

SEPTEMBER INFLATION AND OUTLOOK

I. GENERAL EVALUATION

1. Inflation remained in its downward path. Annual CPI and WPI inflations dropped to 23 percent and 19.1 percent, respectively. Annual CPI inflation excluding food and WPI inflation excluding agriculture also maintained their downward course, and the rate of increase in CPI excluding food became 21.9 percent, while that of WPI excluding agriculture realized as 15.7 percent. These figures have strongly reinforced the perceptions that the inflation target for end-2003 would be achieved. Despite the upsurge in inflation in the first months of the year, the Central Bank had forecasted that the inflation would distinctively drop as of the second half of the year and had shared its prospects with the public through several announcements. Hence, these figures confirm the Central Bank's predictions.

2. During the same period, monthly WPI inflation and CPI inflation became 0.1 percent and 1.9 percent, respectively. Seasonally adjusted CPI inflation realized at such a low of rate of 0.5 percent, while WPI inflation dropped by 0.4 percent. The drop in seasonally adjusted WPI, which was observed for the first time during the 1994-2003 period, is an outstanding development.

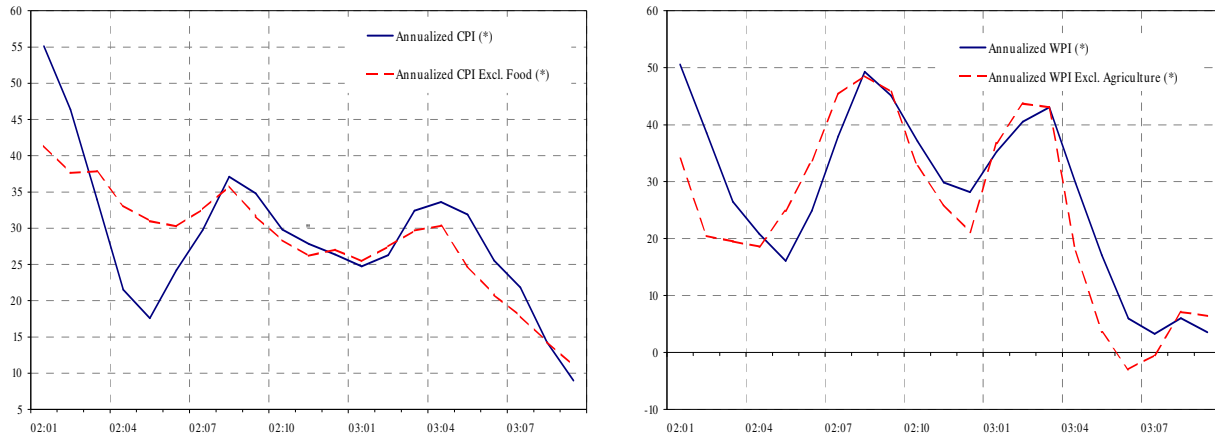
Table 1: General CPI, WPI and Sub-items

	Annual % Change		Monthly % Change			
	2002 Sep.	2003 Sep.	2003 July	2003 Aug.	2002 Sep.	2003 Sep.
CPI	37.0	23.0	-0.4	0.2	3.5	1.9
Goods	38.4	21.7	-1.3	-0.7	4.0	1.3
Services	34.5	25.5	1.4	1.8	2.6	3.0
Excl. Food	35.6	21.9	0.7	0.7	3.0	2.0
Food	42.4	27.0	-3.8	-1.7	5.2	1.6
WPI	40.9	19.1	-0.5	-0.2	3.1	0.1
Public	38.6	14.9	0.8	1.5	3.3	-0.6
Private	41.8	20.8	-1.1	-0.8	3.0	0.3
Public Manufacturing	40.5	17.9	1.0	1.6	3.4	-0.8
Private Manufacturing	38.6	15.8	0.5	0.7	2.5	0.2
Agriculture	49.4	32.0	-3.9	-4.0	4.0	0.4
Excl. Agriculture	38.8	15.7	0.6	1.0	2.9	0.0
Excl. Agr. and Energy	39.2	16.3	0.6	1.1	2.9	0.0

Source: CBRT, SIS

3. Average of the last three-month seasonally adjusted inflation became 0.3 percent in WPI and 0.7 percent in CPI. The annualized figures correspond to 3.6 percent in WPI and 9 percent in CPI. During the same period, the average increase realized as 0.9 percent in CPI excluding food. In annualized terms, this figure corresponds to 11 percent. (Figure 1).

