

## JANUARY INFLATION AND OUTLOOK

### *I. GENERAL EVALUATION*

1. In January 2004, monthly price increases realized as 2.6 percent in WPI and 0.7 percent in CPI. Seasonally adjusted CPI inflation became -0.4 percent, while WPI inflation was 0.7 percent.
2. The downward trend in inflation continued in January 2004 as well. Both the decline in inflation expectations and the maintenance of the stability in exchange rates stood as the main factors that supported this trend. The realization of WPI inflation above CPI inflation stemmed from the agricultural prices. Meanwhile, manufacturing industry prices displayed a slight increase in line with the general trend of inflation.

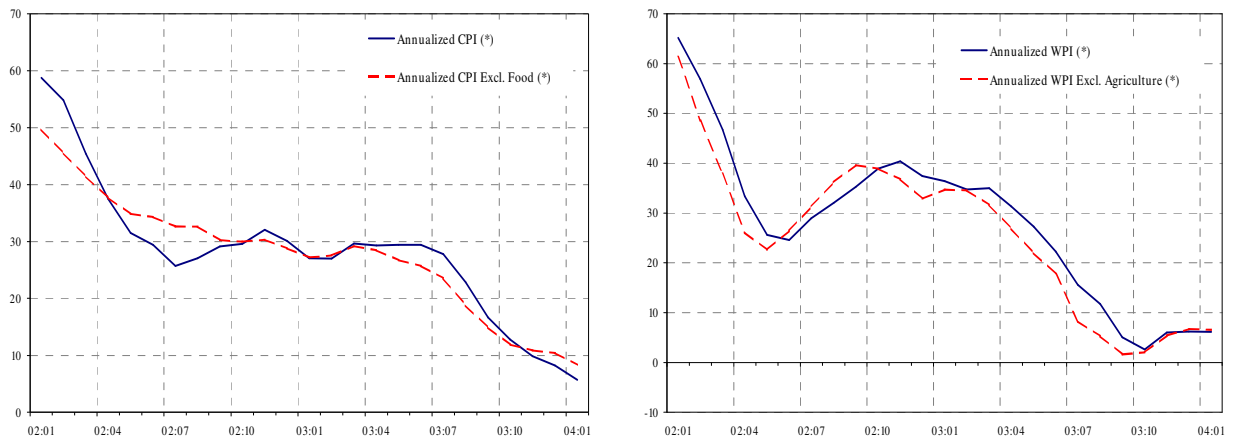
**Table 1: General CPI, WPI and Sub-items**

	Annual % Change		Monthly % Change			
	2003 Jan.	2004 Jan.	2003 Nov.	2003 Dec.	2003 Jan.	2004 Jan.
<b>CPI</b>	<b>26,4</b>	<b>16,2</b>	<b>1,6</b>	<b>0,9</b>	<b>2,6</b>	<b>0,7</b>
Goods	24,8	13,1	2,0	0,7	2,3	0,2
Services	29,7	22,4	0,8	1,1	3,1	1,8
Excl. Food	29,7	15,7	0,9	0,7	2,5	0,5
Food	16,4	18,1	4,0	1,4	3,0	1,4
<b>WPI</b>	<b>32,6</b>	<b>10,8</b>	<b>1,7</b>	<b>0,6</b>	<b>5,6</b>	<b>2,6</b>
Public	38,5	4,2	0,6	0,4	7,3	0,3
Private	30,4	13,4	2,1	0,7	4,9	3,5
Public Man.	43,6	5,1	0,3	0,4	8,5	0,7
Private Man.	29,5	9,1	0,9	0,9	3,6	0,6
Agriculture	31,5	21,8	4,6	0,3	7,7	9,3
Excl. Agriculture	33,0	7,4	0,8	0,7	5,0	0,5
Excl. Agr. and Energy	34,2	7,8	0,8	0,8	5,2	0,6

Kaynak: TCMB, DİE.

3. The six-month average of seasonally adjusted inflation became 0.50 percent in WPI and 0.46 percent in CPI. The annualized six-month average correspond to 6.2 percent and 5.7 percent, respectively. During the same period, the average rate of increase in seasonally adjusted CPI excluding food realized as 0.67 percent. This figure corresponds to 8.3 percent in annual terms. (Figure 1).

