

## INFLATION OUTLOOK

Consumer prices decreased by 0.33 percent during the second quarter of 2010, bringing annual inflation down to 8.37 percent. Thus, consumer prices dropped quarter-on-quarter for the first time since the inception of the index amid lower unprocessed food prices.

Favorable developments in inflation during the second quarter were not confined to food prices, as the rates of core goods and services also displayed a significant deceleration. Seasonally adjusted data suggest that inflation has been slowing down in both services and core goods (goods excluding food, energy, gold, alcoholic beverages and tobacco) compared to the first quarter.

Anticipating that inflation would decrease sharply following the last quarter of 2008, the Central Bank of the Republic of Turkey (CBT) focused on alleviating the harsh impact of the global financial crisis on the domestic economy. In this respect, the CBT has delivered sizable cuts in policy rates, while providing liquidity support to facilitate the smooth operation of credit markets. Accordingly, policy rates were cut by 1025 basis points between November 2008 and November 2009. Considering the favorable developments in credit markets

and the moderate recovery in the economic activity, the Monetary Policy Committee (MPC) ended the easing cycle in December 2009. Notwithstanding the rapid increase in inflation during the last quarter of 2009 and the first quarter of 2010, the MPC, highlighting the persisting downside risks regarding the global economy and the consistency of core inflation indicators with the medium-term inflation targets, declared that policy rates would stay at low levels for a long period of time.

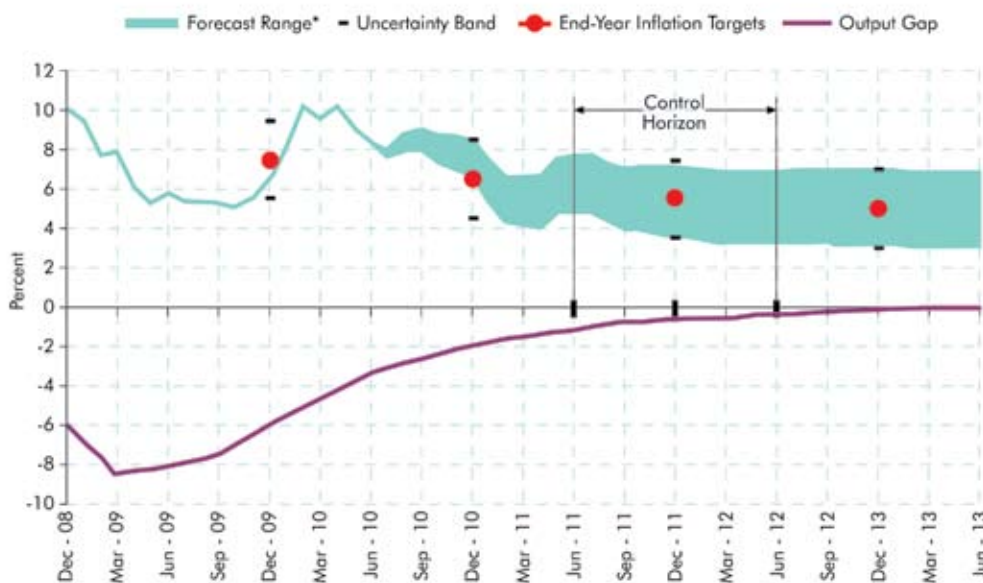
Recent data releases indicate that economic activity continues to recover. Yet, the problems in some European economies since May added to aggregate demand uncertainty for the rest of the year. Accordingly, the pace of economic recovery is likely to face greater downside risks, while aggregate demand conditions are expected to further support disinflation for a while.

While producing inflation forecasts for the upcoming period, the CBT envisages weaker external demand conditions compared to the previous quarter, whereas domestic demand (will continue) to recover as anticipated; as a result of this, the revised forecasts envisage that resource utilization will

stay at low levels and the contribution of aggregate demand conditions to disinflation will increase slightly. Accordingly, with 70 percent probability, the year-end inflation is expected to be between 6.5 and 8.5 percent with a midpoint of 7.5 percent by the end of July 2010.

**For further information:**  
<http://www.tcmb.gov.tr/yeni/eng/> (Governor's Remarks)

**INFLATION AND OUTPUT GAP FORECASTS**



\*The shaded region indicates the 70 percent confidence interval for the forecast.

