

JULY INFLATION, OUTLOOK AND CENTRAL BANK INTEREST RATES

I. GENERAL ASSESSMENT

1. Compared to the previous month, consumer prices and wholesale prices inched down by 0.4 percent and 0.5 percent, respectively, in July. Annual inflation rate for CPI became 27.4 percent and 25.6 percent for WPI. In the first seven months of the year, CPI increased by 11.6 percent, which is 2 points below the price increase in the same period last year.
2. In July, seasonally adjusted increases in CPI and WPI became 0.9 percent and 0.6 percent, respectively. While the last three months' average of CPI was 1.7 percent, that of WPI was recorded as 0.3 percent. These figures correspond to 22.2 percent and 4.2 percent, respectively, on annual basis.
3. Evidently, the favorable developments observed in inflation figures are an outcome of the current economic program. Despite relative slowdown in the rate of appreciation, Turkish lira continued to strengthen in July, which in turn, further easing the cost-push factors. Meanwhile, no demand pressure was observed on prices.
4. The important point to be drawn is that excluding the sub-groups, which mostly depend on uncontrollable factors such as weather conditions rather than on economic policy implementations, the sizeable downward trend in inflation figures observed for a long time continued in July as well and the point reached is quite favorable. The data pertaining to the first seven months bearing the unfavorable effects of Iraq War are still favorable and this can be accepted as the evidence of the success of the disinflation effort.
5. Annual inflation dropped down to 25.5 percent in CPI excluding food and 20.8 percent in WPI excluding agriculture prices. CPI excluding food, which had increased by 17.0 percent in the first seven months of 2002, remained at 11.6 percent in the same period in 2003.

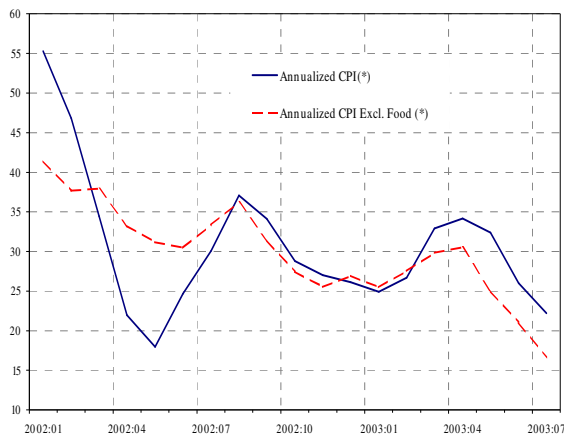
Table 1: General CPI, WPI and Sub-items

	Annual % Change		Monthly % Change			
	2002	2003	2003	2003	2002	2003
	July	July	May	June	July	July
CPI	41,3	27,4	1,6	-0,2	1,4	-0,4
Goods	43,9	27,3	1,6	-1,1	0,6	-1,3
Services	36,5	27,8	1,5	1,7	3,1	1,4
Excl. Food	41,0	25,5	1,5	1,2	2,2	0,7
Food	42,4	34,4	1,9	-4,4	-1,1	-3,8
WPI	45,9	25,6	-0,6	-1,9	2,7	-0,5
Public	44,5	20,9	-2,7	0,0	4,3	0,8
Private	46,5	27,5	0,2	-2,6	2,0	-1,1
Public Manufacturing	46,3	23,9	-3,0	0,2	4,8	1,0
Private Manufacturing	45,8	20,3	0,3	0,2	4,1	0,5
Agriculture	47,2	43,7	-0,1	-7,6	-2,9	-3,9
Excl. Agriculture	45,6	20,8	-0,8	0,1	4,2	0,6
Excl. Agr. and Energy	45,8	21,3	-0,9	0,1	4,4	0,6

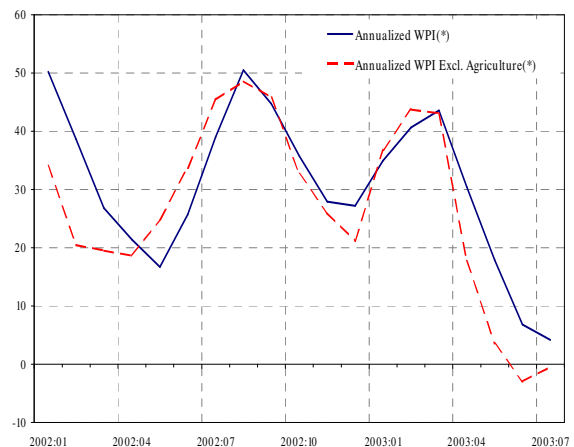
Source: CBRT, SIS.

