

JUNE INFLATION AND OUTLOOK

1. In June, CPI and WPI declined by 0,2 percent and 1,9 percent respectively compared to the previous month. Annual inflation rates displayed a similar trend. While annual CPI realized at 29.8 percent, WPI inflation became 29.6 percent. Consequently, seasonally adjusted increases in CPI and WPI were 1.8 percent and 0.3 percent, respectively.
2. In June, cost-push effects continued to diminish with the ongoing upward trend in Turkish lira and a strong demand pressure was not observed on prices. WPI and CPI general indices fell owing to the drop in food and agriculture prices arising to seasonal reasons.
3. Due to the fact that monthly increases in both CPI excluding food and WPI excluding agriculture remained substantially below the June 2002 levels, annual inflation declined in June. Hence, annual CPI inflation fell compared to the previous year for the first time since February. Moreover, it is observed that downward trend in WPI inflation is increasingly continuing.

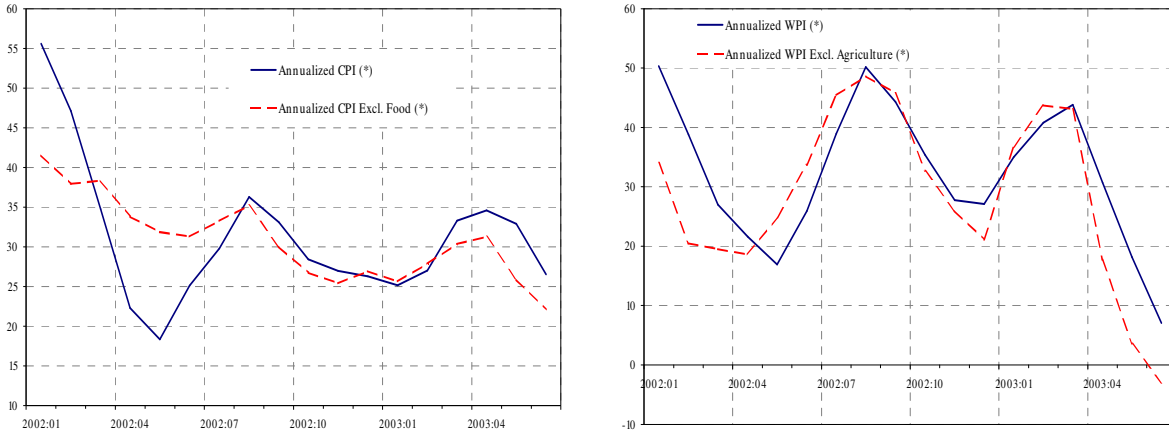
Table 1: General CPI, WPI and Sub-items

	Annual % Change		Monthly % Chnage			
	2002 June	2003 June	2003 April	2003 May	2002 June	2003 June
CPI	42,6	29,8	2,1	1,6	0,6	-0,2
Goods	45,8	29,7	2,5	1,6	0,2	-1,1
Services	36,6	29,9	1,3	1,5	1,4	1,7
Excl. Food	42,0	27,3	2,1	1,5	2,2	1,2
Food	44,6	38,3	1,9	1,9	-4,8	-4,4
WPI	46,8	29,6	1,8	-0,6	1,2	-1,9
Public	44,6	25,1	-1,2	-2,7	4,3	0,0
Private	47,7	31,4	2,9	0,2	0,0	-2,6
Public Manufacturing	45,2	28,6	-0,9	-3,0	5,2	0,2
Private Manufacturing	45,5	24,7	0,7	0,3	2,8	0,2
Agriculture	52,0	45,4	7,2	-0,1	-5,9	-7,6
Excl. Agriculture	45,4	25,1	0,0	-0,8	3,4	0,1
Excl. Agr. and Energy	45,2	25,8	0,0	-0,9	3,5	0,1

Source: CBRT, SIS..

