



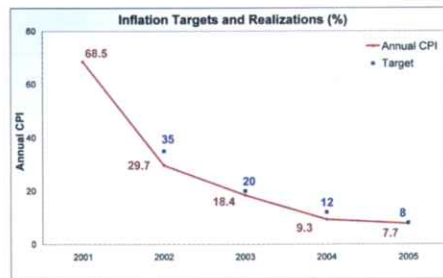
A New Monetary Policy Regime for the Turkish Economy: Inflation Targeting

From "implicit" to "explicit" inflation targeting

The Central Bank of Turkey (CBT) started to implement the inflation targeting regime at the beginning of 2006.

The CBT emphasized in its announcement of early 2002 pertaining to the general framework of monetary policy that "implicit inflation targeting" would be implemented until the necessary pre-conditions for the inflation targeting regime were fulfilled.

Since then, adaptation to the floating exchange rate regime increased, the fiscal dominance has weakened, the financial markets have started to deepen, and the financial sector has become less fragile. Additionally, inflation targets were met for four years in a row, confidence in the economy was restored, and inflation expectations converged with the targets.



The progress made towards economic stability sparked the reverse dollarization process. In 2005, significant steps were taken with regards to the improvement of the institutional infrastructure of monetary policy.

Taking all these considerations into account, the CBT decided to start the inflation targeting regime in 2006.

The General Framework of the Inflation Targeting Regime in Turkey

The experiences of the countries that have adopted this regime have shown us that there is no unique and best application for all countries; on the contrary, the implications of inflation targeting policy differ greatly due to the peculiar idiosyncrasies of the countries. Hence, the general framework of the inflation targeting policy regime has been constructed by considering the peculiarities of the Turkish economy.

The Inflation Target as "Point Target"

The inflation target is set as a "point target" since it has the advantage of being easily understood by the public.

- The Consumer Price Index is the preferred means of defining the inflation target, as it is an indicator easily followed by the public and an effective way of accurately measuring the cost of daily life.

- The announcement of a three-year path is believed to increase the internal consistency of inflation targets and their harmony with other macroeconomic projections. In line with this, the targets for 2006, 2007 and 2008 were set as 5 percent, 4 percent and 4 percent, respectively. The target for 2009 will be announced in 2006.

	2006	2007	2008
TARGET:	5 %	4 %	4 %

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INFLATION TARGETING REGIME IN TURKEY

Timetable of Inflation Report

January 31, 2006
April 28, 2006
July 28, 2006
October 31, 2006

Monetary Policy Committee Meeting Schedule (2006)

January 23, 2006
February 23, 2006
March 23, 2006
April 27, 2006
May 25, 2006
June 20, 2006
July 20, 2006
August 24, 2006
September 26, 2006
October 19, 2006
November 23, 2006
December 21, 2006

Deviations from the Target and Accountability

Since it is measured by a broad measure of inflation, which is consumer prices, the course of inflation may display fluctuations arising from factors outside the control of monetary policy, such as oil prices, changes in international liquidity conditions and global risk perceptions, indirect tax and public price adjustments, and unforeseen movements in the prices of unprocessed food. Therefore, it is impossible for the CBT to ensure that inflation will not make even the slightest deviation from the point targets.

Thus, an "uncertainty band" was determined. The band for 2006 is set as 2 percentage points in both directions. In this framework, accountability mechanism works in two ways: In case of a significant deviation from the target in any period, but within the limits of uncertainty band, the CBT shall explain the reasons behind the said development to the public in its reports. However, if the deviation exceeds the limits of the band, the CBT Law establishes a mechanism by asserting that: "The Bank shall submit information to the Government in writing and inform the public by disclosing the reasons of the incapability of achieving the determined targets in due time published or the occurrence of the possibility of not achieving them and the measures to be taken thereof."

INFLATION REPORT

Since the start of the inflation targeting regime, the quarterly Inflation Report is the main communication instrument of monetary policy. In line with the predetermined timetable, the first issue was made public by a press conference on January 31, 2006. In the first Report, inflation and general macroeconomic developments were discussed in depth. Moreover, the Report included the inflation forecasts of the CBT. It must also be kept in mind that these forecasts were made in the light of the information available at the time of publication of the Report.

