



AN OVERVIEW OF TURKISH ECONOMY

April 2003

CENTRAL BANK OF THE REPUBLIC OF TURKEY

Growth

2002

Estimate at the outset: 3 %

Revised estimate: 6.5 %

Realization: 7.8 %

What were the sources of growth in 2002?

- ✓ Improved expectations due to financial stability ensured by confidence in the current economic program
strict fiscal and monetary policies were instrumental
- ✓ Strong export performance
- ✓ Inventory building in view of the expected recovery
- ✓ Increase in industrial production, especially in the private sector
11.4 % yoy increase in the last quarter
- ✓ Increase in agricultural output
15.3 % yoy increase in the last quarter
- ✓ The baseline effect
- ✓ Unemployment still high
10.6 % in 2002

Growth

2003

Estimate: 5 %

What will be the sources of growth in 2003?

- ✓ Completion of banking sector reforms
- ✓ Stability in TRL and FX markets
Increase in private fixed investment and consumption
- ✓ Favorable developments in expectations
- ✓ Increase in productivity resulting from structural reforms
- ✓ Acceleration in exports
13.4 % yearly increase in January
- ✓ Increase in production
13.7 % and 4.4 % yearly increase in IPI in January and February, respectively

Growth

2003

Expectations as of March: 3.6 %

Declining since the beginning of the year

Why ?

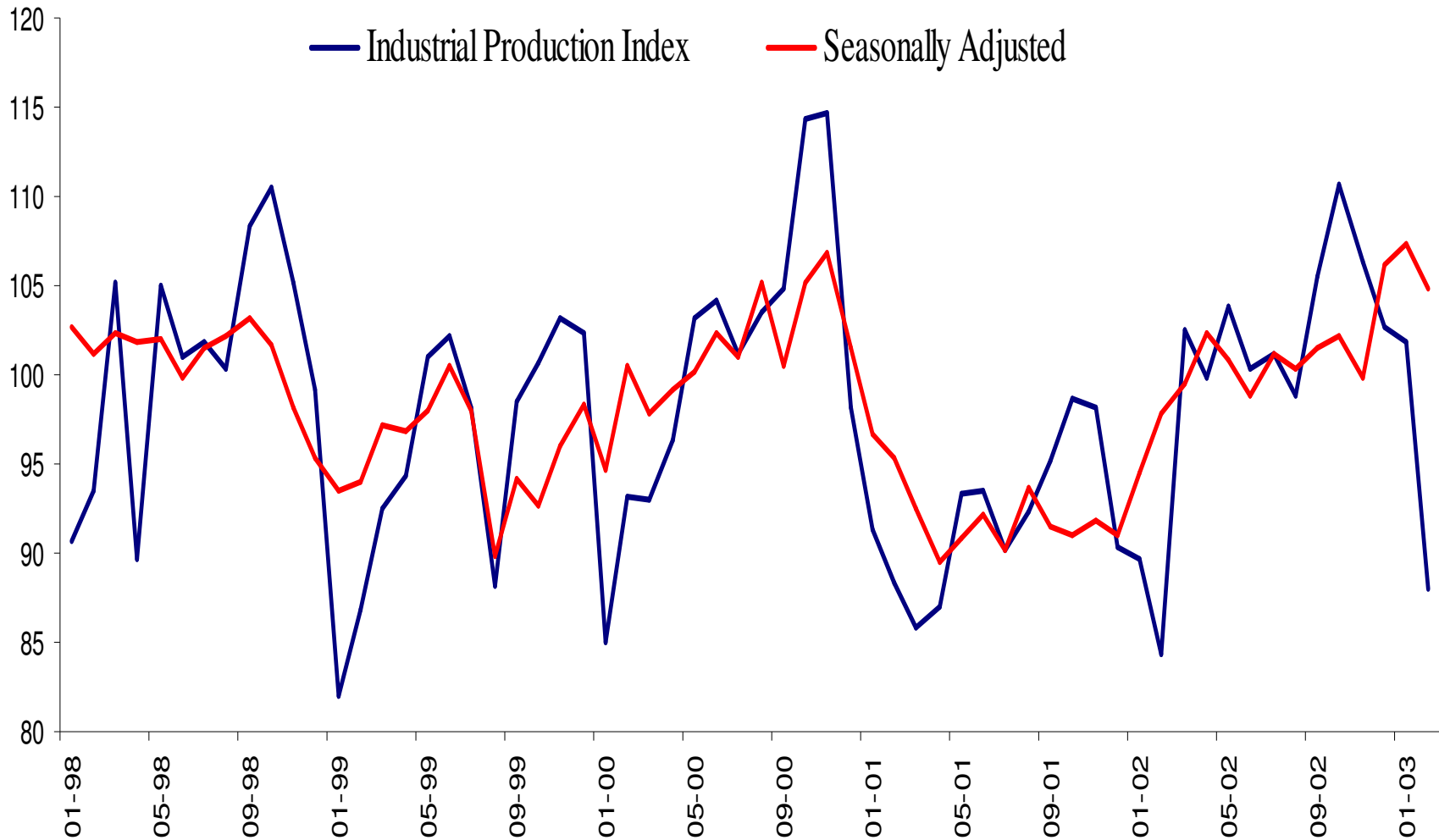
- 4th review under IMF program took too long
- Iraq: Initial impact on tourism revenues, oil price
- Baseline effect no longer