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

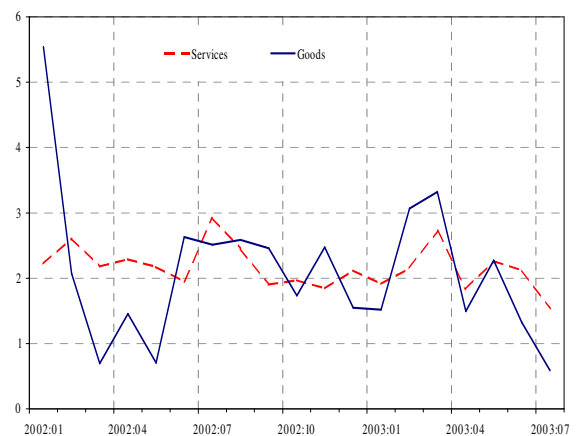
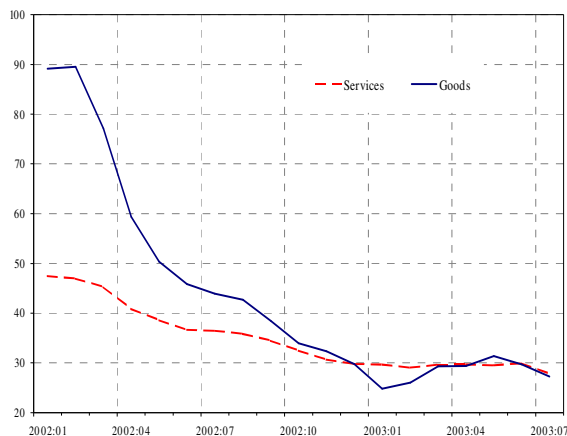
Developments in Consumer Prices

6. As a consequence of the improvement in expectations and the fact that no developments were observed in costs and demand that could generate inflationary pressure in July, the downward trend in CPI inflation continued in July. In July 2002, the rates of increase in CPI and CPI excluding food, which were 1.4 percent and 2.2 percent came down to -0.4 and 0.7 percent in the same period in 2003. Consequently, compared to June 2003, rate of increase in annual CPI dropped down by 2.4 percent while that in CPI excluding food inched down by 1.8 percent.

7. Price increases in almost all CPI sub-groups were limited, however prices in health group increased by 3.4 percent due to seasonal price adjustments in July. With the effect of 2.5 percent and 3.5 percent decline in the prices of food, beverages and tobacco, and clothing material, inflation turned out to be negative in July. However, public sector price adjustments in alcoholic drinks and tobacco have been a factor that limited the decline in food, beverages and tobacco group prices.

8. Rate of increase in the prices of goods decreased by 1.3 percent with the contribution of the food and clothing groups. Increase in the prices of services became 1.4 percent as house rents increased by 1.6, health services by 4.5 percent and hospital services by 6.3 percent. When seasonally adjusted data are analyzed, it is observed that prices of goods and services increased by 0.6 percent and 1.5 percent, respectively, in July 2003. Thus, by July, annual rate of increase became 27.3 percent in the prices of goods and 27.8 percent in the prices of services (Figure 2).