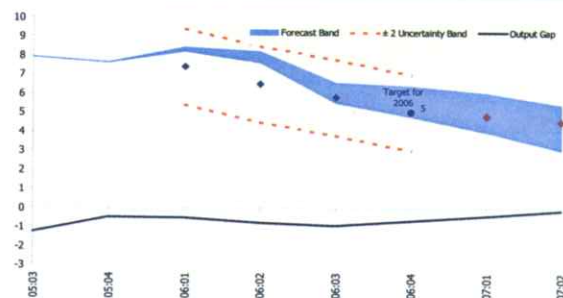
By taking into account the medium term perspective, two forecasts are produced for the period until mid-2007. The first scenario assumes that the short-term interest rate path will remain constant for the first couple of months in 2006 and will display a gradual decline thereafter. The assessments and assumptions of this scenario suggest a decline in inflation forecasts over the next eighteen months. Inflation will exhibit an upward movement in the first quarter of 2006 and then decline again in the second quarter. As of the third

quarter, the downward trend will become more evident and the year end inflation will be close to the targeted rate. Under the currently available information and the assumptions mentioned above, inflation is forecasted to move to the range of 3-5.5 percent by mid-2007.

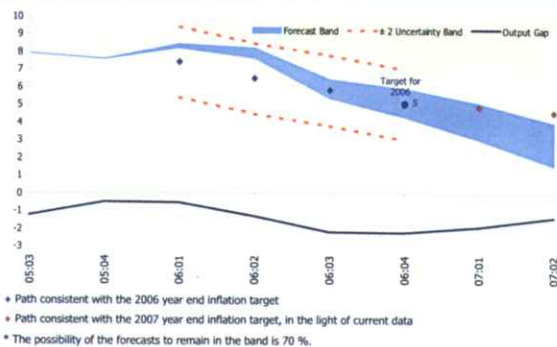
The second scenario is produced under the assumption that the short-term interest rate is fixed at 13.5 percent till the end of 2006. Under this scenario, forecasts indicate that inflation will fall faster compared with the previous scenario, staying within the 4.2-5.8 percent range by the end of 2006 and moving to the 1.5-4 percent range by mid-2007.

It should be stressed that the point forecasts are produced in the light of currently available information. Therefore, all the assumptions underlying the forecasts are subject to change, and that in such a case, both the forecasts and the future stance of the monetary policy may change.

Forecast of Inflation and Output Gap (Baseline Scenario 1)



Forecast of Inflation and Output Gap (Scenario 2: Constant Interest Rate)



Conference on "Inflation Targeting: Performance and Challenges"



The CBT held a two-day international conference entitled "Inflation Targeting: Performance and Challenges" in Istanbul on January 19-20, 2006. The conference hosted speakers and participants from more than 20 countries, including governors, deputy governors and senior managers from central banks, academicians from universities and experts from the financial sector and the press.



On the first day of the conference, the conceptual and operational framework of the inflation targeting regime including central bank independence, accountability, decision making process and communication policies were discussed in individual sessions within the framework of different country experiences.

On the second day, besides the Turkish case, challenges such as exchange rate volatility, high public debt, and dollarization etc., experienced by inflation targeting countries were discussed.

To find out more: <http://www.tcmb.gov.tr> (Conferences)



Workshop on "Inflation Targeting: Policy and Applications"

The CBT in cooperation with the IMF held a workshop on September 12-19, 2005. During the workshop, the general framework of the inflation targeting regime, country experiences and requirements for the successful implementation of the inflation targeting regime were handled. Besides central bankers from countries that implement inflation targeting regime like Canada, Chile, Norway, Czech Republic and Israel; entitled parties from the CBT and the IMF also took part in the workshop.