Q1 2003 ?

- Industrial production: Good in January, but...
- Real sector confidence index down

Growth

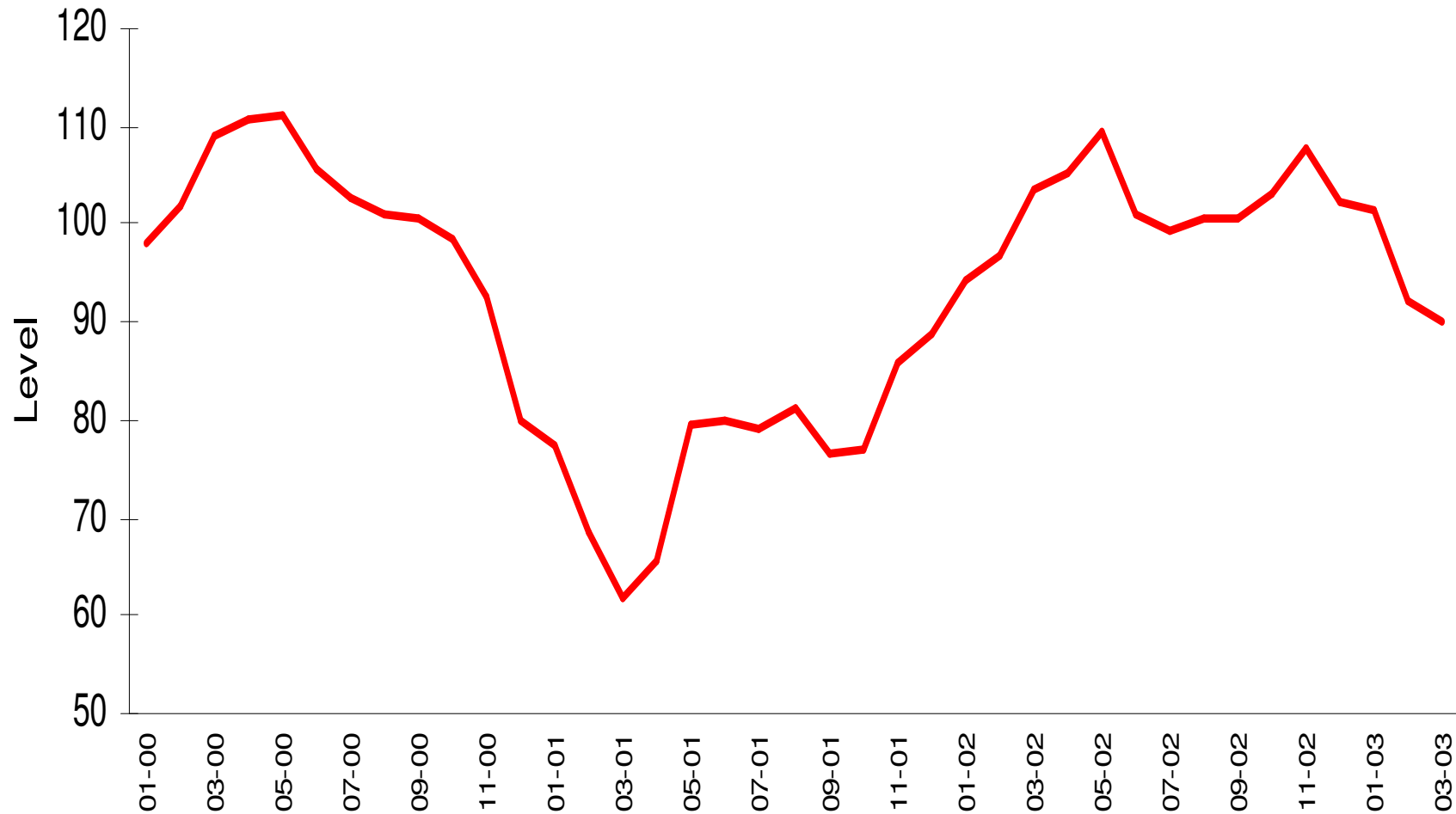
Industrial Production Index



On January 2003, seasonally adjusted industrial production index continued its increasing trend and is now closer to levels before the 2001 crisis. However, in February, the IPI showed a decline contrary to its trend.

Growth

Real Sector Confidence Index



Real Sector Confidence Index = Expectations on (Business climate + export facilities + investment spending + total orders + inventory of finished goods + total employment + production volume + volume of goods sold to domestic market + raw materials inventory tendency).
When the index goes up above 100, we understand that expectations have turned positive, when it goes down below 100, it means that expectations have turned negative.

