



TURKEY

RECENT DEVELOPMENTS AND PROSPECTS

September 2004

Agenda

I. MACROECONOMIC DEVELOPMENTS

II. BUDGET AND DEBT DYNAMICS

III. STRUCTURAL REFORMS

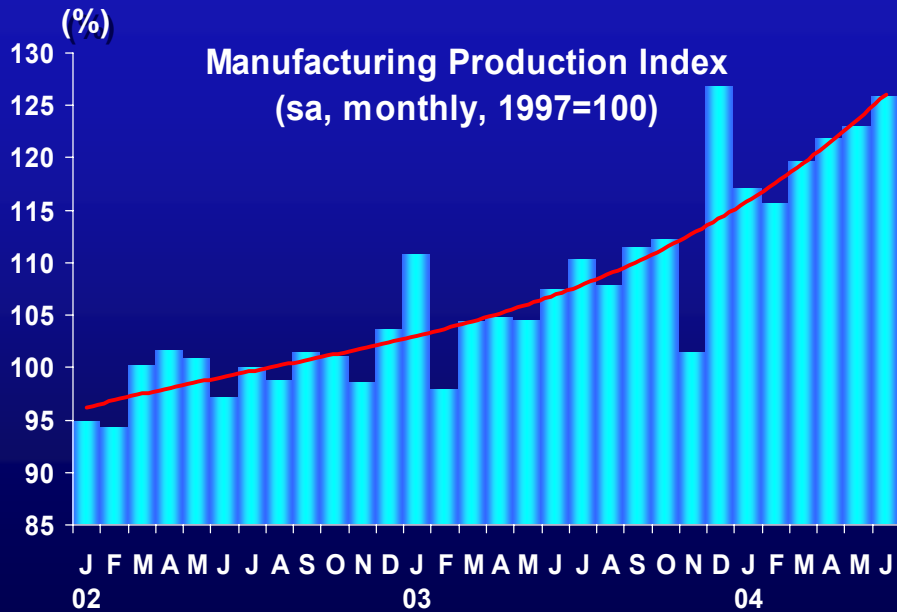
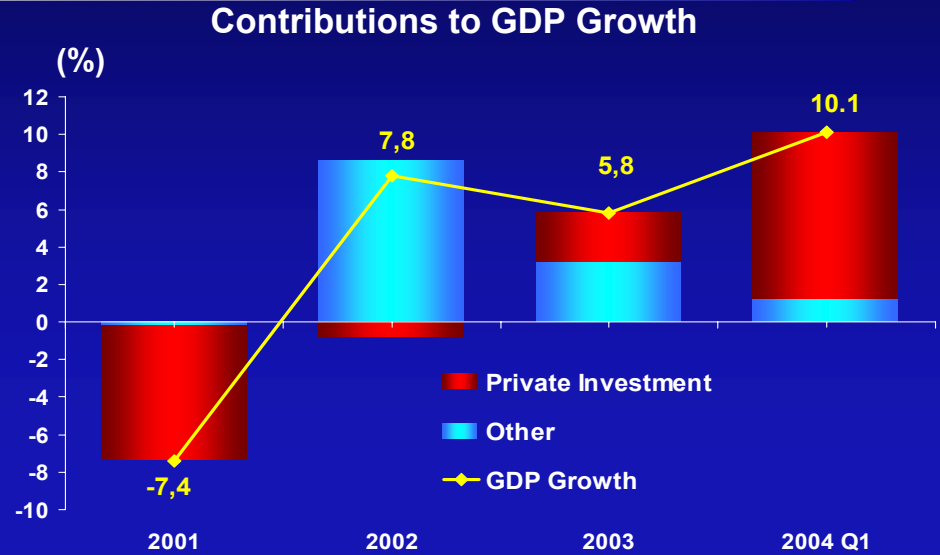
IV. PROSPECTS

**V. GENERAL FRAMEWORK OF THE MONETARY AND
EXCHANGE RATE POLICY**

MACROECONOMIC DEVELOPMENTS

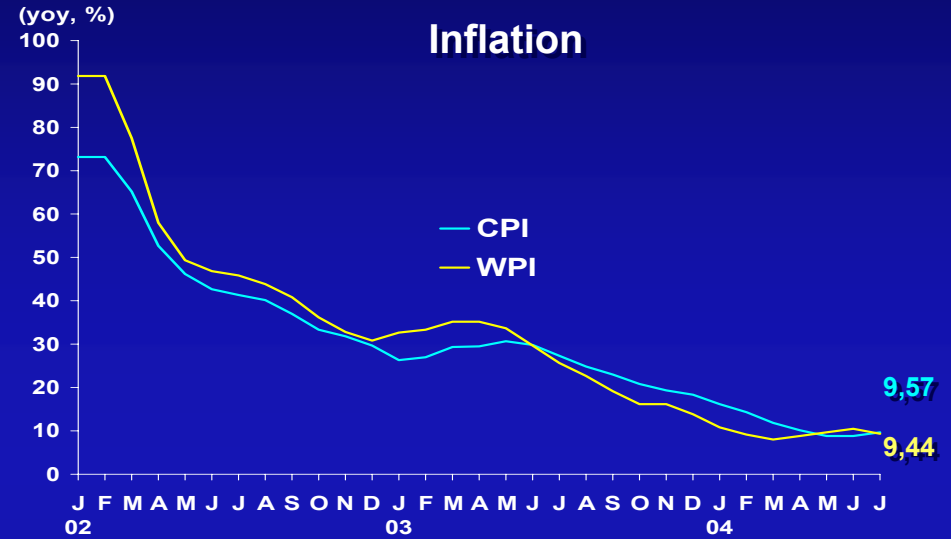
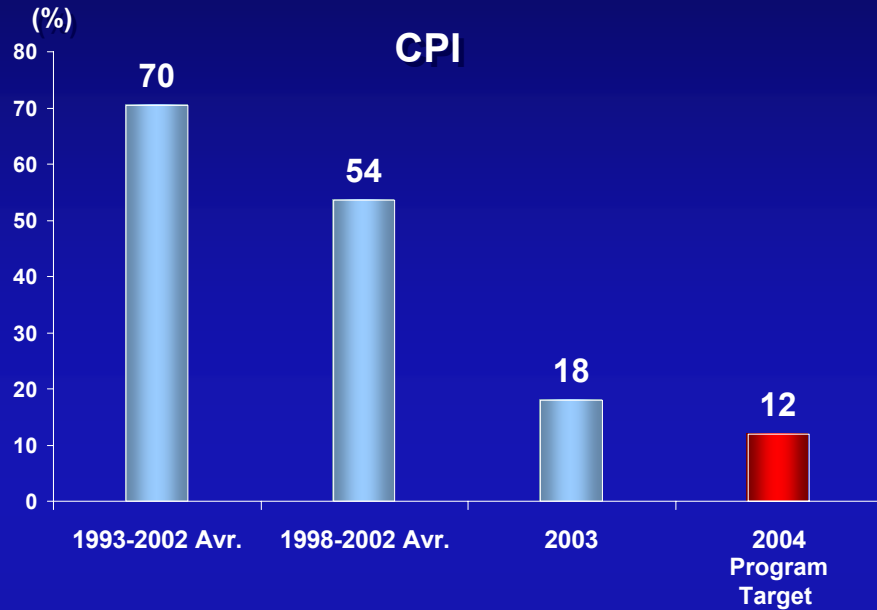
I. MACROECONOMIC DEVELOPMENTS

