



# **TURKEY**

## **RECENT DEVELOPMENTS AND PROSPECTS**

**September 2004**

# Agenda

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**I. MACROECONOMIC DEVELOPMENTS**

**II. BUDGET AND DEBT DYNAMICS**

**III. STRUCTURAL REFORMS**

**IV. PROSPECTS**

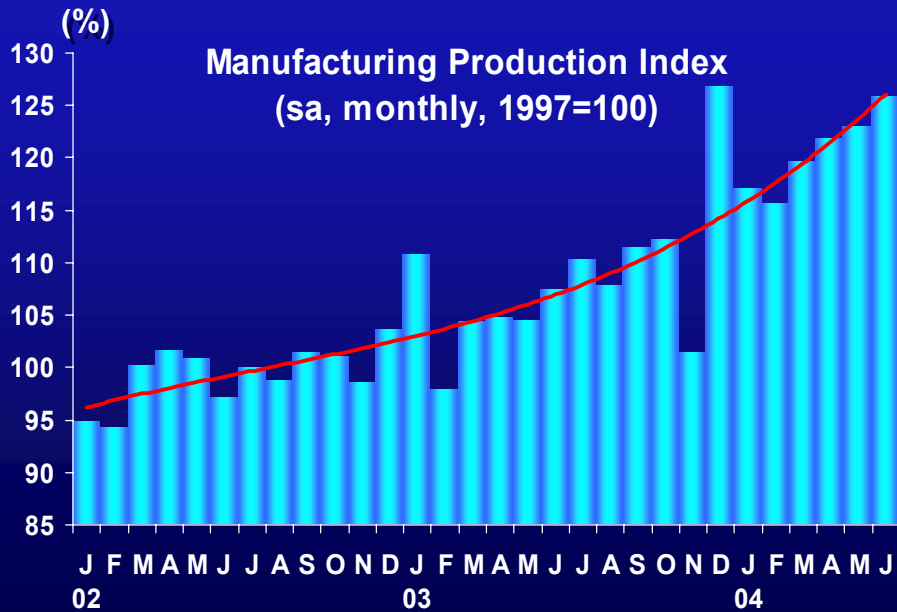
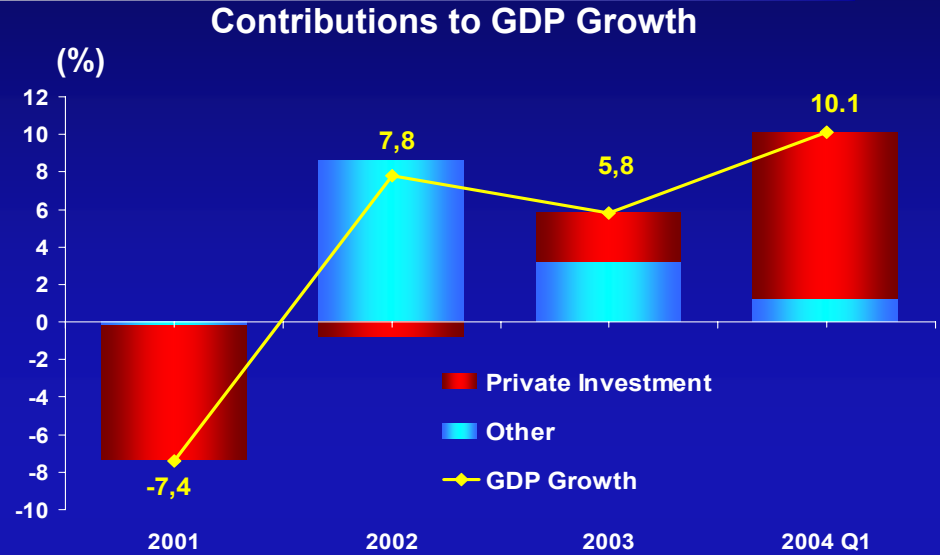
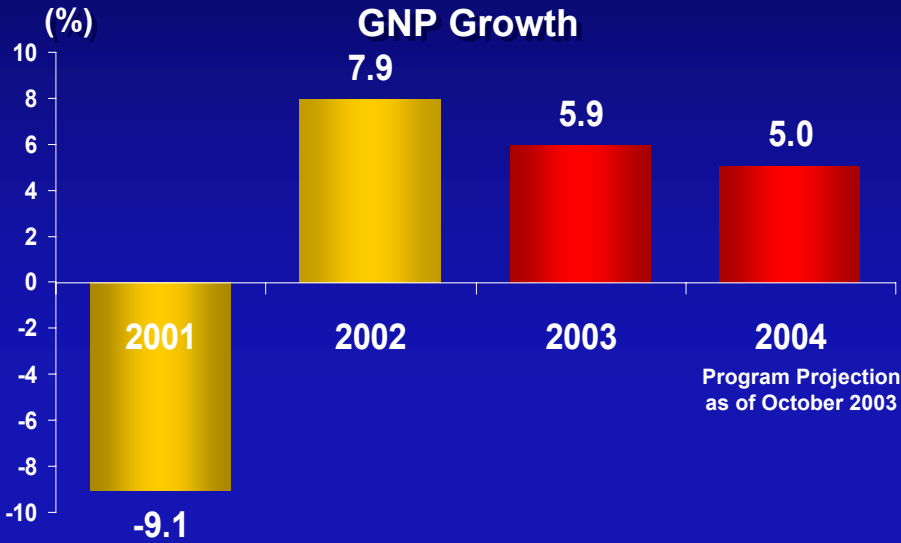
**V. GENERAL FRAMEWORK OF THE MONETARY AND  
EXCHANGE RATE POLICY**

