displayed in July, and reached 43.3 percent in WPI and 36.5 percent in CPI. Calculated as such, while the annual inflation in WPI excluding agriculture reached 48.6, it became 34.9 percent in CPI excluding food. However, the upward trend in inflation was mainly due to the exchange rate depreciation and public sector price adjustments observed in the June-July period, and it is not expected to become a permanent one.

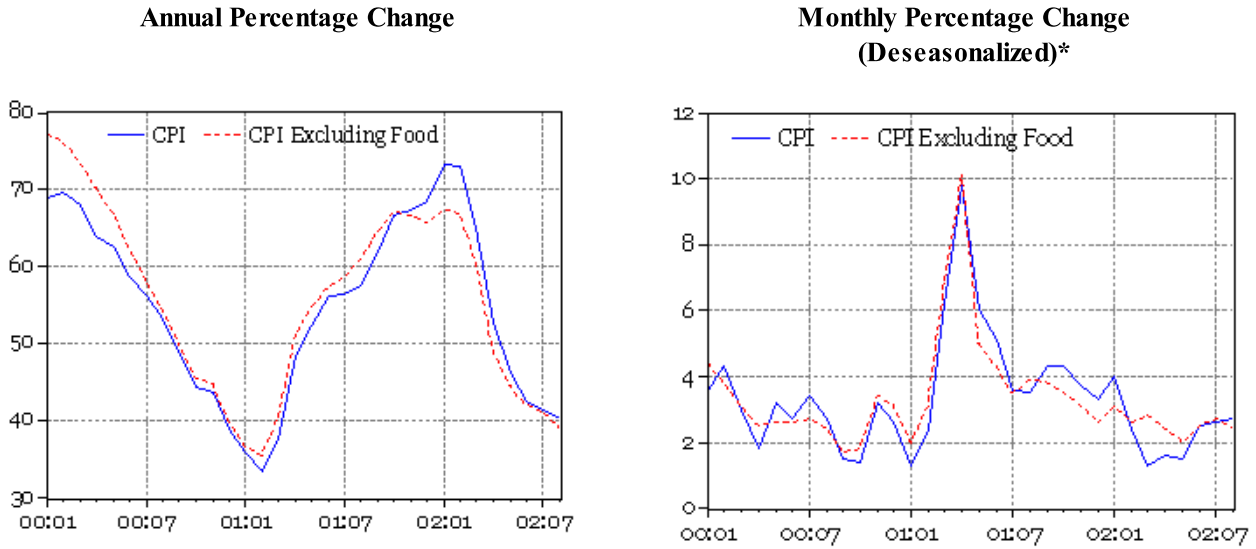
**Table 1: General CPI, WPI, and Sub-items**

	Yearly Change %		Monthly Change %		
	2001	2002	2002		
	August	August	June	July	August
<b>CPI</b>	<b>57,5</b>	<b>40,2</b>	<b>0,6</b>	<b>1,4</b>	<b>2,2</b>
Goods	63,2	42,7	0,2	0,6	1,2
Services	48,2	35,8	1,4	3,1	4,1
Excluding Food	61,1	39,0	2,2	2,2	2,7
<b>WPI</b>	<b>69,6</b>	<b>43,9</b>	<b>1,2</b>	<b>2,7</b>	<b>2,1</b>
Public	86,1	41,3	4,3	4,3	2,7
Private	63,5	45,0	0,0	2,0	1,9
Private manufacturing	74,4	42,4	2,8	4,1	2,3
Excluding Agriculture	78,6	42,2	3,4	4,2	2,5
Excluding Agriculture and Energy	77,0	42,6	3,5	4,4	2,5

### *Developments in Consumer Prices*

5. Although the containing effect of food and textile prices on CPI have diminished, inflation in August remained within the expected range and it stood well below the 3.6 percent level, which is the average inflation rate of the previous years (1987-2001). When the seasonal movements in consumer prices are analyzed, it is observed that the deseasonalized CPI increased by 2.7 percent and CPI excluding food by 2.4 percent in August.
6. The consumer prices in August were affected to a great extent by the increases in the services sector. The increase in prices of health and education services due to seasonal factors and the high rate of increase in the prices of recreation and entertainment services contributed to the overall increase of 4.1 percent in the prices of services sector in August. Meanwhile, increase in the prices of goods stood at 1.2 percent. While the rise in prices of goods was 13.7 percent in January-August period, that of services totaled 20.8 percent. By August, annual increase in prices of goods reached 42.7 percent while prices of goods reached 35.8 percent.