**Figure 1: Annual Percentage Change and Quarterly Moving Averages
CPI and CPI Excluding Food** **WPI and WPI Excluding Agriculture**



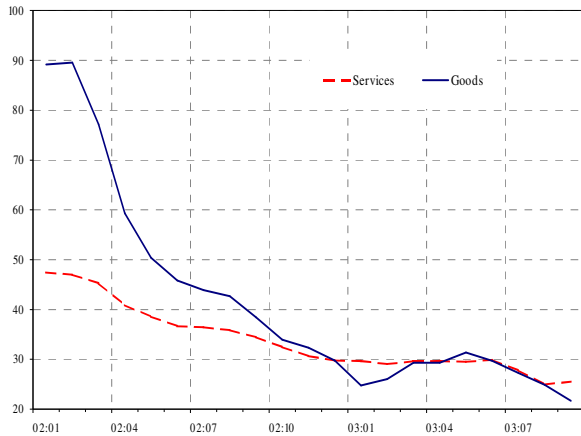
(*) Quarterly Moving Averages (Annualized, Seasonally Adjusted)
Source: CBRT, SIS

Developments in Consumer Prices

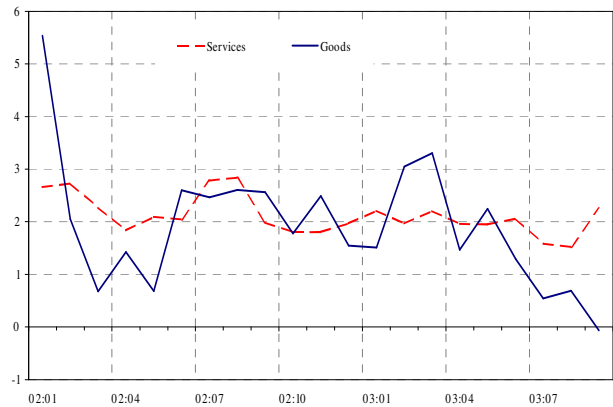
4. The apparent downward trend in consumer inflation continued in September as well. When compared to the August figures, annual inflation dropped by 1.9 percent in CPI and 2.4 percent in CPI excluding food. Another noteworthy development is that annual inflation in goods realized significantly below the inflation in services (Table 1).
5. The monthly rate of change of prices in services group realized at 3 percent. It is observed that price adjustments in education services, which had mostly been carried out during August in the previous years, extended to August and September this year. Apart from the prices in education services, housing rents, which increased above the average of the last period, stood as another determinant in the price increases in services sector.
6. The monthly rate of increase in goods was 1.3 percent. It was observed that food prices maintained its favorable course in September, and the seasonally adjusted September price increase was limited to 0.5 percent.
7. Inflationary developments in the first nine months showed that clothing group had a restrictive effect on CPI. During December 2002 – September 2003 period, CPI rose by 13.8 percent, while clothing and shoes increased by 8.4 percent due to the stagnation in demand for semi-durable consumption goods. Nevertheless, the gap is expected to narrow in December owing to the seasonal factors. On the other hand, the rise in cigarette and tobacco products, which increased by 34.5 percent and the prices in hospital services, which boosted by 46.5 percent, were instrumental in pushing CPI inflation.

Figure 2: Prices of Goods and Services

Annual Percentage Change



Monthly Percentage Change (Seasonally Adjusted)*



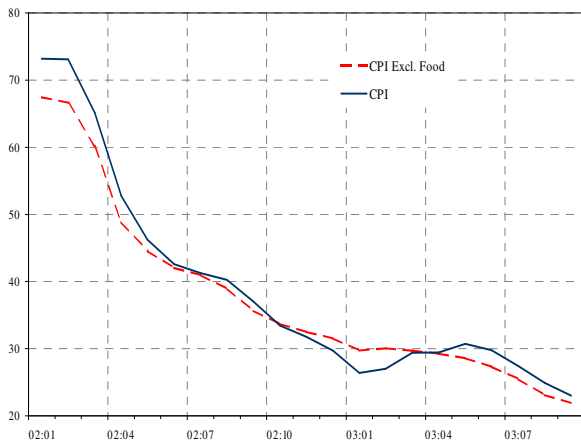
Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