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

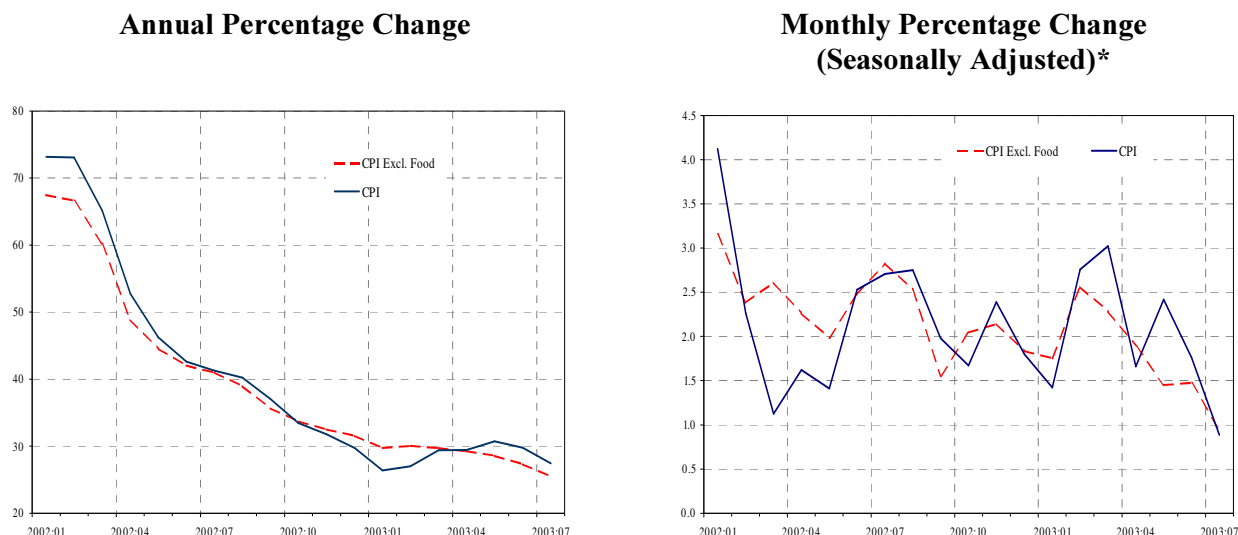


Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

9. There has been a significant decline in both seasonally adjusted CPI and CPI excluding food since March. This trend continued and further accelerated in July and monthly rate of increase in CPI and CPI excluding food became 0.9 percent. It is worth highlighting that the aforementioned rate of change is the lowest level ever reached for both indices during the sample period covering 1994-2003 (Figure 3).

Figure 3: CPI and CPI Excluding Food



Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

Developments in Wholesale Prices

10. The downfall in WPI can mainly be attributed to the decline in agricultural prices. While the contribution of agricultural sector became -0.9 percent, that of manufacturing sector was -0.4 percent.

11. The slump in agricultural prices in June was followed by a further decline in July with the positive effect of the seasonal drop-off in the prices of fresh fruits and vegetables. Seasonally adjusted data indicate that rate of increase in agricultural prices has remained at 0.7 percent. As an outcome of these developments, annual rate of increase in agricultural prices decreased from 45.4 percent in June to 43.7 percent in July. It should be underlined that annual inflation in agricultural sector is the highest among all sub-groups of WPI (Table 1).

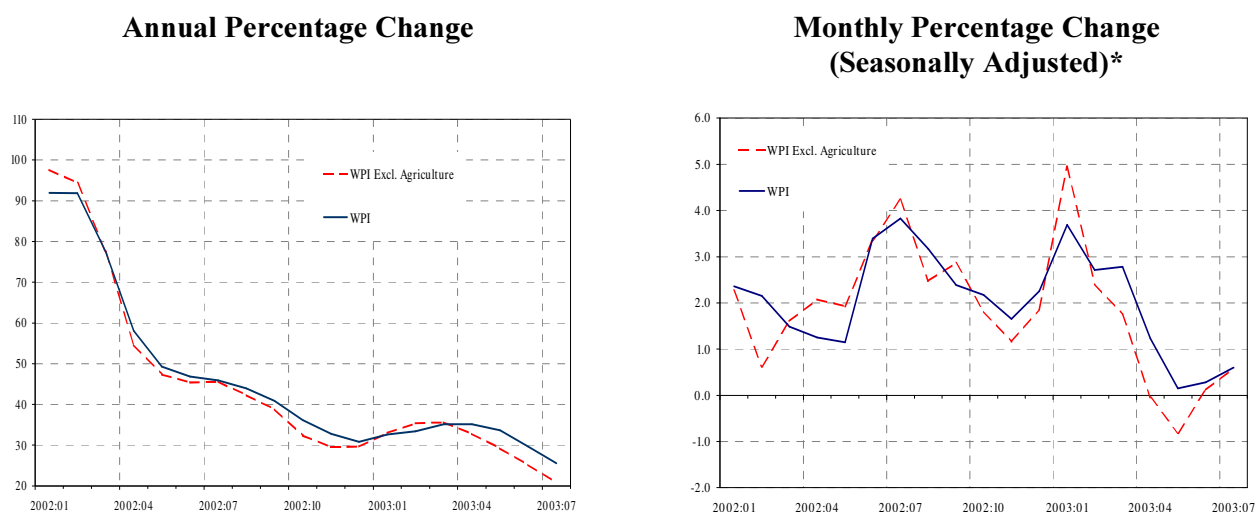
12. Monthly rate of increase in WPI excluding agriculture became 0.6 percent, following the low course in June. The annual rate of increase in WPI excluding agriculture declined from

25.1 percent in June to 20.8 percent in July, thus, the downward trend in WPI excluding agriculture accelerated in July (Figure 4).