4. The last three-month average of seasonally adjusted inflation became 0.6 percent in WPI and 2.0 percent in CPI. The annualized figures for these average inflation rates correspond to 7.1 percent in WPI and 26.5 percent in CPI. During the same period, the monthly increase in CPI excluding food was 1.7 percent. This increase corresponds to 22.1 percent on annual basis. (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

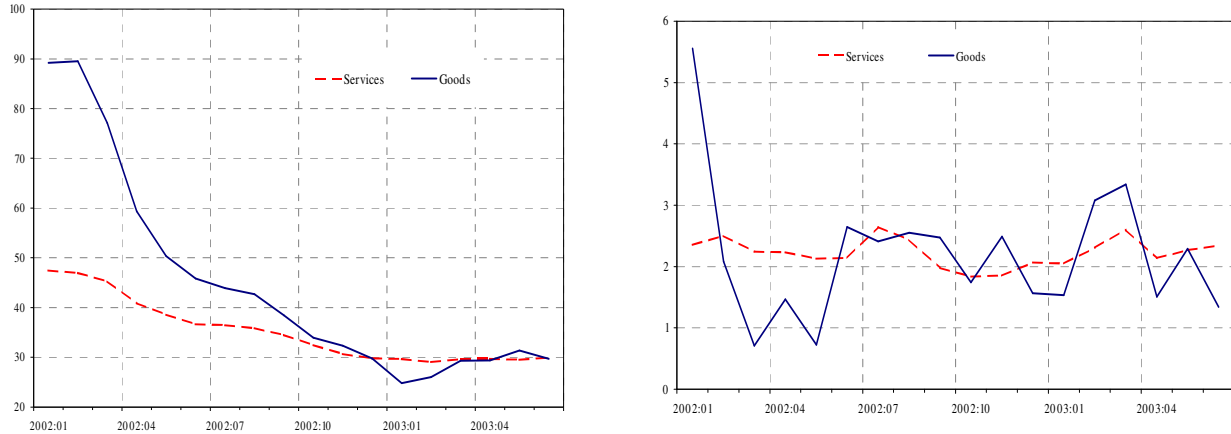
5. In June, the drop in food prices and considerable slowdown in price increases in clothing led to a decline in CPI. Besides, the rate of increase in CPI excluding food decreased by 0.3 point and remained at 1.2 percent. Thus, annual CPI inflation has started to drop again.

6. Prices in the goods group fell by 1.1 percent due to the food item. In the services group, price increase realized at 1.7 percent as a result of price increases in housing rents by 1.7 percent and transportation services by 2.3 percent, as well as an increase of 5.8 percent in communication services as a result of the price adjustments made in telephone charges. It is considered that the price increases in services resulted from the public price adjustments and the demand for housing, which has increased in summer. Seasonally adjusted price increases indicate that the price increase in goods and services became 1.3 percent and 2.3 percent, respectively in June. Annual price increases as of June were 29.7 percent in goods and 29.9 percent in services. (Figure 2).

7. While prices in food and transportation groups declined in overall CPI, price increases in other groups were rather limited as well. Especially the downward trend in durable consumption goods indicates that there has not been a strong demand pressure in the economy yet. Additionally, the course of exchange rates is considered to have a favorable effect on the prices of durable consumption goods.

8. In June, food, alcoholic drinks and tobacco prices fell by 2.9 percent, playing a significant role in the negative realization of the CPI inflation. While food prices declined by 4.5 percent, the price adjustments in TEKEL products limited the rate of decline in the prices of this group. Due to the public price increases, prices in beverages rose by 3.8 percent, while prices in cigarette and tobacco groups increased by 8.5 percent. Moreover, public adjustments in the prices of transportation services, which increased by 2.3 percent, and in the prices of communication services, which showed an increase by 5.8 percent, also restricted the decline in CPI in June.