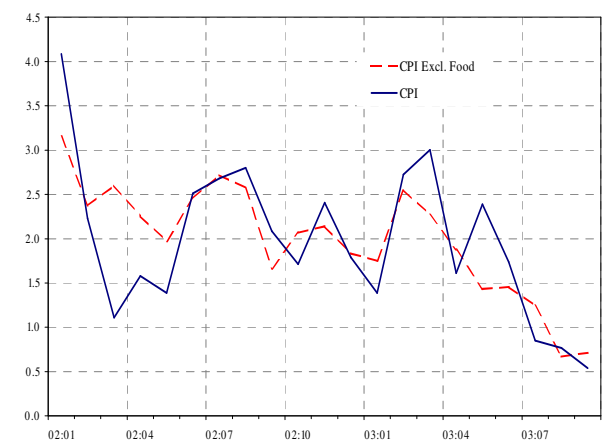
8. When seasonally adjusted price changes are analyzed, it is observed that inflation in September has dropped compared to August. Seasonally adjusted CPI inflation, which was 0.8 percent in August, declined to 0.5 percent in September (Figure 3). A similar development is observed in seasonally adjusted food prices as well. The price increase in seasonally adjusted food prices, which was 0.6 percent in August, dropped to 0.5 percent in September.

Figure 3: CPI and CPI Excluding Food

Annual Percentage Change



Monthly Percentage Change (Seasonally Adjusted)*



Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

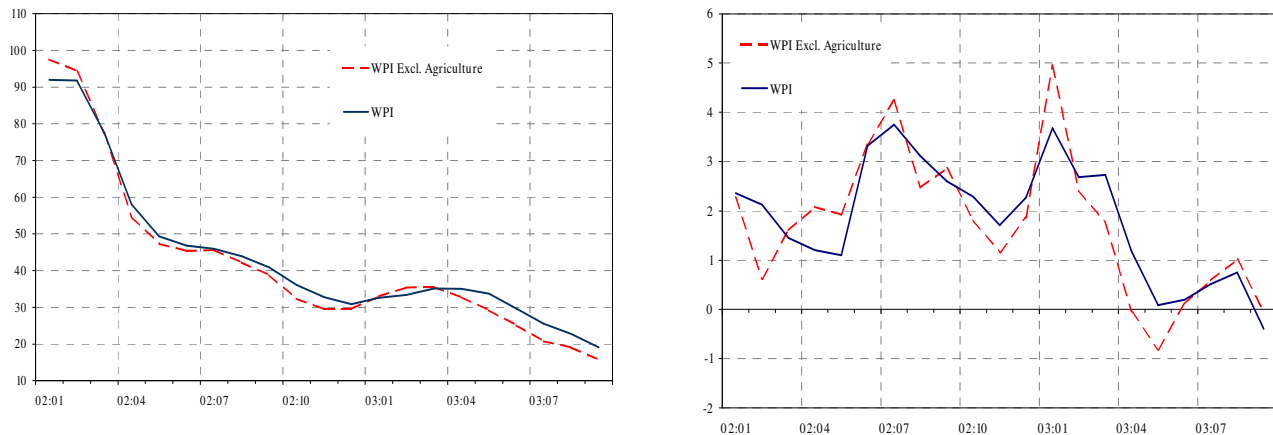
Developments in Wholesale Prices

9. In September, WPI inflation remained at 0.1 percent due the limited increase in agriculture prices and the decline in prices in manufacturing industry. While the contribution of agricultural sector to the change in WPI was 0.2 percentage point, that of manufacturing industry became – 0.1 percentage point. In September, seasonally adjusted WPI dropped by 0.4 percent, the first drop observed in WPI during the 1994-2003 period. As a result of these developments, annual WPI inflation maintained its striking downward trend (Graphic 4).

