Durmuş Yılmaz: Recent economic and financial developments in Turkey

Speech by Mr Durmuş Yilmaz, Governor of the Central Bank of the Republic of Turkey, at the press conference for the presentation of the Inflation Report, Ankara, 30 April 2009.

* * *

Distinguished Guests and Members of the Press,

Welcome to the press conference for the presentation of the April 2009 Inflation Report, one of the most important communication tools of the inflation-targeting regime.

The report typically elaborates global and domestic macroeconomic developments and presents the medium-term inflation forecasts revised in line with the previous quarter developments. It also presents six boxes examining the recent monetary policy decisions and the relevant economic developments.

Now, I would like to give you a short summary of our evaluations and the Central Bank's revised inflation forecasts in the Inflation Report, which will be posted on the CBT website today.

1. Inflation developments

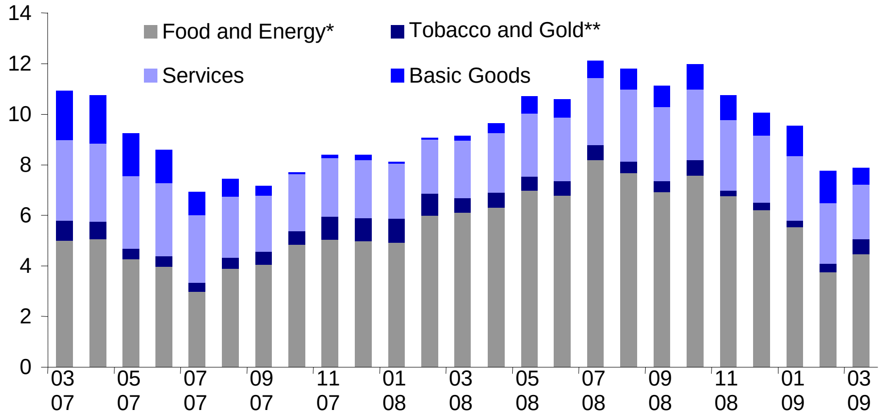
Distinguished Members of the Press,

The world economy has been undergoing a period dominated by dynamics quite unlike to those of previous years. With the loss of confidence resulting from the on-going financial crisis, the global economy entered a significant contraction trend after a long period of time. Impacts of the crisis on real economic activity deepened in the first quarter of 2009. Thus, inflationary pressures, which were perceived as a major concern until the last quarter of 2008, were overtaken by fears of deflation in developed countries in the first quarter of 2009. In this context, I would like to start my speech by once more underlining that inflation developments in Turkey in the first quarter of 2009 should be considered in the light of these global conditions.

In the first quarter of 2009, consumer prices increased by 1.05 percent and annual consumer inflation became 7.89, remaining within the limits of the uncertainty band. Backed by the significant slowdown in economic activity and improvement in cost-based effects, the decline in inflation gained ground and spread across all subgroups. In addition, the short-term exchange rate pass-through on consumer prices remained limited in the previous quarter.

The contribution of all main groups excluding tobacco and gold, which posted high-rated price hikes to annual inflation weakened in the first quarter of the year. While the contribution of food and energy to annual inflation decreased especially due to the marked decline of annual inflation in energy prices, the contribution of services prices also continued to diminish owing to the fall in costs and the slowdown in domestic demand (Figure 1).

Figure 1: Contribution to Annual CPI Inflation



* Food and Energy: Food, non-alcoholic beverages and energy

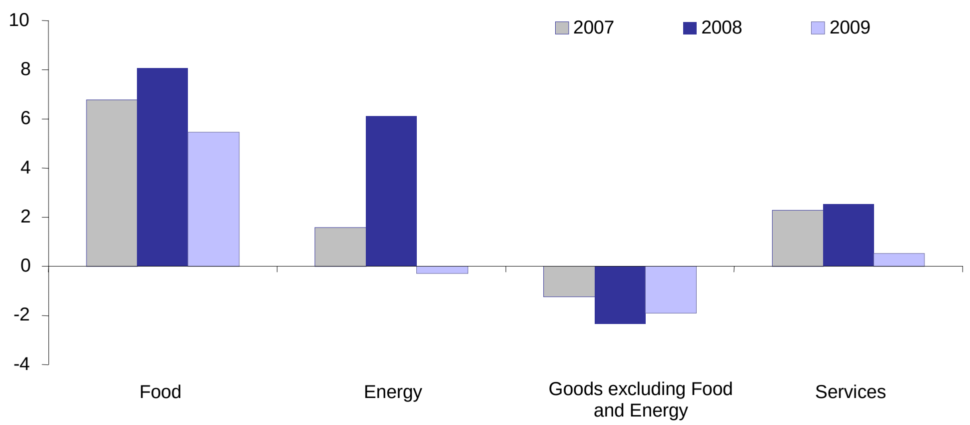
** Tobacco and Gold: Alcoholic beverages, tobacco products and gold.

Source: TURKSTAT, CBT.

In the first quarter, the increase in food prices lost pace over previous years in response to the significant slowdown in the processed food group and energy prices dropped owing to the lagged effects of the recent decline in oil prices. Goods prices excluding food and energy slumped by a lower margin over the first quarter of the previous year. The slowdown in services prices became more pronounced (Figure 2).

Figure 2: CPI Sub-Groups

(First Quarter Percentage Change)

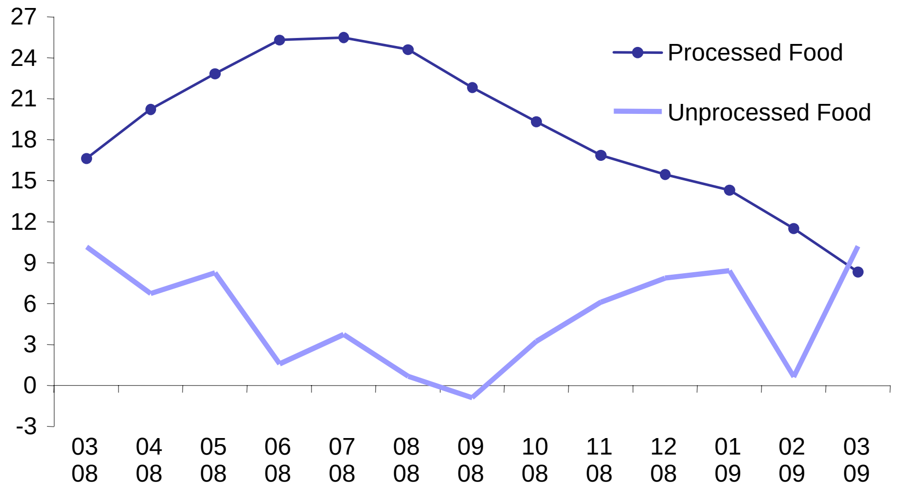


Source: TURKSTAT, CBT.

The unprocessed food group posted monthly price hikes of significant levels in the last quarter of 2007 and the first half of 2008 on account of production losses and cyclical developments all over the world. Annual inflation in this group surged to 25 percent. With the reversal of these effects since the second half of 2008, the downward trend in annual inflation of this group gained pace in this quarter (Figure 3). Meanwhile, the downward trend in the annual rate of increase in food prices is expected to continue in the second quarter as well.