Inflation - 2002

Target CPI for 2002  35 %

Inflation Outcome in 2002  29.7 %

the lowest end year level in two decades

Main factors determining the price developments in 2002:

- ✓ Tight fiscal and monetary policies
- ✓ Successful implementation of structural reforms
- ✓ Increase in the credibility of the program, which in turn had a favorable impact on expectations
- ✓ Relative stability in TRL and foreign exchange markets
- ✓ The absence of demand pressures
- ✓ The significant slowdown in food and agriculture prices

Inflation - 2003

Target CPI for 2003  20 %

announced jointly by the Government and the Central Bank

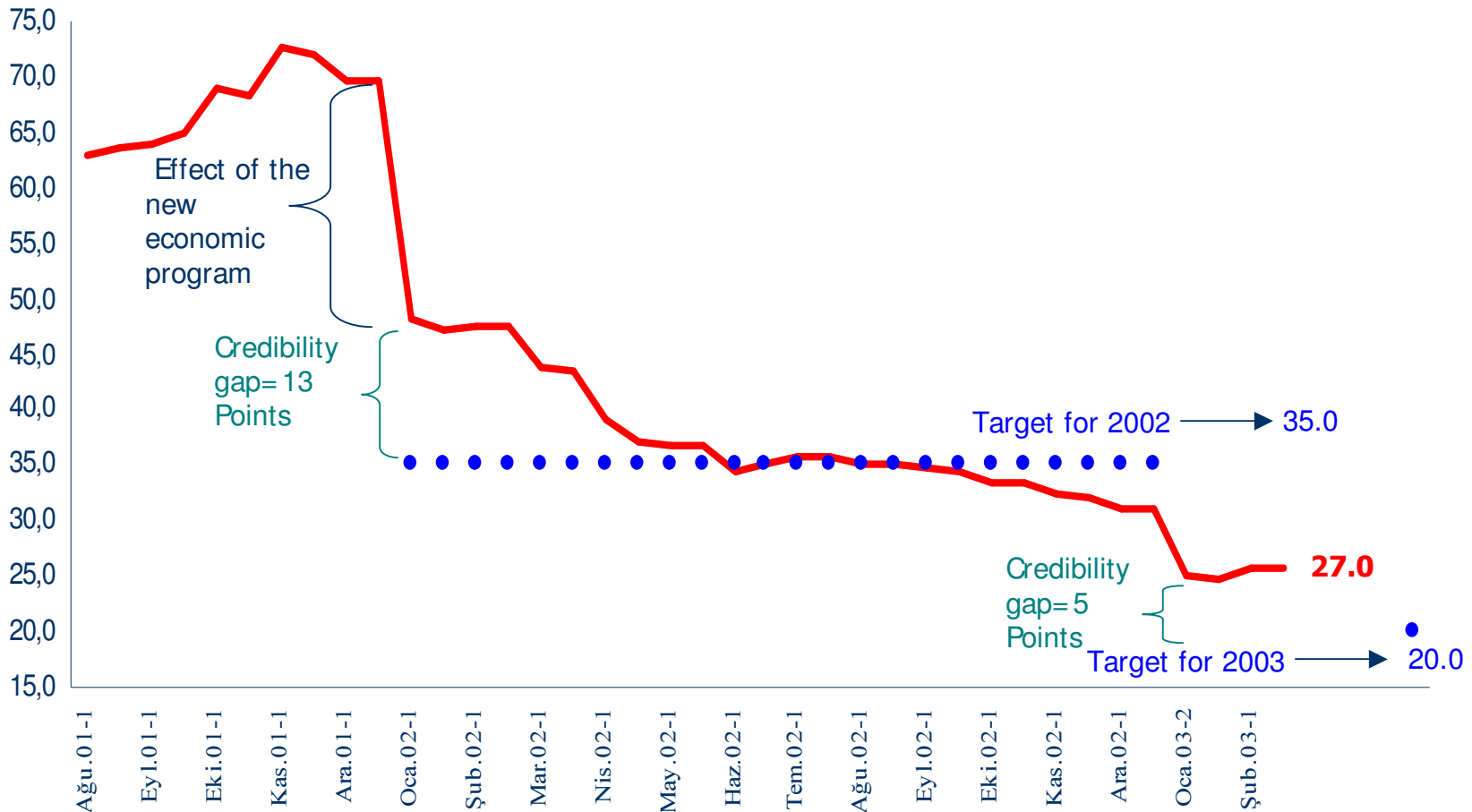
The CPI movements in the first three months of 2003

