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PRESS RELEASE
ON
THE CBRT INTEREST RATE CUTS

I. GENERAL ASSESSMENT

1. Consumer prices that remained well below the targeted inflation both in 2002 and 2003 and the historically low January inflation figures demonstrate the remarkable achievement obtained in disinflation efforts. The main factor behind this success lies, by all means, in the tight fiscal and monetary policies currently implemented in a consistent manner. A series of structural reforms realized since the initiation of the program are reinforcing the belief that this discipline can be maintained in the future as well. In the process, the consumer and investor confidence gradually increased, and thus, as inflation was being reduced, we witnessed a rapid growth at the same time. The consumer price inflation, which was 68.5 percent at the end of 2001, dropped to 16,2 percent in January 2004. In the same period, inflation expectations have increasingly come closer to the targets even more. As a matter of fact, the inflation expectations for the end of 2004 dropped to 13,2 percent as end of January.

2. In the light of recent developments, some crucial points need to be emphasized for the future course of the inflation:

i. The average of seasonally adjusted monthly inflation figures for the last six months – which realized as 0,5 percent for WPI (excluding agriculture) and as 0,7 percent for CPI (excluding food) -- show that the general inflation trend is consistent with the year-end target.

ii. In our previous press releases, we had cautioned the differentiation in the acceleration rate of price increases in goods and services, and had drawn attention to the fact that the rigidity in the service group prices might pose a risk for 2004 inflation. We had also emphasized the importance of January inflation figures, when seasonal price adjustments were made in various goods 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. In the light of available data, however, it is still critically important that the recovery in domestic demand should not get out of control, and the expectations should be managed properly.

iii. Inflation rates rose in the first 5 months of 2003, stemming from higher costs because of the Iraqi War, and as a result of excessive increases in agricultural and food prices due to unfavorable seasonal conditions. Nevertheless, with the advent of favorable weather conditions, the inflation realized at quite low levels for the rest of the year. This created a considerable difference in inflationary trend between the first and second halves of 2003. As the natural outcome of this effect, known also as the base effect, the downward trend in annual inflation will be evident in the first 5 months of 2004. However, due to the base effect again, even if the decline in the general trend of inflation continues during the rest of the year, the trend might come to a standstill, or turn to upward. Yet, it will be consistent with the inflation target. 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 as their reference point, rather than the annual inflation rate, which is a backward-looking variable.

3. Despite the success against inflation, much remains to be done in order to achieve permanent price stability. In the previous press releases the Central Bank clearly underlined the importance of the sustained fiscal discipline and structural reforms, and also stated that this importance will grow even further in the forthcoming period.

4. As mentioned in the press release dated January 2, 2004, the most important risk factor that might develop in reaching the targets regarding inflation and macroeconomic indicators is the indulgence in the mood of relaxation created by success attained so far, and the tendency for deviation of the current economic program. Experiences so far have repeatedly shown that compromises made in the basic principles of economic programs would threaten long-term stability, increasing economic costs. In this context, if the policies are pursued in line with the basic principles of the economic program, especially wage and incomes policies, every sector of the society will benefit in the long run.

5. Recently, the minimum wage and pension increases that have exceeded the targeted inflation rate have been highly debated with respect to their likely impacts on the future inflation figures and budget discipline. As announced in the press release dated January 9, 2004, the Central Bank considers that these developments could hardly pose a risk to inflation through a cost-push effect provided that the increase in productivity recently observed continues in the near future, and 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. The same press release stated that it was necessary to remove the additional burden on the budget imposed by these developments. This would call for a policy favoring low-income groups, without jeopardizing the fiscal discipline that is one of the fundamental components behind the success achieved in the economic growth and disinflation efforts. These measures would also considerably offset the inflationary impacts created by the growth in demand.

6. The prospective impacts of these developments were highlighted in our press release dated January 9, 2003. Fiscal discipline has been an integral factor behind the rapid growth and the success in the fight against inflation in Turkey. Moreover, the importance of fiscal discipline can be traced in the experiences of those countries that have implemented a successful stability program. Therefore, any signal that can be interpreted as a deviation from the fiscal discipline at present or in the medium-term would undermine the atmosphere of confidence, which is hard to establish and very easy to lose. Also the success achieved in growth and inflation would not be permanent. It should also be borne in mind that it is crucially important to carry on with the reforms intended for removing obstacles in front of investment and production in order to attain a more rapid growth and a lower unemployment rate. Enduring macroeconomic stability along with the sustainability of fiscal and monetary policies is the sine qua non condition for attaining these goals.

7. The recent stability in exchange rates and favorable expectations are under way, and no obvious pressure is observed in domestic demand. These developments are considered favorable for disinflation efforts. 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.

8. The Undersecretariat of Treasury announced also that the studies on the likely deviations from revenue projections for 2004, and the necessary measures to be taken for the public finances intended to compensate these deviations were being carried out in order to achieve the primary surplus target. When making policy decisions, the Central Bank will evaluate the said measures in terms of their direct impacts on the inflation, and their indirect effects via expectations, and will closely monitor the developments.

9. The Central Bank sets short-term interest rates, its primary policy instrument, by analyzing likely future movements of variables that affect inflation under various scenarios in the light of price stability, which is the primary objective. In this context, under the main assumption that fiscal discipline and structural reforms will be carried out with determination and that the budget discipline will be achieved mainly through expenditure-cutting measures and revenue-raising measures except for public price increases, it is believed that there is no reason not to achieve the inflation target for end-2004, apart from great external shocks. Undoubtedly, it will come as no surprise that interest rates come down gradually in line with the general downward trend in inflation, if the fiscal discipline and structural reforms are sustained, and the future inflation figures are consistent with the targets. However, it should be once more underlined that this is ”a conditional forecast”. The condition is the maintenance of budget discipline and structural reforms. In this framework, the Central Bank’s outlook for future involves “a conditional optimism”. It should be kept in mind that the Central Bank will closely monitor the developments on the fundamental factors that determine inflation, and will continue to use the short-term interest rates effectively, not only in the case of favorable developments, but also in the case of any development that might deteriorate inflation expectations and threaten price stability.

II. THE CENTRAL BANK INTEREST RATES

10. In the light of the evaluations above, starting from 5 February 2004, the Central Bank (CBRT) has decided to cut short-term interest rates applied at CBRT Interbank Money Market and Repo-Reverse Repo Market at Istanbul Stock Exchange as follows:

a) **Overnight Interest Rates:** Borrowing interest rate was cut to **24 percent** from 26 percent and lending interest rate to **29 percent** from 31 percent.

b) **Other Maturity:** One-week borrowing interest rate was cut to **24 percent** from 26 percent.

c) **Late Liquidity Window Interest Rates:** In the framework of Late Liquidity Window application, CBRT overnight borrowing interest rate applicable between 16:00 –

16:30 Hours at Interbank Money Market was cut to **34 percent** from 36 percent. Borrowing interest rate of 5 percent remained the same.

d) The interest rates on overnight and one-week maturity borrowing facilities provided for primary dealer banks via repo transactions within the framework of open market transactions were cut to **26 percent** from 28 percent.

11. Moreover, the interest rate applicable to one-week-maturity foreign exchange deposits provided for banks within their borrowing limits in the Central Bank Foreign Exchange and Effective Markets, which was cut to 6 percent from 12 percent, as a measure intended to minimize the unfavorable impacts of military operation against Iraq in March 2003 on our markets, was raised to **10 percent** in the light of favorable developments in foreign exchange liquidity of banks and their efficient liquidity management.