Central Bank of the Republic of Turkey

PRESS CONFERENCE FOR THE PRESENTATION OF THE INFLATION REPORT

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28 July 2006, Ankara

Dear Press Members, Distinguished Guests,

The third issue of the Inflation Report, the leading means of communication of the Inflation Targeting regime, which was put into effect as of January 2006, has been published on the website of the Central Bank of Turkey today.

The Inflation Report contains the analyses that will influence the medium-term course of inflation and the inflation forecasts based on these analyses. With this report, the Central Bank, at the same time, shares how it evaluates the general macroeconomic outlook with the public, as well as the likely risks that may lead to deviations from inflation forecasts.

The Content of Inflation Report

The Inflation Report consists of seven chapters.

In the first chapter, a general evaluation related to macroeconomic developments in the near future is made and forecasts and risk elements are summarized. The following five chapters include detailed analyses of the international economy, inflation, supply-demand, financial markets and public finance.

In the last chapter, inflation forecasts until the end-2007 that have been produced on the basis of observations and assumptions on foreign and domestic fundamental macroeconomic variables are presented. The chapter also explains the basic risks to medium-term inflation forecasts.

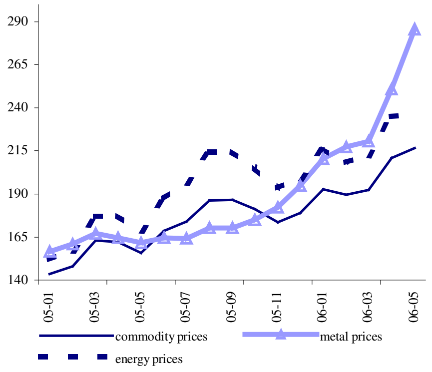
In the same way as in previous issues, this Inflation Report also includes a number of boxes on topical and significant subjects. In the Report, in addition to the boxes that have been prepared in order to ensure better understanding of price dynamics, there are boxes that analyze the FX indebtness of firms in Turkey and the impacts of the rapid rise in energy prices in international markets on Turkey's current account balance.

At this point, after my brief introduction of the third issue of the Inflation Report, I would like to summarize the evaluations and the Central Bank's inflation forecasts that are presented in this Report, which will be published on the Central Bank's website today.

International Economic Developments

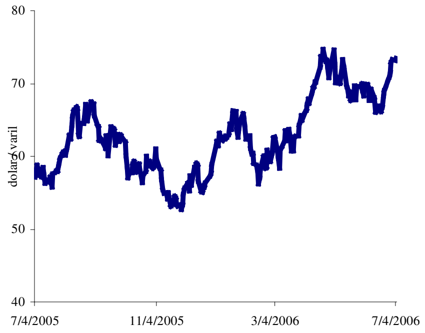
The technological developments on an international scale and the participation of the educated labor force in the world economy following the integration of former Soviet Union economies, China and India into the world trade system curbed the increase in unit labor force costs, thus contributing to keeping inflation under control. Due to worldwide low inflation and a strong growth trend, inflation expectations have receded and accordingly the risk premium dropped in general. Consequently, starting from 2003, global liquidity significantly shifted to the developing markets. However, the recent rises in energy prices (Graph 1 and 2) have led to the exertion of pressure on inflation worldwide. Along with this development, the withdrawal of liquidity in the world markets due to the Japanese Central Bank's decision for monetary tightening and the policy interest rate rises by the central banks of developed countries against increasing inflationary pressures has caused an increase in risk perception. Hence, international liquidity, which had showed a tendency to increase since 2003, entered a downward trend in May 2006. These unfavorable developments in global liquidity conditions have led to an increase in the risk premium in Turkey.

Graph 1. Developments in Commodity Prices (2000=100)



Source: IMF, IFS.

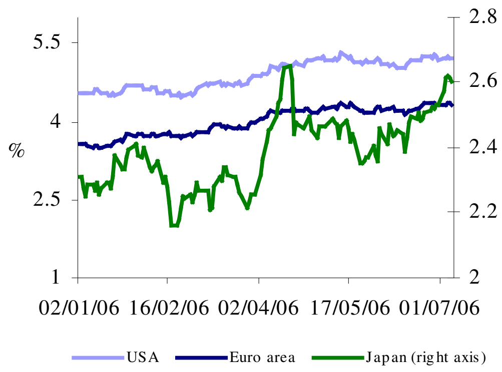
Graph 2. Oil Prices



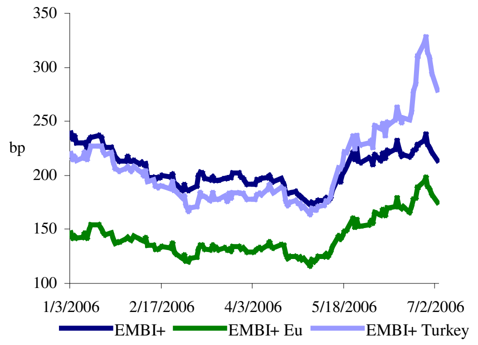
Source: Bloomberg.

Analyzing interest rate developments in developed countries, monetary policy tightening in the US and Eurozone have boosted bond yields in these countries (Graph 3). Nevertheless, the volatility in May 2006 led to a cutback in capital flows towards nearly all developing countries. The indices of developing countries reveal that though the volatility displays differences by country, the directions of indices are the same (Graph 4). This situation implies that the fundamental indicators specific to each country are important. But the main triggering elements originate from global conditions.

Graph 3. Developed Countries' Bond Yields (30 years)



Graph 4. EMBI+ Developments

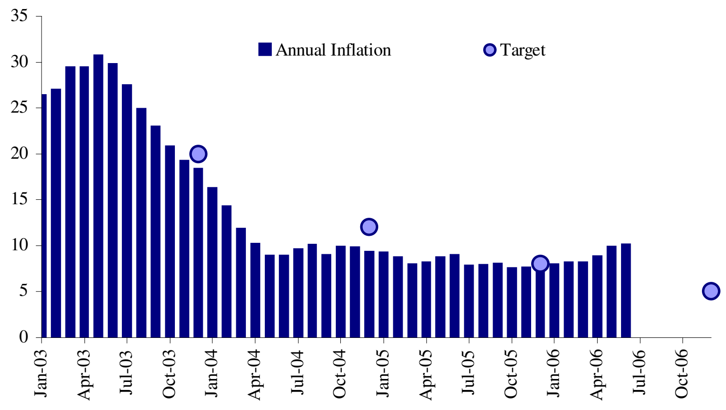


Source: Bloomberg.

