

MAY INFLATION AND OUTLOOK

I. GENERAL EVALUATION

1. In May, CPI increased by 1.6 percent, while WPI declined by 0.6 percent. Annual CPI and WPI inflation became 30,7 percent and 33,7 percent, respectively. Consequently, seasonally adjusted WPI and CPI increases were 0,2 percent and 2,5 percent, respectively.
2. Strengthening of Turkish lira and fall in prices of fuel oil products led to negative realization of WPI inflation for the first time since June 1987. This development points out that the cost-push effects in the economy continued to diminish in May as well.
3. Food prices played a significant role in CPI increase. Despite the fact that overall increase in CPI realized above May 2002 level, the increase in CPI excluding food remained behind May 2002 with 1.5 percent. Increase in CPI excluding food lost pace compared to the previous month and annual inflation in this group, which was 29.3 percent in April, decreased to 28,6 percent in May. Decline in WPI inflation excluding agriculture was also more evident than WPI and annual price increase realized at 29.2 percent in this group (Table 1).

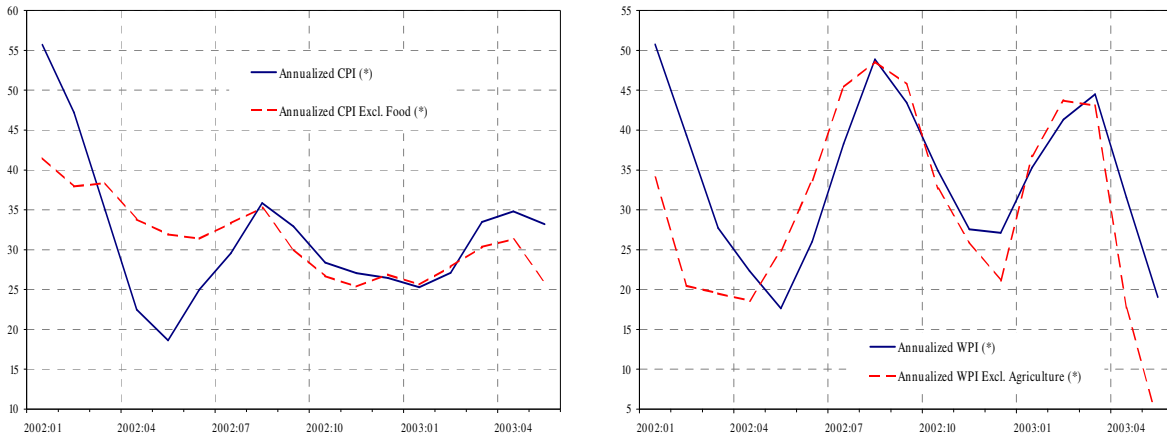
Table 1: General CPI, WPI and Sub-items

	Annual % Change		Monthly % Change			
	2002 May	2003 May	2002 March	2003 April	2002 May	2003 May
CPI	46.2	30.7	3.1	2.1	0.6	1.6
Goods	50.4	31.4	3.3	2.5	0.1	1.6
Services	38.6	29.5	2.7	1.3	1.6	1.5
Excluding Food	44.5	28.6	1.5	2.1	2.0	1.5
Food	52.0	37.8	8.2	1.9	-3.8	1.9
WPI	49.3	33.7	3.2	1.8	0.4	-0.6
Public	46.7	30.4	1.9	-1.2	2.7	-2.7
Private	50.3	35.0	3.7	2.9	-0.4	0.2
Public Manufacturing	46.6	35.0	1.8	-0.9	2.9	-3.0
Private Manufacturing	47.4	28.0	1.6	0.7	1.5	0.3
Agriculture	56.0	48.1	7.8	7.2	-4.1	-0.1
Excl. Agriculture	47.3	29.2	1.8	0.0	1.9	-0.8
Excl. Agr. and Energy	47.0	30.1	1.8	0.0	2.0	-0.9

Source: CBRT, SIS.