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



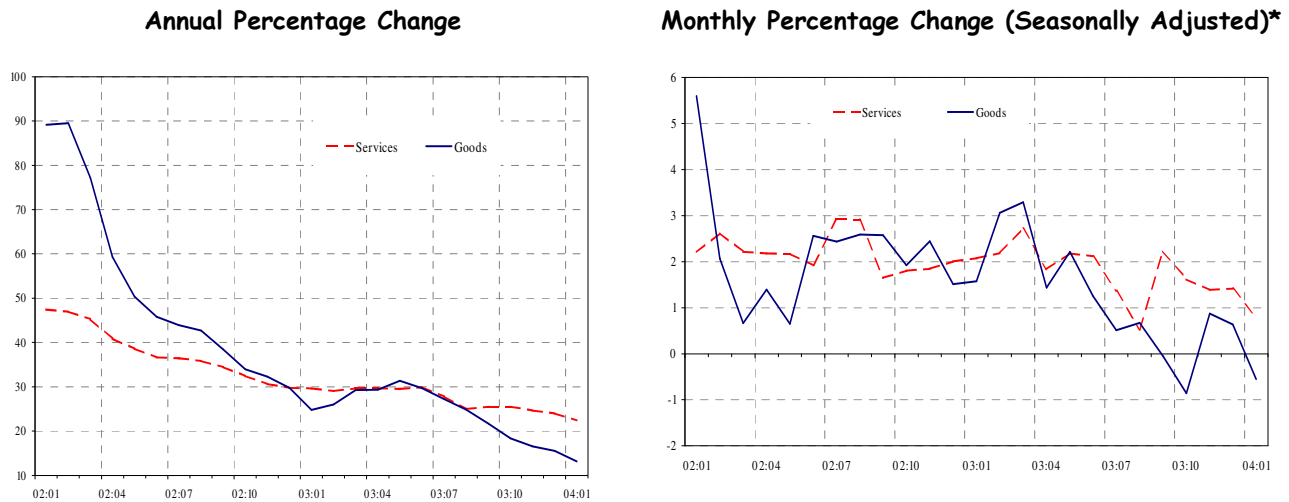
(\*)Six Monthly Moving Averages (Annualized, Seasonally Adjusted)

Source: CBRT, SIS

### ***Developments in Consumer Prices***

4. The downward trend in consumer inflation strenghtened in January 2004. Annual rate of increase dropped to 16.2 percent in CPI and 15.7 percent in WPI. (Figure 2).
5. The flood disaster that occured in Antalya at the end of 2003 did not have an unfavorable impact on consumer prices. In food group, the price increases of which accelerate every year in January due to seasonal reasons, merely rose by 1.4 percent.
6. The price increases in durable consumption goods were rather limited. Past data on this group reveal that prices are periodically adjusted in January and July in general. On the other hand, it has been observed during the last two years that this automatic behavior in prices of house devices has started to change to be replaced by a more rational pricing behavior, which is shaped by demand and cost conditions. Although the course of exchange rates is the main determinant in this development, it can be said that prices of durable consumption goods provide a good example for the change in pricing behavior.