13. Following the 0.2 percent increase in June, public manufacturing sector prices increased by 1 percent in July. In April – June 2003, appreciation of the Turkish lira coupled with favorable international crude oil prices had positively affected the rate of increase in the public manufacturing sector prices. In July, although the positive contribution of the international crude oil prices ended, the favorable outlook based on the course of exchange rates persisted. However, price adjustments in the prices of TEKEL products with the aim of attaining the year-end primary surplus target undermined the decline in the rate of increase in the public manufacturing sector prices.

14. Non-existence of a cost-push pressure makes a positive impact also on rates of increase in private manufacturing sector prices. Actually, the average rate of increase in private manufacturing sector prices was 0.4 percent during April-July 2003. Meanwhile, annual rate of increase in the same sector decreased from 24.7 percent in June to 20.3 percent in July.

Figure 4: WPI and WPI Excluding Agriculture



Source: CBRT, SIS.

* TRAMO/SEATS method has been used for deseasonalization.

II. OUTLOOK

15. Since March 2003, we have been restating in our monthly announcements entitled “Inflation and Outlook” that the interruption in the downward trend in inflation in the first couple of months of the year has no permanent nature and the downward trend would come back in June and the end-year target will be approached. As a matter of fact, as of April, with the ease of cost-push pressures originating from extraordinary conditions in the first few months of the year, the current economic program’s permanent decreasing effect on inflation became once more evident. Following the developments in June, decline in both consumer and wholesale prices indices in July confirms the Central Bank’s predictions and affirms the come back of downward trend in inflation.

16. The survey data and leading indicators relating to production and domestic demand indicate that the recovery in economic activity will persist. The expansion in domestic consumption is yet limited and it has not exerted any significant pressure on inflation. The firm belief that income and fiscal discipline will be sustained, signals that rise in domestic demand will not exceed the increase in production enabled by the production capacity of the economy. However, the Central Bank is still cautious in assessing the domestic demand developments and monitors closely possible domestic demand pressures on inflation.

17. Exchange rate will continue to be an important determinant of end-year inflation. The stable course to be followed by exchange rate and the contribution of a stable exchange rate to the downward trend in inflation certainly depends on steadfast implementation of the economic program.

18. Another important factor in inflationary regime is the course of expectations. According to the results of the CBRT Survey of Expectations pertaining to the second period of July, although the expected average of end-year CPI inflation is 3.7 points above the end-year inflation target of 20 percent, the expectations in the forthcoming period are expected to fall as monthly rate of change of CPI recorded negative figure both in June and July.

19. It is important to underline the importance of maintaining the income and fiscal discipline for disinflation efforts. Any slackening in policy implementations pertaining to public finance would necessitate additional measures providing for increase in public prices or indirect taxes in the rest of the year, therefore it is of utmost importance to avoid such slackening for attaining the inflation target.

20. Consequently, taking into account the importance of not allowing any concessions about the stability program, pursuing the structural reforms and the expectations, we once more restate that no actions or implementations shall be allowed that would lead to fluctuations in the financial markets. The recent steps taken towards this aim are welcomed. This constitutes the basis of the Central Bank's ever strengthening optimistic view about the future course of inflation.

III. CENTRAL BANK INTEREST RATES

21. In light of the above-mentioned developments, CBRT has decided to cut down short-term interest rates at CBRT Interbank Money Market and Repo-Reverse Repo Market at Istanbul Stock Exchange. The new rates are as follows:

- a) **Overnight Interest Rates:** Borrowing interest rate was cut from 35 percent down to 32 percent and lending interest rate from 41 down to 38 percent.
- b) **Other maturity:** One-week borrowing interest rate was cut to 32 percent from 35 percent.
- c) **Late Liquidity Window Interest Rates:** Within the framework of the Late Liquidity Window facility, the CBRT overnight lending interest rate applicable between 16:00 – 16:30 hours at Interbank Money Market was cut down to 43 percent from 46 percent. Borrowing interest rate of 5 percent remained the same.

Moreover, 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 operations were cut down to 34 percent from 37 percent.