10. Rate of increase in agricultural sector prices remained minimal in September (Table 1). Seasonally adjusted data indicate that agricultural prices inched down by 0.8 percent in September, which is the highest rate of decrease in the first nine months of the year 2003.

11. No change was observed in the wholesale prices excluding agricultural prices. Rate of increase in the private manufacturing sector prices remained negligible. Another point to be highlighted is that the average rate of increase in private manufacturing sector prices in April-September 2003 period was 0.4 percent. Meanwhile, compared to the figures in August, a slight decline was observed in public manufacturing sector prices. The oil products manufacturing sector constitute the primary factor that underlies this decline. The primary reason for the favorable developments observed in the rates of increase in the prices of public as well as private manufacturing sectors is the exchange rate movements based on the enhanced confidence with the Turkish lira, backed by the current economic program.

Figure 4: WPI and WPI excluding Agriculture
Annual Percentage Change **Monthly Percentage Change**
(Seasonally Adjusted)



Source: CBRT, SIS.

* **TRAMO/SEATS method has been used for deseasonalization.**

12. WPI increased by 10.7 percent in the first 3 quarters of 2003. While rate of increase in agricultural sector prices exceeded this rate (12.3 percent), private manufacturing sector prices remained below this level with 9.7 percent. Another outstanding development is that rate of increase in the prices of electricity, gas and water group remained quite limited with 2.6 percent.

II. OUTLOOK

13. The atmosphere of confidence achieved as a result of the positive perceptions of economic agents about the sustainability of the economic program brought along stabilization in exchange rates. Thus, the inflation continued the downward trend not only through the input costs but also through the expectations. Moreover, the fact that the recovery in demand is not yet at a level that would put burden on production potential is another factor that backs up the downward trend in inflation. In other words, we can assert that the favorable factors that had helped reduce inflation in the previous quarter persisted in September as well.

14. There is an important point to be underlined here. It is frequently speculated that there are some threshold levels that inflation cannot be decreased further below. In early 2003 it was argued that achieving the 20 percent inflation target was an arduous task, by considering these thresholds. However, these arguments seem to ignore the fact that there is no magical solution for beating inflation. Fiscal discipline and monetary discipline are the sine-qua-non conditions for disinflation efforts. In the absence of exogenous shocks, a failure in achieving a satisfactory decline in inflation despite the improvements in economic fundamentals can only be attributed to unfavorable expectations.

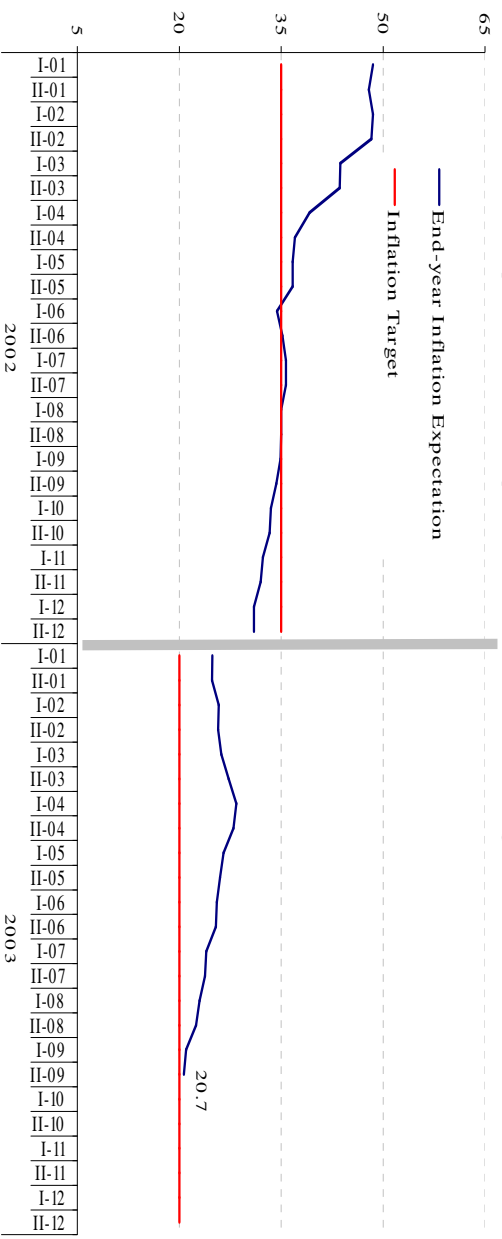
15. Therefore, matching the expected inflation rate with the targeted inflation rate is of utmost importance. It is expected that the perceptions about achieving the end-year inflation target will be more significant with September inflation figures. It is estimated that the annual inflation will achieve the end-year target by keeping up the downward trend in the next months, unless unexpected price adjustments come in the way in the rest of 2003. Both the favorable developments in inflation expectations and harmonization of the expected inflation rate with the targeted inflation rate are very important for the credibility of the end-year target.