A. Outstanding Growth Performance

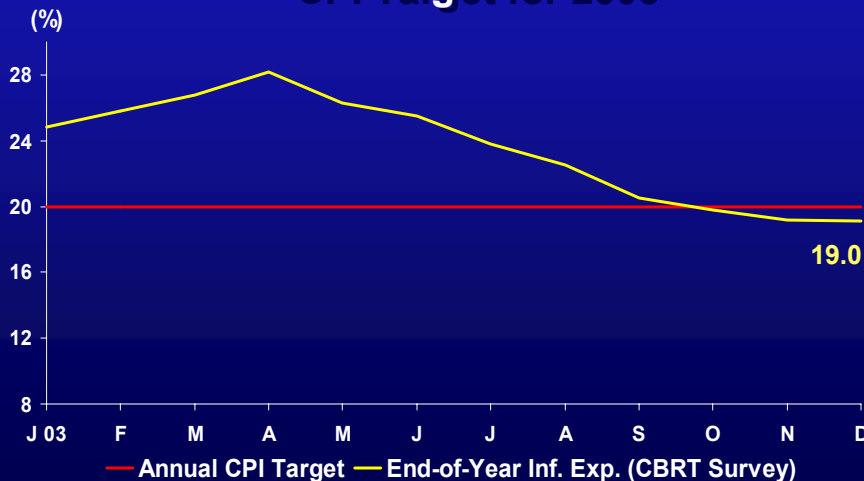


I. MACROECONOMIC DEVELOPMENTS

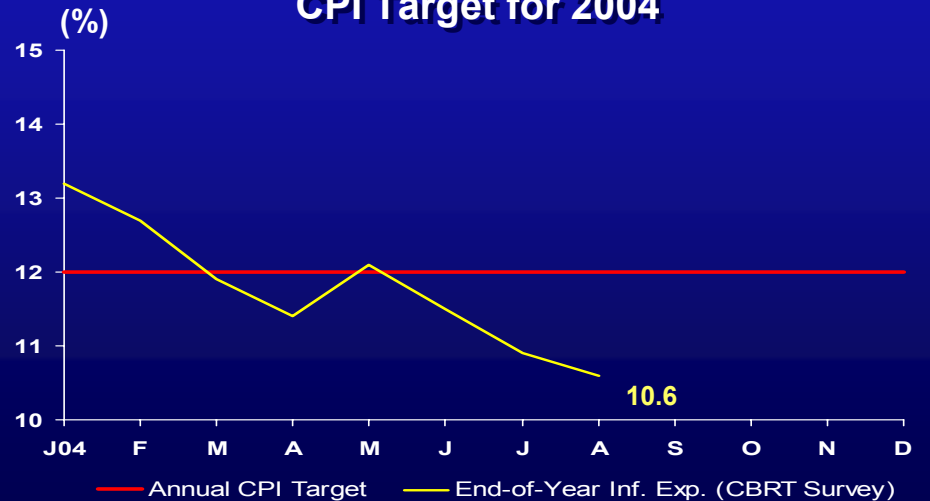
B. Rooting Out The Inflation Inertia



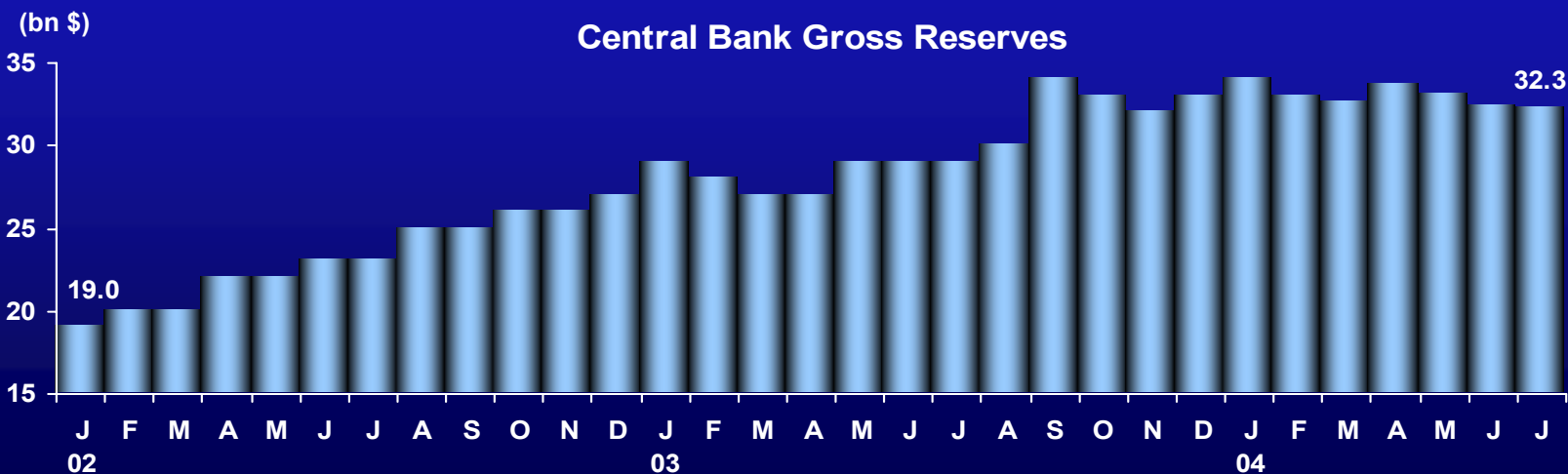
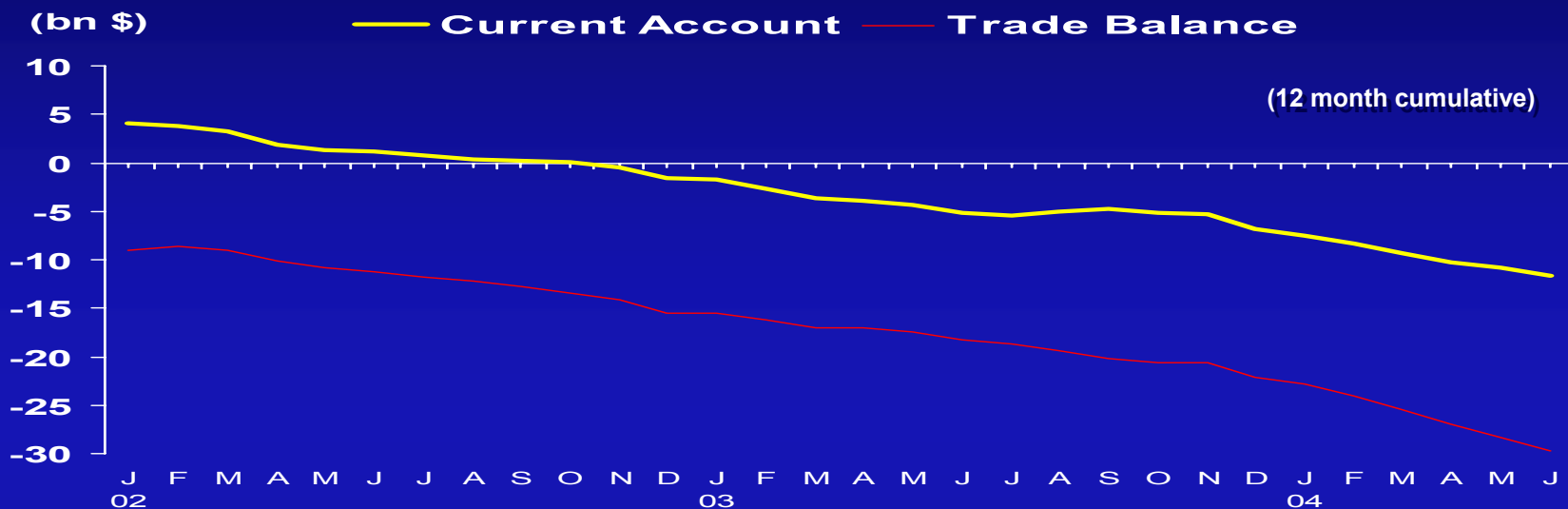
Inflation Expectations and CPI Target for 2003



