

## OCTOBER INFLATION AND OUTLOOK

### I. GENERAL EVALUATION

1. Inflation continued to fall strongly in October. The annual inflation rates dropped to 20.8 percent in the CPI and 16.1 percent in the WPI. The decline in the CPI excluding food and the WPI excluding agriculture continued, and realized as 19.9 percent and 13.8 percent, respectively. These figures have once more demonstrated that the inflation target for end-2003 could be achieved.

2. Monthly price increases became 0.6 percent in WPI and 1.4 percent in CPI. Seasonally adjusted CPI and WPI inflations recorded as minus 0.02 percentage point and minus 0.2 percentage point, respectively. It is noteworthy that the rate of increase in the seasonally adjusted monthly CPI inflation was negative for the first time in the 1994-2003 period.

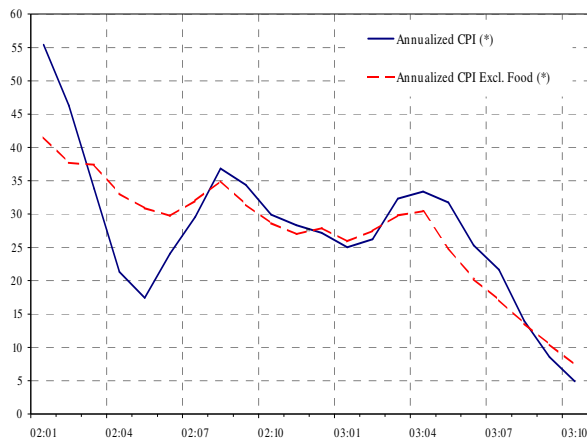
**Table 1: General CPI, WPI and Sub-items**

	Annual % Change		Monthly % Change			
	2002 Oct.	2003 Oct.	2003 Aug.	2003 Sep.	2002 Oct.	2003 Oct.
<b>CPI</b>	<b>33,4</b>	<b>20,8</b>	<b>0,2</b>	<b>1,9</b>	<b>3,3</b>	<b>1,4</b>
Goods	34,0	18,4	-0,7	1,3	4,2	1,4
Services	32,5	25,5	1,8	3,0	1,5	1,5
Excl. Food	33,7	19,9	0,7	2,0	2,9	1,2
Food	32,6	24,0	-1,7	1,6	4,6	2,2
<b>WPI</b>	<b>36,1</b>	<b>16,1</b>	<b>-0,2</b>	<b>0,1</b>	<b>3,1</b>	<b>0,6</b>
Public	33,8	12,4	1,5	-0,6	1,7	-0,6
Private	37,1	17,6	-0,8	0,3	3,7	1,0
Public Manufacturing	35,2	15,5	1,6	-0,8	1,6	-0,5
Private Manufacturing	31,1	14,4	0,7	0,2	1,8	0,6
Agriculture	51,6	24,3	-4,0	0,4	8,1	1,9
Excl. Agriculture	32,3	13,8	1,0	0,0	1,8	0,2
Excl. Agr. and Energy	32,5	14,3	1,1	0,0	1,9	0,2

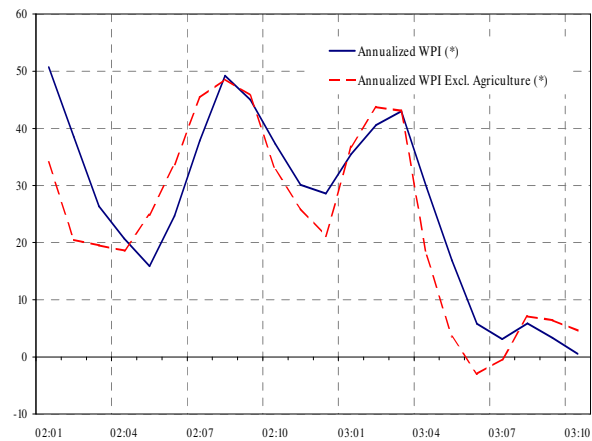
Source: CBRT, SIS

3. Average of the last three-month seasonally adjusted inflation became 0.04 percent in the WPI and 0.4 percent in the CPI. The annualized figures correspond to 0.5 percent and 4.9 percent, respectively. During the same period, the average increase in the seasonally adjusted CPI excluding food was 0.6 percent. This figure corresponds to 7.4 percent in annual terms (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)**