- January: 2.6 %
 - ✓ Realizations are in line with expectations
 - ✓ The de-seasonalized rate of increase is the lowest since March 2002
 - ✓ Limiting factors are items from food, durable consumption goods and clothing sector
 - ✓ The effects of public sector price adjustments
- February: 2.3 %
 - ✓ Acceleration in monthly increase caused an upward push in annual CPI
 - ✓ Seasonal increase in food prices
 - ✓ Accelerated rise in oil prices and transportation prices
 - ✓ Extended price adjustments in health services
 - ✓ Rents limited the increase
 - ✓ Low private manufacturing prices
- March: 3.1 %
 - ✓ Above expectations
 - ✓ Increase in food prices especially went beyond expectations
 - ✓ Continued price adjustments in health services
 - ✓ Increase in prices in telecommunication services
 - ✓ Transportation prices still high

The widespread characteristic of the first three months is that there is no significant revival in consumer demand.

Year-End Inflation Expectations (Consumer Prices)


Although coming closer to the target, inflation expectations for 2003 are still above it because of uncertainties




The credibility gap, which was 13 points when the inflation target was 35 percent, and expectation was 48.3 percent in early 2002, has declined to 5 percent with an inflation target of 20 percent and an expectation of 24.8 percent in the beginning of 2003.

Inflation Outlook

- At the moment, the future course of inflation depends mainly on:

✓ The economic fundamentals  Strengthened by extra measures in the 2003 budget and commitments under the new LOI on incomes policy, past / forward indexation, structural reforms

✓ Domestic demand still low

✓ The degree of impact of developments in Iraq  “Extraordinary Period”

- ❖ Deviations will either be negligible or temporary: **oil prices and exchange rate stabilize**
- ❖ Inflation in the first two months should not mean that the downward trend has stopped or reversed: **baseline effect should be taken into account**

Financial Stability

Primary objective



Price Stability



Financial stability is our supporting objective

- Today, military operation in Iraq is a risk confronting our financial stability objective.

Financial Stability

- But not affected much more than the overall world economy, due to:
 - ✓ Determined implementation of the current program,
 - ✓ Strengthened macroeconomic fundamentals,
 - ✓ The floating exchange rate regime,
 - ✓ The independent Central Bank's warnings through press releases and speeches for more than one year,
 - ✓ Predetermined policy measures taken by the Central Bank to preserve financial stability.