Inflation Expectations and CPI Target for 2004



C. External Balance: Maintaining Strong Reserve Position Against Widening Current Account Deficit

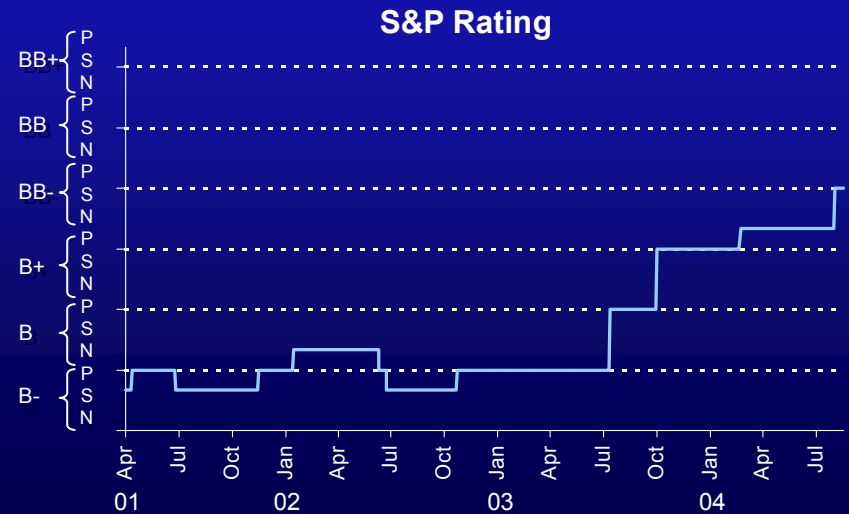
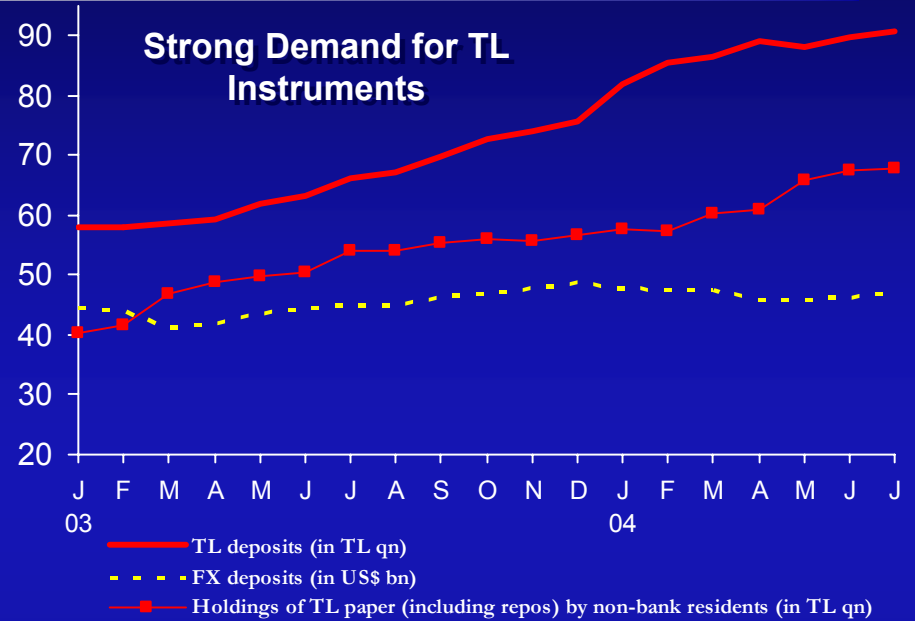
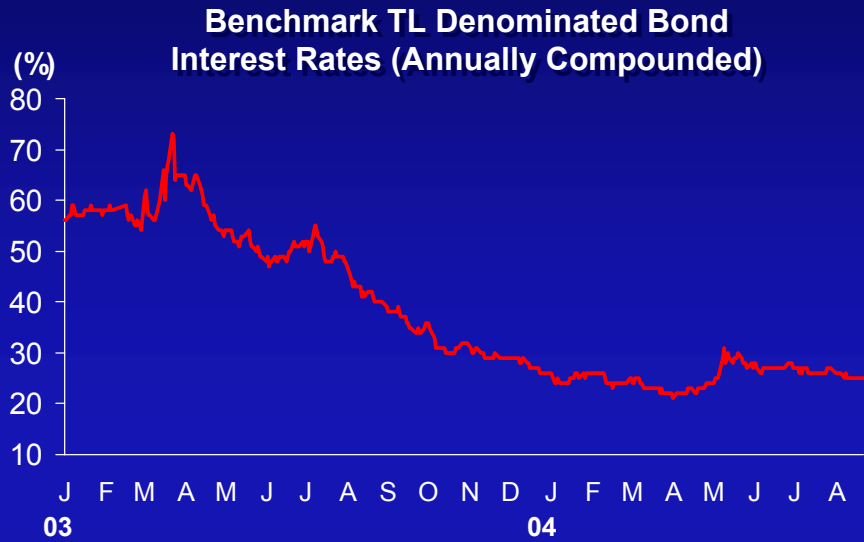


D. External Balance: Developments That Will Contain Widening Current Account Deficit

- ✓ **Scaling back tax incentives for new car purchases**
- ✓ **Making automatic fiscal stabilizers work - intend to use any revenue over performance to strengthen fiscal policy**
- ✓ **Increasing the special levy on consumer credits**
- ✓ **Adjustment of petroleum product prices**
- ✓ **FX and interest rate adjustments**
- ✓ **Prudent consumer credit lending policies by banks**
- ✓ **Increase of consumer credit lending rates**
- ✓ **Prudent monetary policies**