Figure 2: Prices of Goods and Services
Annual Percentage Change **Monthly Percentage Change**
(Seasonally Adjusted)*



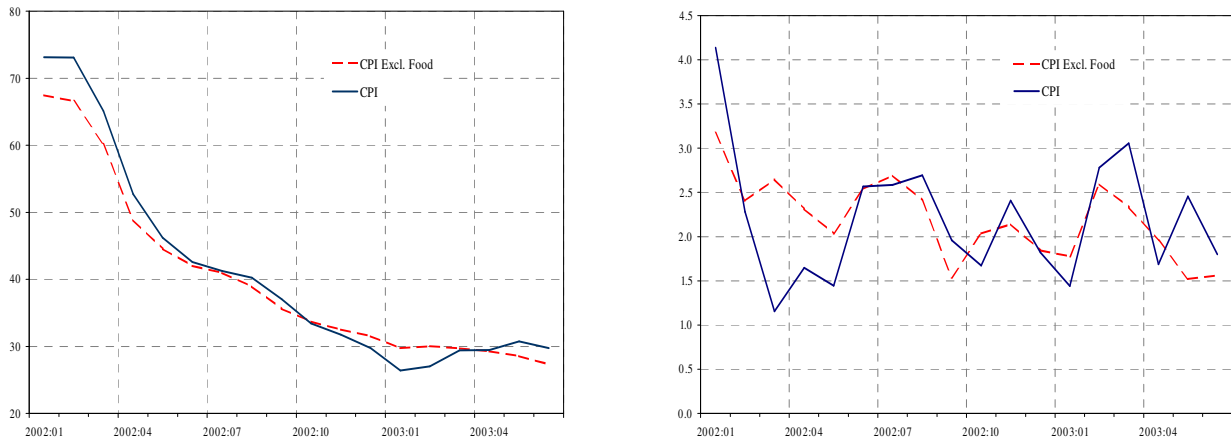
Kaynak: TCMB, DİE.
 Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

9. The seasonally adjusted increase in CPI became 1.8 percent, declining by 0.7 point compared to May. The increase of food prices by 4.0 percent in May in seasonally adjusted terms had a negative impact on overall CPI increase as well. The increase in CPI excluding food became rather limited. In June, the ongoing low upward trend in CPI excluding food and the slowdown in the rate of price increase in the food group led to the drop in the seasonally adjusted increase in CPI. (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.

Developments in Wholesale Prices

10. In June, the 1.9 percent drop in WPI stemmed from agricultural prices. While the contribution of agriculture sector to the referred drop in WPI became – 1.8 points, that of the manufacturing industry was 0.1 point.

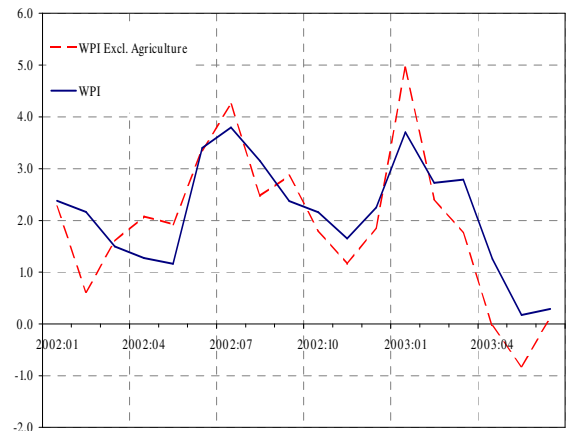
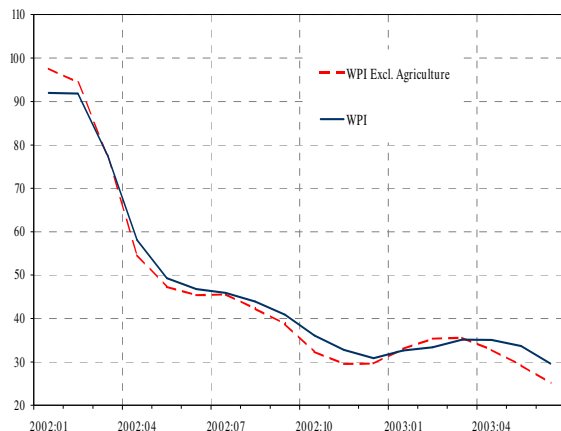
11. Agriculture prices declined by 7.6 percent in June as well, following the 0.1 percent drop in May. (Table 1). High-rated increase in some products due to the weather conditions despite the favorable effect of fresh fruit and vegetable prices that have dropped owing to summer limited the rate of decrease in agriculture prices. Seasonally adjusted data reveal that seasonally adjusted price increase in agriculture realized negative for the first time since June 2002. In line with these rates, the annual price increase in agriculture decreased to 45.4 percent in June from 48.1 percent of May.

