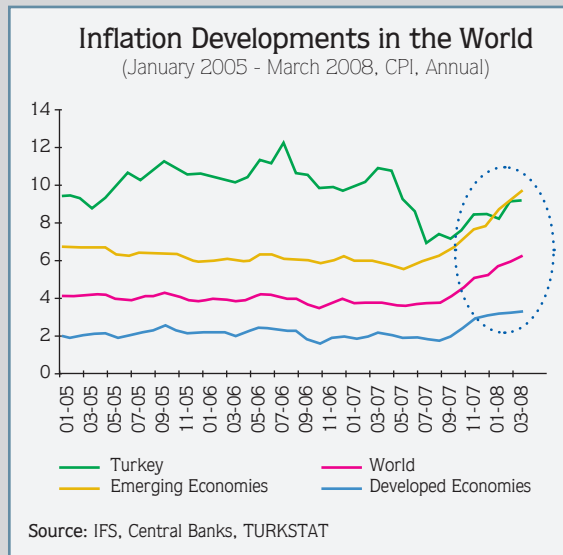


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**INFLATION OUTLOOK IN TURKEY**

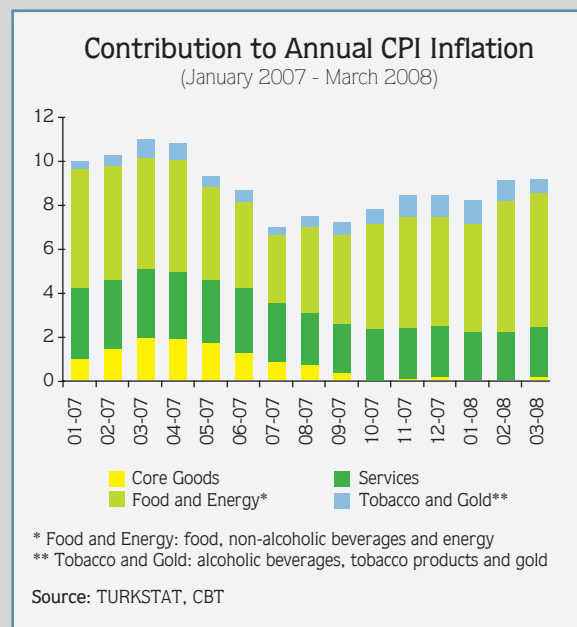


The ongoing fluctuations in international financial markets that started in mid-2007 affect both developed and developing economies in various ways. Besides, the recent upward movement in inflation has continued to persist throughout the world. While the central banks of developed economies have given priority to financial stability and growth during this period, those of emerging economies have focused on the rise of inflation.

In this respect, the Central Bank of the Republic of Turkey (CBT) has been carefully assessing the effects of developments in global financial

markets on the Turkish economy in terms of monetary policy implementations and inflation developments. The CBT has shared its opinions with public via the presentation made by Governor Yılmaz before the Council of Ministers on May 12, 2008, the Inflation Report and the Open Letter on April 30, 2008, and the Summary of the Monetary Policy Committee (MPC) Meetings dated April 30 and May 28, 2008.

In Turkey, inflation breached the upper limit of the uncertainty band at the end of the first quarter of 2008 and was realized as 9.66 percent as of April 2008. This situation resulted mainly from factors beyond the control of monetary policy, such as developments in energy, food and administered prices. In fact, 6.3 percentage points of the annual CPI inflation in April resulted from food and energy items. Moreover, the decline in services inflation came to a halt in the first quarter of 2008, and exchange rate movements resulting from fluctuations in global financial markets led to increases, especially in prices of fuel and high-tech consumer durables. The rise in core inflation indicators has reinforced the risks related to second-round impacts of previous shocks, as well.



Increasing food and energy prices and ongoing uncertainties in the global economy continue to pose a risk, feeding into inflation expectations and core prices and thus increasing the risks regarding price setting behavior and the degree of inflation persistence. As a result, the CBT has moved in the direction of increasing policy rates as of May 2008.

Currently, inflation forecast for the end of 2008 is around 9.3 percent. The forecasts are based on the assumptions on food inflation, oil prices, automatic pricing mechanism in



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## INFLATION OUTLOOK IN TURKEY

electricity and exchange rates, which were revised up in the Inflation Report 2008-II. Indeed, raised assumptions for food inflation have led to upward revisions in inflation forecasts, by about 1.2 points for 2008 and 1.1 points for 2009. Similarly assumptions for oil prices and electricity tariffs have implied upward revisions of forecasts by 0.9 points and 0.4 points for end-2008 and end-2009, respectively. On the exchange

rate front, the first round impact of the recent depreciation is estimated to be around 1.5 to 2 percentage points at the end of 2008. Considering the role of supply shocks under current conditions, the CBT provides projections under alternative scenarios for food and energy prices besides the base scenario, as shown in the Table below:



*The CBT's policy strategy is to tolerate the first round effects of supply shocks but to promptly respond to any deterioration in overall pricing behavior.*