Inflation Developments

By the end of the second quarter of 2006, the annual rate of increase in consumer prices were realized as 10.12 percent, remaining above the uncertainty band that has been formed around the path consistent with the target (Graph 5). While the leading domestic factor, which was determinant in the rise in inflation in the second quarter, became supply-oriented unprocessed food prices, the course of energy and gold prices were among the significant external factors. Moreover, the depreciation of the New Turkish lira due to the deterioration in global liquidity conditions stood as another factor that played a role in the rise in inflation.

Graph 5. Year-End Inflation Target and Annual CPI Inflation



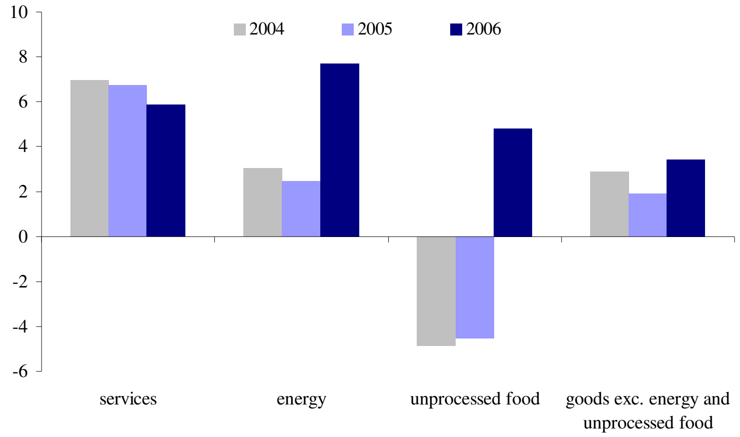
Source: CBRT, TURKSTAT.

The prices in food and non-alcoholic groups, which had entered an upward trend since the last quarter of 2005, became the determinant of the course of consumer inflation in the first half of 2006. While identifying the source of increase in this group, it will be more helpful to evaluate the group separately as processed and unprocessed foods. The prices in the unprocessed food group, which did not display an apparent change in the first five months of 2005, increased by 11.4 percent during the same period of 2006. Meanwhile, price increases in processed food products, which were expected to be more susceptible to demand developments, realized at a limited level.

High-rated increases in international energy prices in the second quarter of 2006 had an unfavorable impact on consumer prices from fuel oil and natural gas prices. These prices showed high-rated rises after March due to crude oil prices entering an upward trend. This trend continued from May onwards because of exchange rate developments. It is highly probable that international oil prices, which re-increased at the end of June, will negatively influence consumer prices in the upcoming period.

When the 2006 increases in energy and unprocessed food prices are compared to previous years, the supply-originated unfavorable effects on consumer inflation can be seen more clearly. Prices of goods excluding unprocessed food and energy, which remained below increases of previous years in the first quarter of 2006, showed a rise above the previous years' levels in the second quarter of the year especially parallel to the depreciation of the YTL (Graph 6).

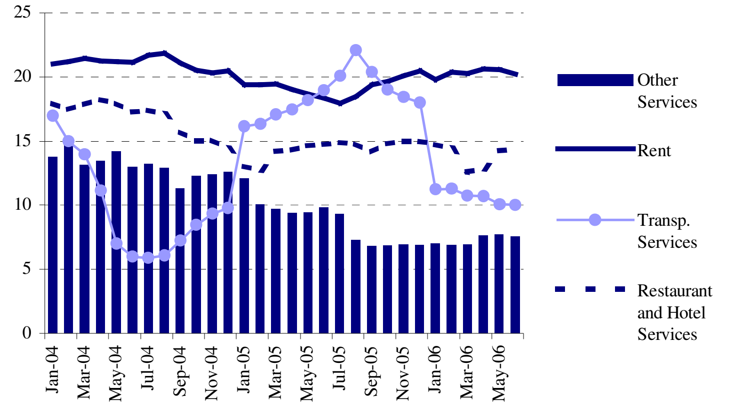
Graph 6. Prices of Goods and Services
(Six-Month Cumulative Percentage Change)



Source TURKSTAT, CBRT.

The high course of services inflation persisted in the second quarter of the year as well, especially due to high increases in rents and the restaurant-hotel group. In the meantime, the annual rate of increase in prices of transportation services remained below the previous year's level. Due to the fact that the prices in the said group are significantly susceptible to developments in fuel oil price increases in this group are highly expected in the upcoming period (Graph 7).

Graph 7. Prices of Services
(Annual Percentage Change)

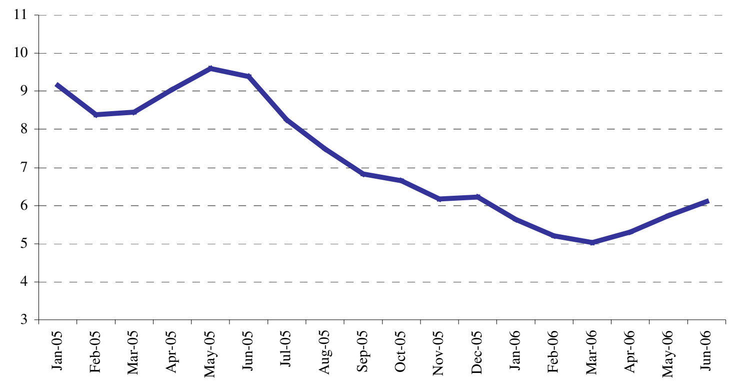


Source: TURKSTAT, CBRT.

