Number: 2003-43

September 18, 2003

PRESS RELEASE
ON
THE CBRT INTEREST RATE CUTS

I. GENERAL ASSESSMENT

1. The primary objective of the Central bank of Turkey (CBRT) is to achieve price stability as stipulated in its Law. Short-term interest rates, which are the main policy instrument of the CBRT, are adjusted by considering to which extent the future trend of inflation is compatible with the inflation target.

2. As has been announced several times by the CBRT, there are a series of variables influencing inflation. The common conviction of various academicians who have studied the inflationary process in Turkey is that the main variables shaping the course of inflation are i) the rate of increase in exchange rate, ii) the expectations about the future trend of inflation, iii) the prices in long-term contracts made in line with these expectations such as wage increases, and iv) the demand pressure determined according to the direction and the size of discrepancy between the current output level and the potential output level.

3. It is no doubt that, the main determinant of the movements in those variables affecting inflation and real interest rates is the current economic policies. In this context, especially fiscal policy comes first, the reason being the still high level of public sector debt, despite its downward trend under the current program. Fiscal discipline is the primary condition for reducing the ratio of public debt to GNP permanently. Such a declining trend will boost the public confidence in debt sustainability and real interest rates will come down, inflation expectations will improve further and exchange rates will stabilize. Such an environment, which would ensure a lasting downward trend in inflation, is also a pre-condition for a sustainable growth, as the increased confidence would boost private sector's consumer and investor spending.

II. OUTLOOK

4. Having left behind the first 8 months of 2003, both the current inflation trend and the movements in the variables affecting this trend are giving favorable signals for the future course of inflation. Inflation has now a significant downward trend. Stability observed in exchange rates in the last few months coupled with the steady decline in expected inflation

rates is promising for the future inflation. The level of production is converging with the potential level of production, however this is not believed to pose any threat for attaining the end-year inflation target.

5. The continuation of this favorable outlook depends on the fiscal discipline. As we have mentioned in our latest press release regarding inflation developments, every step to be taken for the continuation of fiscal discipline and every piece of new information in this regard will minimize the risk of a persisting inflation. In September, we have witnessed promising developments in this regard.

6. Firstly, top authorities have announced that incomes policy will be implemented consistently with both 2003 and 2004 inflation targets. Adjustment of incomes policy in line with the targeted inflation is essential in respect of easing the pressure of production costs on the prices, maintaining favorable course of inflationary expectations, and eliminating the inertia that is gradually losing its importance. Another promising factor for the budget discipline is that in these announcements the danger of populist policies that would harm budget discipline producing unfavorable results in the future has been underlined.

7. Secondly, primary budget surplus realized at a high level in August. It is well known that the stable course of exchange rates has a positive effect on the State Economic Establishments in general. Hence, a significant progress has been made in achieving public sector primary surplus target for end-2003. Here, it will be helpful to underline that the budget realizations may display notable volatility month by month. Besides, the effects of some measures taken for establishing budget discipline are observed in delays. For the continuation of this confident atmosphere, the significance of current developments in respect of the end-year targets should be well understood by everybody. It is apparent that the public needs to be informed of these developments in a more detailed manner. Thus, for example the fluctuations arising from the speculations about the July primary budget surplus would have never been observed if there had been sufficient information.

8. Another encouraging development for the future inflation is the relative drop in crude oil prices in recent weeks. Furthermore, it is observed that excess foreign exchange supply is still continuing. In other words, it seems unlikely that the current stability of Turkish lira against other currencies will deteriorate by negatively affecting the downward trend in inflation, provided that the current economic policy is strictly implemented.

9. Finally, another point that should be emphasized is the seasonal fluctuations observed in monthly inflation figures. Especially consumer inflation realizes at higher levels in autumn months compared to summer months due to the seasonal factors. Therefore, it will

be helpful to consider this fact while evaluating the inflation figures to be announced in the coming months.

III. THE CENTRAL BANK INTEREST RATES

10. In the light of the evaluations above, starting from September 18, 2003, the 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 29 percent from 32 percent and lending interest rate to 35 percent from 38 percent.

b) **Interest Rates of Other Maturities:** One-week borrowing interest rate was cut to 29 percent from 32 percent.

c) **Late Liquidity Window Interest Rates:** In the framework of Late Liquidity Window application, the CBRT overnight borrowing interest rate applicable between 16:00 – 16:30 at Interbank Money Market was cut to 40 percent from 43 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 in the framework of open market operations were cut to31 percent from 34 percent.