Base Scenario		
<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>▶ Food inflation: 13 % and 8 % in 2008 and 2009, respectively</li> <li>▶ Oil Prices: 105 USD per barrel at the end-2008</li> <li>▶ Exchange rates remain unchanged</li> <li>▶ Electricity tariffs adjusted as needed by the automatic pricing mechanism</li> </ul>	<p><b>Interest Rate Response</b></p> <ul style="list-style-type: none"> <li>▶ Gradual and measured tightening towards mid-2008 and constant policy rates thereafter</li> </ul>	<p><b>Inflation Forecasts*</b></p> <ul style="list-style-type: none"> <li>▶ End-2008: 9.3 %</li> <li>▶ End-2009: between 4.9 % and 8.5 %, (mid point: 6.7 %)</li> <li>▶ End-2010: 4.9 %</li> <li>▶ Mid-2011: 4 %</li> </ul>
Optimistic Scenario		
<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>▶ Food inflation: 9 %, 5 % and 4 % in 2008, 2009 and 2010, respectively</li> <li>▶ Oil Prices: 85 USD per barrel at the end-2009</li> </ul>	<p><b>Interest Rate Response</b></p> <ul style="list-style-type: none"> <li>▶ Limited rate increase in the following months, constant policy rates thereafter, and gradual cuts starting from the last quarter of 2008</li> </ul>	<p><b>Inflation Forecasts</b></p> <ul style="list-style-type: none"> <li>▶ End-2009: 5.5 %</li> <li>▶ End-2010: 4 %</li> </ul>
Pessimistic Scenario		
<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>▶ Food inflation: 17 %, 11 % and 10 % in 2008, 2009 and 2010, respectively</li> <li>▶ Oil Prices: 150 USD per barrel at the end-2009</li> </ul>	<p><b>Interest Rate Response</b></p> <ul style="list-style-type: none"> <li>▶ Gradual tightening throughout 2008</li> </ul>	<p><b>Inflation Forecasts</b></p> <ul style="list-style-type: none"> <li>▶ End-2009: 8.1 %</li> <li>▶ End-2010: 5.8 %</li> </ul>

\* 70 % probability

The CBT's policy strategy is to tolerate the first round effects of supply shocks but to promptly respond to any deterioration in overall pricing behavior. Bringing inflation back to 4 percent by the end-2009 would require offsetting the first round effects of potential supply shocks that are expected to continue during 2008-09, and thus create undesired fluctuations in economic activity and relative prices. Hence, the framework incorporates an inflation forecast significantly higher than 4 % at the end of 2009.



Abdullah Yavaş



Ibrahim Turhan

### NEW APPOINTMENTS TO THE CENTRAL BANK

Prof. Dr. Abdullah Yavaş was appointed to the membership of the Monetary Policy Committee on March 12, 2008 and Dr. M. İbrahim Turhan was appointed as Vice Governor of the CBT on May 8, 2008.

**To find out more:** [www.tcmb.gov.tr](http://www.tcmb.gov.tr) (General Information)

### 76<sup>th</sup> GENERAL ASSEMBLY OF SHAREHOLDERS OF THE CBT AND THE ANNUAL REPORT

76<sup>th</sup> General Assembly of Shareholders of the CBT was held on April 24, 2008 at the Head Office Conference Hall. In the meeting, the balance sheet, profit and loss statement and proposed profit distribution of the year 2007 were approved, and the Annual Report 2007 was submitted. With this report, the CBT's strategic plan and its operations, organizational structure and comparative financial statements were shared with public.

M. Vehbi Çitak and Dr. Lokman Gündüz, whose term of office were to expire on April 30, 2008, were reappointed as members of the Board to serve three-year terms.



### INFLATION REPORT 2008-II

The Inflation Report 2008-II was released via a press conference with the participation of Governor Yılmaz on April 30, 2008. The Report examines the recent developments on the inflation front and monetary policy performance, as well as developments in international markets in the framework of the latest developments in global inflation and commodity prices. Besides, aggregate supply and demand conditions, financial markets, public finance developments and risk components in the Turkish economy are evaluated in detail. The Report also includes boxes on several issues; namely the recent developments in global inflation and food prices, the new GDP series introduced by the Turkstat and an assessment of the volatility of emerging-market risk premiums and risk appetite.