It is observed that the depreciation in the YTL stemming from volatilities in financial markets in the last two months was reflected on consumer prices in May and June. Primary effects are perceived in goods that are priced in terms of foreign exchange and import goods in the index. Accordingly, fuel oil and durable consumption goods such as electrical goods and automobiles as well as gold items displayed high increases in the last period. These *primary* effects, which contributed to consumer inflation by nearly 1.5 points in the two-month period, are expected to pursue a sluggish course in the short run.

The Special CPI Aggregate (SCA-D*), which is compiled by the Central Bank of Turkey by excluding unprocessed food, energy, gold, alcoholic beverages and tobacco products, has been increasing on annual basis since April. The said rise resulted from increased seasonal volatility in the clothing and shoes group in April and May compared to the previous year. In this context, it is observed that prior to the exchange rate fluctuations in May, the annual rate of increase in the Special CPI Aggregate was at a limited level, except for a temporary rise that stemmed from the price developments in the clothing and shoes group (Graph 8).

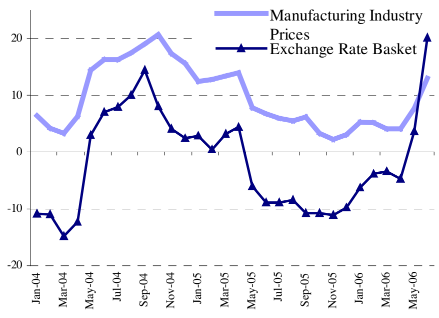
Graph 8. Special CPI Aggregate (D*)
(Annual Percentage Change)



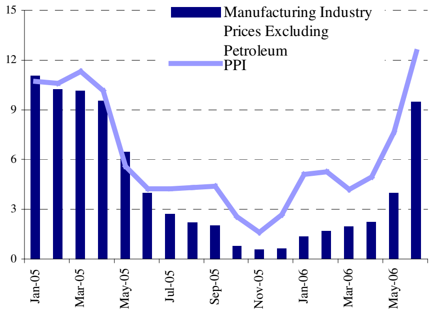
D*: Excluding energy, alcoholic beverages and tobacco, unprocessed foods and gold.
Source: CBRT.

Exchange rate developments affect producer prices more rapidly and at higher levels than they affect consumer prices. As a matter of fact, prices in the manufacturing industry quickly responded to the increases in exchange rate in May and June and showed a rapid rise on an annual basis in line with the 8.98-percent rise observed in producer prices in the second quarter of the year (Graph 9). The increase in oil and commodity prices also contributed to the rapid rise in manufacturing industry prices. In addition, the 12-percent increase observed in natural gas prices in the second quarter of 2006 will exert pressure on costs in the industrial sector. Even if the effect of oil products is excluded following all these developments, it is still observed that the annual rate of increase in prices of the manufacturing industry has accelerated (Graph 10). It can be said that the impact of this development on consumer inflation will vary depending mainly on demand conditions and the future course of services sector inflation.

Graph 9. Manufacturing Industry Prices and Exchange Rate Basket (0,5USD+0,5Euro)
(Annula Percentage Change)



Graph 10. PPI and Manufacturing Industry Prices Excluding Petroleum Products (Annual Percentage Change)



Source: TURKSTAT, CBRT.

It is of critical importance that inflation expectations are in line with medium-term targets in order to enable the convergence of inflation realizations and target inflation figures. For this reason, the course of expectations is being carefully monitored and analyzed.

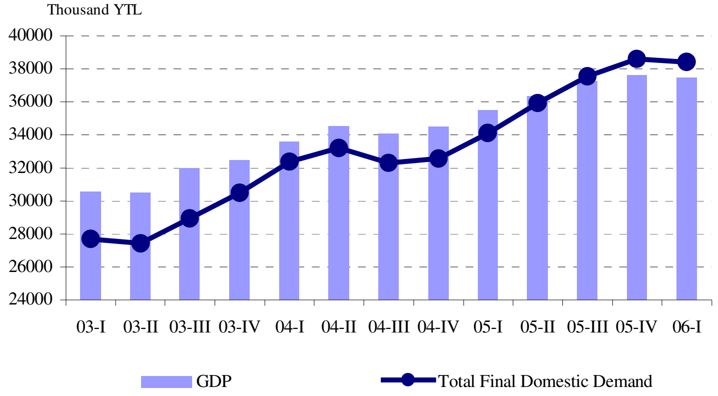
Developments observed in the global as well as the Turkish economy in the second quarter of 2006 have unfavorably affected inflation expectations. The deterioration in expectations started with the CPI inflation of April, which was realized above the expected level. However, since exogenous factors were the main determinant of inflation realizations in April, the deterioration in expectations remained limited. Meanwhile, the main source of the deterioration in expectations was the depreciation of the YTL due to the fluctuations observed in financial markets in May. Inflation expectations for the next 12 and 24 months are significantly above the medium-term targets as of July. Moreover, the fact that the standard deviation of expectations increased in comparison with the increase in averages stands as another indicator of the deterioration in inflation expectations. It is critical that inflation expectations stay in line with medium-term targets in terms of enabling the convergence of inflation realizations and target inflation figures. For this reason, the course of expectations is being carefully monitored and analyzed.

Supply and Demand Developments

Having summarized inflation developments, I would now like to present the Bank's evaluations of supply and demand developments in light of recently announced data.

The Gross Domestic Product (GDP) increased by 6.4 percent in the first quarter of 2006 compared to the same period of 2005 (Graph 11). The greatest contribution to GDP growth came from private investment expenditures. Private consumption expenditures became the second factor supporting growth. As a result of high-rated annual increases in consumption and investment demand, total final domestic demand increased by 13.8 percent compared to the same period of the previous year. When analyzed by quarterly periods, total final domestic demand decreased compared to the previous period, due to the slowdown in consumption demand as opposed to the strong growth trend in investment expenditures.