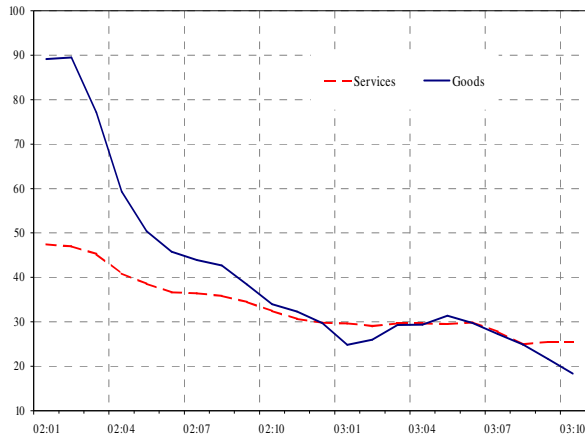
Source: CBRT, SIS

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

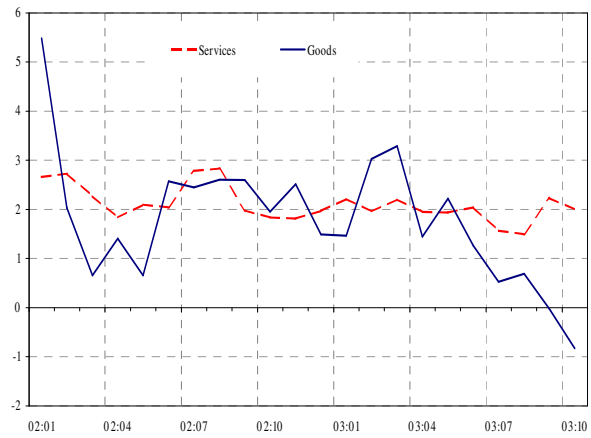
- 4.** The downward trend in consumer inflation continued markedly in October. Annual inflation fell by 2.2 percent in the CPI and by 2 percent in the CPI excluding food compared to the figures of September (Figure 2).
- 5.** The monthly rate of increase in the services group became 1.5 percent. Increased by 3.5 percent in September, the rents barely rose by 2 percent in October, being instrumental in the price increases of the services group.
- 6.** Monthly rate of increase in the goods prices was 1.4 percent compared to September. Maintaining its favorable course in October, food prices fell by 1.2 percent in seasonally adjusted terms.
- 7.** It is observed that the restricting effect of the clothing group on the CPI persisted in October as well. The seasonally adjusted rate of increase in clothing prices, which was 0.4 percent in September, realized as minus 4.9 percent in October. This development results from the restricting effect of demand conditions as well as the considerably strong downward trend in inflation.
- 8.** What is remarkable during the January-October period is that the rate of increase in cigarette and tobacco products arising from the price adjustments in TEKEL products has realized as 34,5 percent, while the rate of increase in hospital services, the sub-item of health group, has become 46,6 percent. It can be said that the high rate of increase in prices of hospital services reflects the backward indexation mechanism in price setting policy. This price-setting behavior can adversely affect the fight against inflation by increasing inflationary inertia.

**Figure 2: Prices of Goods and Services**

**Annual Percentage Change**



**Monthly Percentage Change (Seasonally Adjusted)\***



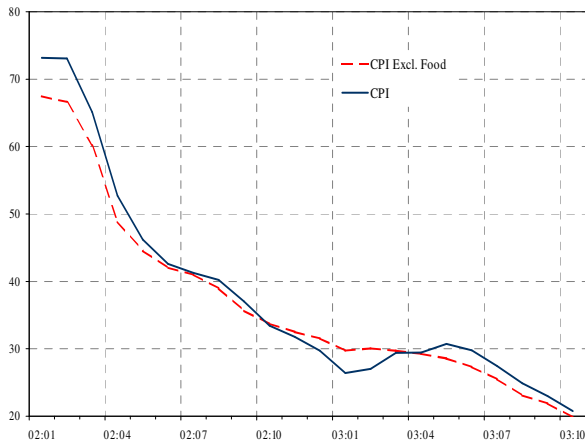
Source: CBRT, SIS.

