

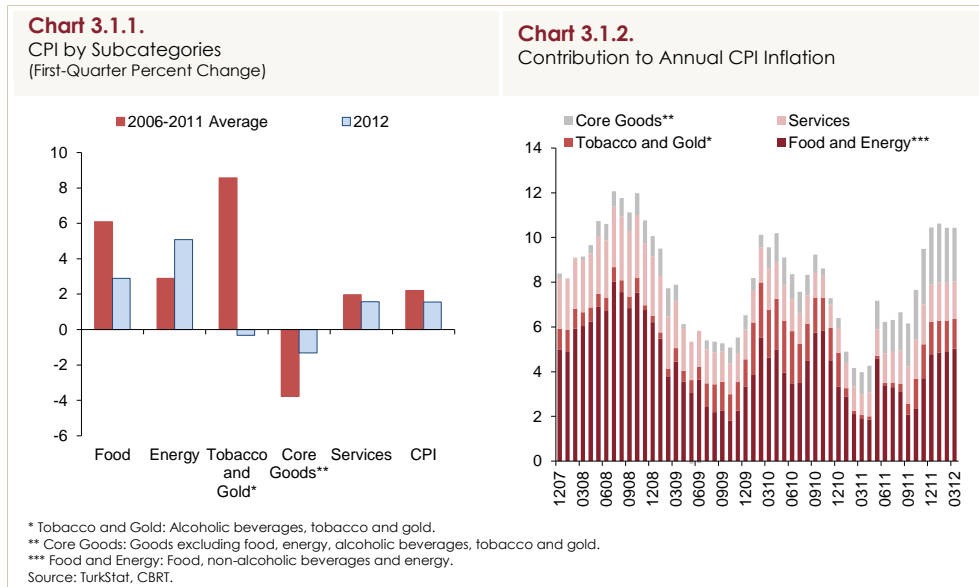
3. Inflation Developments

3.1. Inflation

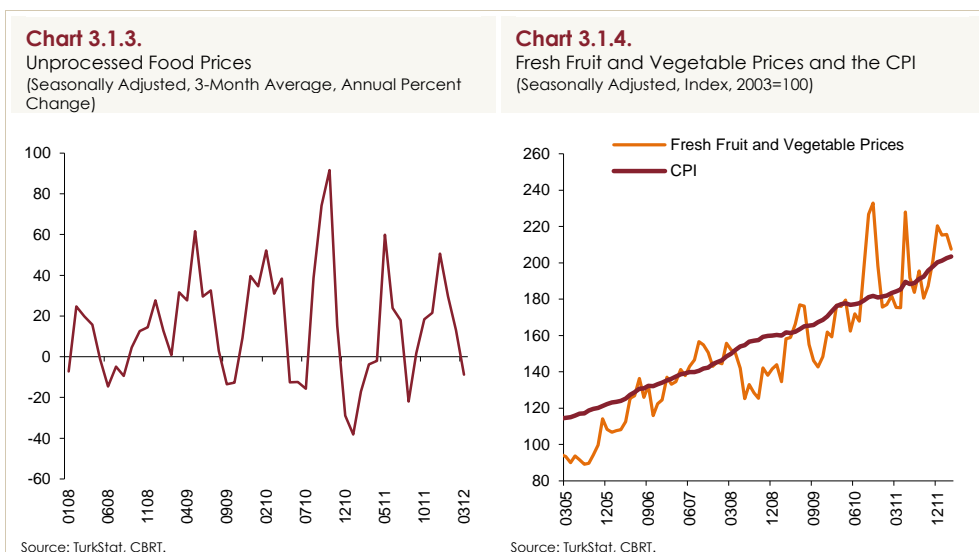
In the first quarter of 2012, annual consumer inflation stood at 10.43 percent, remaining broadly unchanged from the previous quarter. The accelerative effect of the higher-than-envisioned increases in energy prices due to developments in international oil prices was contained by the recently favorable course of unprocessed food prices. Having soared due to depreciation of the Turkish lira throughout 2011, annual inflation in core goods assumed a downward course in the first quarter of the year. Meanwhile, prices of services remained moderate. Hence, inflation remained close to January Inflation Report forecasts in the first quarter.