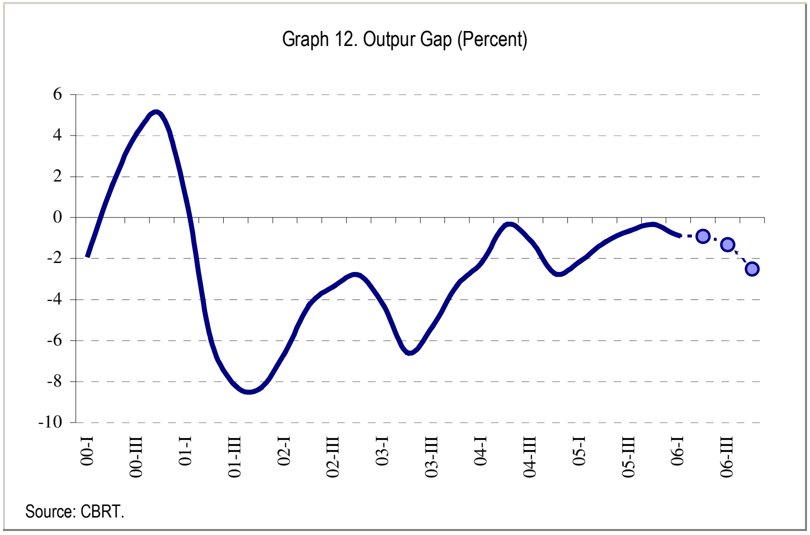
Graph 11. GDP and Total Final Domestic Demand
(Seasonally Adjusted)



Source: TURKSTAT, CBRT.

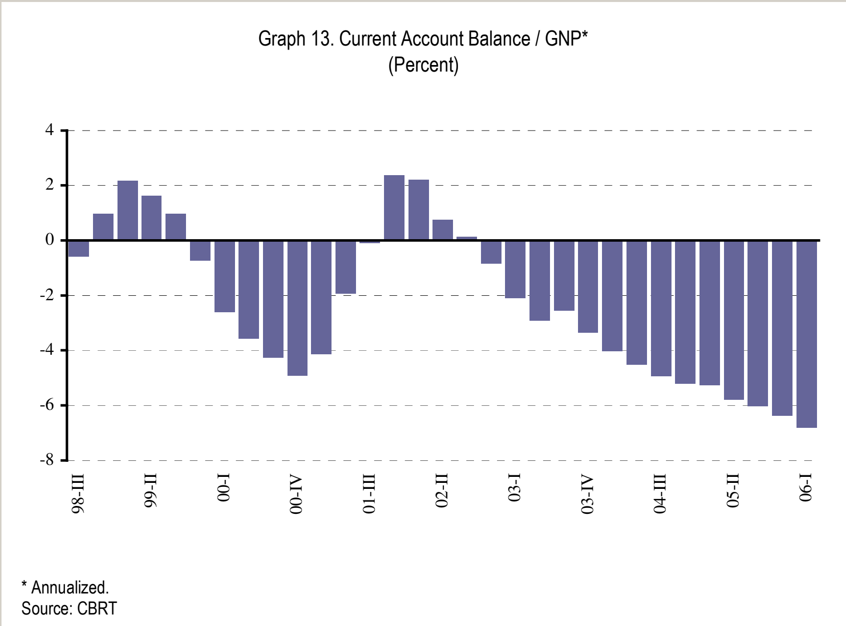
In the first quarter of 2006, increases in manufacturing industry partial labor productivity continued. Hence, the positive course of productivity developments, which are among the factors that exert a downward pressure on inflation, also became effective in the said period. However, during the current period, cost conditions have significantly changed owing to the rapid depreciation of the YTL. In other words, the *direct* support of the strong position of the YTL vis-à-vis foreign currencies to the disinflation process has been removed.

Updated indicators for consumption and investment expenditures provide signals for a re-acceleration of growth in the second quarter of the year, following the slowdown in economic activity observed in the last quarter of 2005 and first quarter of 2006. However, the environment of uncertainty caused by the fluctuations seen in financial markets since mid-May is expected to affect domestic demand unfavorably and slow down the growth trend in the second half of the year. In fact, the upcoming three-month tendency of the Business Tendency Survey (BTS) domestic market orders and sales indicators showed declines in May and June. In support of these indicators, total domestic sales of automobiles decreased rapidly in June compared to the previous month. This development further alleviates demand-oriented inflationary pressures for the upcoming period. As is also seen from output gap estimations, the downward pressure of demand conditions on inflation is expected to increase in the second half of the year (Graph 12).



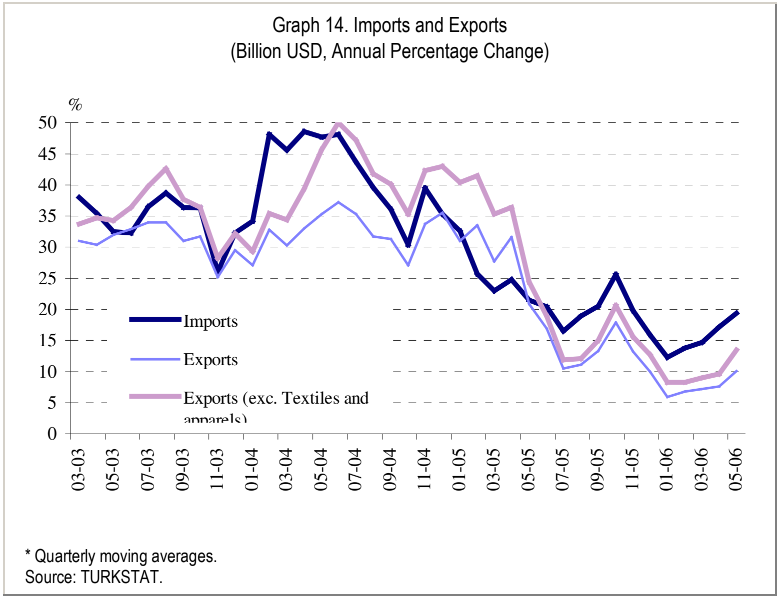
The current account deficit became USD 16.6 billion in the period from January-May 2006 , corresponding to 6.9 percent of the GNP on an annual basis as of the first quarter of the year (Graph 13). The foreign trade deficit, which widened due to the fact that the rate of increase in imports exceeded that of exports, was instrumental in increase of the current account deficit. In addition, the decrease observed in net tourism revenues in the January-May period also led to an increase in the current account deficit.