Figure 3: Food Prices

(Annual Percentage Change)



Source: TURKSTAT, CBT.

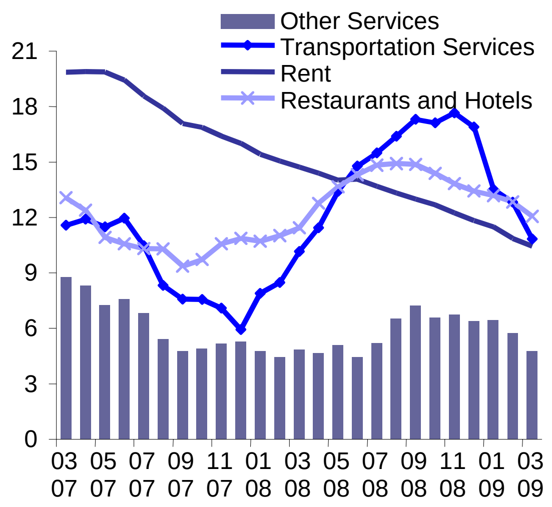
Esteemed Guests,

I would like to further clarify the developments related to services prices as I deem it helpful to focus on them to better understand the significant downturn in the underlying trend of inflation. Services inflation, which had remained relatively elevated in the first three quarters of 2008 due to the second round effects of energy and food prices, has eased considerably since the last quarter of 2008 following the sharp contraction in aggregate demand. The cumulative rate of change in services prices during first three months of 2009 was merely 0.53 percent on lower costs and weaker domestic demand, which is the lowest percentage recorded in the 2003 based CPI index's history.

The slowdown in the growth rate of services prices has spread across all services subgroups (Figure 4). The lagged effects of dips in international oil prices had a favorable impact on transport services in the first quarter. Rental price movements remained quite below the averages of previous years due to the contraction of domestic demand. The prices of the restaurants and hotels group also followed a similar course owing to shrinking demand and decelerating food prices (Figure 5). I would particularly like to draw attention to the decrease of annual rent inflation. Seasonally adjusted data point to a continual and accelerating downward trend in rents in the first quarter of the year. The slowdown in services prices is expected to continue in the upcoming period as well.

Figure 4: Services Prices

(Annual Percentage Change)



Source: TURKSTAT, CBT.

Figure 5: Services Prices

(First Quarter Percentage Change)

Source: TURKSTAT, CBT.

The first quarter saw a significant decline in the prices of durables excluding gold (Table 1). While the said decline was mainly driven by the SCT (Special Consumption Tax) reduction on automobiles, white goods and electronic products to be effected for a limited period of three months from March onwards, automobile prices, by displaying sharp decline, were chief determinants in prices of this group. The favorable effect of these reductions started to be observed on the domestic sales of automobiles and household goods in March (Figure 6). Moreover, the temporary VAT cut on furniture and IT products for a three-month period will have a short-term restraining effect on annual inflation in durables. Nevertheless, the lagged effects of the exchange rate pass-through on the prices of durable goods are expected to be partially seen following the depletion of current inventories.

Table 1. Prices of Durable Goods

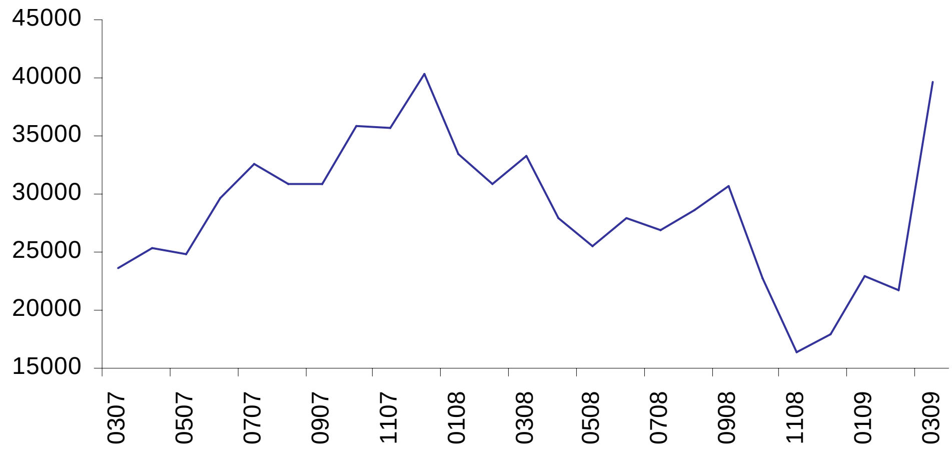
(Quarterly and Annual Percentage Change)

	2008					2009
	I	II	III	IV	Annual	I
Durable Goods (excl. gold)	1.58	2.81	-1.80	0.61	3.19	-2.49
Furniture	4.13	7.60	-1.27	-1.31	9.17	-3.17
Electric and non-electric appliances	1.16	0.68	0.12	6.04	8.13	-4.26
Automobiles	1.04	2.44	-3.63	-2.30	-2.56	-1.36
Other	0.04	0.89	1.02	2.27	4.29	0.36

Source: TURKSTAT. CBT.

Figure 6: Domestic Sales of Automobiles

(Seasonally Adjusted, Quantity)

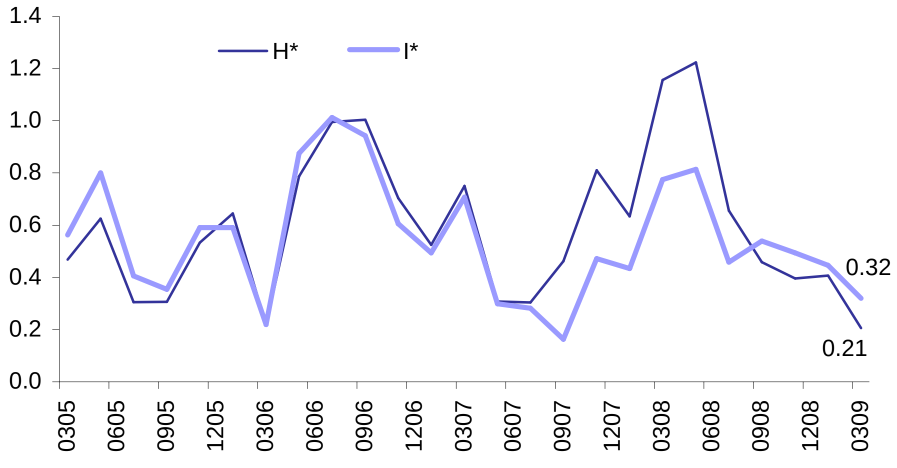


Source: TURKSTAT, CBT.

Core inflation indicators displayed a continual and accelerating downward trend in the first quarter of 2009. The CPI index excluding energy, unprocessed food, alcoholic beverages, tobacco products and gold fell by 2.66 percentage points year-on-year, while, with a further exclusion of processed food, the index dropped by 1.41 percentage points year-on-year. Even though the SCT cut in the second half of March was also influential in this development, the ongoing decline in the seasonally adjusted rates of change in both indices points to a continuing downward trend in inflation (Figure 7).

Figure 7: Special CPI Aggregates H* and I*

(Seasonally Adjusted, Monthly Increases, 2-Month Average)



* SCT adjusted H and I series

Source: TURKSTAT, CBT.

