

DECEMBER INFLATION AND OUTLOOK

I. GENERAL EVALUATION

1. In December 2002, WPI and CPI increased by 2,6 percent and 1,6 percent, respectively. Thus, the annual inflation rate, which was 88,6 percent for WPI and 68,5 percent for CPI at the end of 2001, dropped to 30,8 percent for WPI, the lowest level of the last 16 years, and 29,7 percent for CPI, the lowest level of the last two decades, at the end of 2002. The inflation remained below the year-end target for CPI by 5,3 points, and for WPI by 0,2 point.

2. Favorable circumstances that appeared in November continued in December to some extent as well, and the downward trend in inflation expectations and inflation rates kept its momentum in line with these developments. In overall December, the exchange rate basket (1 US dollar + 0,77 euro) declined by about 0,5 percent on average when compared to November, and hence, exchange rate developments did not lead to a cost-push pressure on prices.

3. It was observed that in the first 7 months of the year, price increases in food and agriculture groups remained vastly below the overall increases in CPI and WPI. While this gap was closed partially in the second half of the year, price increases in food and agriculture accelerated somewhat in the last quarter of the year due to the month of Ramadan and the following religious holiday, and had an unfavorable impact on November and December inflation rates.

Table 1: CPI, WPI and Sub-items

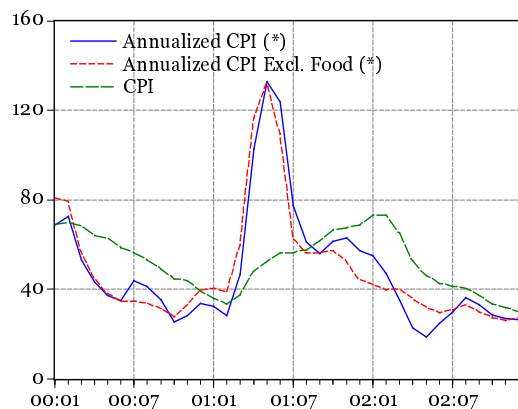
	Year-on-Year % Change		Monthly % Change		
	2001	2002	2002		
	December	December	October	November	December
CPI	68,5	29,7	3,3	2,9	1,6
Goods	80,9	29,7	4,2	3,6	1,6
Services	48,2	29,8	1,5	1,5	1,7
Excluding Food	65,6	31,5	2,9	2,0	1,3
WPI	88,6	30,8	3,1	1,6	2,6
Public	99,7	32,4	1,7	0,3	1,6
Private	84,6	30,3	3,7	2,1	3,0
Public Manufacturing	99,8	34,3	1,6	0,0	2,8
Private Manufacturing	94,5	27,7	1,8	1,6	2,0
Excluding Agriculture	96,3	29,6	1,8	1,2	1,9
Excl. Agr. And Energy	95,1	30,0	1,9	1,1	2,0

Source: CBRT, SIS

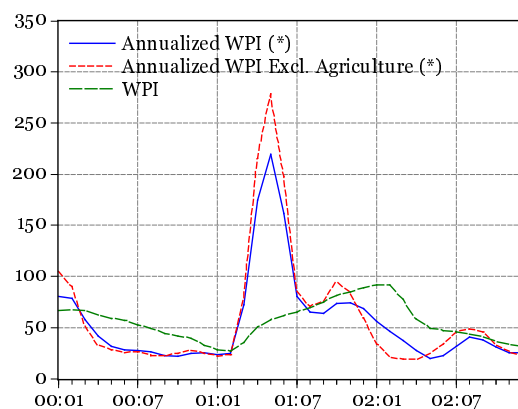
4. The seasonally adjusted annual CPI and WPI inflation, which are calculated by annualizing the quarterly moving averages, maintained its downward trend also in December and declined to 25,6 percent in WPI and 26,3 in CPI. The annual inflation, which is calculated by this method, became 21,1 in WPI (excluding agriculture) and 27,4 percent in CPI (excluding food).