Let me once again underline certain points we have frequently emphasized in our previous presentations regarding the recently revisited topic of current account deficit. First of all, we have underlined the fact that the Turkish economy has grown strong enough to overcome higher levels of current account deficit thanks to the integration of Turkey into international financial markets, large-scale structural reforms and macroeconomic stability. Secondly, we have expressed our expectation that structural measures such as the social security reform and more effective taxation of the unregistered economy would exert downward pressure on the current account deficit by increasing the amount of total domestic savings. Thirdly, we have said that the quality of current account financing has increased due to extended maturities in external borrowing and the increase in direct foreign capital investments. All these developments help allay concerns about the sustainability of current account deficit. However, the Central Bank is closely monitoring the extents of current account deficit today, as it has always done. In this framework, the Central Bank had, in the past, warned the banking and firm sectors about the exchange rate risk they undertook, and continues to make the same warnings today.



After emphasizing these points once again, I would like to summarize developments in imports and exports. The rate of increase in imports and exports, which started to lose pace in the second half of 2005, has gained momentum in the recent period (Graph 14). Despite remaining below the overall exports performance, exports in the textile and clothing sectors, which has a significant share in the total exports, increased in May as opposed to the decrease observed in the first four months of the year. The export increases of May in capital-intensive sectors such as motor vehicles, machinery-equipment, electrical machines and devices and communications devices became effective in the overall exports performance.

If the components of imports are analyzed, it is observed that imports of intermediate goods excluding oil products increased rapidly in April and May in line with the revival in industrial production. According to seasonally adjusted data, imports of consumer and investment goods, which increased at a very high rate in the first quarter of the year, continued to increase in the April-May period in annual terms despite a slowdown compared to the previous period. As for imports of consumer goods, the base effect resulting from the low performance of the previous year led to high-rated increases in annual terms.

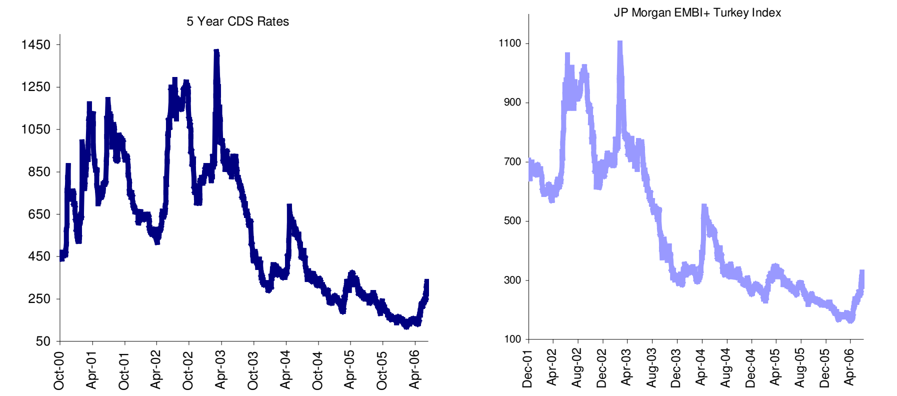


In light of available information, the current account deficit is expected to decrease in 2006 compared to 2005, in terms of its ratio to the GNP. Meanwhile, it is anticipated that direct foreign capital revenues, which reached USD 8.6 billion in 2005, will further increase in 2006 due to ongoing privatizations and mergers. As a result, the current account deficit is expected to lose its destructive impact on the fragilities of the economy.

Financial Markets and Financial Intermediation

As I explained at the beginning of my presentation, the outlook of international liquidity conditions, which was in favor of developing countries, entered a period of change in May due to the uncertainties observed in the monetary policies of developed countries. In addition, the risk appetite towards country groups including Turkey declined and the risk premium increased rapidly. In other words, one of the risk factors, which was mentioned in the Inflation Reports published in January and April, was realized. As a result, Turkey witnessed a sudden deterioration in the credit risk premium (measured by the EMBI spread) by around 150 basis points during May and June and the New Turkish Lira depreciated more than 20 percent against the US$ in the meantime (Graph 15).

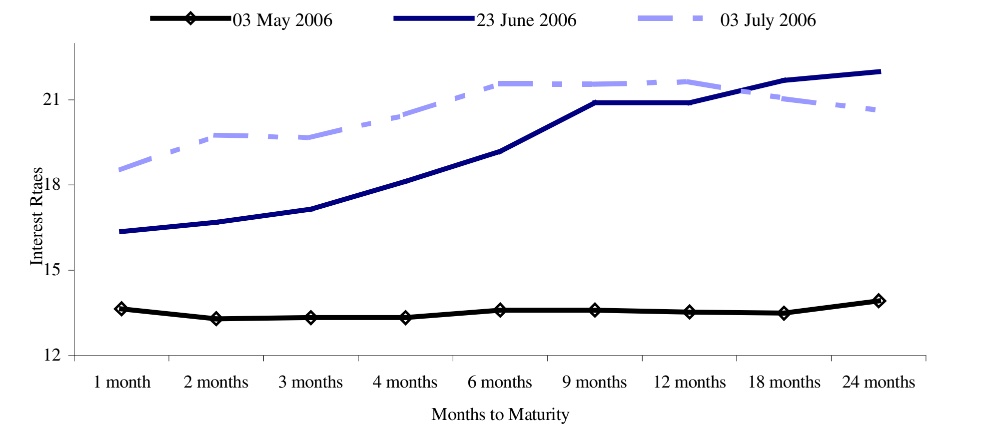
Graph 15. Risk Premium Indicators



Source: Bloomberg.

The interests of the government security markets in the ISE increased in all maturities as of the first week of May where international liquidity conditions had started to deteriorate and yield curves started to shift upwards (Graph 16). The upward trend of interests continued until monetary policy decisions were made in the Monetary Policy Committee on 25 June 2006. Nevertheless, as a result of the Central Bank's response regarding monetary policy and the normalization of international liquidity conditions, a downward trend was observed in the longer maturity end of the yield curve as of the beginning of July.