Financial Stability

The Central Bank's Policy Measures:

● In the TRL Market:

- ✓ The Central Bank lowered the interest rate charged for funding the banks without any limit via the “Late Liquidity Window”
- ✓ O/N funding facility at the Istanbul Stock Exchange Repurchase Market

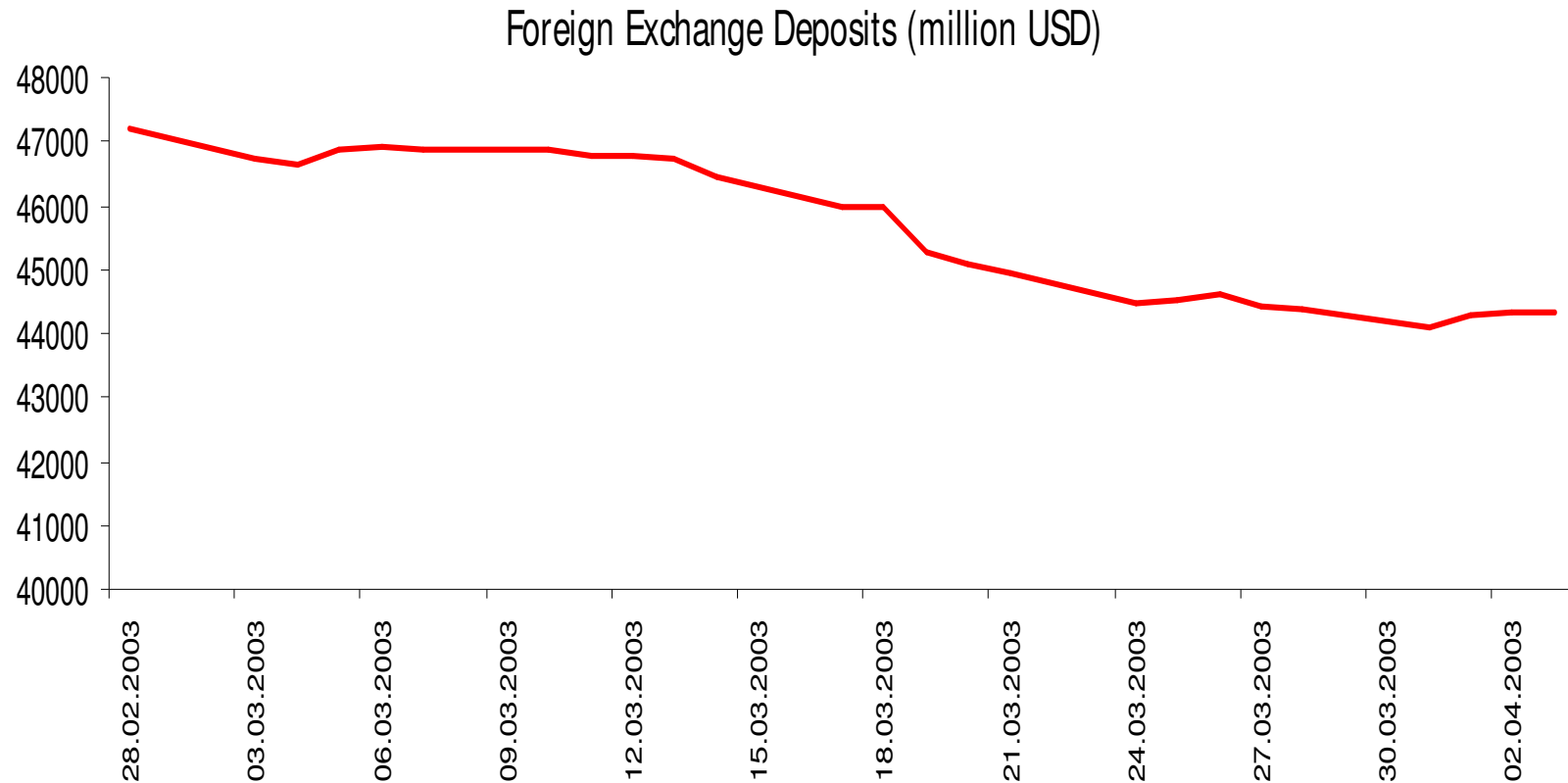
● In the FX Market:

- ✓ The Central Bank lowered the interest rate to be applied for one-week maturity FX deposit facility within the banks' limits of borrowing in the FX Deposit Market at the Central Bank
- ✓ The Central Bank increased in the amount of FX banknotes held in the Central Bank's branches to meet possible rise in demand
- ✓ The Central Bank stands ready to intervene in case of excess volatility due to fx liquidity shortage or speculative actions