4. The last three-month average of seasonally adjusted inflation became 1.4 percent in WPI and 2,4 percent in CPI. The annualized figures for the referred inflation correspond to 19,0 percent in WPI and 33,2 percent in CPI. During the same period, monthly WPI inflation excluding agriculture realized at 0.3 percent, while that of CPI excluding food became 1.9 percent. In annual terms, WPI inflation excluding agriculture and CPI inflation excluding food were 3.4 percent and 25.9 percent, respectively (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

5. In May, CPI inflation realized 0.4 point above the market expectations and 1.2 points of the 1.6 percent rise in CPI stemmed from the price increases in food and clothing.

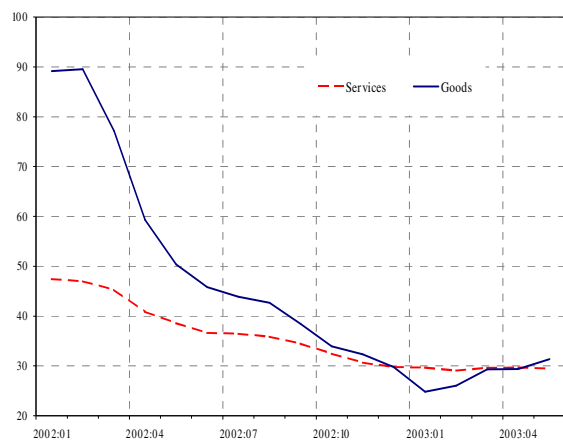
6. Despite the increase in clothing prices by 6.4 percent, price increase in goods realized at 1.6 percent. Although price increases in health services remained at a low level, prices in services group rose by 1.5 percent due to the rise especially in transportation prices. Seasonally adjusted price increases indicate that price increase in goods and services became 2,3 percent in May. Annual price increases as of May were 31,4 percent in goods and 29.5 percent in services (Figure 2).

7. Price increase in food, beverages and tobacco group realized at 1,8 percent in May. In seasonally adjusted terms, price increase in food became the second highest increase of the last 17 months by 4,2 percent, after the increase of 6.2 percent in March. High course of agriculture prices in previous months is deemed to have played an important role in price increases in food. On the other hand, price increase in clothing resulted from the seasonal factors.

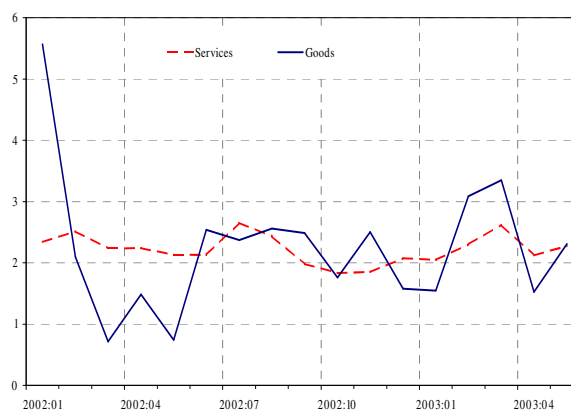
8. In CPI, price increases at groups other than food and clothing were rather limited in general. In May, an increase of 1.5 percent in rents and accordingly an increase of 0.9 percent in housing stood as a significant factor that restricted the increase in CPI as in April. Cut in the heating costs of housing owing to the decline in fuel oil prices for the last two months also played an important role in this development. Apart from housing, price increases in transportation, health, entertainment, education and other goods and services remained below 1 percent as well.

Figure 2: Prices of Goods and Services

Annual Percentage Change



Monthly Percentage Change (Seasonally Adjusted)



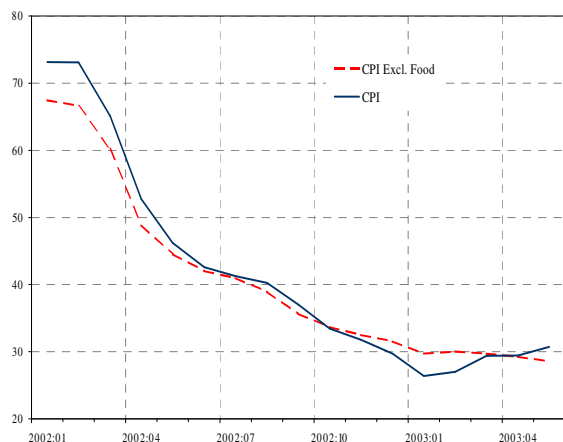
Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