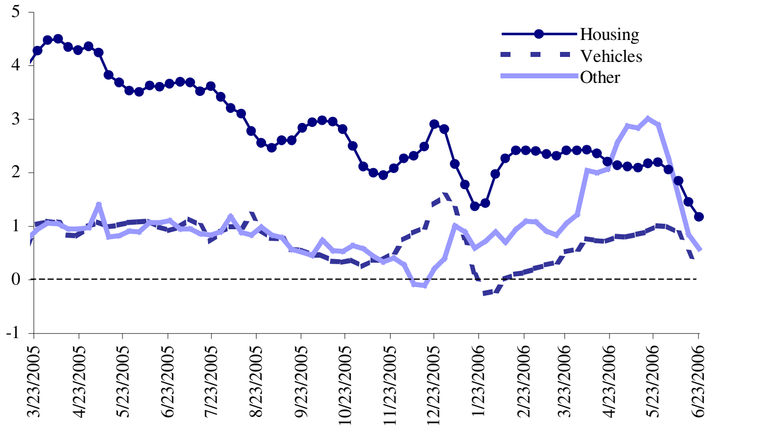
Graph 16. Yield Curves



Source: ISE.

When the recent developments in credits are analyzed, the slow-down of the rate of increase in consumer credits is remarkable (Graph 17). The weekly volume of vehicle credits and other credits decreased slightly . It is anticipated that the slowdown of the rate of increase in credits will become more evident in the upcoming period.

Graph 17. Consumer Credits Developments*
(Weekly Nominal Percentage Chnage)



*

Weekly percentahe changes of four week moving averages.
Souece: CBRT.

After this period, we have seen once more that effective risk management carried out by banks, households and firms is very important in the floating exchange rate regime. In the upcoming period, the Central Bank will continue to monitor the developments in the banking sector and credits carefully, in relation to both financial stability and price stability.

Public Finance

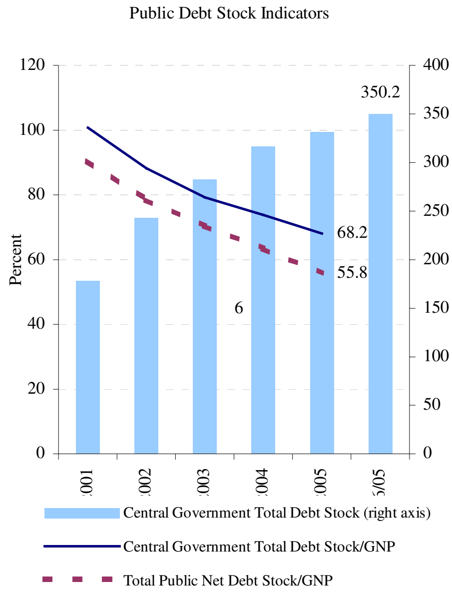
When budgetary developments are analyzed, it is seen that the central government budget displayed quite good performance in the first half of 2006. By June 2006, the primary budget surplus reached 80 percent of the end-year target, as taxes and non-tax revenues were realized at high levels. These developments seem to be promising for achieving the public sector primary surplus target of 6.5 percent of the GNP in 2006. The favorable course of budgetary performance has played a very important role in limiting the risk perceptions caused by the financial fluctuations in May and June.

As we have learnt from our past experiences, the developments in debt dynamics have a significant effect on the expectations of economic agents. Hence, the risk premium is affected through this channel and this reflects on interest rates and inflation. For this reason, it is of great importance that the developments in the debt stock are followed closely. In this framework, I would like to talk briefly about the developments in the total debt stock of the public sector.

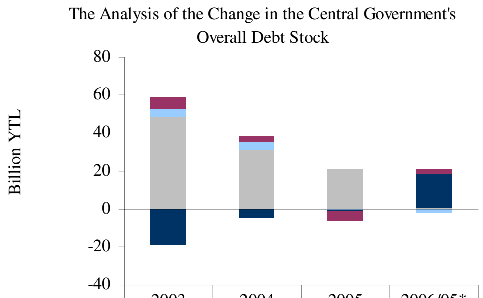
By May 2006, the central government's debt stock, which constitutes a major part of the total public sector debt stock, increased by 5.6 percent compared to end-2005 (Graph 18). High primary surplus and privatization revenues limited the rate of increase of debt stock, while the depreciation of the New Turkish Lira increased the debt stock.

In the first four months of 2006, debt stock of the central government displayed a limited increase in nominal terms. However, it should be kept in mind that the said increase, which originated from exchange rates, was derived from the accounting carried out in this period and that the real cost will be seen along with the debt payments. Therefore, rather than the increase observed today, the value to be gained by the exchange rates on the dates of FX-denominated debt payments, will be effective on the debt stock. In addition, the relatively longer maturity of the current FX-denominated debt stock and the fact that the Treasury holds a large amount of FX-deposits, keep the risks originating from volatilities in the exchange rate under control in favor of the public sector.

Graph 18. Public Debt Stock Indicators (Billion YTL)



Source: Treasury..



	2003	2004	2005	2006/05*
Parity Effect**	6.2	3.0	-4.8	2.5
Exchange Rate Effect***	-18.8	-4.6	-0.8	17.8
Foreign Debt Net Increase	4.0	4.1	-0.6	-2.3
Domestic debt Net Increase	48.8	31.2	21.1	0.6

Source: Treasury, CBRT.

(*)It shows the change compared to 2005.

(**)It shows the changes resulting from movements in USD/Euro and USD/SDR parities.

(***) It indicated the changes resulting from movements of New Turkish lira against USD.

Not: The change in Net debt stock represnts the change excluded from exchange rate and parity effects.