Financial Stability

Signs of stability and confidence:

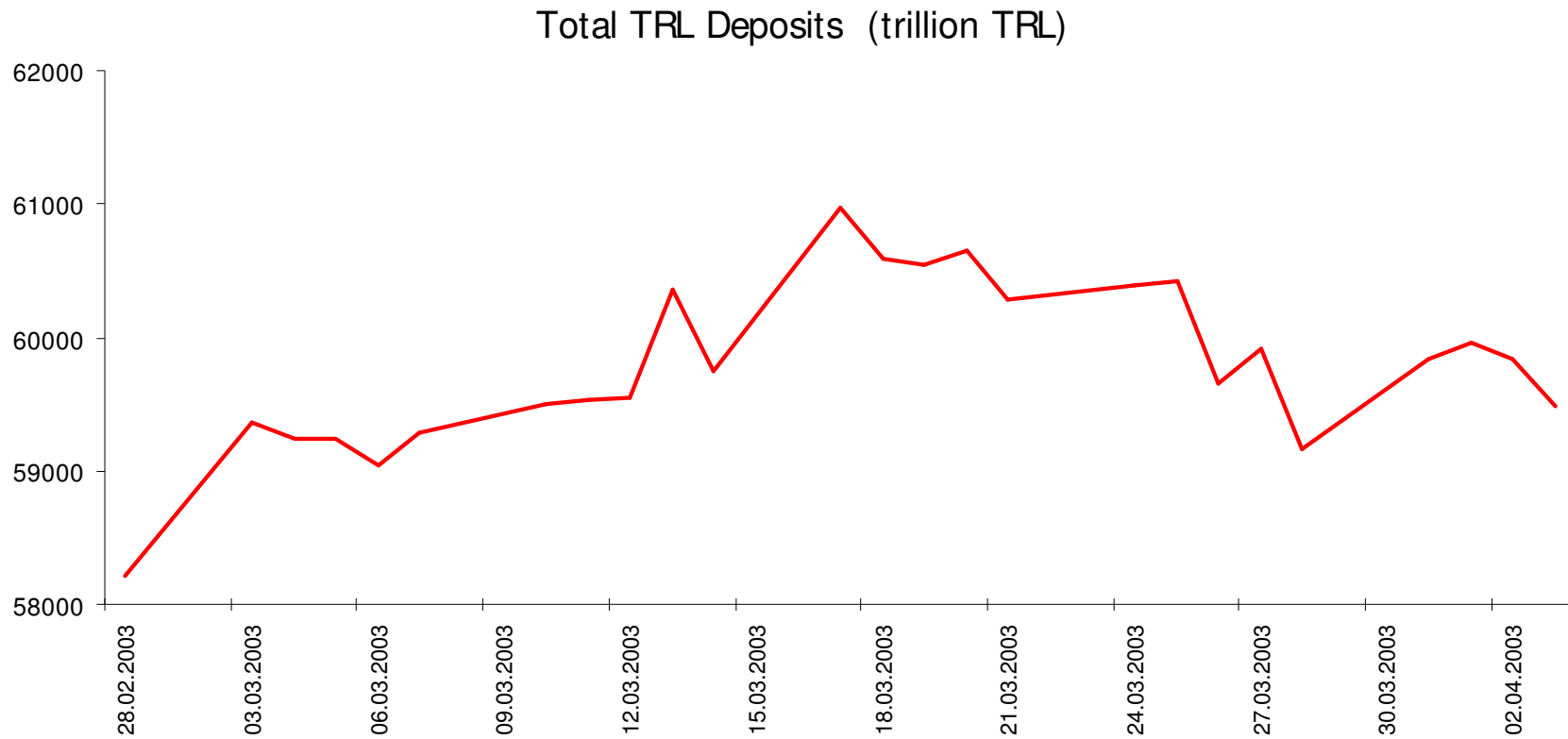
- Gradual decline in FX deposits, but no sharp fluctuations



Financial Stability

Signs of stability and confidence:

- No sharp fluctuations in TRL deposits
- Increase in TRL deposits within the period between February 28th-April 3rd