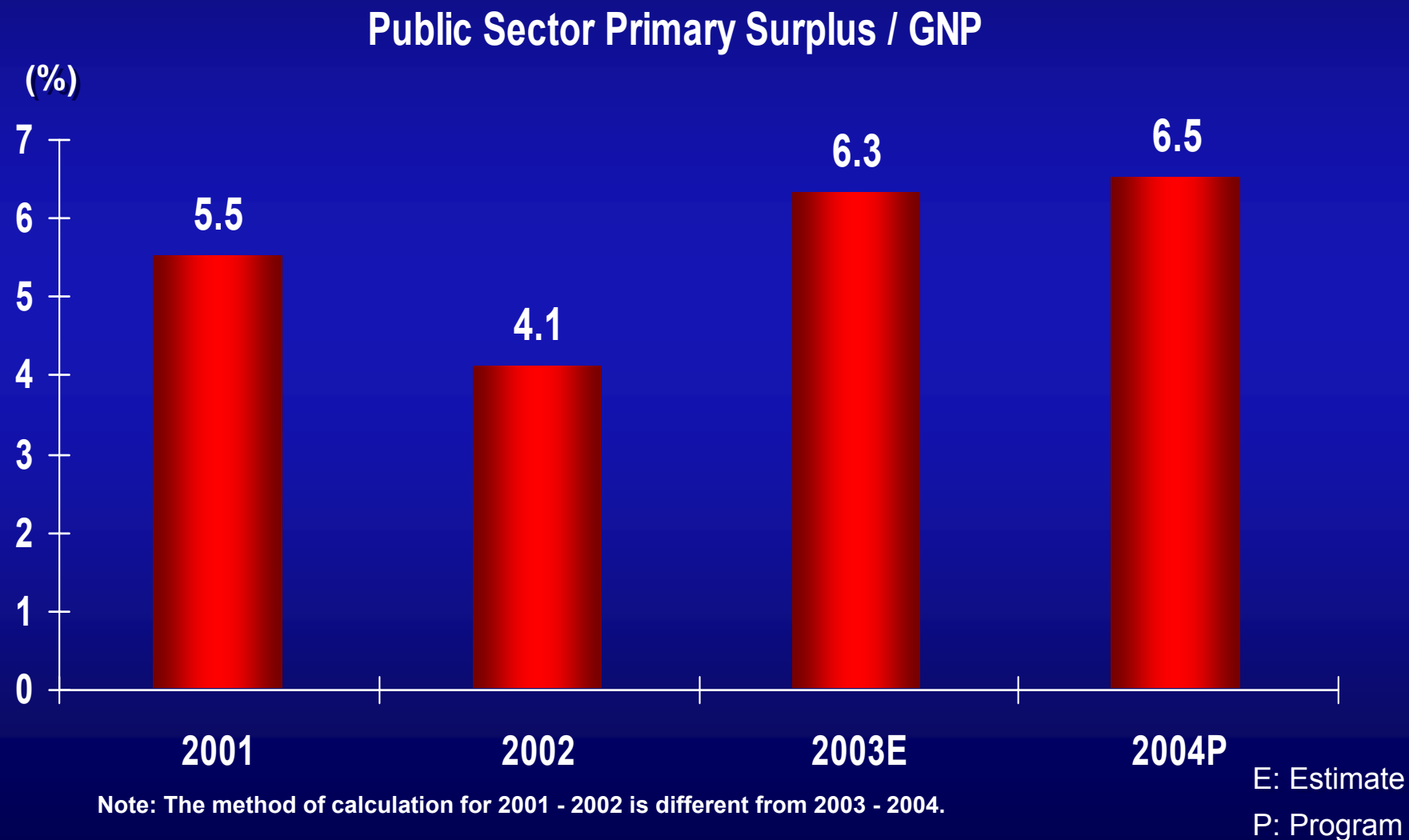
I. MACROECONOMIC DEVELOPMENTS

E. Market Sentiment



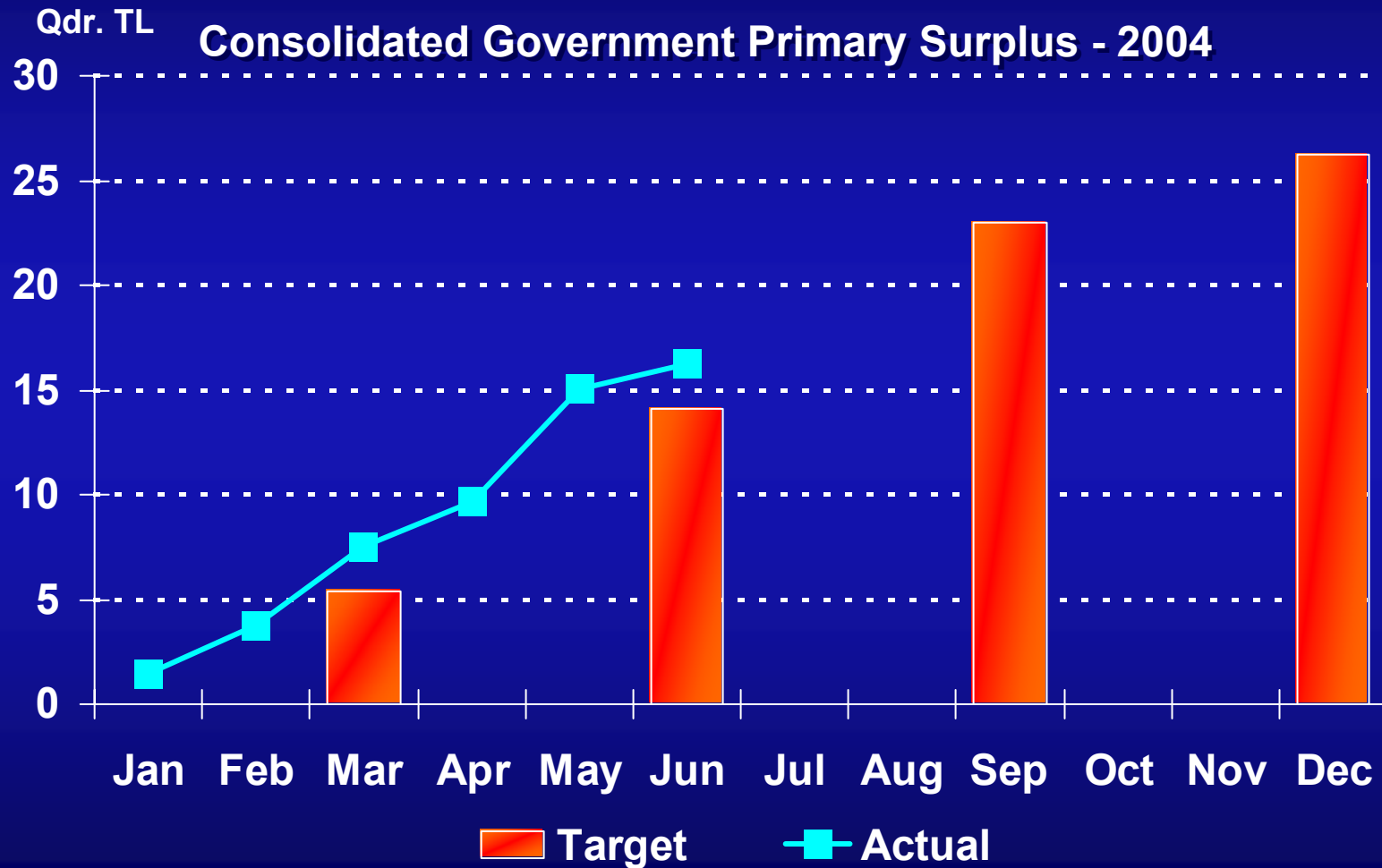
BUDGET AND DEBT DYNAMICS

A. Fiscal Adjustment



II. BUDGET AND DEBT DYNAMICS

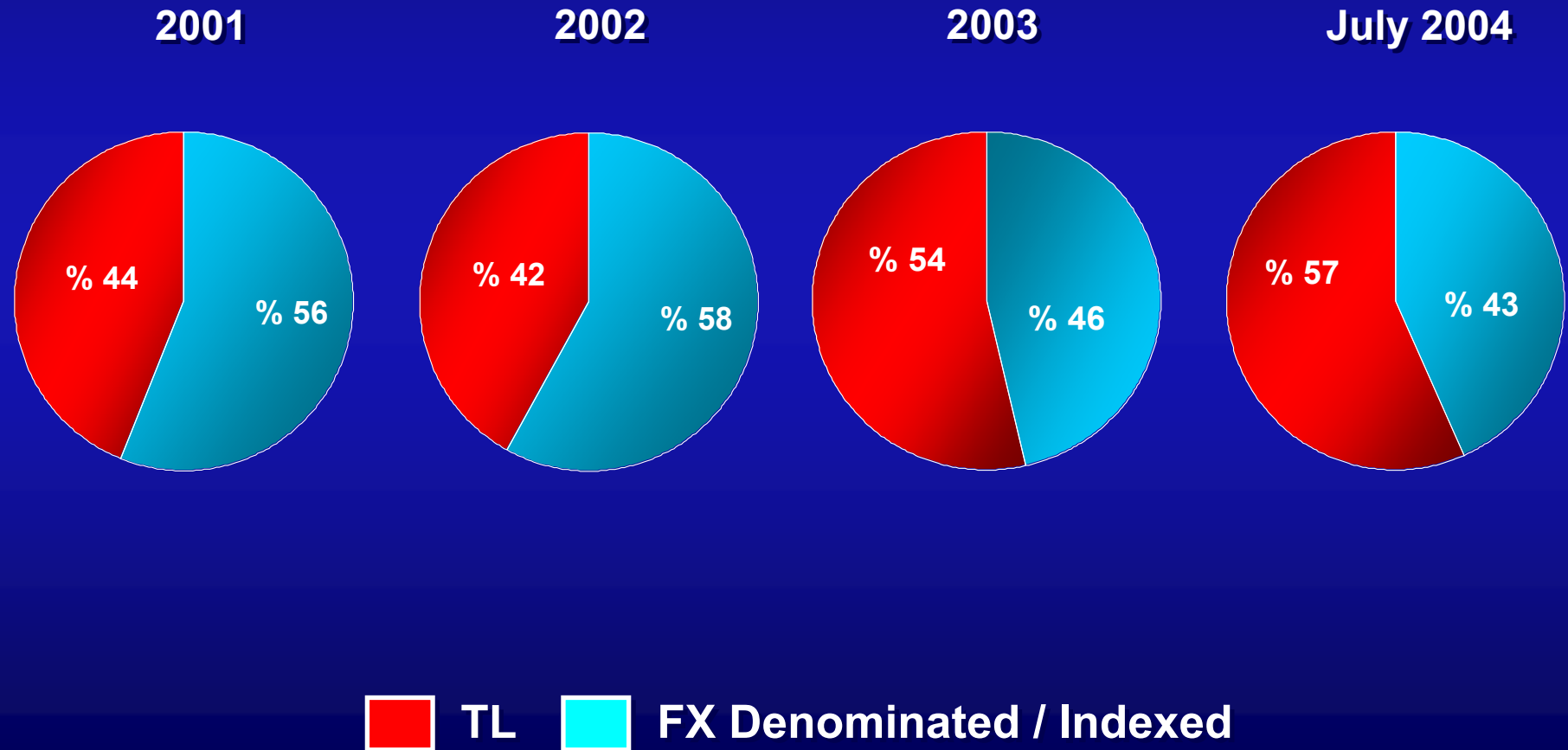