Across subcategories, quarterly price changes in main expenditure groups excluding energy and core goods were below the average of the past years in the first quarter (Chart 3.1.1). Energy prices had a major effect on the lingering of high annual inflation in this period. Annual energy inflation rose by 3 percent in the first quarter, adding an extra 0.46 percentage points to inflation compared to end-2011 (Chart 3.1.2). Meanwhile, the contribution of food inflation was down by 0.22 percentage points amid the mild course of unprocessed food prices. Adverse effects of the depreciation in the Turkish lira on core goods, especially on durables, largely tapered off in this period, and the contribution of core goods to annual inflation declined by 0.15 percentage points. Meanwhile, the contribution of services prices to inflation remained unchanged.

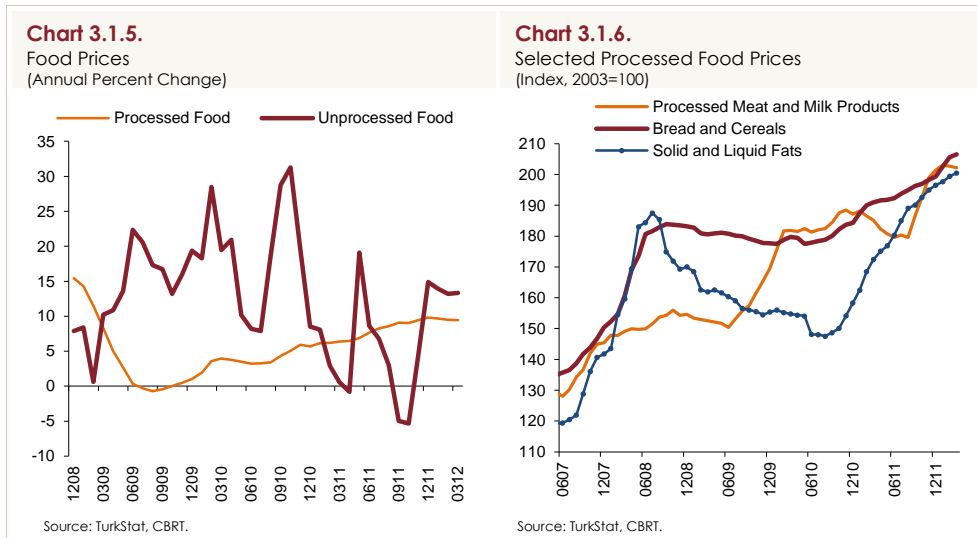
Overall, energy prices posted a higher-than-envisioned rise in the first quarter amid the upward course of oil prices. Persisting uncertainties regarding oil prices feed into upside risks on short-term inflation outlook. On the other hand, the relatively favorable course of unprocessed food prices poses downside risks to inflation.



In the first quarter of the year, unprocessed food prices recorded an all-time-low first-quarter increase with 3.66 percent, and registered an annual inflation going down to 13.35 percent (Table 3.1.1). In seasonally adjusted terms, subsequent to the surge in the last quarter of 2011, the unprocessed food prices declined amid the favorable course of fresh fruit and vegetable prices (Chart 3.1.3). Having soared substantially in the previous quarter, prices of fresh fruits and vegetables saw notable downward corrections despite adverse weather conditions (Chart 3.1.4). Thus, unprocessed food inflation was below January Inflation Report forecasts in this period, with a declining contribution to annual inflation down by 1.69 percentage points.



Annual processed food inflation posted a quarter-on-quarter decline by 0.38 percentage points to 9.44 percent (Chart 3.1.5). In this period, the rise in bread prices by 5.15 percent amid the arrangement in the communique on Bread and Bread Varieties of the Turkish Food Codex, was the main factor to contain the decline in annual processed food inflation. Meanwhile, quarterly inflation in the processed food prices excluding bread remained below seasonal averages, and decelerated quarter-on-quarter. Having accelerated since the last quarter of 2010 in line with both domestic and international developments, prices of fats and oils remained on an upward track, albeit at a slower pace (Chart 3.1.6). Following the surge in the previous quarter, prices of dairy products edged down in this period in tandem with the decline in milk prices, while processed meat products accelerated slightly quarter-on-quarter. Overall, annual food inflation dropped to 11.25 percent and remained below the January Inflation Report projections amid the developments in unprocessed food prices.