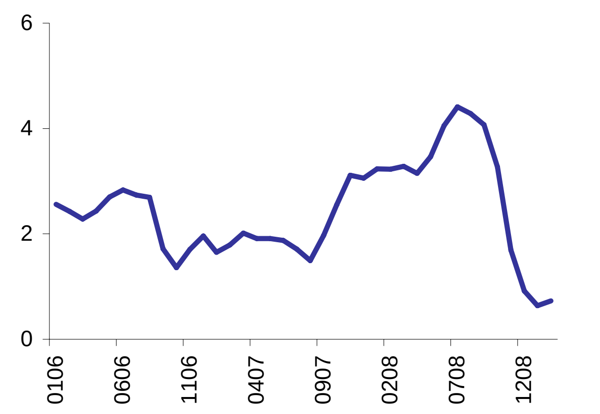
Distinguished Members of the Press,

As I mentioned at the beginning of my speech, economic stagnation, which grew more widespread in late 2008 and the first quarter of 2009, accompanied by the fall in international commodity prices has led to a significant decline in global inflation. As illustrated in the slide, the downward trend in consumer price inflation in developed markets became more pronounced, while inflation in emerging markets lost ground significantly.

Annual consumer price inflation in developed markets declined from 4.4 percent in July 2008 to 0.7 percent in February 2009. Concurrently, consumer price inflation in emerging economies dropped from 9.9 percent to 6.4 percent as of the same period (Figure 8 and 9).

Figure 8: Consumer Price Inflation in Developed Markets

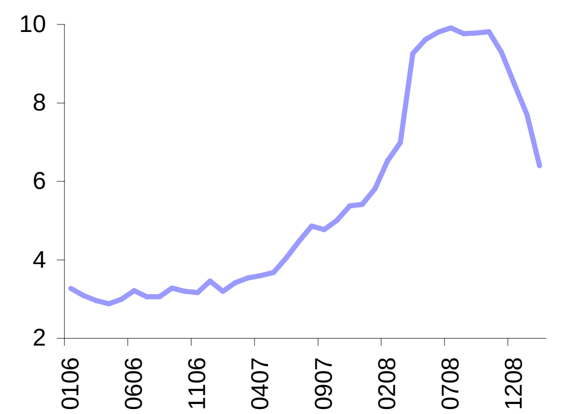
(Annual Percentage Change)



Source: Bloomberg, CBT.

Figure 9: Consumer Price Inflation in Emerging Markets

(Annual Percentage Change)



Source: Bloomberg, CBT.

2. Monetary policy response

Distinguished Members of the Press, Dear Guests,

After making brief remarks on inflation developments, now I would like touch on the policies pursued by the Central Bank in this period.

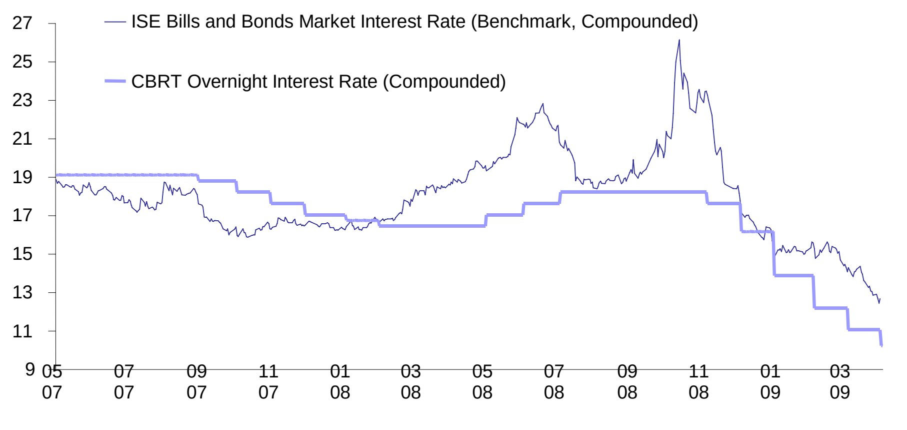
As I mentioned earlier in my speech, the first quarter of 2009 is characterized as a period where impacts of the global financial crisis on the real economy were felt more clearly and inflationary pressures that dominated a major part of 2008 have been overtaken by fears of deflation and growth. With the effect of commodity price declines and slumps in domestic economic activity since mid-2008, inflation in Turkey took a sharp plunge in this period. Waning inflationary concerns have allowed the Central Bank to focus on restraining the potentially devastating effects of the crisis on the Turkish economy without conflicting with our primary objective of maintaining price stability. Considering the policies that have been implemented since the second half of 2008 within this context assumes great importance.

Recent data point to an ongoing slowdown in economic activity of the first quarter of the year. Although domestic demand showed signs of a limited recovery over the previous quarter, it still maintains its weak course. Labor market data also indicate that this downward trend will continue and that it will take some time for economic activity to recover. Slumps in commodity prices and the significant slowdown in foreign demand in this period also add to the downward trend of inflation. Within this framework, the Central Bank adopted a strategy of front-loading policy easing by cutting overnight rates by a total of 700 basis points from November 2008 to April 2009 (Table 2).

Table 2: Monetary Policy Committee (MPC) Decisions in 2008 and 2009		
MPC Meeting Dates	**Decision on Interest Rates (Percentage points)**	**Interest Rate**
17 January 2008	-0.25	15.50
14 February 2008	-0.25	15.25
19 March 2008	No change	15.25
17 April 2008	No change	15.25
15 May 2008	+0.50	15.75
16 June 2008	+0.50	16.25
17 July 2008	+0.50	16.75
14 August 2008	No change	16.75
18 September 2008	No change	16.75
22 October 2008	No change	16.75
19 November 2008	-0.50	16.25
18 December 2008	-1.25	15.00
15 January 2009	-2.00	13.00
19 February 2009	-1.50	11.50
16 April 2009	-0.75	9.75
Source: CBT.		

Benchmark bond rates came down significantly driven by the policy rate cuts and the partially easing tensions in global financial markets (Figure 10). Moreover, the signal given by the Central Bank for possible necessity of maintaining downward flexibility for a long period of time coupled with moderate recovery in risk perceptions contributed to the decline in market interest rates.

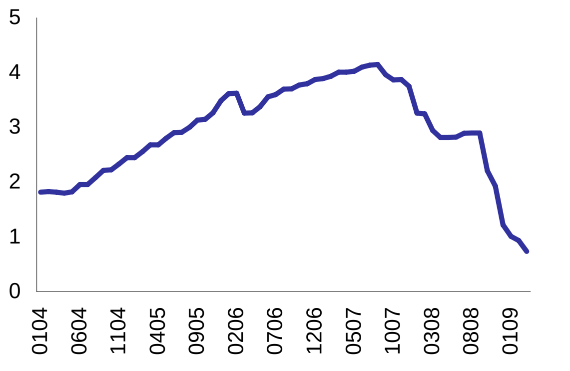
Figure 10: Interest Rate Developments (Percent)



Source: ISE, CBT.

