

PRESS RELEASE ON THE CBRT INTEREST RATE CUTS

I. GENERAL EVALUATION

1. In "Outlook" section of our press release entitled June and Inflation and Outlook" dated July 4,2003, it was emphasized that:

- (i) downward trend in inflation became more evident with the figures pertaining to June inflation,
- (ii) developments observed in exchange rates in the last few months and favorable developments in inflation expectations coupled with the prospective tendency of these variables in the near future encourages CBRT to think positive about the future inflation trend,
- (iii) the announcements made by officials were deemed favorable in terms of conformity with the inflation target, however cost of increase in wages and salaries exceeding budget targets would create adverse effects on inflation as these increases will be met by increasing taxes instead of cuts in other expenditure items,
- (iv) taking into account the above-mentioned points and departing from the supposition that the program would be implemented without any interruptions, the most important development that could pose threat to the future trend of inflation could be the signals about increasing domestic demand, however actual production, which was still below the potential production level, would palliate the unfavorable pressure to be exerted by domestic demand on inflation,
- (v) the negative effect that might arise from demand pressure could be compensated sufficiently by the recent developments in exchange rates, the favorable inflation expectations and the strong likelihood of sustenance of these trends,

- (vi) these favorable developments should not be perceived as a short-sighted opportunity to increase profit margins by the private sector; long-term interest should be considered and actions should be taken responsibly,
- (vii) the downward inflation trend achieved could only be stopped by deviations from the program and it was of utmost importance that fiscal discipline was maintained and structural reforms were carried on timely and uninterruptedly.

In light of these points, welcoming the above-mentioned developments, the CBRT warned that any kind of relaxation would be a big economic mistake and departing from the supposition that no concessions would be allowed in fiscal discipline and structural reform process, the CBRT envisioned that the favorable developments observed in inflation since April would continue and the end-year inflation target of 20 percent would be attained.

2. The developments observed since early-July have strengthened the probability that the fundamental factors determining the inflation will pursue a favorable course in the following period as well. These developments reinforced the CBRT's hopeful vision for the future trend of inflation too. The structural reform process and measures on budget discipline are the leading ones among these developments. Significant progress was made in concluding the Fifth Review conducted with the IMF and in effecting the reforms that are essential for the implementation of the program successfully. Moreover, it is acknowledged that the budget discipline will mainly be maintained through expense-restrictive measures. This development is considered to be encouraging with respect to the inflation of the following period.

3. Meanwhile, these favorable developments reflected on the market expectations for inflation as well. The results of expectation survey for the first half of July point at a noteworthy decline in inflation expectations. Various econometric models, which are used by the Central Bank in forecasting inflation for the following period on the assumption that current fiscal and structural policies will be maintained, produce hopeful results that are consistent with year-end inflation target. These results are consistent with the improvement in the market expectations too.

II. THE CENTRAL BANK INTEREST RATES

4. In the light of the evaluations above, starting from 16 July 2003, 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 35 percent from 38 percent and lending interest rate to 41 percent from 45 percent.
- b) Other Maturity: One-week borrowing interest rate was cut to 35 percent from 38 percent.
- c) Late Liquidity Window Interest Rates: In the framework of Late Liquidity Window application, CBRT overnight borrowing interest rate applicable between 16:00 – 16:30 Hours at Interbank Money Market was cut to 46 percent from 50 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 transactions were cut to 37 percent from 41 percent.