Fuel prices soared by 8.07 percent in the first quarter amid the surge in international oil prices. Consequently, energy prices rose by 5.08 percent, adding 0.74 percentage points to inflation in the respective period (Chart 3.1.7 and Table 3.1.1). In the meantime, bottled gas and solid fuel prices also posted increases well above historical averages by 8.59 and 5.55 percent, respectively. In addition, water tariff hikes were close to seasonal averages, while increases to electricity and natural gas tariffs were relatively mild. Thus, annual energy inflation went up by a quarter-on-quarter 3 percentage points to 13.39 percent in the first quarter. Hikes in oil prices were reflected on electricity and natural

gas prices by April, thus pulling energy prices up by 3.5 percentage points, and adding about 0.5 points to CPI inflation.

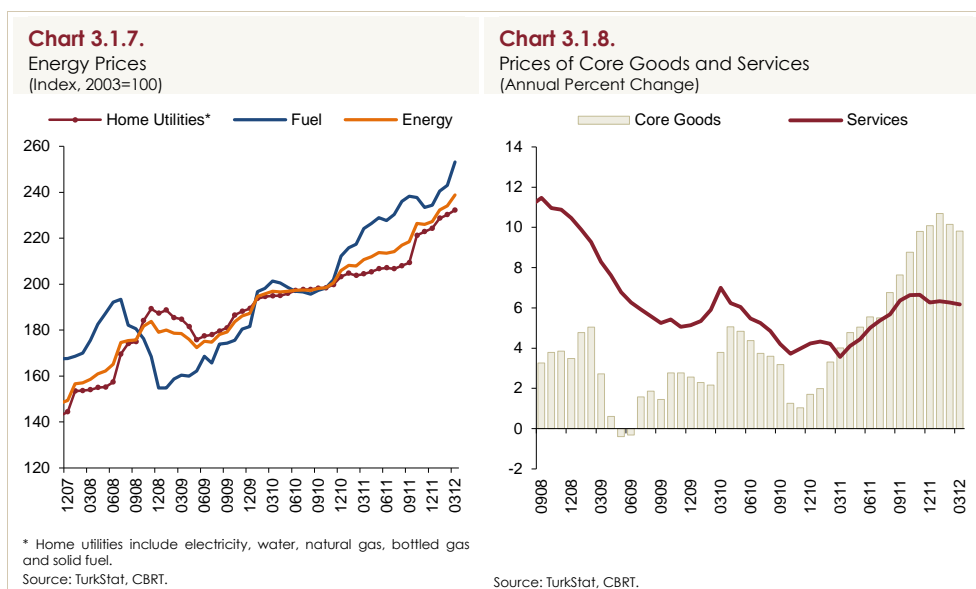


Table 3.1.1.
Prices of Goods and Services
(Quarterly and Annual Percent Change)

	2011					2012
	I	II	III	IV	Annual	I
CPI	1.57	1.83	1.07	5.66	10.45	1.55
1. Goods	1.53	2.05	0.73	7.29	11.97	1.54
Energy	2.27	1.37	2.34	4.03	10.36	5.08
Food and Non-Alcoholic Beverages	3.77	-2.46	1.18	9.57	12.21	2.89
Unprocessed Food	5.08	-5.79	-1.00	17.23	14.89	3.66
Processed Food	2.61	0.57	3.03	3.30	9.82	2.25
Goods (excl. energy and food)	-0.68	6.32	-0.36	6.93	12.51	-1.14
Core Goods	-1.08	7.73	-1.55	4.92	10.09	-1.32
Durable Goods (excl. gold)	4.26	1.85	3.69	1.90	12.19	1.41
Alcoholic Beverages, Tobacco and						
Gold	0.81	1.05	4.38	14.46	21.70	-0.33
2. Services	1.67	1.22	2.02	1.22	6.27	1.57
Rent	1.08	0.99	1.35	1.21	4.71	0.89
Restaurants and Hotels	1.65	1.80	2.37	2.14	8.20	1.99
Transport	2.28	2.10	3.07	1.73	9.49	2.12
Communication	1.96	-1.71	0.35	0.47	1.04	0.06
Other Services*	1.61	2.14	2.56	0.65	7.12	2.24

* Services excluding rents, restaurants, hotels, transport and communication.