B. Fiscal Targets Under the Program Overperformed in the First Half of 2004



II. BUDGET AND DEBT DYNAMICS

C. Improved Debt Structure (1)

Total Debt Stock

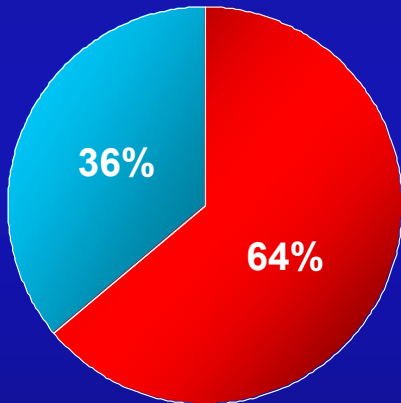


II. BUDGET AND DEBT DYNAMICS

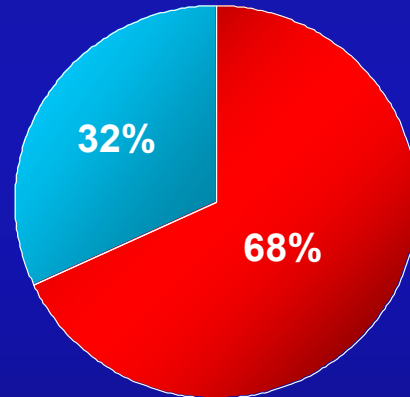
C. Improved Debt Structure (2)