12. Meanwhile, the monthly rate of increase in WPI excluding agriculture realized at a limited level in June, as in April and May. WPI excluding agriculture, which declined by 0.8 percent in May, rose by 0.1 percent in June. In annualized terms, WPI excluding agriculture decreased to 25.1 percent in June from 29.2 percent of May (Figure 4). The limited increase in WPI excluding agriculture resulted from the 0.2 percent rise in overall manufacturing industry prices.

13. Following the 3 percent drop in May, public manufacturing industry prices rose by 0.2 percent in June. The decline in May stemmed from the sectors that are sensitive to the movements in exchange rates and international crude oil prices. In June, the decline arising from movements in international crude oil prices reduced, while the effects of the ongoing appreciation of Turkish lira against exchange rate basket continued. Despite these favorable effects, price adjustments in TEKEL products prevented a decline in public manufacturing industry prices. Nevertheless, on annualized terms, the gradual drop of public manufacturing industry prices to 28.6 percent in June from 48.8 percent of February is a favorable development.

14. Non-existence of cost-push effect in private manufacturing industry in line with public manufacturing industry restricted the rate of price increase to 0.2 percent. In June, annual rate of increase in private manufacturing industry prices decreased to 24.7 percent from 28 percent of May.

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.

II. OUTLOOK

15. The current Economic Program, which was put into practice in May 2001, rests upon robust measures intended to establish monetary and fiscal discipline and stipulates that a series of structural reforms shall be implemented in order to eradicate the main reasons underlying the long-lived distorted economic structure. From the time it was first announced till this very day, the program has been generally adhered to. However, contrary to this general tendency, some deviations, though temporary, have taken place sometimes due to some exogenous factors and sometimes due to the hesitancy of those who had made the program decisions personally and those who committed to adhere to the program.

16. As a consequence of the general adherence to the fundamental principles of the program, substantial lows in inflation figures has been attained, a faster-than-expected economic growth has been achieved and a downward trend has started in the ratio of public debt to national income. Maintaining these achievements certainly requires steadfast implementation of the program. It is clear that greater achievements can be possible in case such deviations are nonexistent.

17. The inflation figures of June, which were announced yesterday, constitute another proving indicator of the outcomes of uninterrupted and steadfast implementation of the economic program. Actually, Central Bank of Turkey announced in paragraph 40 of its February Inflation and Outlook Report dated March 11, 2003 that: “the downward trend in inflation can only be sustained, if the envisaged measures are carried out and the program is strictly implemented. In the medium term, such trend will enable our economy to attain the inflation levels that the developed countries enjoy. Depending on which scenario comes true in the “extraordinary period”, it is expected that deviations from the main trend will either be negligible or temporary, on condition that the said measures are carried on”. With these expressions the CBT reiterated that the downward trend in inflation would continue only if the program is strictly adhered to. In the same press release as well as in the following releases, it was asserted that a notable downward trend would be observed in inflation in the second half of the year. Actually, the inflation figures pertaining to June verifies CBRT’s envision. The CBT frequently reiterates that despite some risks, the end-year inflation target of 20 percent is well within reach provided the economic program is strictly adhered to. We firmly believe that our envision of attaining the end-year inflation target will be confirmed if the fundamentals of the program are strictly adhered to and implemented.