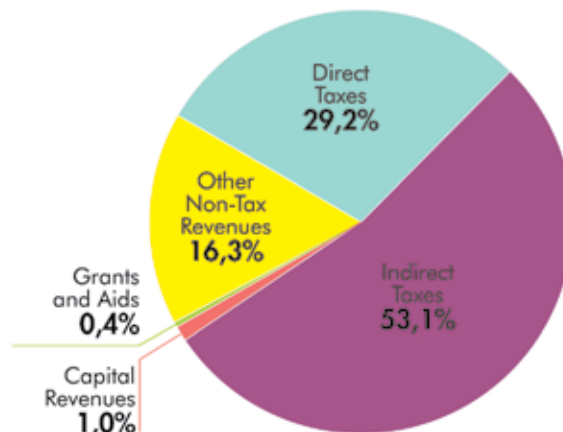
## BALANCE OF THE PUBLIC SECTOR

Public sector budget includes the consolidated budget, State Economic Enterprises (SEEs), local administrations, funds, social security institutions and revolving funds. General equilibrium of the public sector is calculated by consolidating the revenues and expenditures of these administrations.

Public sector general balance shows the sources that are used to finance the public sector's revenues, expenditures, savings and investments, along with the difference between savings and investment, in a particular period of time. In other words, public sector general balance comprises the public sector's revenues, expenditures, savings, investments, transfers made and borrowings.

Tax is the biggest source of revenue for Turkey's budget. Under the Turkish tax system, taxes are classified into two groups; direct and indirect taxes. Direct taxes consist of those imposed on incomes, profits, capital gains and properties. Whereas, indirect taxes consist of domestic taxes on goods and services, international trade and turnover, along with other taxes. An important point with respect to this classification is that the taxpayer pays the tax directly and on his/her behalf. In general terms, taxes imposed on income and wealth are considered direct, while those imposed on spending are considered indirect.

**REVENUES OF 2009\***  
Total: 209,5 Billion TRL



Source: Treasury  
\* Provisional

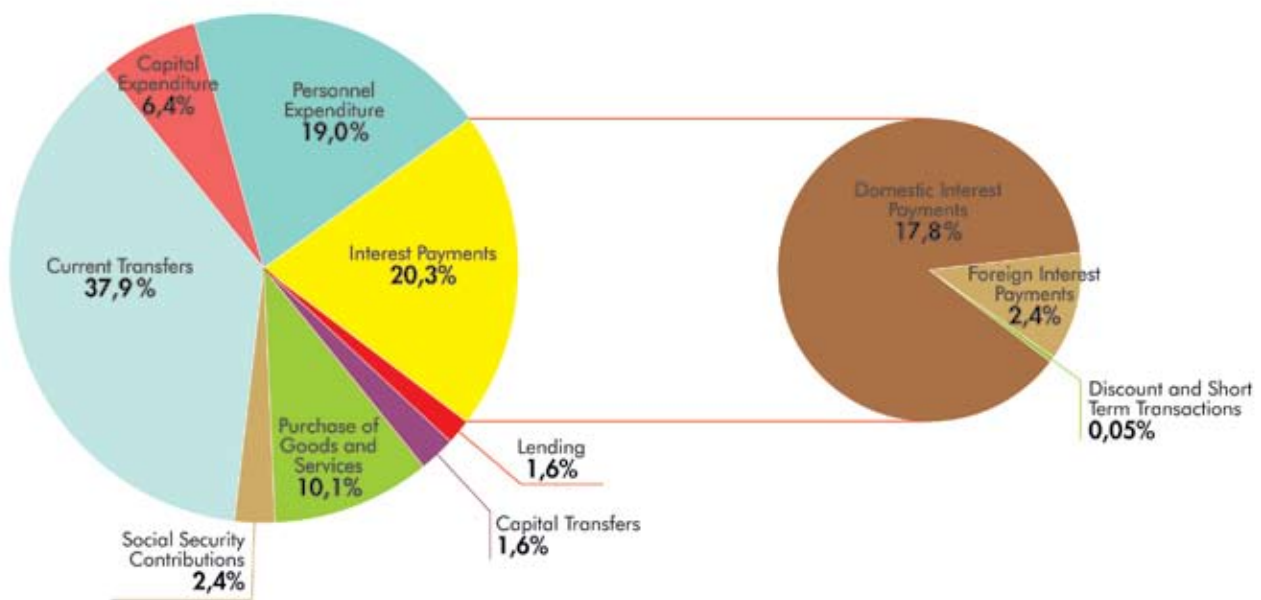
The total tax burden in Turkey is low compared to developed economies and unlike such economies, the ratio of indirect taxes is rather high compared to direct taxes. This is due to problems in tax collection and gives some indication as to the ratio of unregistered economic activity to registered economic activity.

According to tentative figures of 2009, general budget expenditures became TL 262 billion 113 million. Current transfers, interest payments and personnel expenditures constitute the biggest portion

of these expenditures. Of these, interest expenditures denote payments of public debts; current transfers denote outright payments with no intention of capital accumulation (Treasury grants, duty losses) and personnel payments denote payments to public servants on the payroll. 88 percent of interest payments are made for domestic debts.

According to tentative figures issued by the Undersecretariat of Treasury for 2009, the ratio of public net debt stock to GDP became 32.5 percent, and 90 percent of it was composed of TL debts. The average number of days to maturity of domestic debts was 24.4 months and that of external debts was 74 months.