Figure 2: Prices of Goods and Services

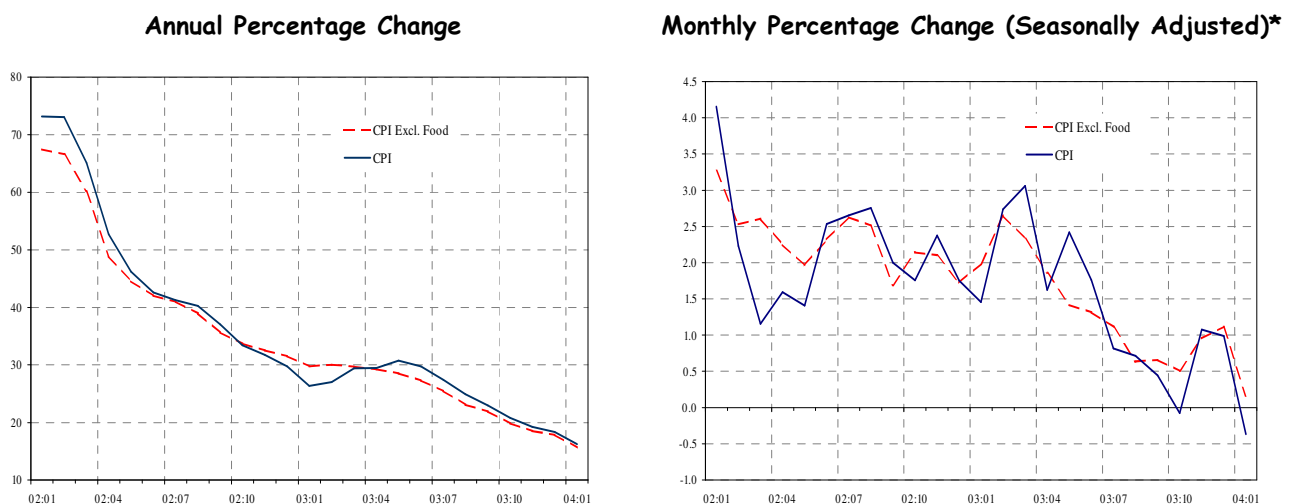


Source:CBRT, SIS.

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

7. While price increases in goods group remained at 0.2 percent due to the slight rise in food prices and the decline in clothing prices, prices in services group realized as 1.8 percent due to the negative impact of adjustments made in prices in rents, restaurant, patisserie and hotel groups. In seasonally adjusted terms, prices in goods group fell by 0.6 whereas prices in services group increased by 0.8 percent.

Figure 3: CPI and CPI Excluding Food



Source:CBRT, SIS.

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

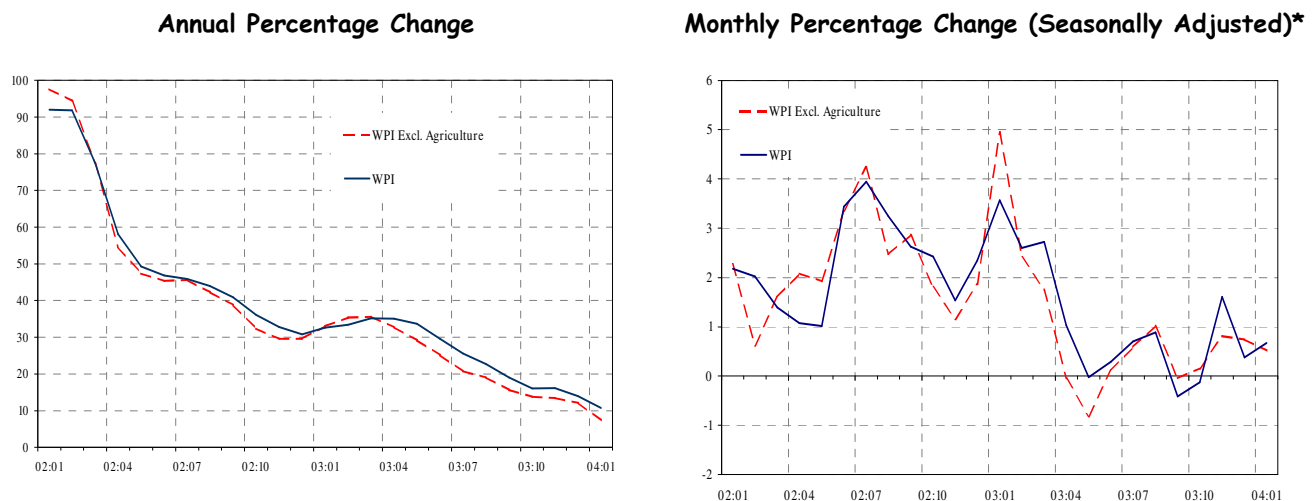
## ***Developments in Wholesale Prices***

8. In January 2004, with 0.5 percent, WPI inflation excluding agriculture maintained its downward course, which has been continuing since April 2003 (Figure 4).

9. In January, agricultural prices, which rose by 9.3 percent, made the highest contribution to the increase in WPI. The realization of this increase above the average January increase of 8.6 percent recorded between the years 1995-2003 is an outstanding development. The seasonally adjusted rate of increase in agriculture prices rose by 3.9 points compared to the previous month and realized as 4.2 percent. Such high rates of increase in agricultural prices mainly resulted from the severe winter conditions and the unfavorable impact of flood disaster in Antalya on fresh vegetable and fruit prices. As a result, it is assumed that the high rate of increase in agricultural prices has stemmed from severe seasonal conditions and that it is not expected to be permanent in the coming months.

10. Prices in manufacturing industry maintained their limited upward trend. Monthly price increases realized as 0.6 percent in private manufacturing industry and 0.7 percent in public manufacturing industry. The limited increases in this group mainly stemmed from the depreciation of average value of US dollar by 2.9 percent and 6 percent in December and January, respectively.