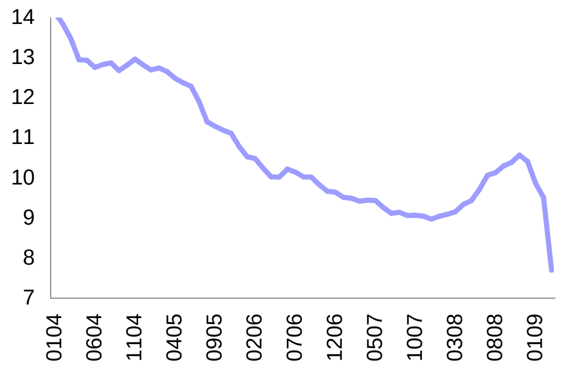
Sharp decline in inflation arisen from deepened global financial turbulence-related developments allowed both developed and developing countries to make substantial cuts in policy rates (Figures 11 and 12).

Figure 11: Policy Rates in Developed Countries



Source: Bloomberg, CBT

Figure 12: Policy Rates in Inflation-Targeting Developing Countries

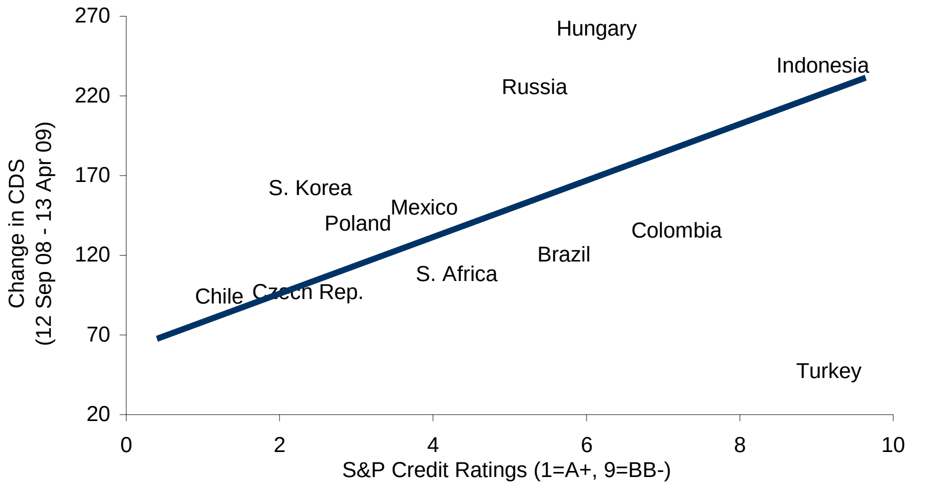


Source: Bloomberg, CBT

Distinguished Guests,

The financial crisis that erupted in the markets of developed countries deepened starting from September 2008, influencing the global financial system as a whole. This led to tremendous hikes in the risk premia of developing countries. In general, countries with low credit ratings end up with more apparent deterioration in risk premia, whereas the opposite applies to Turkey. In this period, being among developing countries having the lowest credit ranking, the decline in Turkey's risk premium was somewhat limited. In other words, Turkey's risk premium has resisted the deterioration in global risk perceptions more than is implied by her credit rating, thus clearly differing it from other developing countries in terms of the risk-premium-credit rating relationship (Figure 13). This indicates that traditional criteria used in determining credit rating and credit risk level may remain inadequate for accurately reflecting actual credit risk levels of countries at the times during which country specific characteristics come to the forefront.

Figure 13: Relation Between CDS Rates and Credit Ratings

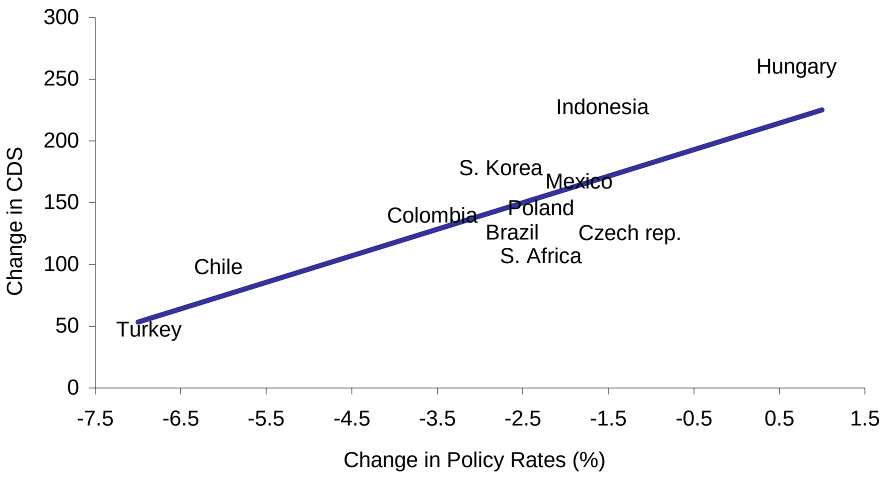


Source: Bloomberg, CBT.

Countries that experienced a decline in their risk premia enjoyed room for policy rate cuts in the period of deepening financial crisis (Figure 14). In this period, contrary to many developing countries, the foreign exchange indebtedness of households in Turkey remained at low levels. This factor, accompanied by the resilience of the financial system and the restricted deterioration in risk premia during the global financial crisis, allowed the Central Bank of the Republic of Turkey to opt for policy rate cuts of large amounts.

Figure 14: Decisions on Interest Rates and Changes in Risk Premia

(as of 16 April 2009)



Source: Bloomberg, CBT.

Distinguished Guests,

The measures taken against the global financial crisis were not limited to policy rate cuts. In this period, a lot of countries not only take measures to regulate the functioning of the markets, but also exercise non-traditional monetary policy implementations. In this period, the Central Bank of Turkey also took measures against the potential adverse effects on financial stability, a prerequisite for price stability. In the first quarter of 2009, a counter-cyclical monetary policy was adopted in the money market on the one hand and a number of decisions were made to regulate the Foreign Exchange and Banknotes Markets-Foreign Exchange Deposit Market on the other hand. In this framework, the maturity of foreign exchange deposit borrowed by the Banks from the Central Bank was extended; the lending rate for transactions, which the Central Bank is a party to, was reduced and the maturity of interbank transactions in the said market was extended. Besides, foreign exchange selling auctions were held at the times of ailing price movements in the foreign exchange market. In addition to these measures, the conditions for the Liquidity Support Facility offered to banks under extraordinary conditions were revised.

Now, I would like to once more underline that if problems in international markets further deepen and adversely affect domestic financial markets, the Central Bank will continue to take additional measures and to employ other policy instruments.

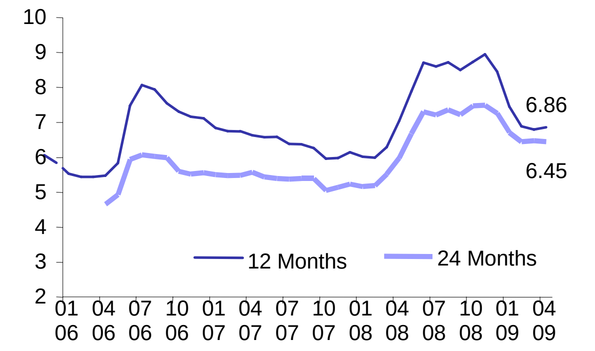
Esteemed Guests,

Inflation expectations displayed a downward trend in the first quarter of 2009 in line with decelerating inflation. As the incoming information on inflation and economic activity confirmed our forecasts and vindicated the CBT's monetary policy decisions, inflation expectations also responded favorably following a low course in the second quarter of 2009.