Source: TurkStat, CBRT.

Having soared throughout 2011, annual inflation in core goods assumed a downward course by the first quarter in tandem with the alleviating cumulative effects of exchange rate. Accordingly, core goods posted a year-on-year inflation by 9.82 percent in March (Chart 3.1.8). On the back of the slowdown in durable goods inflation, seasonally adjusted data also signaled a slowdown in the underlying trend of core inflation in the first quarter (Charts 3.1.9 and 3.1.10). Subsequent to the rise in January, prices of core goods remained unchanged in

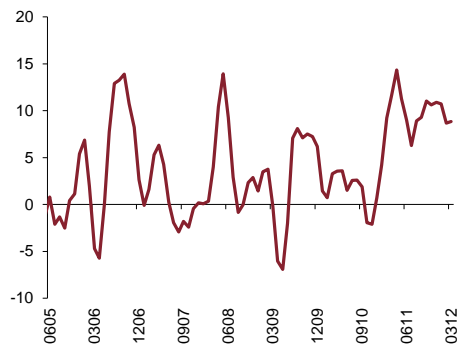
February and March amid the declining prices of electrical and non-electrical home appliances other than automobiles and white goods. Meanwhile, annual rate of increases in the prices of core goods excluding durables continued to trend upwards in this quarter (Table 3.1.2). In particular, due to protection measures on textiles and ready-wear, clothing prices continued to rise both in seasonally adjusted terms and on an annual basis, notwithstanding the fall in the manufacturing prices (Chart 3.1.10).

Table 3.1.2.
Prices of Core Goods
(Quarterly and Annual Percent Change)

	2011					2012
	I	II	III	IV	Annual	I
Core Goods	-1.08	7.73	-1.55	4.92	10.09	-1.32
Clothing and Footwear	-12.04	25.08	-12.13	11.72	8.01	-10.90
Durable Goods (excl. Gold)	4.26	1.85	3.69	1.90	12.19	1.41
Furniture	0.75	5.04	2.88	4.01	13.25	3.19
Electrical and Non-Electrical Appliances	2.87	-1.26	0.34	3.29	5.27	0.94
Automobile	6.31	2.29	5.68	0.52	15.52	1.09
Other Durable Goods	2.15	2.71	1.85	3.00	10.06	1.22
Other	1.82	2.09	1.54	3.44	9.18	2.76

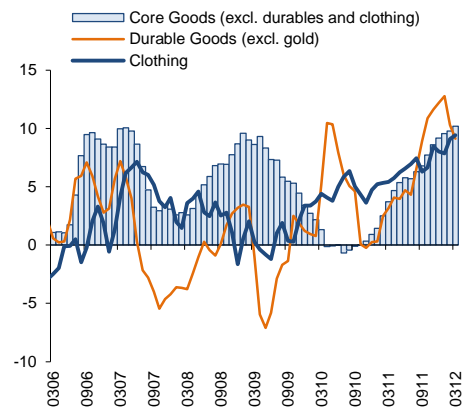
Source: TurkStat, CBRT.

Chart 3.1.9.
Prices of Core Goods
(Seasonally Adjusted, 3-Month Average, Annual Percent Change)



Source: TurkStat, CBRT.