Domestic Debt Stock

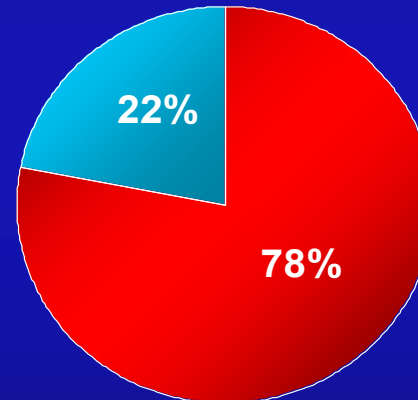
2001



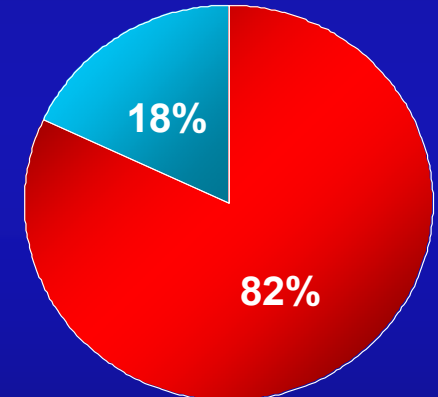
2002



2003



July 2004



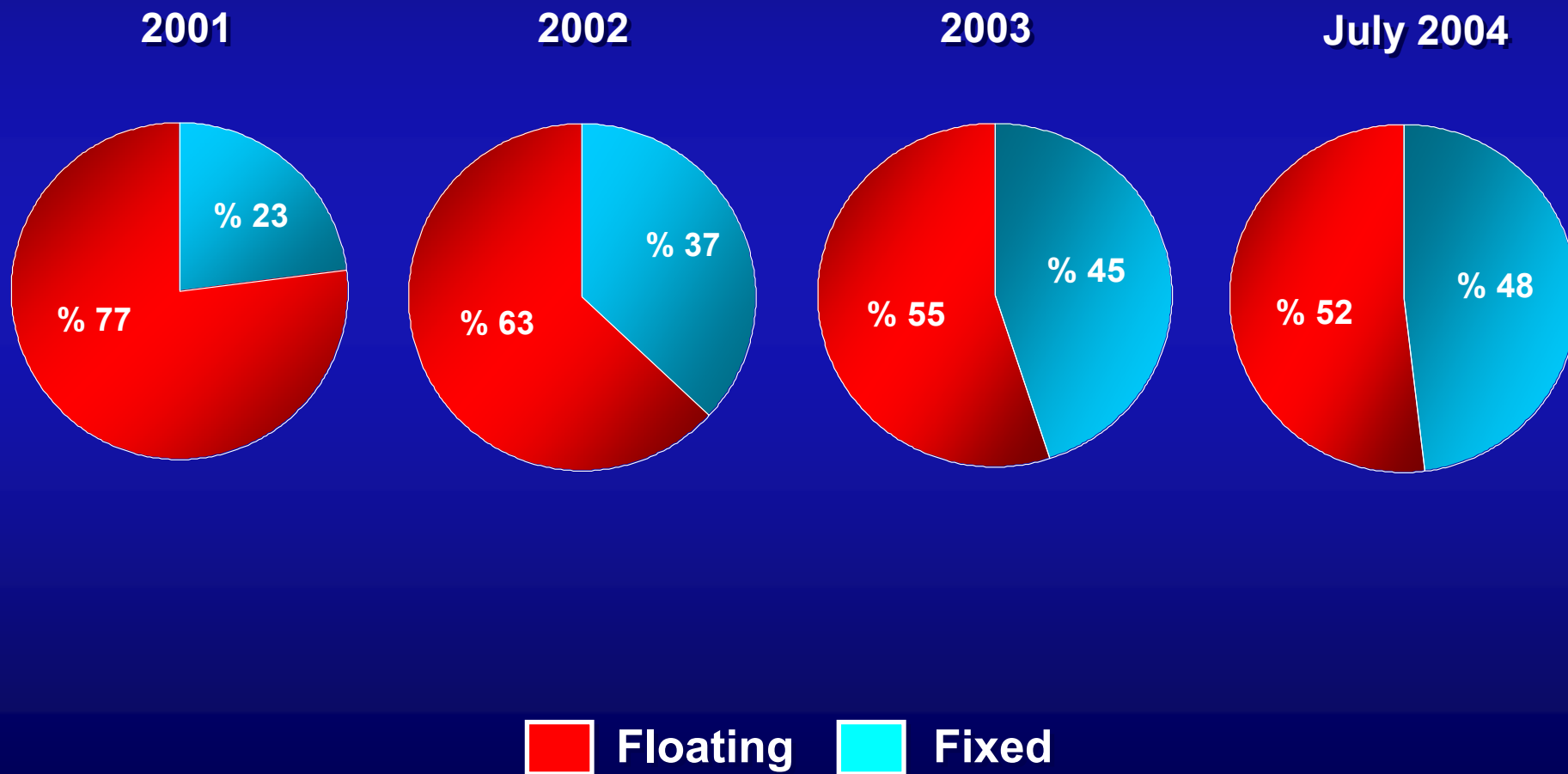
TL



FX Denominated / Indexed

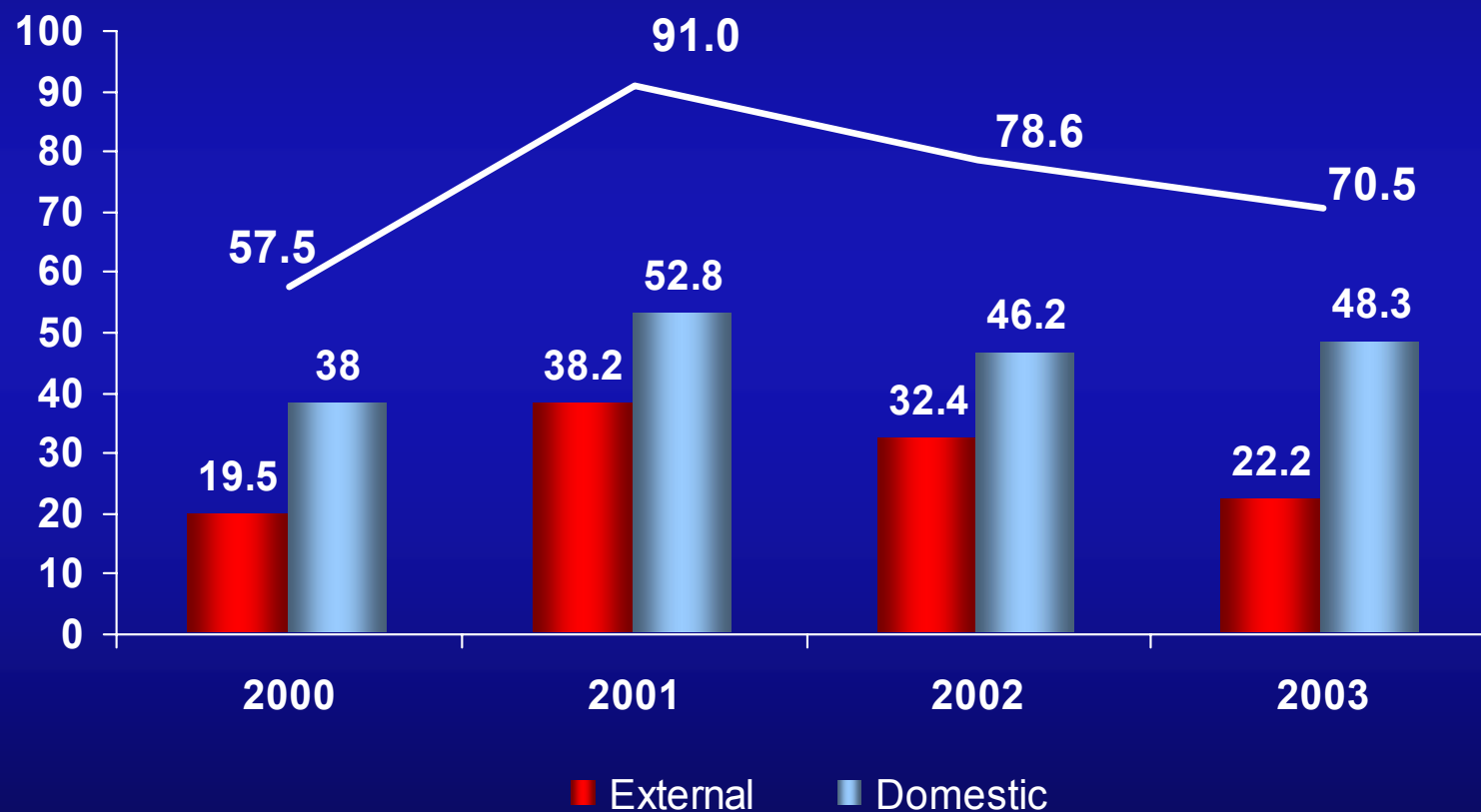
C. Improved Debt Structure (3)