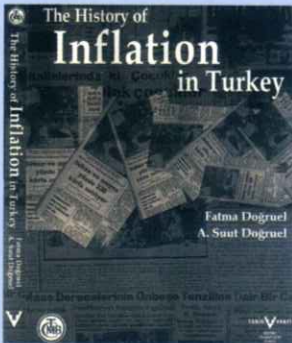
London School of Economics (LSE) – Chair in Contemporary Turkish Studies



A new chair in Contemporary Turkish Studies in the European Institute was established at the LSE, which is one of the leading academic institutions in the world. The Chair, in which studies regarding Turkey will be handled within the concept of European Studies, will focus on political, economic and other current issues, with the aim of informing Europe about contemporary Turkey. Upon the opening of the Chair, on October 27, 2005, Governor Süreyya Serdengeçti made a speech on "The Turkish Economy and the European Union" and mentioned the prospective effects of Turkey's accession to the European Union.



To find out more: <http://www.tcmb.gov.tr> (Governor's Remarks)



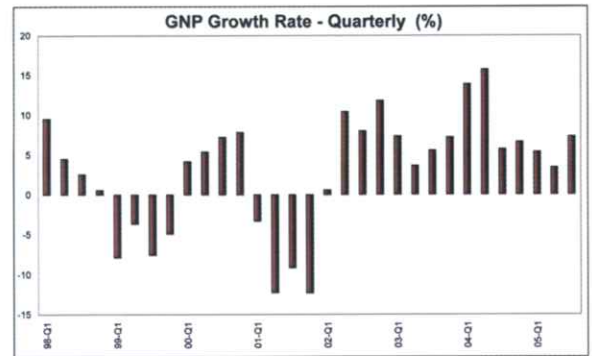
The History of Inflation in Turkey

An album-book titled "The History of Inflation in Turkey" has been published with the collaboration of the CBT and the History Foundation of Turkey. The book explains when and how Turkey experienced inflation, how inflation affected daily life beginning from the Republican era, the domestic and external conditions of the era, why inflation became chronic and other related issues from a historical perspective. It is also emphasized in the book that thirty years of high and chronic inflation has led to serious social problems in Turkey.

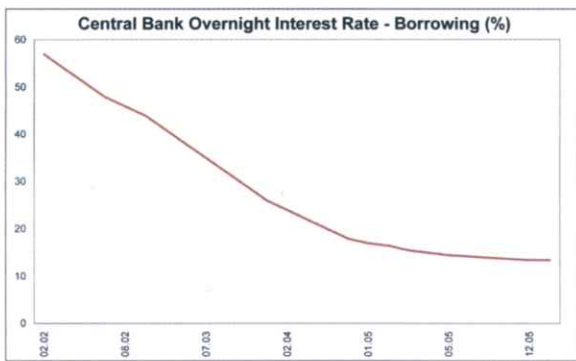
AT A GLANCE



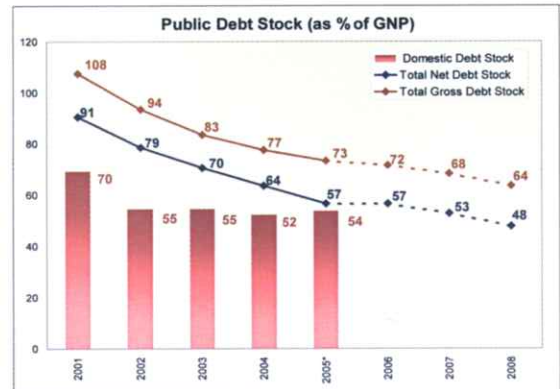
Source: CBT



Source: Turkstat



Source: CBT



*As of 2005Q3

Source: Treasury, State Planning Organization

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The New Turkish Lira:

With the help of the decisive implementation of the stabilization program, Turkey has finally experienced single digit inflation after thirty five years. During this process, uncertainty within the economy diminished and the predictability of economic indicators increased. All these factors enabled the redenomination of the Turkish lira by dropping six zeros, at the beginning of 2005. Turkish lira

banknotes and coins were in circulation with the New Turkish Lira banknotes during 2005. Since the beginning of 2006, New Turkish Lira has become the only currency in circulation.

Web Site: (www.tcmb.gov.tr)

Statistical data, reports, periodical publications, research papers, Governor's remarks, press releases and other announcements can be reached from the web site.

E-alert System provides the capability of being notified about the Central Bank of Turkey publications through electronic mail with the frequencies chosen.