Before delivering the last part of my speech, I would like to touch on the transition to the inflation targeting regime and the timing of this process. As it is known, after the economic crisis in 2001, a need for a trusted monetary policy strategy arose. As the fixed exchange rate regime had just collapsed in the said period, only the strategies where monetary aggregates or inflation itself were used as the anchor could be adopted. In the strategy where monetary aggregates were targeted, it was basically assumed that money demand could be estimated exactly and that inflation was determined by monetary aggregates. However, it was impossible to estimate the money demand in a high-inflation environment nor to assert the existence of a predictable relation between the inflation and monetary aggregates. Therefore, the only option left comprised a monetary policy strategy where only inflation itself was used as the anchor. The successful implementation of this policy, which is called inflation targeting, depends on the creation of certain conditions. The first step taken in this respect is the change made in Central Bank Law in 2001, which provided legal assurance of the Central Bank's independence by strengthening the institutional infrastructure of the Bank and set its primary objective as "maintaining price stability". After other conditions were met and the necessary preparations had been completed, the transition to formal inflation targeting was adopted. During the transition process, "implicit inflation targeting" was implemented. The reasons for choosing this implementation were basically the continuation of fiscal dominance, insufficient macroeconomic stability, the upcoming currency reform and the formation of new inflation indices. After all these factors were eliminated and necessary technical preparations had been made, the formal inflation-targeting regime was introduced at the beginning of 2006. The occurrence of deviations from inflation targets should be taken for granted in the inflation targeting process. There are a countless number of related examples in countries' experiences. However, as far as we know, there has not been a single country that abandoned the inflation-targeting regime because of failure. A deviation from targets does not imply that the inflation-targeting regime has failed. The important point here is that the Central Bank takes the necessary measures in order for inflation to converge to the target again and shares its activities with the public in a transparent manner. The Central Bank of the Republic of Turkey has taken the required measures to attain the target again and it will continue to do so in the future.

Medium-term Forecasts

At this point, I would like to present the medium-term inflation forecasts, which were prepared in order to answer questions about the inflation trend in the upcoming period and the period of time needed to converge to the target.

Current Stance, Short-term Outlook and Assumptions

Firstly, I will summarize the macroeconomic outlook that provides a basis to medium-term forecasts. As I have mentioned earlier, the environment of uncertainty created by the fluctuation that started in financial markets in mid-May, also affected the demand conditions for the relative price increases in imported goods as a result of the increase in interests and the depreciation of the YTL. In this context, it is foreseen that domestic demand, which maintained a strong trend in the second quarter of the year, will lose momentum in the upcoming period and that growth will slow down in the second half of 2006. Meanwhile, the depreciation of the YTL is expected to have a positive impact on the export performance of labor-intensive sectors, but slow down the increase in imports. In conclusion, it is projected that despite the increase in net foreign demand, domestic demand will slow down relatively and that the total demand will be of a contractionary nature. In this framework, the downward pressure on inflation exerted by demand conditions is expected to increase in the second half of the year.

In the Inflation Report published in April, it was stated that the medium-term forecasts were produced with the assumption that the strong position of the New Turkish lira would be maintained and would continue to support the decline in inflation. However, due to the rapid depreciation of the New Turkish lira stemming from turbulences in financial markets since May, the cost conditions have changed and thus, the support from the position of the New Turkish lira vis-à-vis foreign currencies to the downward trend in inflation will not be in place in the short-run.

In the former inflation report, it was projected that the disinflation process would resume starting from the second quarter provided there were no exogenous shocks. However, in the second quarter of 2006, the annual inflation rate climbed and breached the upper limit of the uncertainty band of the inflation target. As I have said before, the factors underlying this have been the supply-oriented developments in the unprocessed food group, supply shocks such as the high level of energy and oil prices and cost factors stemming from the depreciation of the New Turkish lira due to deterioration in global liquidity conditions. It is projected that the direct effects of the fluctuations in exchange rates on prices would diminish as of August. However, despite this projected decrease, it is predicted that some fluctuations might be observed in inflation in autumn due to seasonal price adjustments.

Assumptions on the exogenous factors comprise the projections pertaining to basic macroeconomic fundamentals of the Eurozone such as interest rates, inflation and growth as well as assessments of international commodity prices and the analysis of global liquidity conditions on financial markets. Accordingly, a domestic demand-pulled growth of 2-2.5 percent is expected in the Eurozone in 2006 , while the Harmonized Index of Consumer Prices (HICP) inflation is projected to be over 2 percent in the second half of 2006 and throughout 2007.

Following the relative stability in the first couple of months of 2006, crude oil prices re-entered an upward trend by April. Therefore, while producing forecasts, the assumptions pertaining to oil prices have been revised upwards. As it is difficult to foresee the path that oil prices will follow, inflation forecasts are produced under the main scenario where oil prices are assumed to maintain their current level.

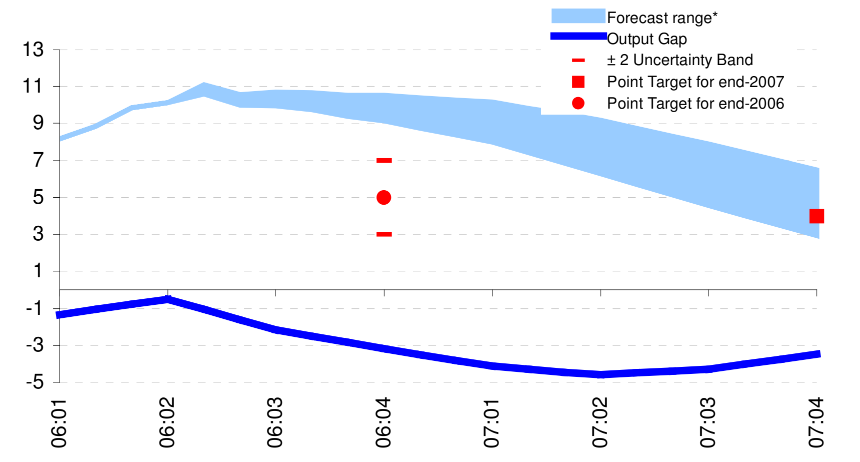
One of the most important developments in the international conjuncture since the Inflation Report of April was published has been the change in global liquidity conditions. In this framework, the international liquidity shock, which had been categorized as the main risk factor, has materialized. Therefore, deterioration in inflation expectations and risk perceptions pertaining to Turkey increased substantially as of June. The forecasts presented in this Report have been produced under the assumption that expectations would be managed wisely in the upcoming period, no deterioration process in international liquidity conditions would be experienced similar to the recent one and, accordingly, the risk premium would not display a significant change compared to its current level.