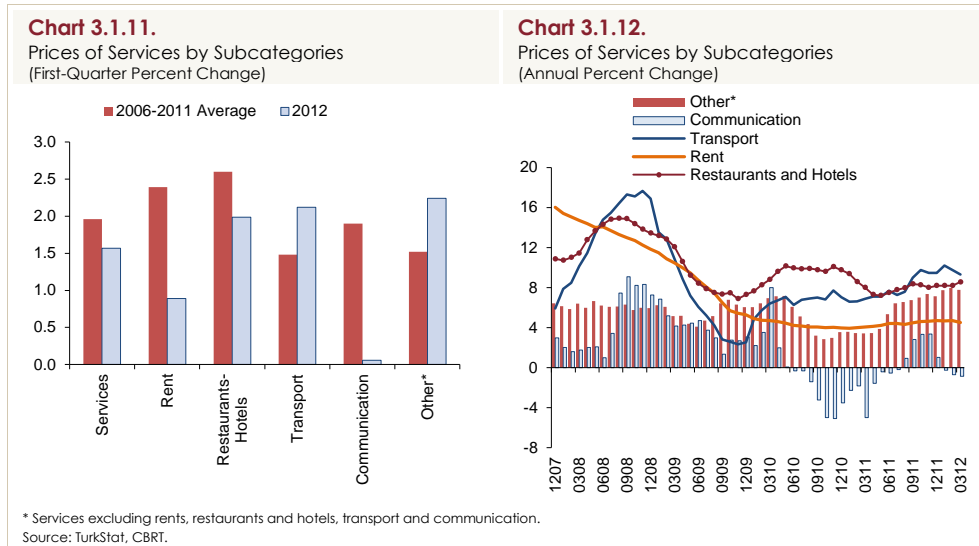
Chart 3.1.10.
Prices of Core Goods
(Annual Percent Change)



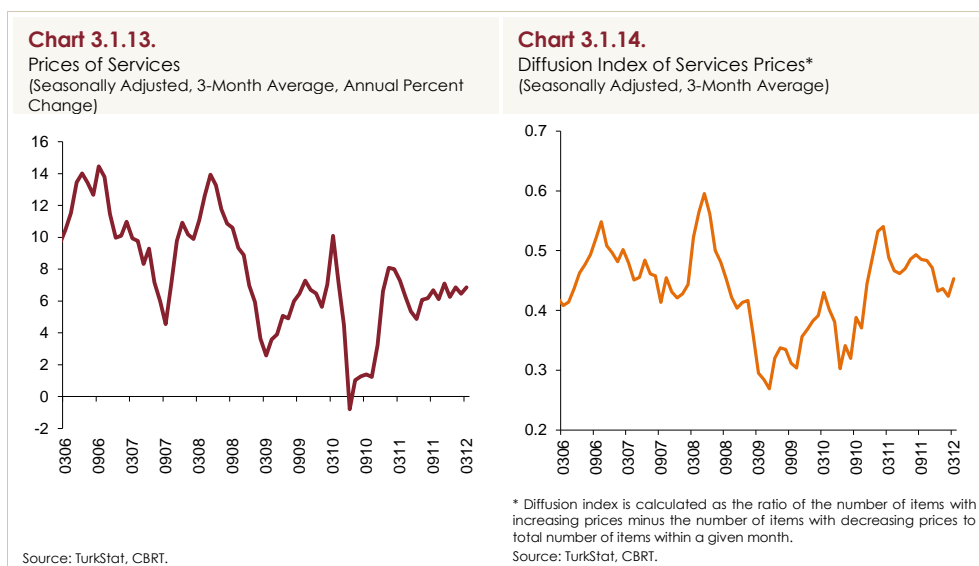
Source: TurkStat, CBRT.

Having risen by 1.57 percent in the first quarter, prices of services lost pace compared to previous years (Chart 3.1.11). Prices of services increased by a year-on-year 6.17 percent by the end of the first quarter (Chart 3.1.8). Across subcategories, rents, restaurants and hotels as well as communication services posted quarterly price increases below historical averages (Chart 3.1.11). In particular, prices were flat in the highly competitive communication services, remaining below the first-quarter figures in 2011 (Chart 3.1.12). Year-on-year increase in rent was as low as 4.5 percent. Meanwhile, due to the acceleration