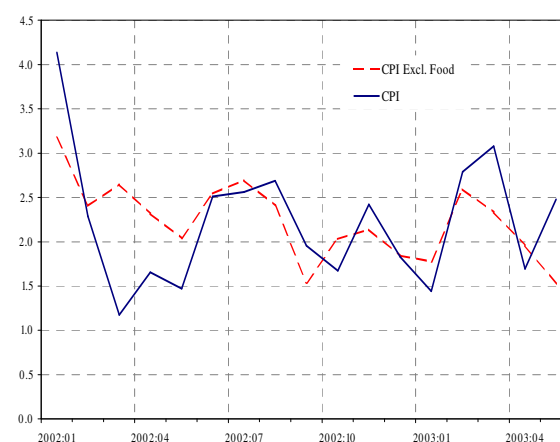
9. The seasonally adjusted increase in CPI, which climbed to 2.5 percent in May from 1.7 percent in April, mainly stemmed from the rise in food prices. Meanwhile, seasonally adjusted monthly food prices rose to 4.2 percent from 0.6 percent in the same period. On the other hand, seasonally adjusted CPI increase excluding food dropped to its lowest level of the last 8 months with 1.5 percent (Figure 3).

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.

Outlook

15. After the end of the military operation in Iraq, extraordinary conditions were eased and outlook for inflation turned positive in April. With the appreciation of Turkish Lira and developments in fuel prices, this process resulted in a 0.6 percent decline in WPI for the first time since June 1987. Except for the clothing prices that increased due to seasonal factors and food prices that displayed a rise above expectations, prices in CPI sub-groups only inched up in April.

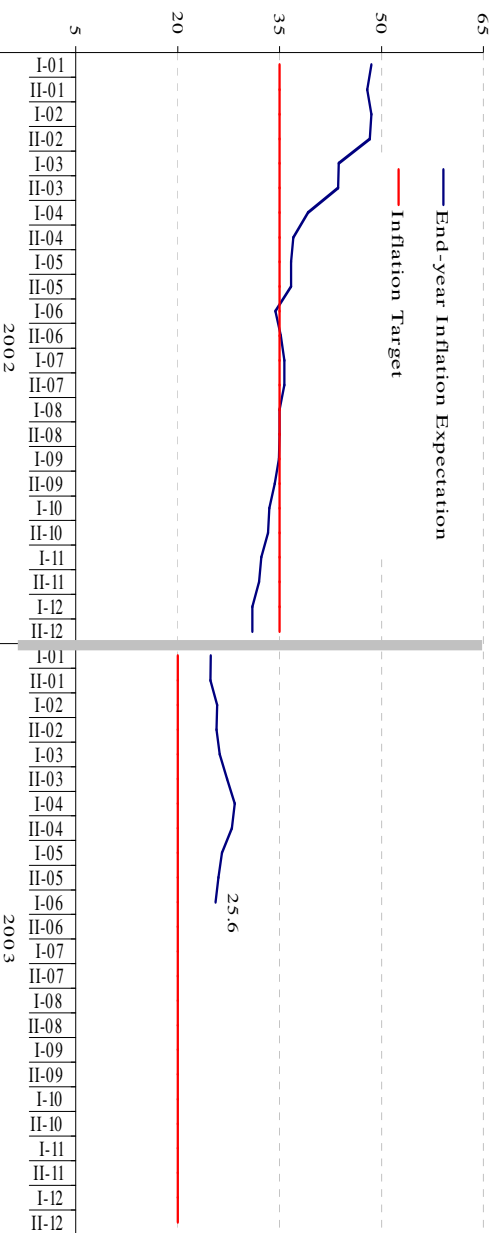
16. In May, actual CPI inflation exceeded the expected level and annual inflation reached 30.7 percent. However, it is evident that the increase in inflation mainly stems from price hikes in clothing and food groups as well as the base effect due to the course of inflation in the first half of 2002. Actually, the favorable developments in inflation become more evident when the prices except for the agriculture and food sectors are analyzed. According to seasonally adjusted data, rates of increase in CPI excluding food and WPI excluding agriculture decelerated compared with the first four months of the year and decline in annual price increases is pursued.