**Figure 4: WPI and WPI Excluding Agriculture**



Source: CBRT, SIS.

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

11. In line with the developments mentioned above, annual WPI inflation and WPI inflation excluding agriculture declined to 10.8 percent and 7.4 percent, respectively. High rates of increase in these indices in January 2003 owing to the developments in Iraqi War stimulated the drop in annual inflation rates in January 2004.

## ***II. OUTLOOK***

**12.** January inflation figures have once more revealed that the inflation target for 2004 is achievable. The average seasonally adjusted monthly inflation figures for the six-month period, which are 0.5 percent for WPI excluding agriculture and 0.7 percent for CPI excluding food, show the consistency of general trend of inflation with the end-year inflation target.

**13.** In January, while monthly consumer prices were below consensus forecast, monthly wholesale prices were above forecast. Due to adverse seasonal conditions, a 9.3 percent increase in agricultural sector prices was instrumental for the increase in WPI. If it is considered that the wholesale prices rose only by 0.5 percent excluding agricultural sector, then it will be obvious that the wholesale price inflation has turned out to be positive. On the other hand, with the advent of favorable weather conditions, it is most likely for the agricultural sector prices to return to its normal course. However, even though the rise in agricultural sector prices seems likely to have an adverse effect on February food prices, it is likely that these effects do not continue throughout the year. Consequently, the agricultural price increase in the WPI, which mainly resulted from severe seasonal conditions of January, is not expected to endure in the following months. According to the Central Bank's evaluations, the developments in January inflation carry positive clues for the future trend of inflation.

**14.** In the previous press releases we had cautioned the differentiation between the rate of price increases in goods and services, and had drawn attention to the fact that the rigidity of service group prices might pose a risk for 2004. We had also emphasized the importance of January inflation figures, when seasonal price adjustments were made in various items listed under service group. Within this framework, the relative slowdown in service sector price increases and the consistency of January price increases in this sector with the year-end target was a positive signal for 2004 inflation. However, the convergence of services inflation to good inflation is conditional on two factors: the recovery in domestic demand should be modest, and the expectations should be managed properly. At this point, the importance of fiscal discipline must be highlighted once again.