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

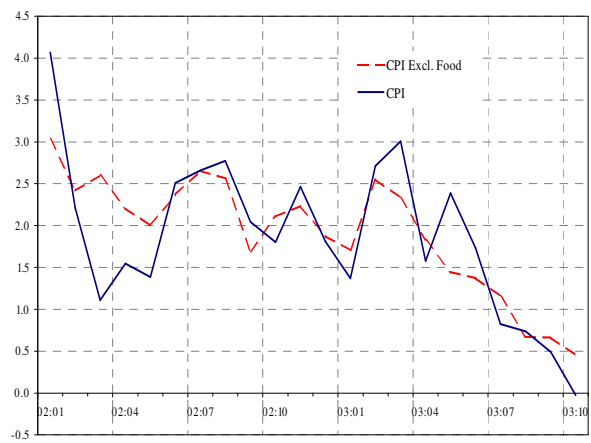
9. The seasonally adjusted increases show that in October, inflation went below the September figure. Increasing by 0.5 percent in September, the seasonally adjusted CPI declined by 0.02 percent in October (Figure 3). A similar development was observed in seasonally adjusted food prices as well. The rate of increase in seasonally adjusted food prices, which was 0.4 percent in September, dropped to minus 1.2 percent in October.

**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.

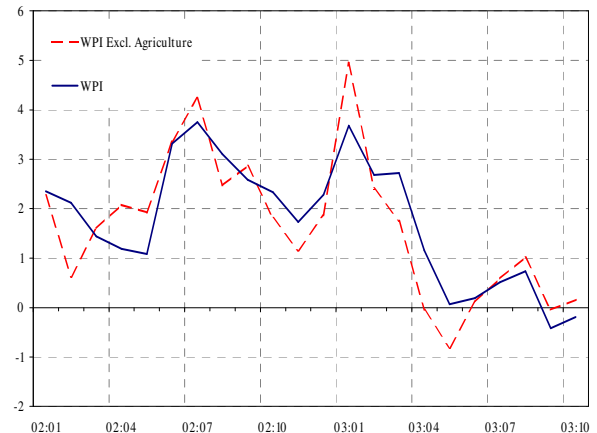
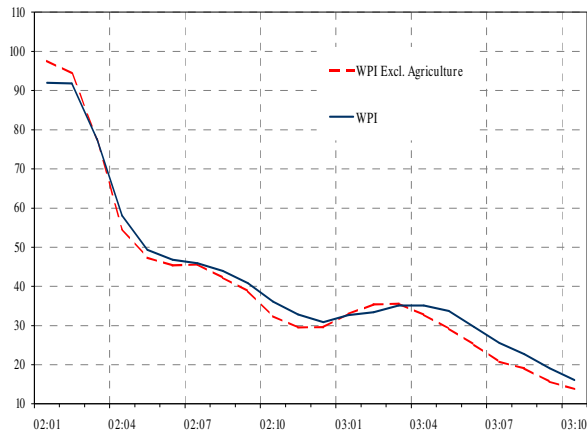
## Developments in Wholesale Prices

10. Thanks to the limited rise in the agricultural and manufacturing industry sector prices, rate of increase in the WPI remained at 0.6 percent in October 2003. While the contribution of the agricultural sector to this increase was 0.4 percent, that of the manufacturing industry sector was 0.3 percent. Thus, the seasonally adjusted WPI slipped down by 0.2 percent in October, which denotes that the significant downward trend in annual WPI inflation has continued (Figure 4).

11. The rate of increase in agricultural sector prices was also minor in October (Table 1). According to the seasonally adjusted data, agricultural sector prices dropped down by 0.6 percent in October 2003.