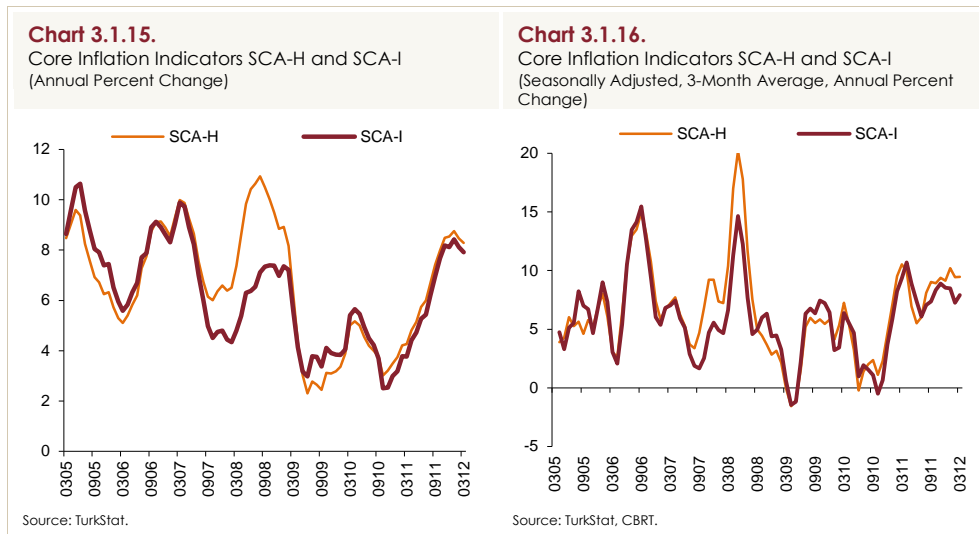
of domestic fuel prices, transport services inflation surpassed the average of the preceding periods. Overall, consumer inflation remained elevated, while prices of services exhibited a relatively favorable outlook in the first quarter of the year.



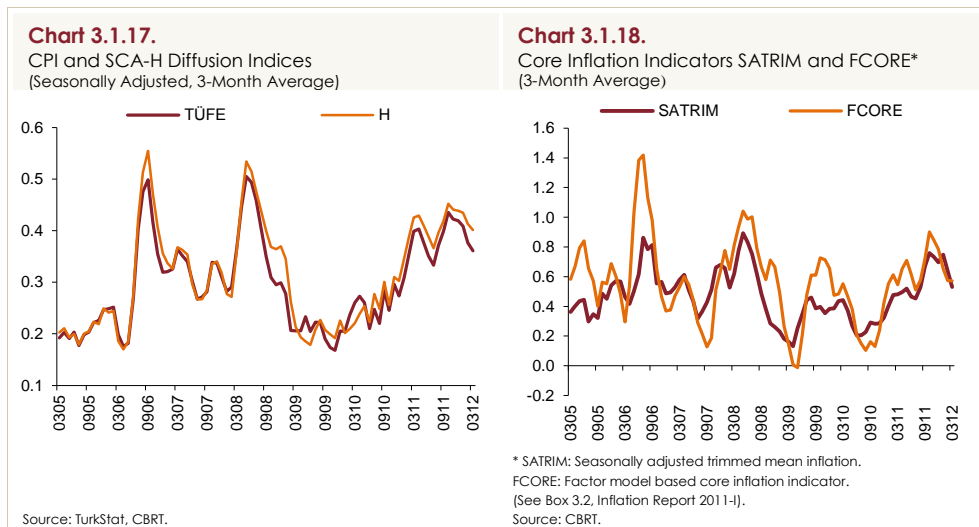
Seasonally adjusted data point to a flat outlook in the underlying trend of services inflation in the first quarter (Chart 3.1.13). The diffusion index, which entails information on the extent of the spillover of the price increases, edged up during the last month, by remaining below the previous quarter on a quarterly basis (Chart 3.1.14). Subcategories of the diffusion index suggest that the relative deterioration in the last month was mainly fuelled by transport and other services.