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# **MACROECONOMIC DEVELOPMENTS**

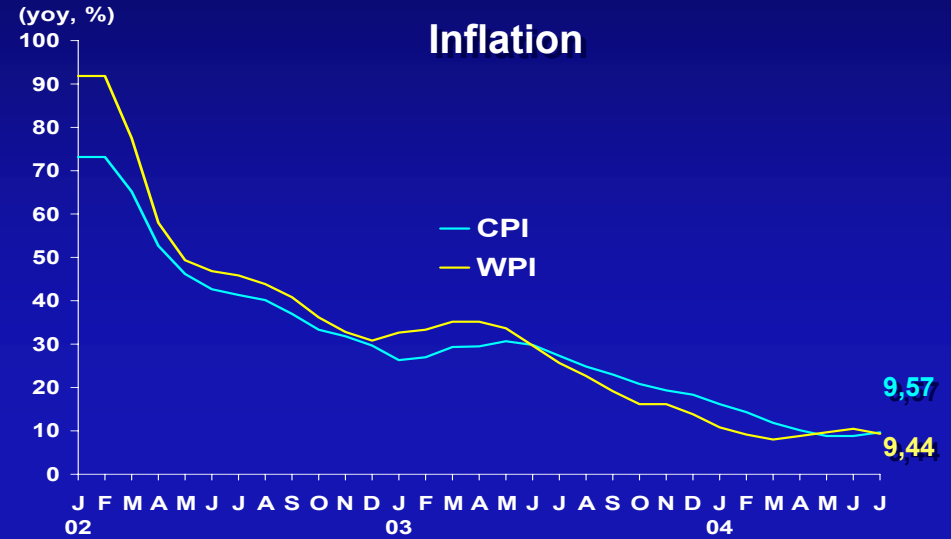
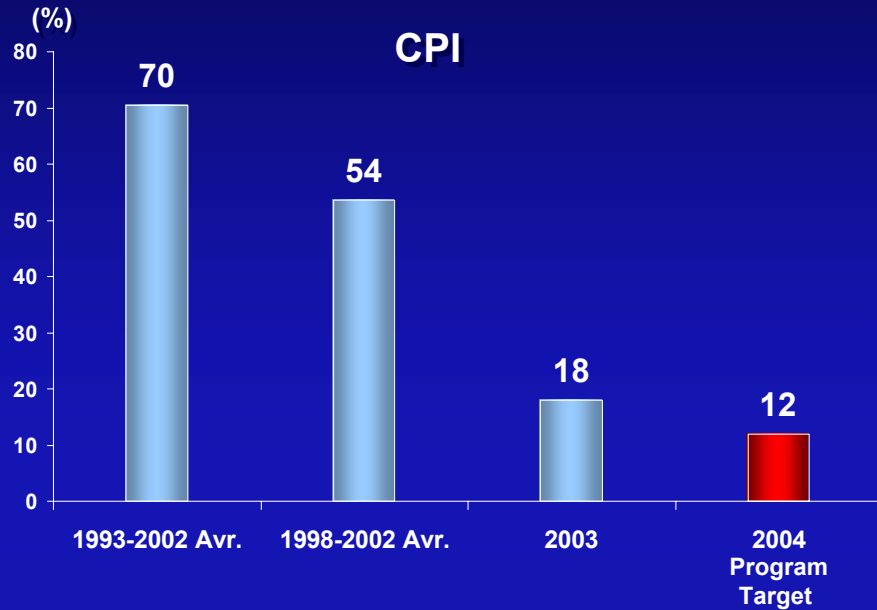
# I. MACROECONOMIC DEVELOPMENTS