Figure 1: Annual Percentage Change and Quarterly Moving Averages

CPI and CPI Excluding Food



WPI and WPI Excluding Agriculture



Developments in Consumer Prices

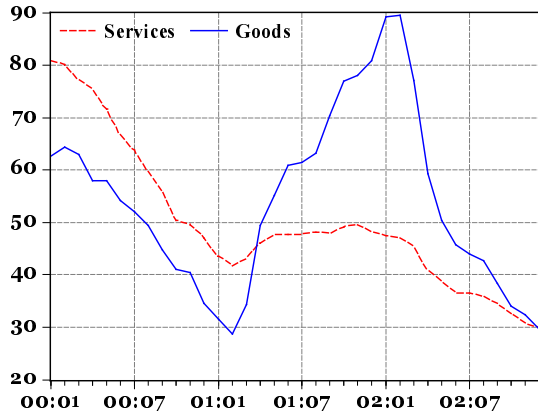
5. In December, 1 point out of 1.6-point CPI increase stemmed from the increase in food prices. In food group, the seasonally adjusted rate of price increase realized at 2,5 percent, remaining considerably above the overall seasonally adjusted increase in CPI, which was 1,8 percent. On the other hand, persistence in low price increases in services, modest increase in housing prices and slowdown in prices of household appliances are among the reasons that restricted the increase in CPI in December.

6. Despite the increase in food prices, rate of price increase in goods group remained at 1,6 percent. When food group is excluded, the rate of increase in goods group declines to 1 percent. Low increase in clothing prices and the downward trend in prices of household appliances were the factors that resulted in low increase in prices of goods group in December. Moreover, the rate of increase in prices of services remained at low level as in recent months, and year-end price increases in both groups came closer to each other (Figure 2).

7. While rent increase in housing group, which occupies a considerable place within CPI, maintained its trend of the last quarter, increases in water, electricity and other expenses in housing realized at the lowest level of the last nine months. In this context, the price increase in housing group remained at its lowest level by 1,6 percent in 2002 after April 2002. This development stemmed from the slowdown in public price increases as well. The fact that the limited increase in housing prices, the second large sub-item of CPI, had a favorable effect on the increase in CPI in December.