Though inflation expectations for every term fall compared to the previous Inflation Report period, the decline in short-term inflation expectations appears to be more evident since April 2009 (Figures 15 and 16).

Figure 15: 12 and 24-Month Ahead* CPI Expectations

(Annual Percentage Change)

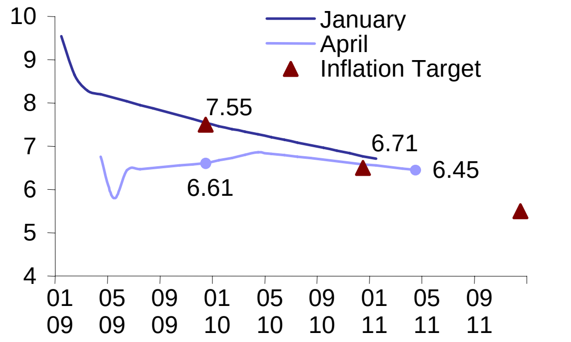


* Second survey term expectations of the CBT Expectations Survey.

Source: CBT.

Figure 16: Inflation Expectations Curve*

(Annual Percentage Change)



* Constructed through the linear interpolation method by employing the inflation expectations of various terms in the CBT Expectations Survey. Second survey term expectations of the CBT Expectations Survey.

Source: CBT.

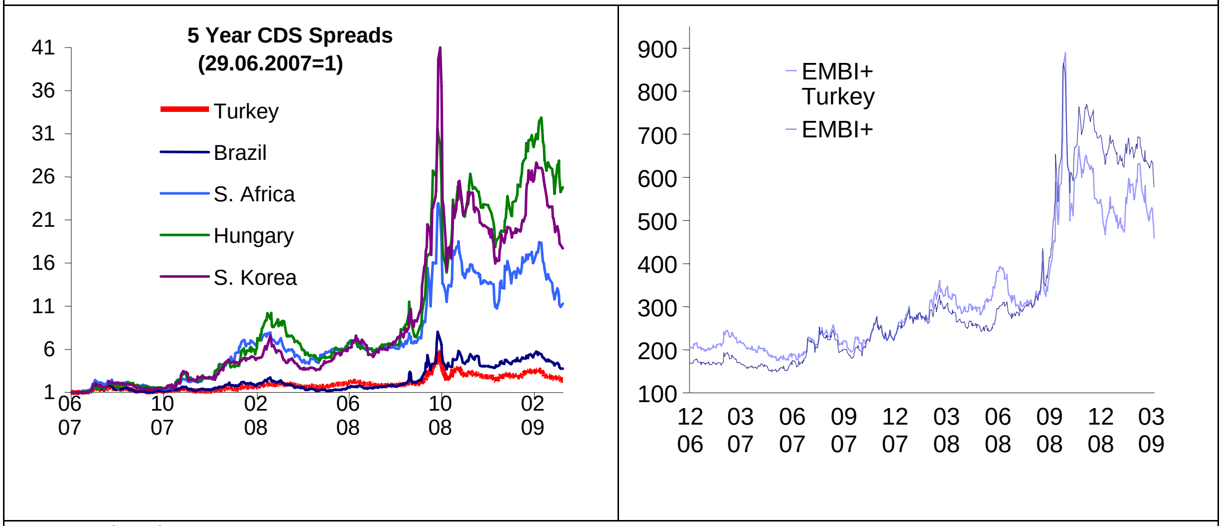
3. Inflation and monetary policy outlook

Distinguished Guests,

After summarizing inflation and monetary policy developments in the first quarter of 2009, in this part of my speech, I would like to share with you the evaluation of the Central Bank of Turkey about the inflation outlook and monetary policy in the upcoming period. I will also add the Central Bank's inflation forecasts presented in the Inflation Report, which is to be posted on our website soon. Firstly, I will briefly touch on the economic framework underlying these forecasts.

In spite of all the measures taken to alleviate its effects on the financial system and economic activity, no clear indication yet to signal that the global crisis is coming to an end. Within this context, challenges regarding the emerging markets' access to global capital still persist and the risk premium indicators of these countries remain highly elevated despite the limited rebound observed at the end of the first quarter of 2009 (Figure 17).

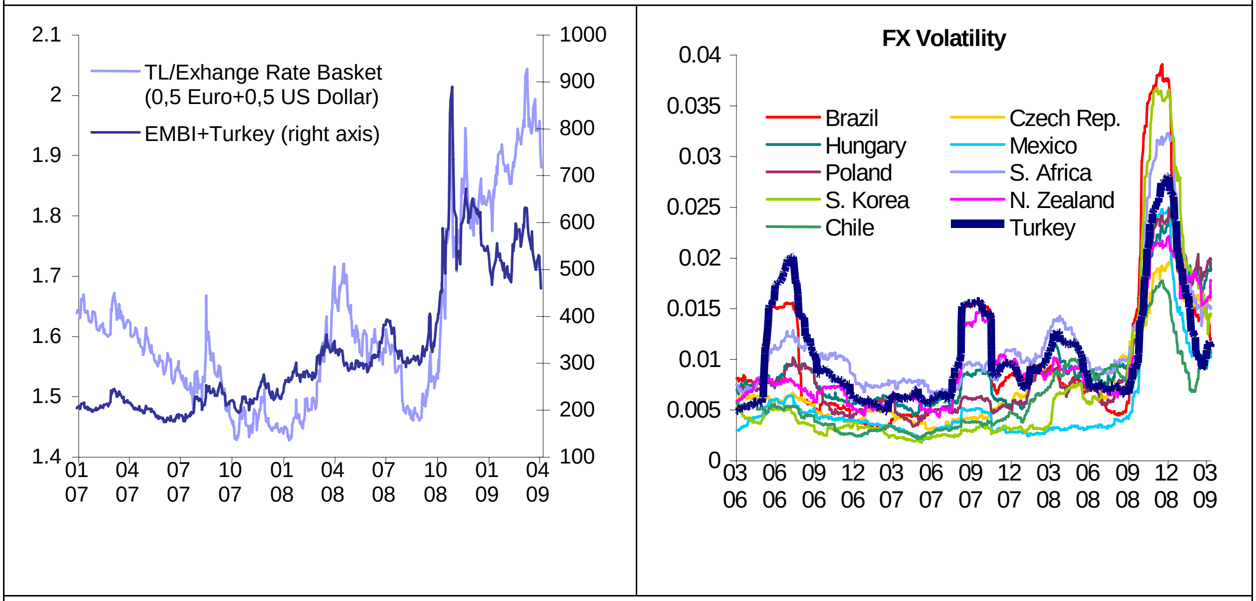
Figure 17: Risk Premium Developments



Source: Bloomberg.

In the first quarter of 2009, the Turkish lira did not widely differentiate from the currencies of other developing countries in terms of changes in value. Having said that, the relatively low level of volatility in the Turkish lira – one of the currencies with the highest volatility historically and susceptibility to the global risk appetite – became more evident in 2009, the year during which the distinctive characteristics of the countries came to the forefront (Figure 18).