17. We have previously underlined the potential adverse effects of the rise in agriculture prices on CPI food group. These adverse effects were partly reflected on the prices in May. Meanwhile, the unfavorable course of food prices is expected to reverse in the period ahead. Agriculture prices, even if seasonally adjusted, displayed a sharp rise in the first five months of the year. However, favorable weather conditions are expected to make a decreasing effect on agricultural prices as of June, which in return would decrease food prices too. Therefore, a course similar to that of WPI inflation is expected to be observed in CPI inflation in the period ahead.

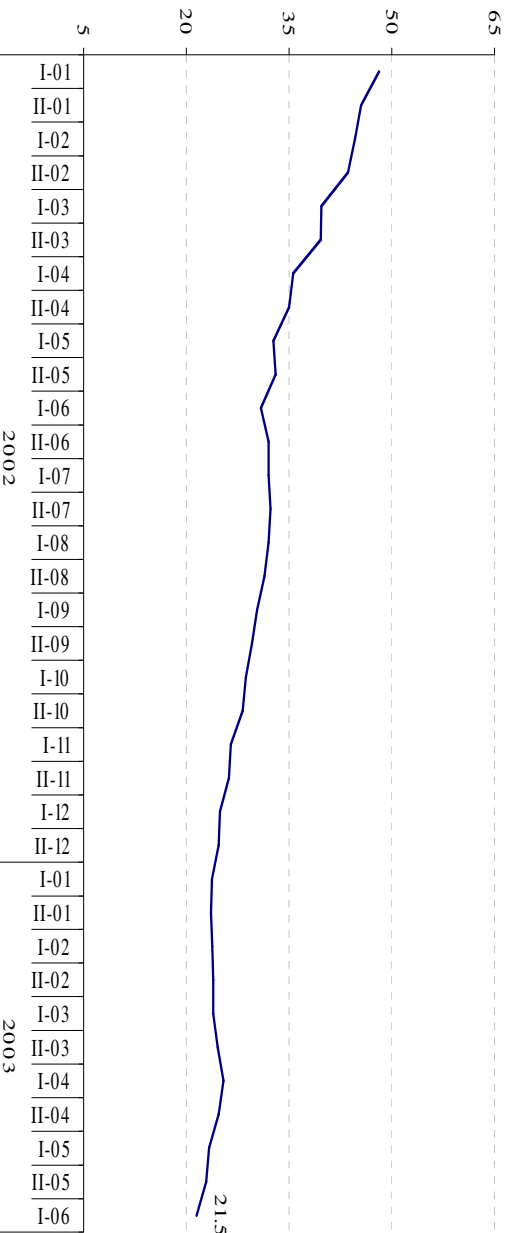
18. Despite above-mentioned projections, public price adjustments made at the end of May are feared to pose risk to the expected decline in inflation. Discount in natural gas prices, can still restrict the effect of this adverse situation. Moreover, recovery in domestic demand that may become more evident in the second half of the year is another factor that might jeopardize targeted inflation.

19. Consequently, despite favorable developments observed in inflation, CPI inflation exceeded the expected level in May and cumulative inflation reached 12.2 percent in the first five months of the year. When inflation components are analyzed, the factors, which push up inflation, are expected to be reversed; therefore the period ahead is believed to be a promising one for inflation developments. In this context, we would like to reiterate what is required to attain the end-year inflation targets: Public price adjustments shall be consistent with targeted inflation; domestic demand shall not create a cost-push effect in prices, structural reforms and fiscal discipline shall be carried out decisively and fluctuations in the market shall be minimized through efficient management of expectations.

**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