16. Undoubtedly, in disinflation efforts, the Central Bank policy should be in line with the targets. But this alone may not suffice. Achieving fiscal discipline backed up by structural reforms and steering the expectations in line with this discipline still holds good as an important pre-condition for the sustainability of accomplishments in inflation. Conducting public finances policy consistent with the program and ensuring that the incomes and tax policies embrace the targeted inflation rate as an endogenous parameter are also crucial points for the sustainability of the downward trend in inflation in 2004.

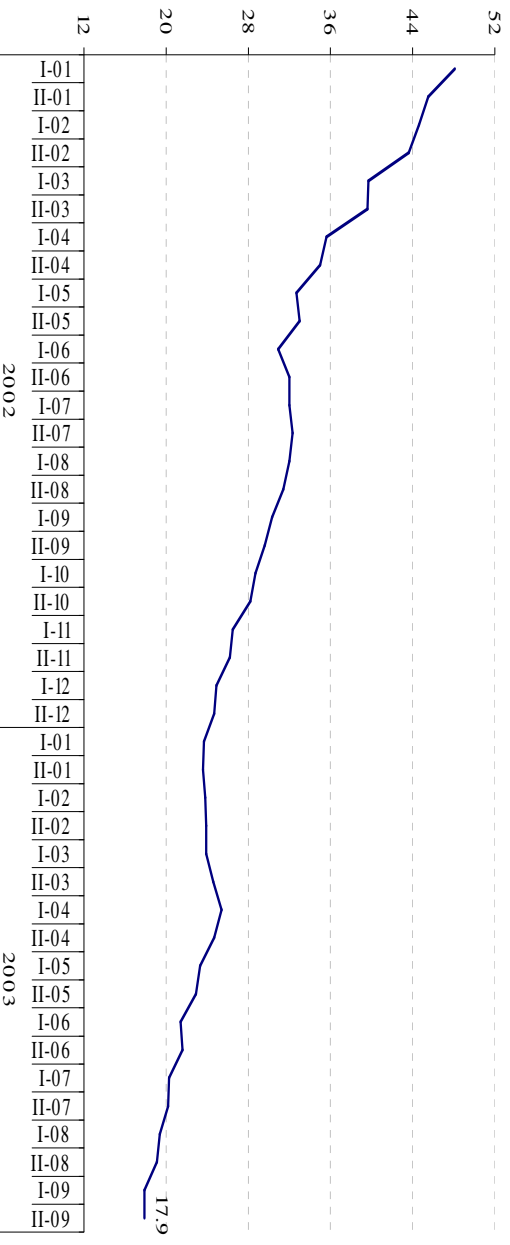
17. Similar to September, also October is a month that displays higher inflation figures than those in summer months due to seasonal factors. There may be some seasonal increases especially in food and clothing prices. However, it is estimated that these probable increases will be limited to seasonal factors and will not jeopardize attaining the inflation target.

18. It should be underlined here once again that the Central Bank's decisions on short-term interest rates, the main policy instrument, are taken by only considering the future course of inflation. In other words, the correct interest rate policy for the Central Bank is the one that is consistent with the inflation target. In this framework, the short-term interest rates will move according to which extent the future inflation rates are consistent with the targeted inflation path, rather than exchange rate, current account deficit, growth rate or any other variable.

Figure 5: Inflation Expectations According to CBRT Expectations Survey
End-year Inflation Expectations and Inflation Target: 2002-2003



Inflation Expectations for the Next 12 Months



Source: CBRT Expectations Survey