**EXPENDITURES OF 2009\***



Source: Treasury  
\* Provisional

### CENTRAL BANK WORKING VISITS

Within the framework of a working visit between 14-18 June 2010, the CBT welcomed visitors from the Central Bank of Afghanistan whom were given presentations by several departments. A study program was organized for officers from the Bank of Albania between 16-18 June 2010, for them to visit the Accounting, Research and Monetary Policy and Human Resources Departments. In the context of central bank working visits, for the staff from Central Bank of Azerbaijan, Human Resources Seminar between 26- 28 May 2010, Modeling Seminar on macroeconomic modeling between 31 May- 2 June 2010, Monetary Policy Seminar with the aim of providing information about monetary policy implementations at the CBT between 7-9 June 2010, and payment Systems Seminar with the aim of providing information about payment systems at the CBT between 21-23 June 2010 were held.

### CONTEST FOR ACADEMIC STUDIES

A contest was organized by the CBT with a view to support academic studies in the field of the Turkish economy, central banking or monetary policy and make the study of these subjects accessible to a larger audience. Ph.D. dissertations accepted by their respective dissertation committees and articles that have been published in international peer-reviewed journals were submitted to the contest, which was announced with a press release published on our website on 4 February 2010. At the end of the evaluation process, three applicants were awarded an academic encouragement award and each of them received a prize of TL 1,500.00 for their respective studies. The results of the contest were announced to the public in a press release on 2 August 2010. The press release for the second round of the said contest was posted on our website on 6 October 2010.

**For further information:** [www.tcmb.gov.tr/yeni/eng/](http://www.tcmb.gov.tr/yeni/eng/) (Announcements / Press Releases)

### "CONTEMPORARY TURKISH PAINTING" EXHIBITION

The "Contemporary Turkish Painting" exhibition was held at the City Museum of Skopje between June 12-July 4, 2010, featuring a selection of works from the Central Bank's Art Collection. The exhibition presented a selection of 51 paintings from 30 internationally renowned Turkish painters. The selection included

examples that relate to the pre-1950 period and the ideal of modernist tradition; as well as those shaped by post-modernist developments of the post-1950 period. Senior management of the Central Bank of Turkey, Turkish and foreign bankers and businessmen; staff of the Turkish Embassy in Skopje; the diplomatic corps in Skopje; civil senior officers and representatives of arts and culture circles; and members of the press honored the opening ceremony of the exhibition with their presence.

### INFLATION REPORT 2010-III

The Inflation Report 2010-III was presented by Governor Yılmaz at a press conference held on July 27, 2010. The Report elaborates the financial outlook that forms the basis of monetary policy decisions and global and domestic macroeconomic developments, and presents medium-term inflation forecasts that have been revised in view of

previous quarter developments. The Report also contains text boxes on the factors determining the monetary policy stance in emerging markets, the main inflation trend, capacity utilization ratios for both domestic and external markets, observations on employment conditions, a comparison between the 2000-2001 and 2008-2009 crises with respect to non-farm employment and production, an international comparison of budget deficits and public debt stocks as well as monetary policy in the September 2008-July 2010 period.

**For further information:** <http://www.tcmb.gov.tr/yeni/eng/> (Publications/ Reports)

### MEETING WITH REPRESENTATIVES FROM THE ECONOMICS SECTION OF NATIONAL NEWSPAPERS



A meeting was held in İstanbul on July 29, 2010 to address representatives from the economics sections of national

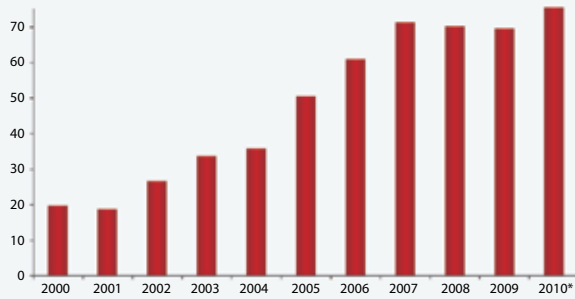
newspapers. At the meeting, Governor Durmuş Yılmaz and Deputy Governors Prof. Erdem Başçı, Mr. Burhan Göklemmez, Assoc. Prof. Mehmet Yörükoğlu and Dr. M. İbrahim Turhan and members of the Monetary Policy Committee Prof. Abdullah Yavaş and Prof. Turalay Kenç were present, questions pertaining to the Inflation Report were addressed; and current issues such as the fiscal rule, global crisis, exit strategies, economic developments and expectations were elaborated on.