**To find out more:** [www.tcmb.gov.tr](http://www.tcmb.gov.tr) (Periodic Publications)

### CONFERENCES

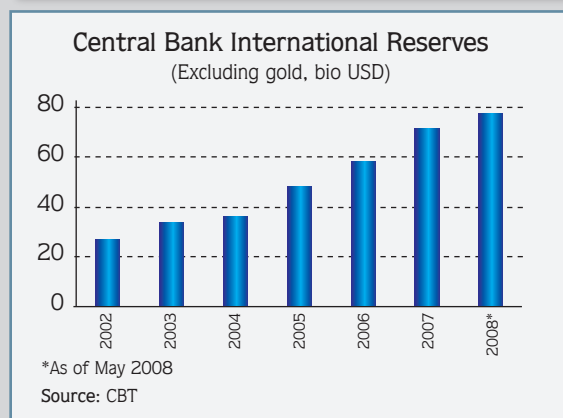
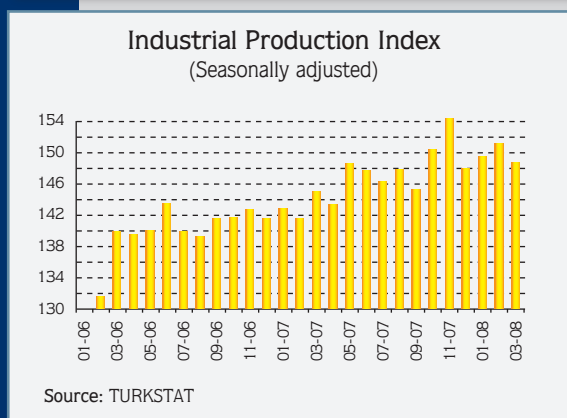
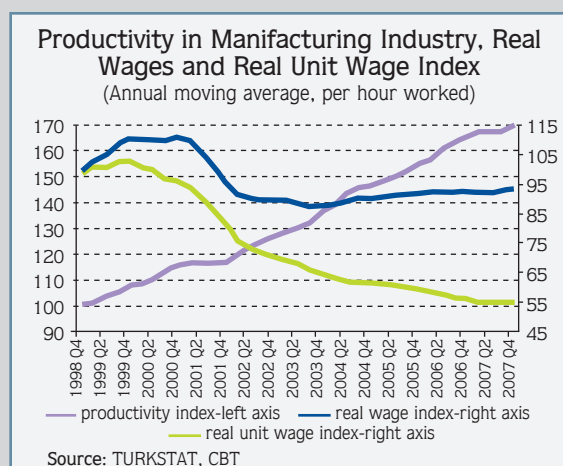
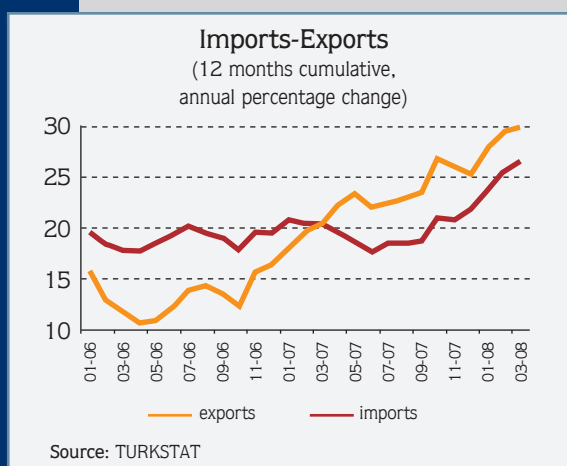
- The CBT and the Bilkent University organized the conference on "Current Issues in Economic Governance" jointly on April 2-3, 2008, in Ankara.
- The CBT organized the "Workshop on Inflation Targeting" on May 9-10, 2008, in İzmir for the member countries of the Economic Cooperation Organization (ECO). During the workshop, participant countries have shared their experiences on inflation targeting regime.



### WORKING PAPERS

- Expectations, Communications and Monetary Policy in Turkey (Soner Başkaya, Hakan Kara, Defne Mutluer) Working Paper No. 08/01, March 2008

## AT A GLANCE



### FINANCIAL SUPPORT PROGRAM FOR ACADEMIC STUDIES

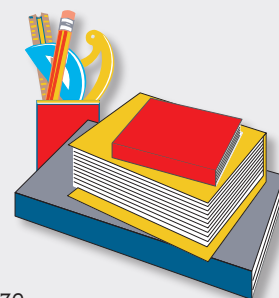
In the design and implementation of monetary policy, the CBT closely monitors recent developments and current studies of the academic environment, and also provides necessary support for such academic studies. In this context, the CBT aims to strengthen its responsibility in the academic environment.

The "Financial Support Program for Academic Studies" was established within the CBT in order to organize and institutionalize the support. The aim of the Program is to provide financial support to both national and international academic and policy-making conferences and other academic activities of universities, institutions, and non-governmental organizations (e.g. 15<sup>th</sup> World Congress of the International Economic Association).

Applications for support are considered by the CBT, and support is provided on conditions that;

- ▶ The purposes of studies are closely related with the issues that are given the utmost priority by the CBT.
- ▶ The studies contribute to the understanding of the Bank's policies by the general public.

Top management and staff from various departments of the CBT participate in some of these activities supported by the CBT, thus enhancing the communication between the Bank and general public and academicians.



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CBT Interest Rates*	Borrowing	Lending
Overnight (%)	15.75	19.75

Central Bank Foreign Exchange Reserves (As of 23 May 2008, Billion USD)	78.31
CPI (Annual % Change, April 2008)	9.66

\* As of 23 May 2008.