TL Denominated Debt Stock



D. Declining Debt Burden

Net Public Debt Stock / GNP



STRUCTURAL REFORMS

III. STRUCTURAL REFORMS: TAKING STOCK

A. Substantial Progress in Structural Reforms

- ✓ **Improving the Fiscal Administration**
- ✓ **Debt Management Reform**
- ✓ **Social Security Reform- The First Stage**

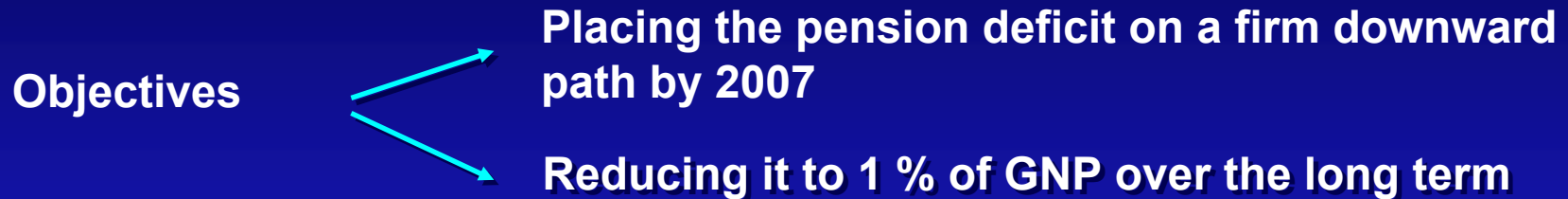
- ✓ **Banking Reform**
- ✓ **Independent Central Bank**

- ✓ **Agricultural Reform**
- ✓ **Opening Up Key Sectors To Competition**
- ✓ **Independent Regulatory and Supervisory Agencies**

- ✓ **Steps to Improve the Investment Environment**

III. STRUCTURAL REFORMS: ONGOING

B. Creating a Self Sustaining Social Security System

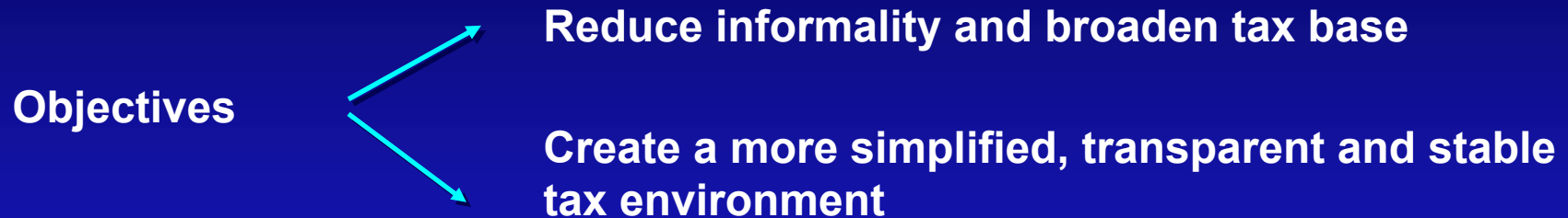


Main pillars of the social security reform:

- ✓ **Unification of three social security institutions**
 - unite three social security institutions under one roof
 - standardize the social security coverage among institutions
 - parametric changes to achieve long term sustainability
- ✓ **Establishment of universal health insurance**
 - create a health insurance system which will minimize cost to government
- ✓ **Transfer of social assistance functions to one institution**

III. STRUCTURAL REFORMS: ONGOING

C. Reforming the Tax System



Main pillars of the tax reform:

- ✓ **Tax administration reform to combat the informal economy and to improve compliance and efficiency of tax collection**
 - make the Revenue Department a semi-autonomous agency within the Ministry of Finance
 - reorganization along functional lines, and
 - move tax policy functions into the Ministry of Finance
- ✓ **Simplification and streamlining of the tax system**
- ✓ **Rationalization of financial transaction taxes**

III. STRUCTURAL REFORMS: ONGOING

D. Strong Financial Sector: Engine of Growth

Objective



Sound financial system as the engine of sustainable growth

Main pillars of the banking reform:

- ✓ Improved regulatory and supervisory framework
 - A new Comprehensive Law on Credit Institutions in line with E.U. practices
- ✓ A new road-map for restructuring and privatization of state banks
- ✓ A strengthened institutional capacity and a new strategy for asset resolution
- ✓ Transfer of non-bank financial institutions to the BRSA

III. STRUCTURAL REFORMS: ONGOING

E. Further Developing the Infrastructure For a Competitive Market Economy

Objective  Highly competitive market economy

Main pillars

- ✓ **Competitive Real Sector**
 - Liberalization of key sectors : Energy, Telecommunications, Petroleum, Sugar, Tobacco, Civil Aviation
- ✓ **Competitive Financial Sector**
 - Privatization of State Banks
- ✓ **Privatization of Big Ticket Companies**
 - TÜPRAS (Petroleum Refinery)
 - PETKIM (Petrochemicals)
 - THY (Airlines)
 - Tekel (Tobacco Company)
 - Türk Telekom
 - National Lottery
- ✓ **Efforts to Enhance a Business Friendly Environment**

PROSPECTS

IV. PROSPECTS

A. New Economic Program

- **Key Features**
 - ✓ Strong Ownership
 - ✓ Social Consensus
 - ✓ EU Convergence (EU Pre-accession Economic Program)
 - ✓ Basis for a New Stand-By Arrangement

- **Macroeconomic Objectives**
 - ✓ Sustainable High Growth
 - ✓ Price Stability and Single Digit Inflation
 - ✓ Debt Reduction

- **Macroeconomic Policies**
 - ✓ Continuation of Prudent Fiscal Policies
 - ✓ A Monetary Framework focused on Price Stability
 - ✓ Floating FX regime

IV. PROSPECTS

B. European Union Perspective

- ✓ **Expected European Council Decision in December 2004 to open accession negotiations**
- ✓ **During the last 4 years, one third of Constitution has been amended**
- ✓ **Groundbreaking Reforms:**
 - Freedom of expression, opinion, religion, association upgraded
 - Death Penalty abolished
 - Right to learn and broadcast in local languages and dialects granted
 - National Security Council restructured
 - New Civil Code enacted
 - New Penal Code to be discussed in the Parliament
- ✓ **Support of Parliament and Public Opinion**
- ✓ **Meeting the Maastricht Criteria continues to be the ultimate goal for the economic policy making**
- ✓ **Medium term economic program to accelerate convergence**