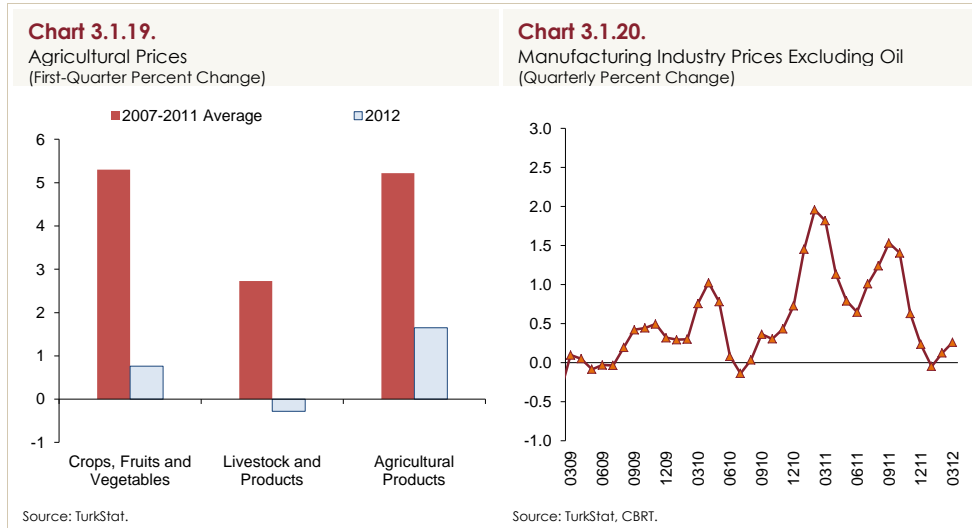
The courses of annual inflation in core indicators SCA-H and SCA-I were similar to annual core inflation, thereby edging down quarter-on-quarter to 8.28 percent and 7.91 percent, respectively, by the end of March (Chart 3.1.15). Seasonally adjusted data indicate that the underlying trend of SCA-H remained flat, while the underlying trend of SCA-I decelerated slightly in the first quarter of the year (Chart 3.1.16).



Diffusion indices for CPI and SCA-H went down in this period (Chart 3.1.17). Alternative core inflation indicators monitored by the CBRT also declined since end-2011 (Chart 3.1.18). However, both the diffusion indices and the core inflation indicators remained above historical averages.



In the first quarter of 2012, the decelerating agricultural inflation and the appreciation of the Turkish lira were influential on the course of producer prices. Accordingly, annual producer price inflation declined quarter-on-quarter by 5.1 percentage points to 8.22 percent. In the farm group, prices of vegetable products as well as fresh fruits and vegetables recorded a relatively mild increase in this period compared to the first period of 2011 (Table 3.1.3). Similarly, livestock prices fell by 0.28 percent in the same period (Chart 3.1.19). Hence, year-on-year farm inflation dropped by 4.38 percentage points to 6.16 percent at the end of the first quarter. Price developments in agricultural products were reflected on consumer prices through fresh fruit and vegetable prices, while affecting the subcategories of the manufacturing industry through certain farm products that are subject to industrial production. The plunge in domestic cotton prices, which started in early 2011, continued in this period, causing the prices of the manufacturing of clothing and textiles products to decline below seasonal averages to 5.77 percent and 1.19 percent, respectively. Meanwhile, notwithstanding the flat course of livestock prices, prices of the manufacturing of meat products and processed meat products were up in this period.



Manufacturing prices followed a mild course in the first quarter amid exchange rate developments (Chart 3.1.20). In particular, appreciation of the Turkish lira in the first two months had a dominating effect on the manufacturing prices despite rising international commodity prices. In fact, TL-denominated import prices posted a quarter-on-quarter decline in this period (Chart 3.1.21). Thus, manufacturing industry prices excluding oil soared by a low 0.79 percent,

thereby causing the annual inflation to decline by 5.12 percentage points quarter-on-quarter to 8.30 percent. Prices of intermediate and capital goods had a benign outlook, despite the interruption of the slowdown in March amid the relative deterioration in exchange rates, besides the developments in commodity prices. Meanwhile, durables and non-durable goods saw higher quarterly price increases by 2.36 percent and 1.4 percent, respectively. Prices of durables soared mainly on the back of manufacturing of furniture prices, which have steadily risen on a quarterly basis. The rise in prices of non-durable goods, on the other hand, was mostly driven by food manufacturing prices. Overall, the first quarter was marked by a mild course in the prices of manufacturing industry excluding oil, as well as farm with a relatively weak course for producer prices.