Figure 18: Exchange Rate Developments



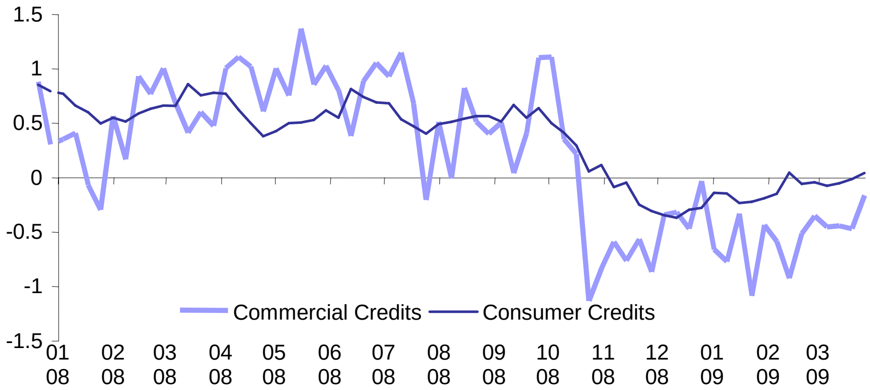
Source: Bloomberg and CBT.

The expectation that the global capital squeeze will not end in the upcoming period indicates that the potential pressure on the exchange rates of developing countries may persist.

Tightness in financial conditions continued in the first quarter of the year. Prolonged uncertainties pertaining to the global economy accompanied with deceleration in economic activity kept the banks' lending appetite at low levels. The elevation in credit risk, the decline in foreign financing facilities and the short maturity of deposits urged banks to be cautious in terms of credit supply and curbed the decline in credit interest rates. In spite of a limited rebound in credits recently, we believe there is little chance for this move to become a permanent recovery as long as the global economy is not stabilized (Figure 19).

Figure 19: Commercial and Consumer Loans

(4 Week Moving Average, Percent)

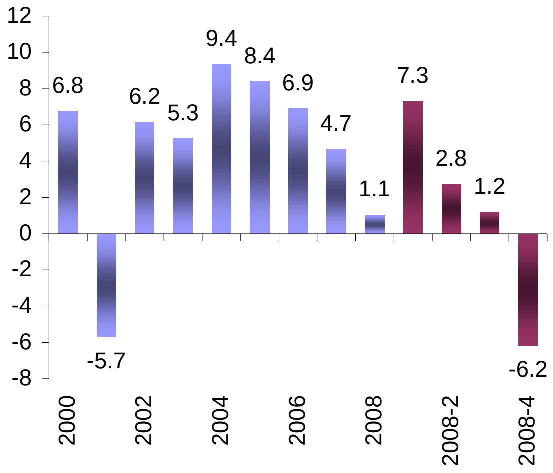


Source: CBT.

Distinguished Members of the Press,

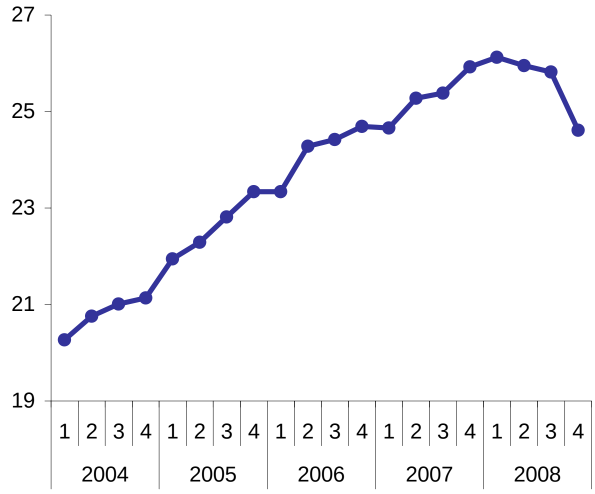
In the first quarter of 2009, the sharp contraction in global economic activity and its larger than anticipated impact on domestic activity called for a downward revision of the outlook for aggregate demand developments from the previous reporting period. In the January Inflation Report, economic activity was expected to display a significant decline in the last quarter of 2008, while it was anticipated that the speed of contraction would start to lose pace during the first quarter of 2009. In line with expectations, the Gross Domestic Product (GDP) displayed a sizeable drop in the last quarter of 2008 on a quarterly and on an annual basis (Figures 20 and 21). Recent readings suggest that economic activity will display a sharper-than-envisaged slowdown and that the contraction in the economy in the first quarter of the year will register double-digit figures. This development was the main reason underlying the downward revision in the outlook for inflation and monetary policy in the last three months.

Figure 20: Quarterly GDP Growth Rate (Percent)



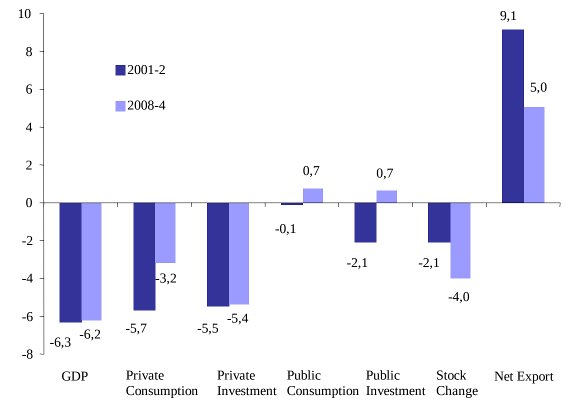
Source: TURKSTAT.

Figure 21: GDP (Seasonally Adjusted Fixed Prices of 1998, Billion TL)



Source: TURKSTAT, CBT.

An analysis of Gross Domestic Product developments in terms of output in the last quarter of 2008 reveals that all the subcomponents except those of the agriculture sector contributed negatively to growth. A comparison of this financial crisis with that in 2001 points to a similarity between not only the Gross Domestic Product growth rate, but also the composition of production sectors (Figure 22). On the other hand, making the said comparison also in terms of expenditures is crucial considering the projections pertaining to the timing of the possible rebound in economic activity. To this end, we believe that it will be useful to exclude the quarterly additional contribution of public expenditures in the last quarter of 2008 and focus on other components. Firstly, excluding public sector demand, the difference in growth in the two periods compared exhibits a fairly unfavorable outlook for the last quarter of 2008. The relatively high depletion in inventories in this period compared to that in 2001 reveals the relative strength of the aggregate demand shock and the sharpness of the downturn in capacity utilization rates. Moreover, the differentiation in private consumption demand and net exports performance indicates a rather lower contraction of domestic demand besides the adverse effect of the global shock on net foreign demand in the current period (Figure 23).

Figure 22: Contribution to Growth by Output (Percentage Points)	Figure 23: Contribution to Growth by Expenditures (Percentage Points)
	
Source: TURKSTAT.	Source: TURKSTAT.

Turkey's export performance has become more vulnerable to global cyclical changes in recent years as the share of durables and capital goods in our exports has increased over time. In fact, the significant slowdown in our major trading partners and the consequent contraction in exports were among the determinants of the sharp downturn in aggregate demand. Therefore, the assumptions on the global economy with respect to the inflation and monetary policy outlook presented in the Inflation Report that will be posted on our Website shortly are very important.