12. Compared to September 2003, wholesale prices excluding agriculture increased by 0.2 percent. Rate of increase in the prices of private manufacturing industry sector was minimal. Another point to be underlined is that in the April – October period the average rate of increase in the prices of private manufacturing industrial sector stood at 0.5 percent. Meanwhile, public manufacturing industry sector prices fell compared to September mostly owing to the petroleum products manufacturing sector. These favorable developments both in public and private sector manufacturing industry prices can be attributed to exchange rate movements, which came out as a consequence of the current economic program that have brought confidence in the Turkish lira.

**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.**

13. WPI increased by 11.3 percent in the first ten months of 2003. While the rate of increase in the agricultural sector prices exceeded this figure with 14.4 percent, rate of increase in the private manufacturing industrial sector prices lagged behind with 10.3 percent. Due to the decrease in electricity prices, the price increase in the gas, electricity and water group remained at 2.7 percent.

## **II. OUTLOOK**

14. The inflation figures pertaining to October have almost certainly verified that the end-year inflation target is attainable. The downward trend observed in annual inflation since June 2003 continued in October 2003 as well, and CPI inflation dropped down to 20.8 percent, coming closer to the end-year target.

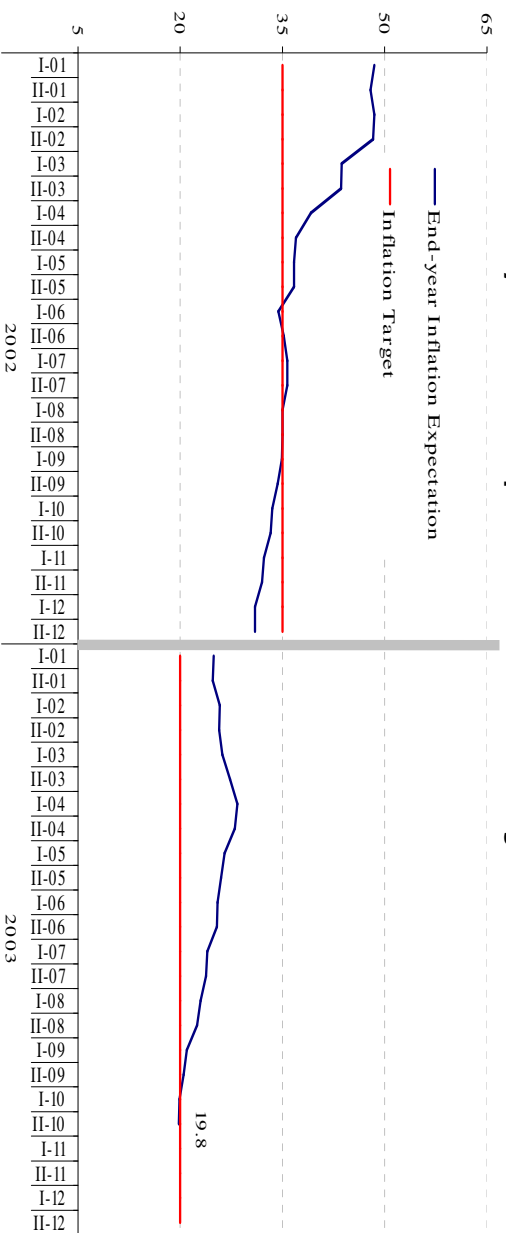
15. The success achieved in disinflation efforts during the last two years rests upon monetary and fiscal discipline. The ongoing monetary policy implementations that are consistent with the inflation targets are continuing to steer expectations towards the targets. The biggest impact of fiscal discipline on inflation dynamics works through expectations. Although declined relatively in the last two years, the level of total debt stock and its share in GDP is still quite high in Turkey. Therefore, the essentials of the current and future fiscal policies are of utmost importance for the disinflation efforts. Achieving an acceptable and a stable level in debt stock in the medium and long-term can only be made possible by running a primary surplus. Within this context, not only the size of the primary surplus, but also the way it is achieved plays an important role in steering expectations about inflation and debt stock. With the strengthening expectation that the economic program would be implemented without compromise, stability will be brought to exchange rates as well as to interest rates, which in turn will reduce the uncertainties and cost-push pressure on pricing behavior. Moreover, the continuation of fiscal discipline will put disposable income under control and prevent an excessive recovery in the domestic demand.