### WORKING PAPERS, ECONOMIC NOTES, BOOKS AND RESEARCH

- Effects of Monetary Unions on Inequalities (Timur Hülagü, Devrim İkizler Working Paper No. 10/14, August 2010)
- Understanding Sectoral Growth Cycles and the Impact of Monetary Policy in the Turkish Manufacturing Industry (Saygın Şahinöz, Evren Erdoğan Coşar Working Paper No. 10/13, July 2010)
- New Real Effective Exchange Rate Indices for Turkey (Hülya Saygılı, Mesut Saygılı, Gökhan Yılmaz Working Paper No. 10/12, July 2010)
- Estimation of Monetary Policy Expectations Through Market Indicators in Turkey (Harun Alp, Hakan Kara, Gürsu Keleş, Refet Gürkaynak, Musa Orak Working Paper No. 10/11, June 2010)

**For further information:** <http://www.tcmb.gov.tr/yeni/eng/> (Publications/Research)

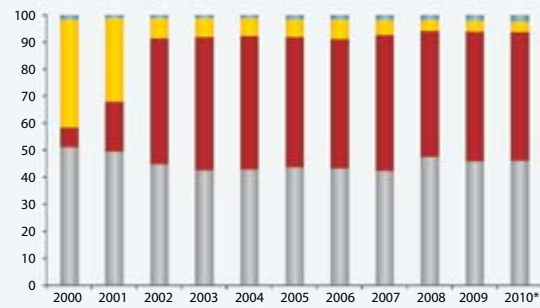
**Central Bank International Reserves  
(Excluding Gold, Billion USD)**



Source: CBT

\*As of 24.09.2010

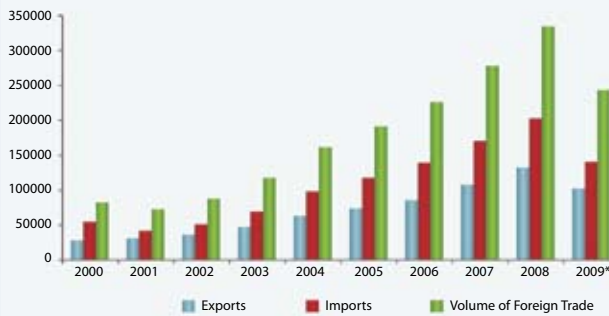
**Export by Currencies (% share)**



Source: TURKSTAT

\*As of August 2010

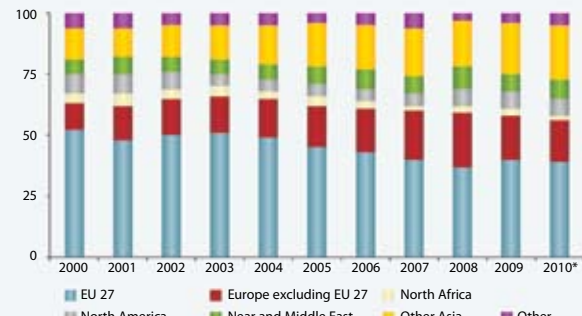
**Foreign Trade by Years (Million USD)**



Source: TURKSTAT

\*Provisional

**Import by Countries (% share)**



Source: TURKSTAT

\*As of August 2010



## BUSINESS TENDENCY SURVEY

The Business Tendency Survey, which has been conducted since December 1987, is a compilation of the assessments of senior managers on the recent past, current situation, as well as their expectations regarding the future course of the business environment.

The survey frame consists of survey units of the manufacturing industry production index of TurkStat with the base year 2005.

Respondents are sent two surveys, monthly and quarterly (in January, April, July and October).

The monthly survey is designed to collect the respondents' views regarding production, sale orders, employment, inventories, prices, unit costs, capacity utilization rates, inflation (producer prices), interest rate on credits, and the general course of business conditions. Of these questions, five are assigned to the evaluation of the current situation; 15 are assigned to past and future trends; and 2 questions are assigned to rates.

The six questions included in the Quarterly Survey are aimed at finding out the factors restricting production, assessment of the level of production capacity, the time required to produce current orders and an evaluation of the domestic and foreign competitive position. Of these additional questions, one question is assigned to rank various factors in order of importance; while the remaining questions are assigned to define tendencies of the past three months and assessments of the current situation.

As the general framework of the BTS involves multiple-choice questions, the answers are formulated as follows: "increased, remained unchanged, decreased"; "above normal, normal for the season, below normal"; "will increase, will remain unchanged, will decrease"; "more than sufficient, sufficient, not sufficient"; or "improved, remained unchanged, deteriorated".

Aggregated results are available in a time series format on the Central Bank's Electronic Data Delivery System (EDDS).

**For further information:** <http://www.tcmb.gov.tr/yeni/eng/> (Data Surveys)

CBT Policy Rate*	
One Week Repo	7,00

\* As of September 2010.

Central Bank Foreign Exchange Reserves (As of 24.9.2010, Billion USD)	75,79
CPI (Annual % Change, September 2010)	9,24

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