18. There are certain points to be emphasized about the inflation developments in June that were delineated in the above paragraphs. Firstly, the rates of change in consumer prices, wholesale prices and private manufacturing sector prices remained well below the market expectations. Secondly, monthly consumer prices inflation reached the lowest level since July 1990, wholesale prices inflation came down to the lowest level since June 1987 and private manufacturing sector prices dropped down to historical lows since 1982. Thirdly, annual inflation rate decreased substantially. Annual inflation in consumer prices declined by 0.9 percent while wholesale prices inflation dropped down by 4.1 percent in June. The prevailing downward trend in annual consumer prices inflation excluding food prices sustained in June in as well. A similar trend was observed in rise in private manufacturing sector prices. Fourthly, these developments also confirm that the “base effect” which is one of the reasons that underlies the relatively high rates of annual inflation in the first half of the year, is gradually easing off.

19. Certainly, the CBT, which determined interest rates within the framework of the objective of attaining price stability, does not hinge on the current inflation trend but it attached utmost importance to determine whether the changes in inflation trend are temporary

or permanent ones and mainly focuses on the future inflation trend. Therefore, it would be wise to take a short glance at the indicators that would shape inflation trend in the forthcoming period: Most academicians studying inflation in Turkey agree that the main variables affecting inflation trend in Turkey are: (1) rate of depreciation in foreign exchange, (2) expectations about the future trend of inflation, (3) prices –such as increase in wages– quoted in contracts signed within the framework of such expectations, (4) demand pressure determined according to the way and degree of difference between the real production level and the potential production level. The first two of these points, in another words, developments observed in exchange rates in the last few months and favorable developments in inflation expectations coupled with the prospective tendency of those variables in the near future encourages CBT to think positive about the future inflation trend.

20. The future courses of private as well public sectors income policies are also important. Increases in wages and salaries shall be determined in a way not to conflict with the inflation target. The rates of increase in wages and salaries of public servants shall be indicative in this regard. Therefore, setting public sector wages and salaries harmonious with the target inflation rate is of utmost importance. In terms of conformity with inflation target, the announcements made by officials are deemed favorable. However, although confirming to the inflation target, the cost of increase in wages and salaries exceeding budget targets would create adverse effects and some additional costs on especially interest rates as these increases will be met by increasing taxes instead of cuts in other expenditure items.

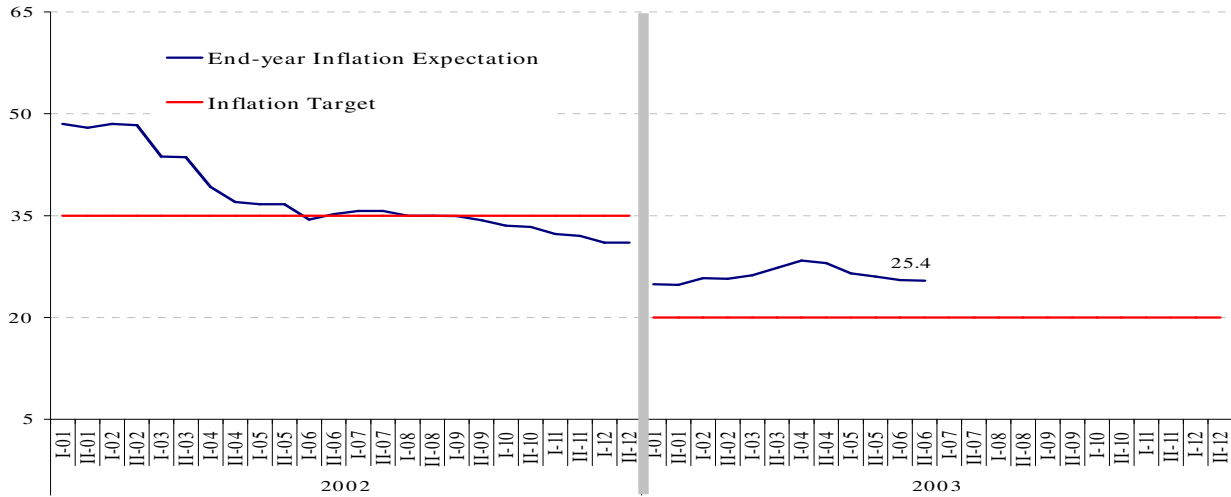
21. Taking into account the above-mentioned points and departing from the supposition that the program would be implemented without any interruptions, the most important development that could pose threat to the future trend of inflation can be the signals about increasing domestic demand. However, the studies at the CBT show that although converging, the actual production stills falls short of potential production level. Moreover, it should be borne in mind that the demand pressure evaluations envisions a significant increase in domestic demand accompanying the end-year inflation target of 20 percent, therefore it is once more confirmed that the current program is a consistent one. Although remaining below the potential production level palliates the unfavorable pressure to be exerted by domestic demand on inflation, this should not be perceived as an short-sighted opportunity to increase profit margins by the private sector, long-term interest should be considered and actions should be taken responsibly.