16. It is observed that inflation trend has shifted on a different plateau since the second half of the year. Undoubtedly, the appreciation of Turkish lira has played an important role in this development. However, given that inflation expectations for the next 12 months have constantly remained below the past inflation figures since the beginning of 2002, it is clear that the favorable exchange rate developments cannot be the only reason for the success of disinflation. The impact of consistent policies on inflation expectations became a main factor in the decline in inflation. We anticipate that, in 2004, formulation of the public price adjustments and the incomes policy consistent with the inflation target will support these favorable developments. However, the inflationary inertia, which is still observed to be persistent in some sectors, can be wiped out only by abandoning the backward-looking indexation mechanism in pricing behavior.

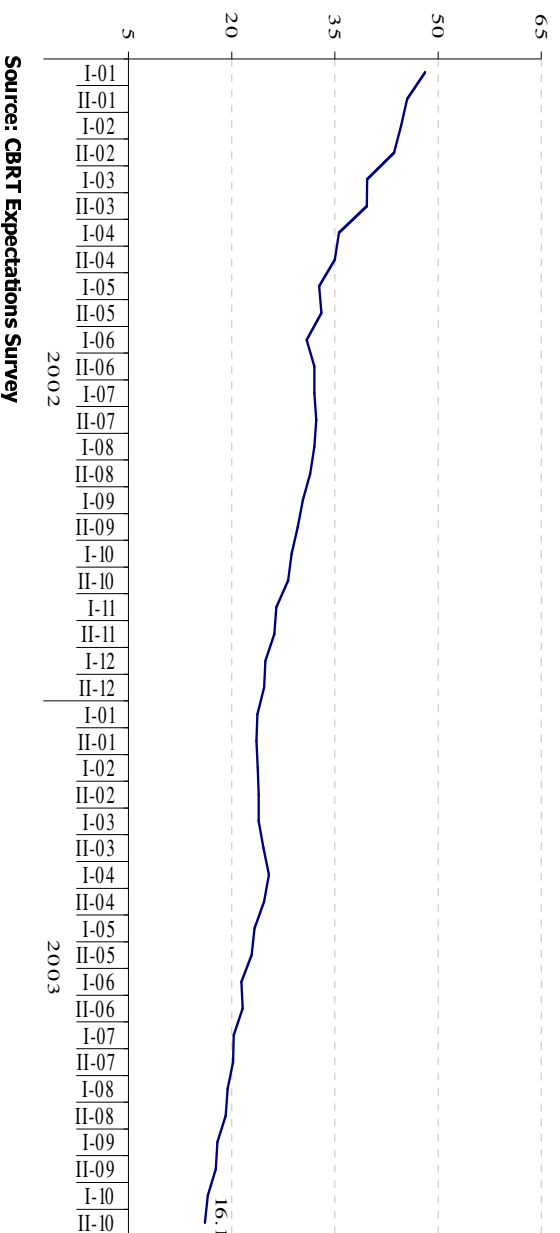
17. The real interest rates, which have been declining since April, are expected to have a stimulating impact on domestic demand in the remaining of the year and in 2004. However, it is predicted that the relatively modest increase in real wages and incomes will restrict domestic demand and consumption. The rise in public sector salaries and wages designated for 2004 indicates that real income increases will remain limited next year as well, which, in turn, will restrict domestic consumer spending. Accordingly, as it is in 2003, total output of the economy is not expected to exceed its production potential in 2004. Within this framework, it is estimated that the recent movements in exchange rates during October will have little effect on the consumer prices of November and December.

18. Consequently, it is expected that inflation will keep up its downward trend in 2004 as well, along with the discipline in monetary and fiscal policies. However, structural reforms must be pursued without compromise in order that all these achievements obtained so far may be permanent and be further improved. Every step taken towards impending tax reform, increasing productivity in the public sector as well as improving the general investment environment, and increasing competitiveness will contribute to maintain the downward trend in inflation.

**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