GENERAL FRAMEWORK OF THE MONETARY AND EXCHANGE RATE POLICY

A. Monetary Policy Framework Since 2002 (1)

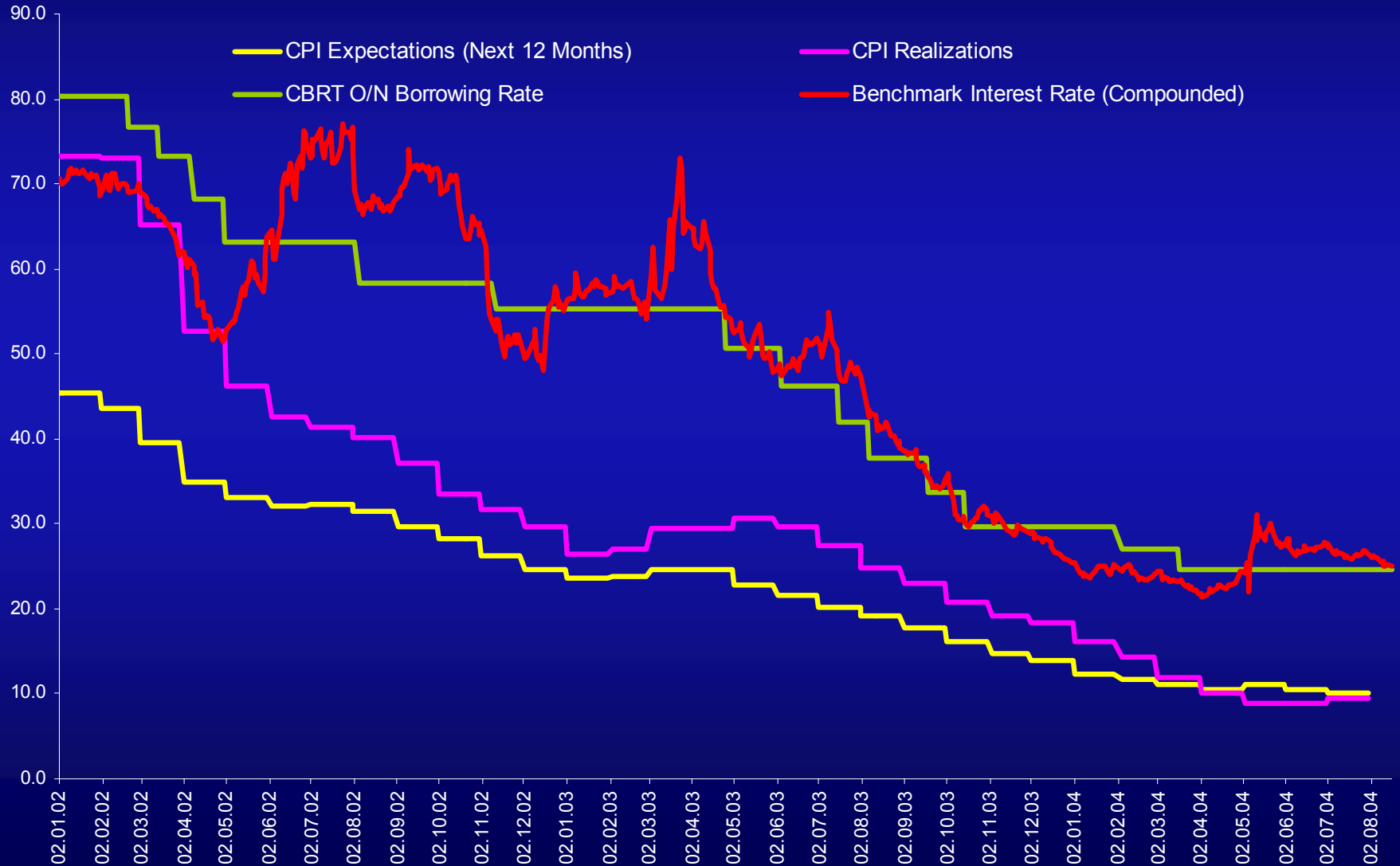
- ✓ **The primary objective of monetary policy is to achieve price stability.**
- ✓ **In accordance with its law, the CBRT is free to use all monetary instruments to achieve its primary goal.**
- ✓ **Main policy instrument of the CBRT is the short-term interest rates.**

V. GENERAL FRAMEWORK OF THE MONETARY AND EXCHANGE RATE POLICY

A. Monetary Policy Framework Since 2002 (2)

- ✓ In early 2002, the CBRT announced that since then it was going to implement implicit inflation targeting.
- ✓ In this setting, the CBRT changes short-term interest rates solely based on inflation outlook.
- ✓ Put it in another way, its objective is to minimize the difference between its inflation forecast and the targeted inflation rate.
- ✓ There is no other variable in its objective function.
- ✓ The exchange rate regime is “almost” a pure float.

B. Evolution of Inflation Expectations and Interest Rates



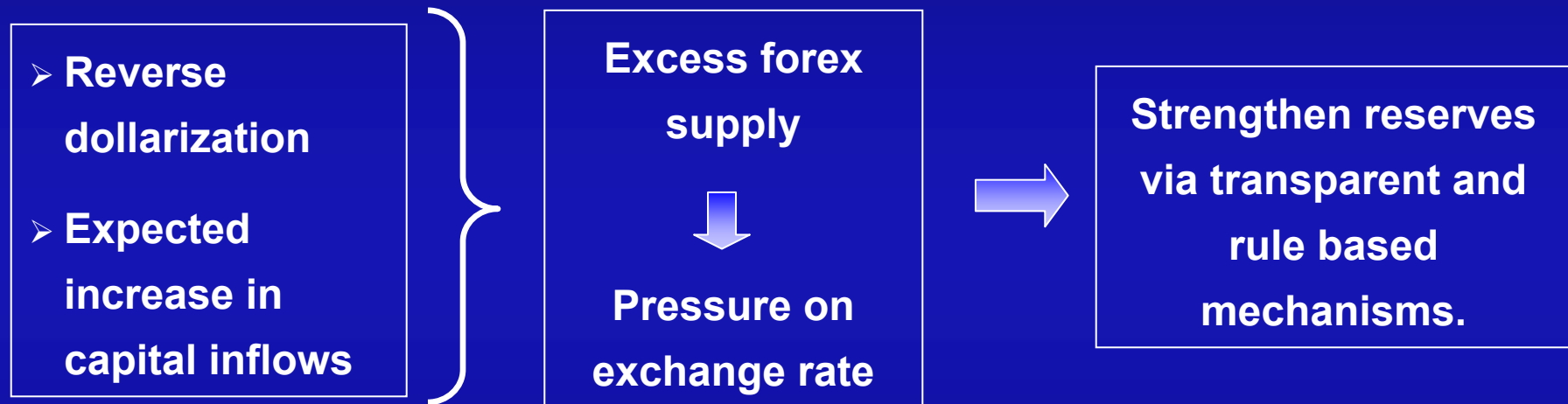
C. Exchange Rate Policy (1)

Floating Exchange Rate Regime

- ✓ Exchange rates are determined in the market.
- ✓ The CBRT may only intervene in the foreign exchange market to dampen excessive volatility on both sides in a transparent way, if it poses danger to price stability.
- ✓ Interventions may also be in the form of warnings and announcements.

C. Exchange Rate Policy (2)

The appreciation of the Turkish lira is, in fact, the natural outcome of the increasing confidence in the current program implementation.



- In order to strengthen the international reserves, the CBRT introduced foreign exchange purchase auctions, taking the developments in the areas of balance of payments and reverse dollarization into account.
- Under the floating exchange rate regime, the CBRT gives high importance to developing derivative markets and hedging instruments.

D. Foreign Exchange Rates and the CBRT Forex Purchase