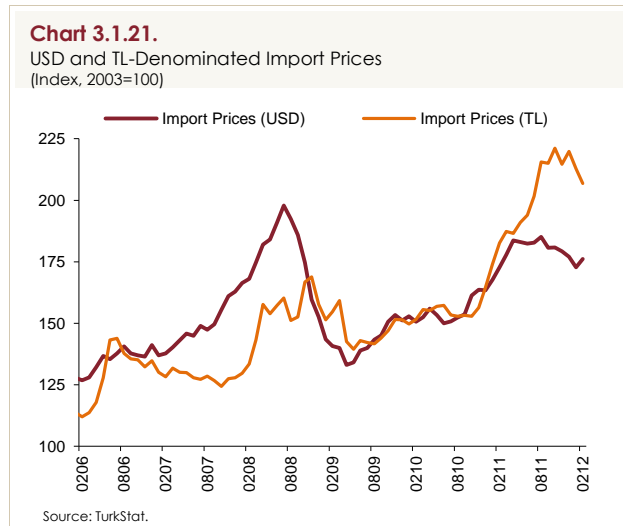


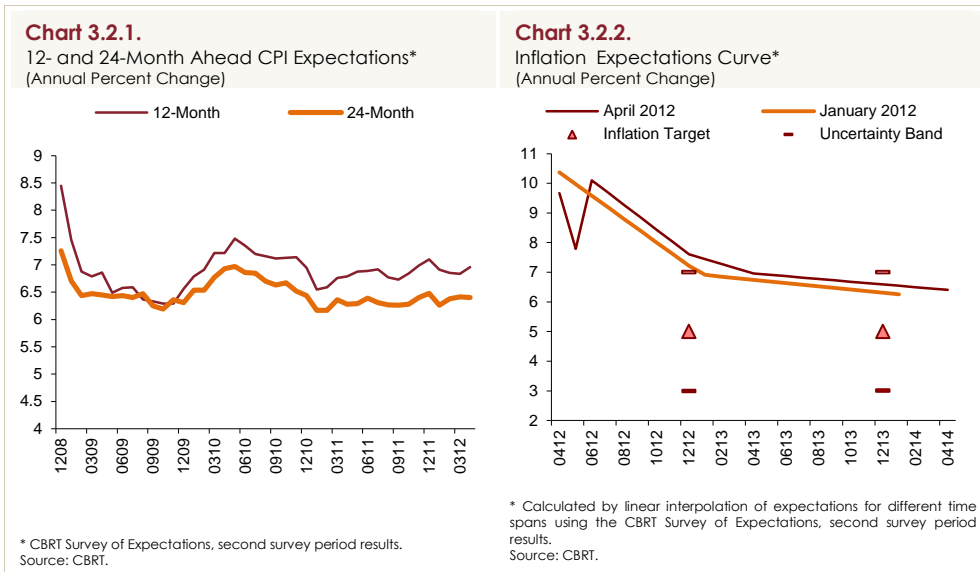
Table 3.1.3.
PPI and Subcategories
(Quarterly and Annual Percent Change)

	2011					2012
	I	II	III	IV	Annual	I
PPI	5.40	0.77	3.31	3.28	13.33	0.65
Agriculture	5.84	-1.73	-6.03	13.09	10.53	1.65
Crops, Fruits and Vegetables	6.81	-2.67	-9.84	17.18	9.83	0.76
Livestock and Animal Products	-1.26	-0.39	2.68	5.51	6.56	-0.28
Industry	5.31	1.30	5.24	1.48	13.92	0.45
Mining	9.70	1.08	4.94	2.93	19.76	0.90
Manufacturing	6.27	1.98	4.98	0.72	14.59	1.06
Manufacturing (excl. petroleum)	5.55	1.95	4.67	0.70	13.42	0.79
Manufacturing (excl. petroleum and basic metals)	4.85	1.53	4.12	1.39	12.38	0.93
Electricity, Gas and Water	-4.08	-4.73	7.89	7.91	6.38	-4.64

Source: TurkStat, CBRT.

3.2. Expectations

Having risen in the last quarter of 2011 amid soaring annual consumer inflation, inflation expectations remained flat in the first quarter of 2012. Expectations did not deteriorate in this period despite the high course of inflation. However, following the hikes to electricity and natural gas tariffs effective as of April, especially the 12-month ahead expectations were revised upwards (Charts 3.2.1 and 3.2.2).



The distribution of survey respondents' for both 12-month and 24-month ahead inflation expectations converged in this period (Charts 3.2.3 and 3.2.4).