Forecasts

While assessing the future trend of inflation, the Central Bank uses both numerical and discretionary methods. Numerical methods comprise structural models, simulation methods and other statistical measurement techniques, while discretionary methods rely mostly on expert opinion.

Graph 19 below presents inflation and output gap forecasts, which have been produced by compiling the said methods, covers an 18-month period including the second half of 2006 and the whole of 2007. It is projected that with 70 percent probability, end-2006 inflation would be somewhere between 9.1 percent and 10.5 percent. According to the forecasts, which have been produced under the assumption that the Central Bank would adopt a measured monetary tightening in the rest of 2006 in addition to the measures taken in June and would gradually decrease interest rates in 2007; inflation would display a significant decline as of the second quarter of 2007 and there is 70 percent probability thatend-2007 inflation would be somewhere between 3 percent 6.5 percent.

Graph 19. Inflation and Output Gap Forecasts

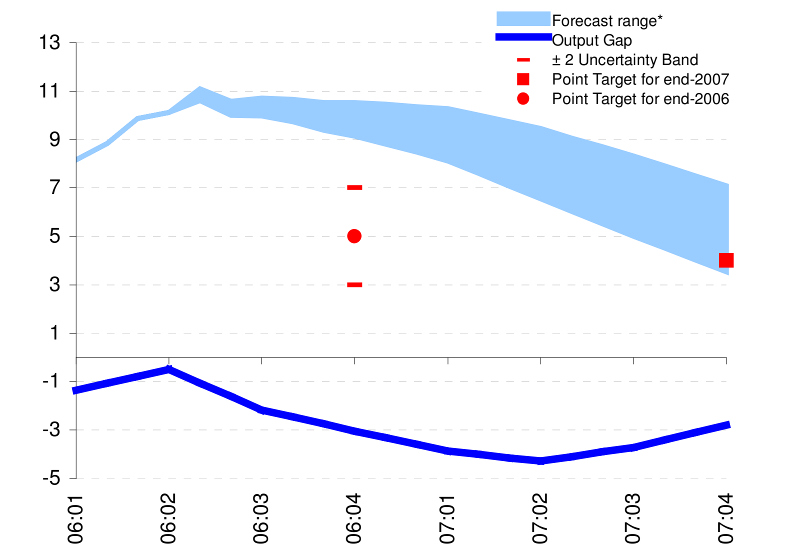


*The probability of inflation staying within the forecast range is 70 percent.

At this stage, I would like to draw your attention to an important point. The forecasts that I have just mentioned have been produced under the current data set and with a medium-term perspective. It should be borne in mind that all the assumptions underlying the forecasts are prone to change at any time and in such a case, both the forecasts and the stance of monetary policy would be revised.

The forecasts presented in Graph 20 have been produced under a scenario where the current status outlined above as well as the short-term outlook and assumptions pertaining to fundamental variables have been maintained and where short-term interest rates are assumed to be maintained constant at the pre-20 July Monetary Policy Committee Meeting level for a year.

Graph 20. Inflation and Output Gap Forecasts (Constant Interest Rate)



****The probability of inflation staying within the forecast range is 70 percent..**

According to the forecasts produced under these assumptions, it is projected end-2006 inflation would be somewhere between 9.1 percent and 10.5 percent with 70 percent probability and end-2007 inflation would be somewhere between 3.5 percent and 7.0 percent. These forecasts, which are based on the assumption that the stance of monetary policy in June would remain intact, point to a need for measured monetary tightening in the rest of 2006 in order to attain the end-2007 target. The Monetary Policy Committee meeting decision dated July 20, 2006 shall be deemed as a step towards this end. Moreover, it should be emphasized that not only interest rates but also any new data pertaining to factors affecting inflation would necessitate a change in these evaluations .

In conclusion, under the cautious stance of monetary policy, the medium-term targets are believed to be attainable. It should be reiterated that these forecasts are produced in a framework where fiscal discipline is not relaxed, the incomes policy is in line with the inflation target and the expectations are managed properly.

Risk Factors

The uncertainties regarding the course of oil prices, global inflation worries and likely changes in international liquidity conditions are considered to be the main exogenous risks for the upcoming period.

A rise in oil prices leads to significant price increases in sectors such as energy and transportation that use petroleum products as a direct input. If the increase in oil prices continued, no policy response would be given to the primary effects. However, in case the likely developments in oil prices affected inflation expectations negatively and led to some kind of change in general pricing behavior, the Central Bank would take the necessary measures.

Continued concerns over inflation in developed countries and sustained monetary tightening are also deemed to be important risk factors. Recent developments point to the fact that fluctuations in risk appetite might continue to be one of the main risk factors with respect to inflation. If such a risk materialized, no response would be given to the direct effects stemming from relative price changes on inflation, but no deterioration in medium-term expectations and pricing behavior would be allowed.

Under current conditions, refraining from any implementations that might lead to a deterioration in risk perceptions and expectations is vital for the sake of both price stability and macroeconomic stability. Any steps taken towards curbing the risk perception would decrease the cost of establishing and maintaining stability. It should be borne in mind that the main factor for achieving non-inflationary growth is the confidence in the sustainability of macroeconomic stability. Therefore, maintaining the determined stance on structural arrangements that would enhance the quality of fiscal discipline and ensuring the uninterrupted implementation of reforms that would improve competition and investment environment, which would support a rise in productivity in the long-run, are of crucial importance. In this framework, it is vital to continue the harmonization and convergence efforts to the EU as well as to implement structural reforms in the economic program without interruption. A continuation of the determined steps taken in these areas in the last few years would contribute to surmounting the changes in international conjuncture with minimum fluctuations.

The Central Bank will continue to announce its evaluations about inflation in a transparent manner and inform the public about monetary policy to be followed in order to attain the medium-term inflation target.