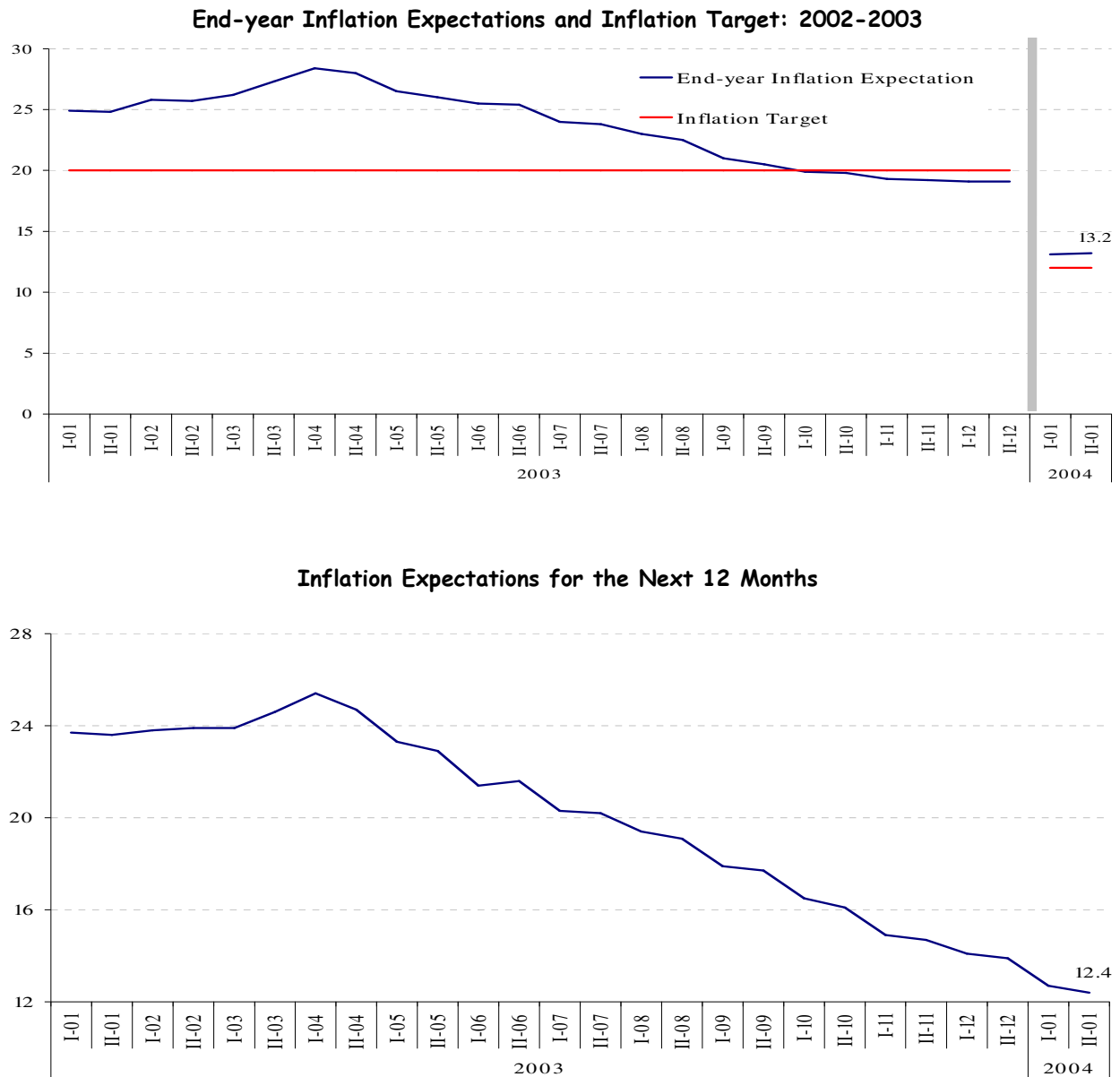
**15.** Currently, the stability in exchange rates as well as the favorable developments in expectations are continuing, and the recovery in domestic demand is progressing in a controlled manner. In light of the available data, the variables that affect inflation figures, such as domestic demand, exchange rates and expectations are estimated to follow a course that is consistent with the end-year target, provided that the fiscal discipline and political stability prevail and there is no exogenous shock. Although these developments indicate that the downward trend in inflation is likely to continue in the upcoming period, this projection is still a conditional one. Such projections will be very sensitive to the developments regarding budget targets. The Central Bank will continue to closely monitor the developments regarding financing of the deficit to be occurred in budget targets, and will retain its cautiously optimistic stance provided that the

measures are taken to curb expenditures rather than resorting to public price adjustments and tax adjustments that might trigger a cost-push effect. In other words, opting for slashing expenses to compensate the adverse effects of increases in minimum wage and pensions on the budget will not only support the positive expectations and the downward trend in inflation on the demand side, but also help accelerate investments. In the press release dated January 21, 2004 issued by the Undersecretariat of Treasury, it was announced that the impending adverse effects of the increases in the minimum wage and pensions would be compensated by slashing other budget spending items, which is highly welcomed with respect to the future inflation.

16. At this point, it should be underlined once more that the Central Bank would continue making its monetary policy decisions by considering the future course of inflation only, not the past inflation. Therefore, economic units should consider the general trend of inflation and the consistency of future inflation with the targeted inflation as their reference point, rather than the annual inflation rate, which is a backward-looking indicator. As explained in detail in the press release of February 5, 2004, fluctuations in annual inflation figures that can be attributed only to the base effect, will not contain any information related with the end-2004 inflation and thus will not affect the monetary policy decisions.

17. Despite the success against inflation, much remains to be done in order to achieve permanent price stability. Steps intended to improve efficiency, especially in the public sector, are of extreme importance as they enhance the quality of fiscal discipline. Moreover, every step taken towards the enhancement of the competitiveness, the deepening of the financial system by performing the banking reforms, the improvement of investment environment for domestic and foreign investors, and the advancement of the quality of governance, will help overcome the obstacles on the way to sustainable growth and price stability. On the other hand, it should be born in mind that the signals given for the sustainability of the current economic program and fiscal discipline would provide an environment where the downward trend in inflation could go hand in hand with high growth rate. Within this framework, the Central Bank will go on emphasizing the importance of fiscal discipline and structural reforms in the fight against inflation in the future as well.

**Figure 5: Inflation Expectations According to CBRT Expectations Survey**



Source: CBRT Expectations Survey