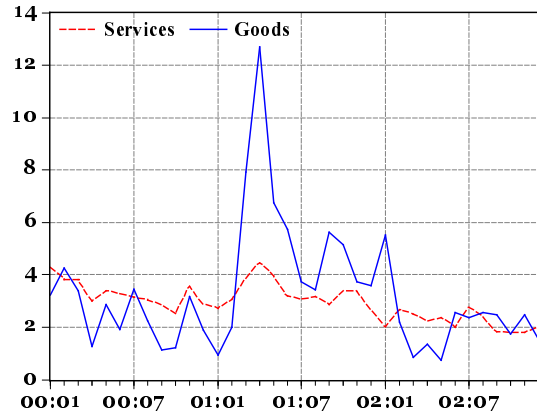
Figure 2: Prices of Goods and Services

Year-on-Year % Change



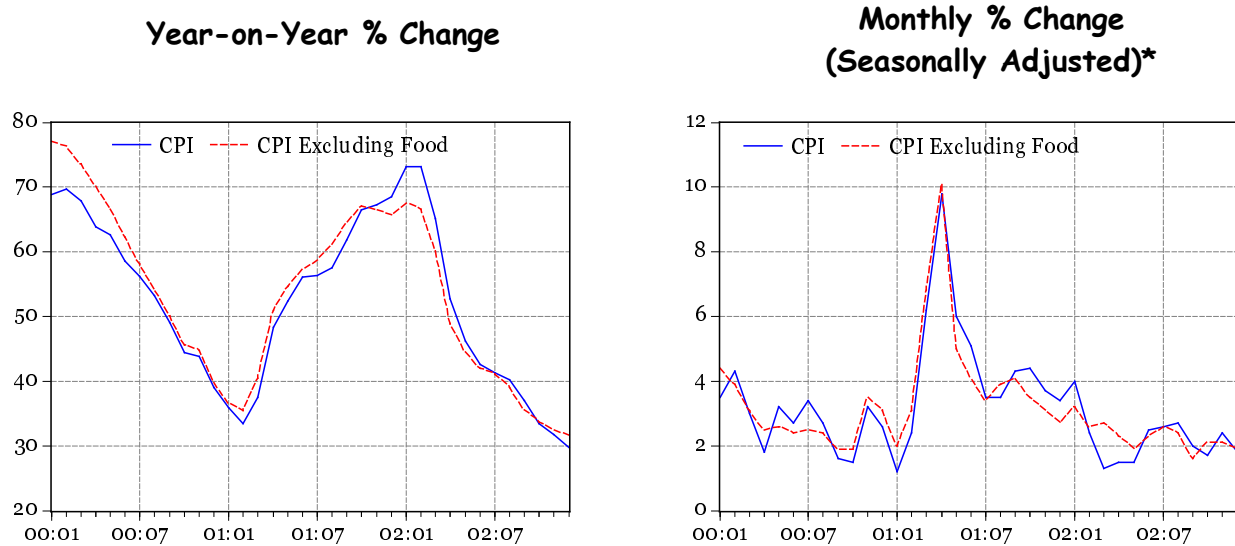
Monthly % Change

(Seasonally Adjusted)*



8. Household goods prices dropped due to the slowdown in electrical and non-electrical appliances. A drop of 0,4 percent in December points out a decline in the prices of this group for the first time between 1989-2002. Especially the year-end sale campaigns conducted by white goods manufacturers prior to the price adjustments to be made in January are considered to have an effect on the slowdown in prices.

Figure 3: CPI and CPI Excluding Food



Source: CBRT, SIS.

*TRAMO-SEATS method has been used in seasonal adjustment.

Developments in Wholesale Prices

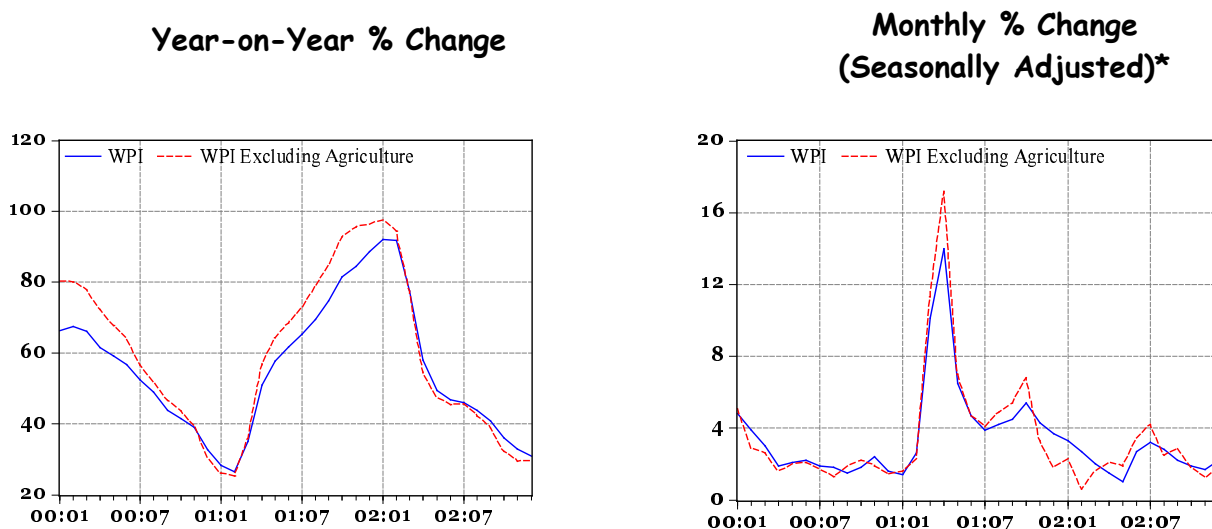
9. Following a significant acceleration in October compared with March-September period, rate of increase of agricultural prices had slowed down in November and picked up in December again. The rise in the agricultural prices coupled with the effect of post-election public price adjustments on manufacturing industry sector prices were the factors that increased the rate of change of WPI. When the seasonally adjusted data on increase are analyzed, it is observed that agricultural prices rose more sharply in December than they did in November, increasing from 2.8 percent to 4.0 percent.

10. The rate of increase in public manufacturing industry prices, which had relatively decelerated in October and November, picked up in December again and reached 2.8 percent. The increase in public manufacturing prices was mainly due to rise in the prices of the monopoly tobacco products and the foods processing sector, which constitute an important part of the public manufacturing industry, after the elections. Meanwhile, prices in those public

manufacturing sectors that produce basic metal, metal goods and chemical products and are sensitive to exchange rate movements have decreased. The increase in prices in private manufacturing sector was mainly due to the 3.3 percent increase in food and beverages production sector, which has the biggest share in private manufacturing sector. Furthermore, TL appreciation on a monthly average basis continued to have a positive effect on price increase in private manufacturing sector

11. In addition to the above mentioned developments, the slowdown observed in the increase in seasonally adjusted WPI inflation was interrupted in December and realized at 2,2 percent. WPI excluding food, which was 1.2 in November increased and reached 1.9 percent in December (Figure 4).