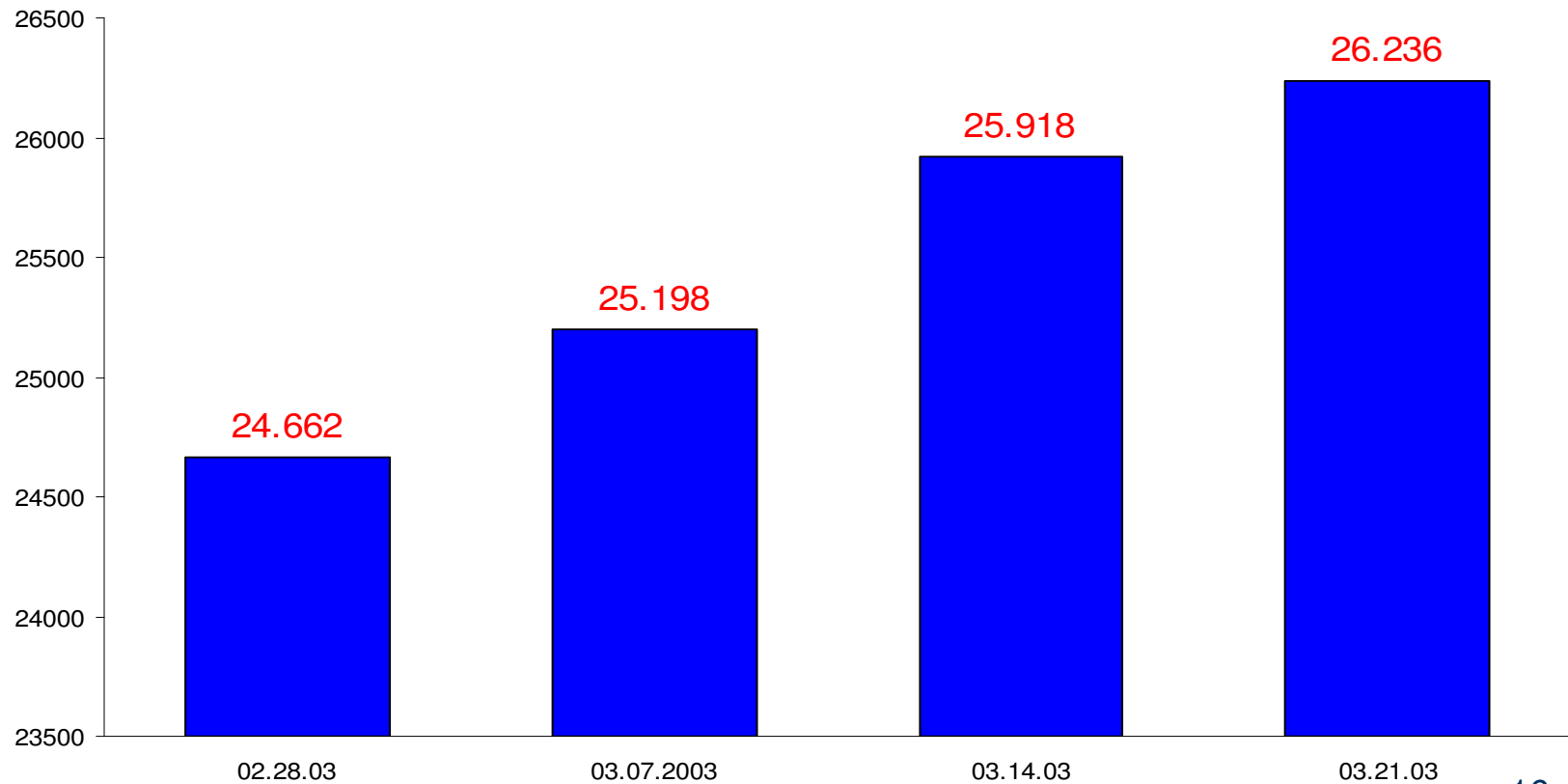


Financial Stability

Signs of stability and confidence:

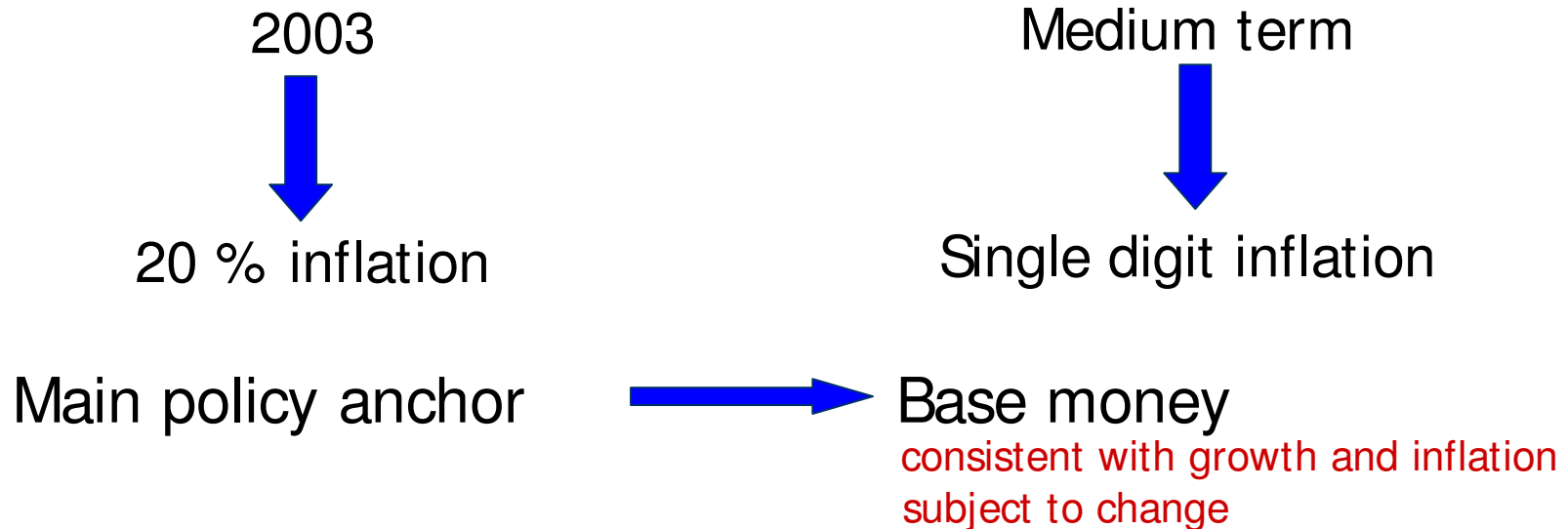
- Increase in government securities holdings

Government Securities Held by Residents (TRL+ FX) (trillion TL)



Monetary Policy in the Future

The objective of monetary policy is to attain the inflation targets



Main policy anchor

Base money

consistent with growth and inflation
subject to change

● Formal inflation targeting will be adopted when conditions allow:

- ✓ Favorable internal environment
 - ❖ Sustained fiscal discipline
 - ❖ Reduction in backward looking indexation
 - ❖ Supportive incomes policy
- ✓ Favorable external environment

Monetary Policy in the Future

- The Central Bank completed institutional and technical preparations for formal inflation targeting:
 - ✓ Strengthening economic databases and reporting packages
 - ✓ Development of inflation forecasting systems
 - ✓ Preparation of a core quarterly macroeconomic model
 - ✓ Publications of statistics and reports
 - ✓ Additional press releases related to Monetary Policy Council meetings also will be issued
- Committed to the floating exchange rate regime
 - Intervention to dampen excessive volatility
 - Re-introduction of forex purchase auctions
 - Balance of payments
 - Currency substitution

Monetary Policy in the Future

● Progress in strengthening forex and money markets:

The measures already introduced in 2002:

- ✓ Reserve requirements
 - ❖ Lengthening the average period
 - ❖ Raising the proportion of reserve requirements applied averaging
- ✓ Removal of stamp duty on forward contracts
- ✓ Removal of tax in interbank forex transactions
- ✓ Introduction of one-month deposit auctions
- ✓ The Central Bank's gradual withdrawal as a blind broker
- ✓ The Turkish Lira Interbank Offer Rate
- ✓ Re-entrance of state-owned banks to overnight money markets

The key priority for 2003 will be:

- ✓ Reduction in tax distortions and increase in efficiency of the markets
 - ❖ Elimination of the BLTT on interbank deposits and repo transactions
 - ❖ Adjustments of the tax regulations of CBT bills to government securities