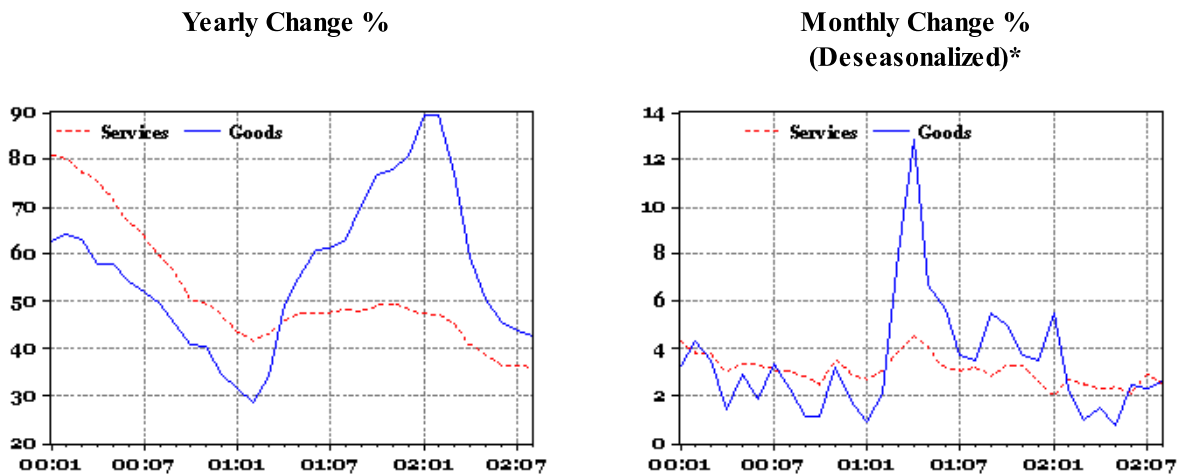
**Figure 1: CPI and CPI Excluding Food**



Source: CBRT, SIE.  
 \* TRAMO/SEATS method has been used for deseasonalization.

- The prices of consumer durables i.e. electrical and non-electrical devices, private transportation vehicles and cultural and recreational devices, which displayed a high rate of increase in July, increased by 2.7 percent in August. This development was mainly due to the stable course of the exchange rate and absence of pressure from the demand side. However, compared with July, the increase in prices of private transportation vehicles accelerated in August because of the revival in exports and entry of new models to the market and reached 5.2 percent.

**Figure 2: Prices of Goods and Services**



Source: CBRT, SIE.  
 \* TRAMO/SEATS method has been used for deseasonalization.

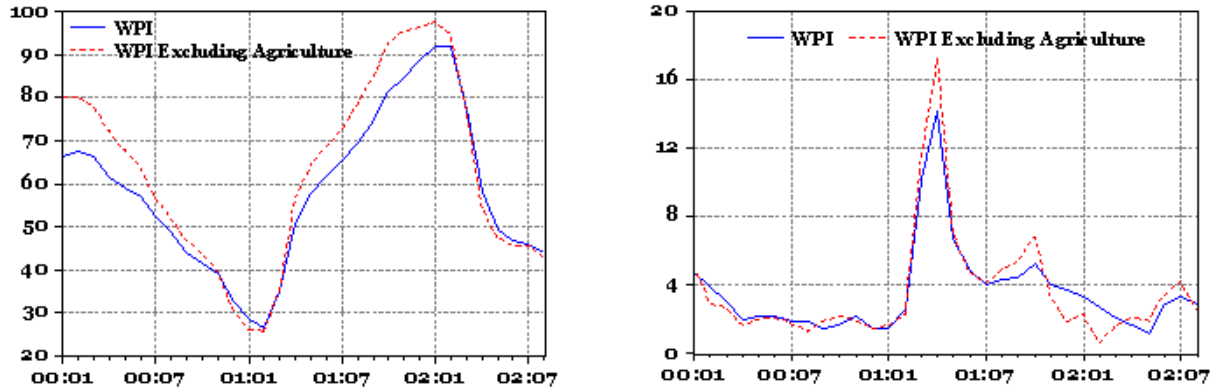
**Developments in Wholesale Prices:**

- In August, increase in prices of manufacturing industry was the main factor determining the WPI increase. Agriculture prices, which have dropped below seasonal averages since May, increased by 0.9 percent in August and reached a level that is quite close to the average value of 0.8 percent of the last 7 years. As a result of the stabilization of the exchange rate and the remarkable slowdown in public price adjustments, the manufacturing industry prices stood well below the July figure of 4.3 percent and increased only by 2.4 percent. In August, Deseasonalized WPI and WPI excluding agriculture increased by 2.9 and 2.5 percent, respectively.

**Figure 3: WPI and WPI Excluding Agriculture**

**Yearly Change %** **Monthly Change %**

(Deseasonalized)\*



Source: CBRT, SIE.  
 \* TRAMO/SEATS method has been used for deseasonalization.

## II. OUTLOOK AND EXPECTATIONS

9. The increase in uncertainty perceptions of economic agents due to political developments have been a contributing factor to the exchange rate depreciation and rising interest rates since last May. This, in turn has adversely affected inflation expectations and inflation rates in the last few months. As revealed also by the Central Bank Expectations Surveys, the unfavorable developments in the financial markets have slowed down the decreasing trend in inflation expectations in June and July. However, restoration of stability in foreign exchange and Turkish lira markets in August has prevented these developments from having permanent effects on inflation. Pursuing the resolute implementation of the economic program after the announcement of the election date has contributed to the establishment of confidence in the markets again.

10. When the August inflation figures, inflation expectations and our estimations for the future values of variables that determine inflation are taken into consideration, it is observed that the end-year inflation target is fairly attainable. When the risk factors are analyzed however, it is observed that there is some uncertainty about inflation as there is a possibility of further increases in oil prices and some more public price adjustments. Still, there is no sound reason that can impede the decelerating tendency in inflation next year, provided the resolute implementation of the current economic program, which has successfully reversed the inflation process, is continued.



Figure 4: Inflation Expectations According to the Expectations Survey of the CBRT

Source: CBRT