22. The negative effect that might arise from demand pressure could be compensated sufficiently by the recent developments in exchange rate, the favorable inflation expectations, and the strong likelihood of continuation of these trends. With the incomes policy, pursued in line with the inflation target, the inflationary effect of the third factor will be neutralized. In the framework of this analysis, it is obvious that the current downward inflation trend could only be stopped by deviations from the program. It is of utmost importance that fiscal discipline is maintained and structural reforms are carried on timely and uninterruptedly. For this reason, it should always be kept in mind that the above-mentioned factors, instrumental in inflationary dynamics, are extremely sensitive to fiscal policy and structural reforms. Therefore, making the legal and administrative arrangements needed for structural reforms, by giving priority to social security system, and taking the measures for the continuation of fiscal discipline before the completion of the 5th Review with the IMF are considered as important elements to support the downward inflation trend.

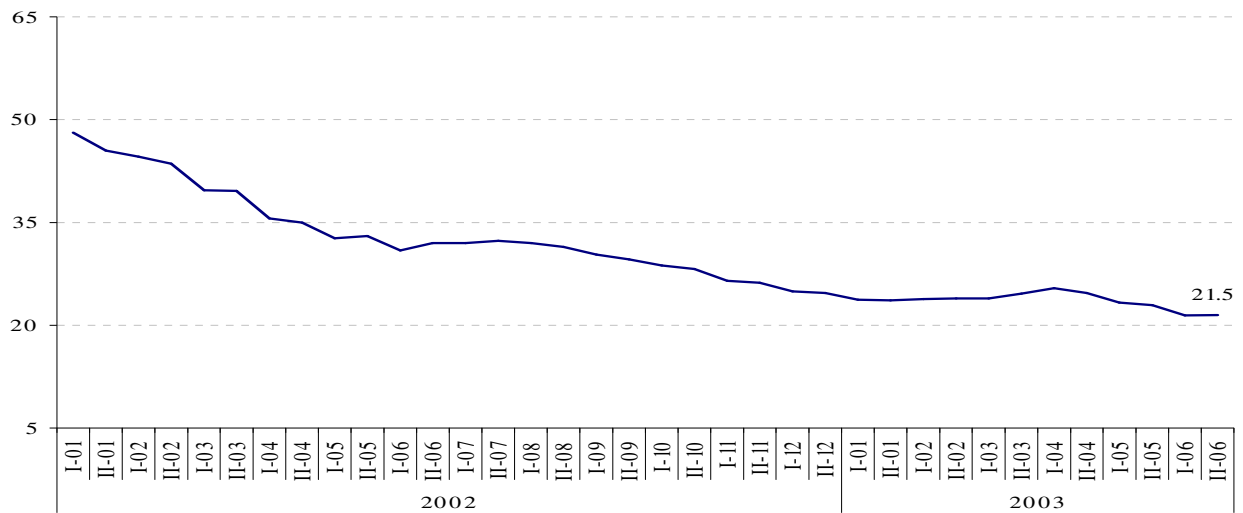
23. Consequently, welcoming the above-mentioned favorable developments and warning against any kind of relaxation that would be a big economic mistake and departing from the

supposition that no concessions would be allowed in fiscal discipline and structural reform process, the CBT envisages that the favorable developments observed in inflation since April would continue. As was reiterated in the previous press releases, the CBT also envisions a substantial downward movement in the months ahead and believes that the end-year consumer prices inflation target of 20 percent will be attained.

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