Figure 4: WPI and WPI Excluding Agriculture



II. INFLATION IN 2002 AND OUTLOOK FOR 2003

12. After February 2001, when the exchange-rate-based stability program was abandoned, and the exchange rate was allowed to float freely, certain measures were taken intended primarily to meet the liquidity needs of the markets and to re-activate the payments system, in order to alleviate the negative effects induced by the crises. After the emergency measures were taken and financial stability was restored, the Transition Program for Strengthening the Turkish Economy was put into practice in May 2001 in order to decrease inflation to the levels of the developed countries in the medium and long-term, and to ensure that economy follows a stable and sustainable growth path. Based on the government's commitment that there would be no deviation from the fiscal discipline in the year 2002 as well, additional external financing was obtained from international institutions in the last quarter of 2001. In the same period, the structural items of the program were strengthened. As a result of the fiscal and monetary discipline provided by the economic program implementation and comprehensive structural reforms together with the display of decisiveness in the fight against inflation, the macroeconomic indicators started to improve by end-2001, while inflation expectations and inflation entered into a downward trend.

13. The downward trend in inflation started to slow down resulting from depreciation in Turkish lira that occurred in the months of June and July 2002 due to the political developments after May 2002, and significant increase in the public prices. However, the potential negative impact of these developments on inflation did not last long as stability in financial markets was restored in August. The structural reforms undertaken also played an important role in limiting the adverse effects of political developments on economy.

14. The policies implemented and the progress in structural reforms have enhanced confidence in the program and decreased the inflation expectations, which in turn became crucial in disinflation process. Certain macroeconomic developments in 2002 also contributed to the decrease in inflation. First of all, domestic demand developments did not exert an upward pressure on inflation. Actually, the high rate of increase observed in production in the second quarter of 2002 was mainly due to stock piling and revival in exports, while increase in consumption and investment spending remained limited to a great extent. It is

believed that the correlation between inflation and exchange rate has weakened gradually with the adoption of floating exchange rate regime, and the resulting delayed pass-through of temporary exchange-rate volatility to inflation has played an important role in disinflating the economy, beginning from 2002. In addition to these, the rate of change of food prices, which realized at the lowest level of the last 15 years, caused the inflation to remain below the target.

15. 2002 year-end CPI inflation, which is the lowest level in the last 20 years, is also below the expected CPI inflation of 31 percent in the CBRT Expectations Survey. According to the results of the CBRT Expectations Survey conducted in the second half of December 2002, the decreasing trend in inflation expectations for the next 12 months that started in September has sustained its trend and came down to 24.7 percent (Figure 5). Although this level is above the 2003 year-end target of 20 percent, it indicates that important steps were taken for decreasing inflation expectations when compared with the figures obtained at the outset of 2002. Actually, the difference between the expected inflation and targeted inflation, which was 15 percentage points in the end of 2001, came down to below 5 percentage points by end-2002, supporting this view.

16. In 2003, besides favorable developments like political stability and enhanced confidence in the program, which will support the downward trend in inflation, there are still some exogenous and endogenous risks that might adversely affect the disinflation process. On top of exogenous risks is the realization of a military operation in Iraq, and the resulting probable pressure to be exerted on the inflation by affecting expectations, exchange rate and oil prices.

17. The major endogenous risk is the possibility of a recovery in domestic demand, which had a restricting impact on inflation in 2002, in a way to impose an inflationary pressure. Therefore, the impact of domestic demand conditions on inflation will be closely monitored in the pursuit of our target. Another risk factor with respect to inflation is the likelihood of adverse weather conditions that might result in low harvest, contrary to 2002. In such event, the agricultural and food prices might not follow the same downward trend as they did in 2002.

18. As stated in our previous announcements, in spite of the internal and external risks that are underlined above, the inflation target of 20 percent for 2003 will be achieved if the current monetary program is supported by the fiscal discipline and structural reforms.

Figure 5: Inflation Expectations According to CBRT Expectations Survey