The impact of the global financial turmoil in the corporate sector has become more evident and global growth has significantly contracted. The credit crunch in international credit markets still persists and there is yet to be a notable improvement in global economic indicators. Our baseline scenario in the January Inflation Report envisaged a gradual recovery in the global economy as of early 2010. On the back of the deepening global financial turmoil in the past period, many international institutions revised their growth forecasts for 2009 and 2010 downwards by a significant margin (Table 3). The forecasts for global economic activity, which were revised in the last three months, indicate a sharper contraction for 2009 compared to our forecasts presented in the January Inflation Report and a slower and more gradual recovery throughout 2010. Within this framework, compared to the previous report, the revised forecasts are based on a deeper contraction in 2009, and a global recovery that will be visible by mid-2010, rather than at the beginning of 2010. I would like to clarify that the word "recovery" in this Report refers to "a significantly positive growth in economic activity in year-on-year terms".

Table 3: Forecasts for Annual Growth

	2009		2010	
	Previous Forecast	**New Forecast**	**Previous Forecast**	**New Forecast**
IMF				
World	0,5	-1,3	3,0	1,9
Developed Countries	-2,0	-3,8	1,1	0,0
USA	-1,6	-2,8	1,6	0,0
Eurozone	-2,0	-4,2	0,2	-0,4
Developing Countries	3,3	1,6	5,0	4,0
OECD				
Total OECD	-0,4	-4,3	1,5	-0,1
USA	-0,9	-4,0	1,6	0,0
Eurozone	-0,6	-4,1	1,2	-0,3
Consensus Forecasts				
World	-0,2	-2,1	2,0	1,9
USA	-1,8	-2,7	2,3	1,8
Eurozone	-1,4	-3,4	0,8	0,3

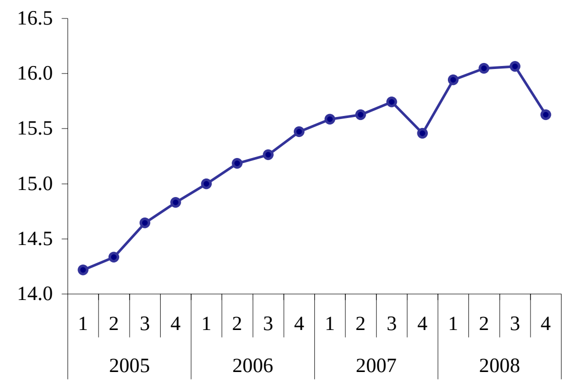
Source: IMF World Economic Outlook, January and IMF World Economic Outlook, April.

OECD Economic Outlook, 2008/II, December and OECD Economic Outlook, Interim Report, March.

Consensus Forecasts, January and Consensus Forecasts, April.

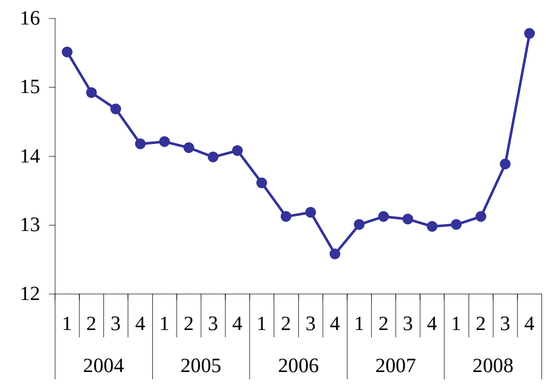
The contraction in economic activity in the last quarter of 2008, which was mainly driven by the contraction in the export-oriented industrial sector, accelerated the deterioration in non-agricultural employment and unemployment climbed to a record high with the additional effect of the significant rise in the labor force participation rate (Graph 24 and 25). The most recent data indicate that the rise in the unemployment rate continued with further acceleration in the first quarter of 2009. Within this framework, it is estimated that the current conditions will continue to curb the upward trend in unit labor costs and the rise in domestic demand.

Graph 24: Non-Agricultural Employment (Seasonally Adjusted, Million People)



Source: TURSTAT, CBT.

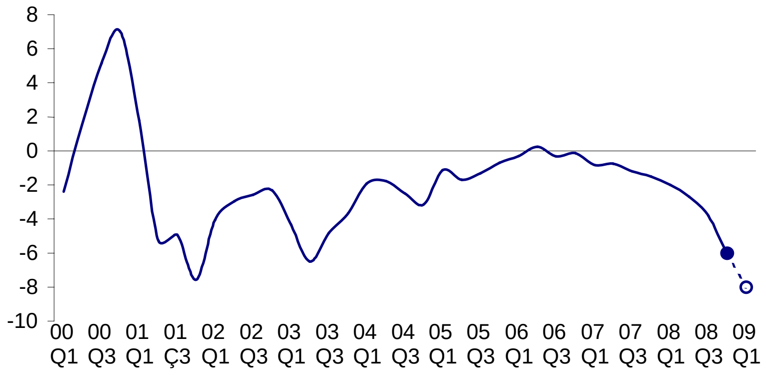
Graph 25: Non-Agricultural Unemployment (Seasonally Adjusted, Percent)



Source: TURKSTAT, CBT.

The rapid policy rate cuts coupled with the fiscal stimulus plan designed to revive domestic economic activity are expected to underpin domestic demand as of the second quarter of 2009. As I have mentioned earlier in my speech, reaching lasting stability in the global economy will take time and therefore, no notable recovery is expected in domestic economic activity in the short run. Within this framework, aggregate demand conditions are expected to continue to support disinflation for some time (Graph 26). In sum, compared to the January Inflation Report, the revised inflation forecasts are based on increased favorable contribution from aggregate demand conditions to disinflation.

Graph 26: Output Gap (Percent)



Source: CBRT.

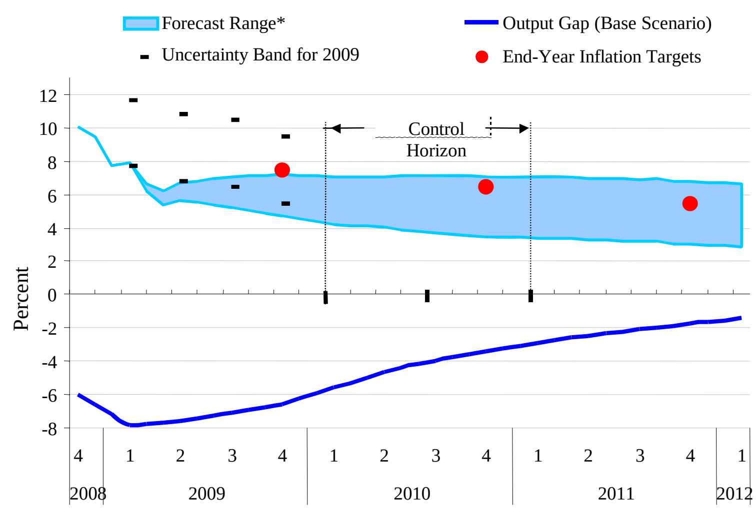
The problems in global economy and tighter credit conditions still persist. Following recent financial measures and policy rate cuts, domestic demand is expected to gain a relatively stable trend in the second quarter of 2009 and growth is expected to generate positive rates as of the final quarter of 2009. Meanwhile, considering the current global economic outlook, it is estimated that access to foreign financing facilities will remain limited for a while, economic agents will continue their cautious stance and no significant pick-up will be observed in aggregate demand in the short run. Moreover, when the sharp decline in non-agricultural employment is taken into account, it is estimated that the level of disposable income will remain low for a while and the precautionary saving tendency will continue to curb domestic demand. Within this framework, we believe that the recovery in economic activity will be gradual and the downward pressures on inflation will continue.

Despite the downward revision in the outlook for economic activity, there have been no major developments that require revising the oil and food price assumptions stated in the past Report. Therefore, the forecasts have been based on a framework in which oil prices would hover around USD 55 per barrel throughout the forecast horizon. The previous assumptions for oil prices at 55 USD per barrel, and food inflation of 7.5 percent for 2009 and 6 percent thereafter are maintained.

Distinguished Members of the Press and Dear Guests,

In line with the framework that I have presented so far and based on the assumption that there will be measured policy rate cuts in the short run and after that policy rates will be kept constant for a while, our revised forecasts suggest that with 70 percent probability, inflation will be between 4.8 percent and 7.2 percent (mid-point 6.0) at the end of 2009, and between 3.5 percent and 7.1 percent (mid-point 5.3) at the end of 2010. We expect inflation to come down to 4.9 percent by the end of 2011 (Graph 27).

Graph 27. Forecasts for Inflation and Output Gap



*Indicates a 70-percent confidence interval for the forecast

To sum up, the sharp weakening in aggregate demand has not only led to faster-than-envisaged rate cuts, but has also required a downward revision in the medium-term inflation forecasts. The revised forecast suggests that the recent rate cuts have lowered the probability of significantly undershooting the end-year inflation target. However, given the tightness in financial conditions and the absence of clear signs of recovery in the global economy, it may be necessary for monetary policy to maintain an easing bias for a considerable period.

It should be emphasized that any new data or information regarding the inflation outlook may lead to a change in monetary policy stance. Therefore, I would like to repeat once again that the assumptions on future policy rates underlying the inflation forecast should not be perceived as a commitment on behalf of the Central Bank of Turkey.

4. Risks and alternative scenarios

Distinguished Members of the Press,

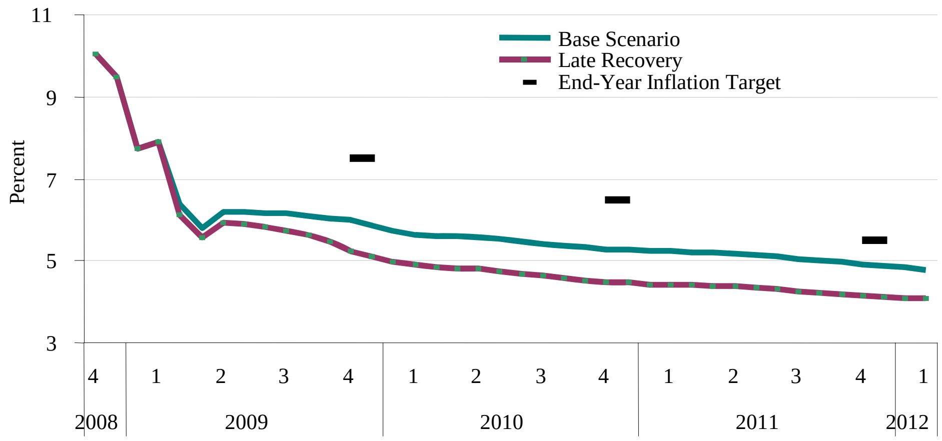
I would like to devote the last part of my speech to the risks to monetary and inflation policy in the upcoming period, as well as the alternative projections that we mentioned in our Inflation Report within this framework.

Currently, developments in the global economy are influencing the monetary policy outlook via credit channels and portfolio flows as well as via the foreign trade channel. As uncertainties regarding the global economy still persist, assumptions pertaining to the timing and magnitude of recovery are still important, as was the case in the January Inflation Report**.**

As you will recall, in the January Inflation Report, three different scenarios were presented based on the depth of economic contraction and the timing of recovery: (i) baseline scenario, (ii) early recovery and (iii) late recovery, and the medium-term inflation forecasts were based on these scenarios. In this Report, the “early recovery” scenario was dropped because global economic growth forecasts were continuously revised downwards. Therefore, the final chapter of the April Inflation Report contains only one alternative scenario that is compared with the baseline. In the alternative scenario, it is assumed that the global crisis will grow deeper and recovery in global activity will start at the beginning of 2011. In this scenario, commodity prices are envisaged to go below the assumptions presented in the baseline scenario; credit conditions are projected to remain tight for a while and recovery in foreign demand would be a prolonged and slower process due to the late recovery in the global economy. Meanwhile, crude oil prices are projected to drop to USD 45 per barrel and remain at this level throughout the forecast horizon. This projection is above the one presented in the January Inflation Report, as OPEC announced that it would not allow sharp falls in oil prices. Meanwhile, it is foreseen that food prices inflation would remain below the baseline scenario and therefore will become 5.5 percent by the end of 2009 and 5 percent afterwards.

Against this background, assuming that measured policy rate cuts continue throughout 2009, it is projected that with 70 percent probability, inflation will be between 3.9 and 6.5 percent with a mid-point of 5.2 percent at the end of 2009, and between 2.7 and 6.3 percent with a mid-point of 4.5 percent at the end of 2010. Furthermore, inflation is expected to go down to 4.2 percent by the end of 2011. To sum up, these forecasts indicate that in the case of a longer-than-expected slowdown in global economic activity, inflation would remain below the medium-term forecasts even if the measured policy rate cuts continue throughout 2009 (Graph 28).

Graph 28: Inflation Forecasts: Baseline and Alternative Scenarios



Distinguished guests,

The developments in fiscal policy are another major factor that may affect the outlook for inflation and monetary policy. Recently, budget revenues have been declining in line with the slowdown in economic activity. Meanwhile, expenditures have been rising due to the counter-cyclical fiscal policy that was put into practice to mitigate the adverse effects of the global crisis on domestic economic activity, leading to a significant rise in the budget deficit. Probable adjustments in excise taxes and/or administered prices in order to stabilize the budget could cause some volatility in inflation over the short term. Moreover, higher financing requirement of the government might weaken the favorable impact of monetary policy decisions and the fiscal measures on economic activity. Therefore, in order to reap gains from the short-term expansionary fiscal policy, it is important to commit to a credible medium-term fiscal framework that would ensure fiscal discipline and debt sustainability.

Uncertainties regarding the magnitude of the impact of problems in global financial markets on the real economy still persist. The CBT will continue to take the necessary measures to contain the adverse effects of global financial turmoil on the domestic economy, provided that they do not conflict with the price stability objective. Prudent monetary policy is necessary but not sufficient to maintain the resilience of the economy in the face of the global crisis. Therefore, strengthening the commitment to fiscal discipline and the structural reform agenda is also critical to facilitate expectations management and to support the effectiveness of monetary policy decisions. In this respect, the commitment to the European Union accession process, and timely implementation of the structural reforms envisaged in the Pre-Accession Economic Program remain to be of the utmost importance. I would like to state that, with respect to macroeconomic stability and price stability, we closely monitor developments regarding structural reforms intended to enhance the quality of fiscal discipline and to ensure sustainability of productivity gains. Thank you very much for your attention.