## A. Outstanding Growth Performance

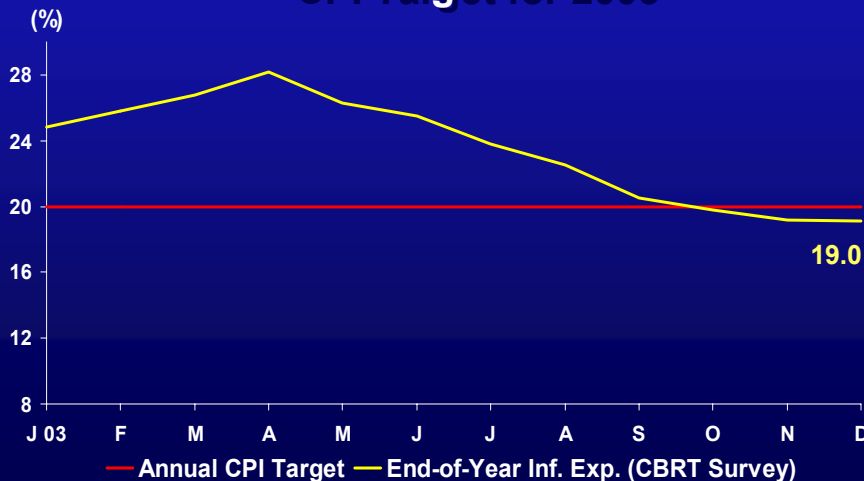


I. MACROECONOMIC DEVELOPMENTS

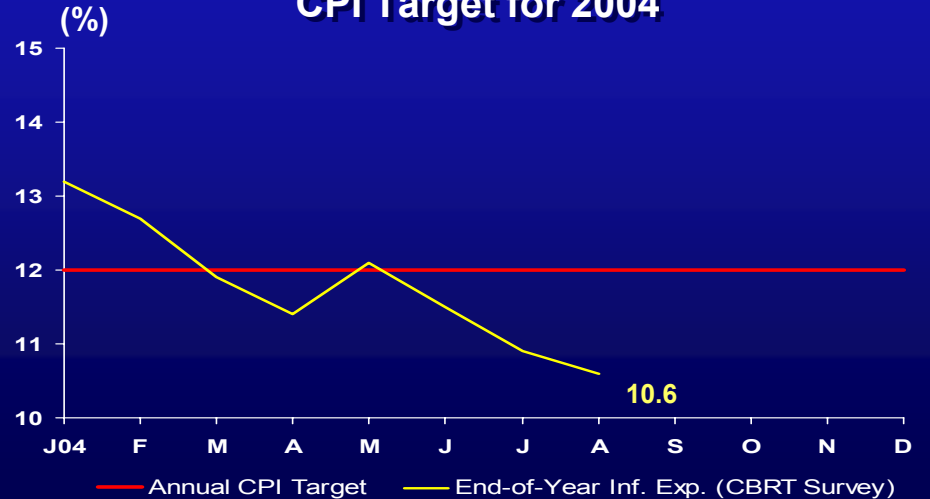
B. Rooting Out The Inflation Inertia



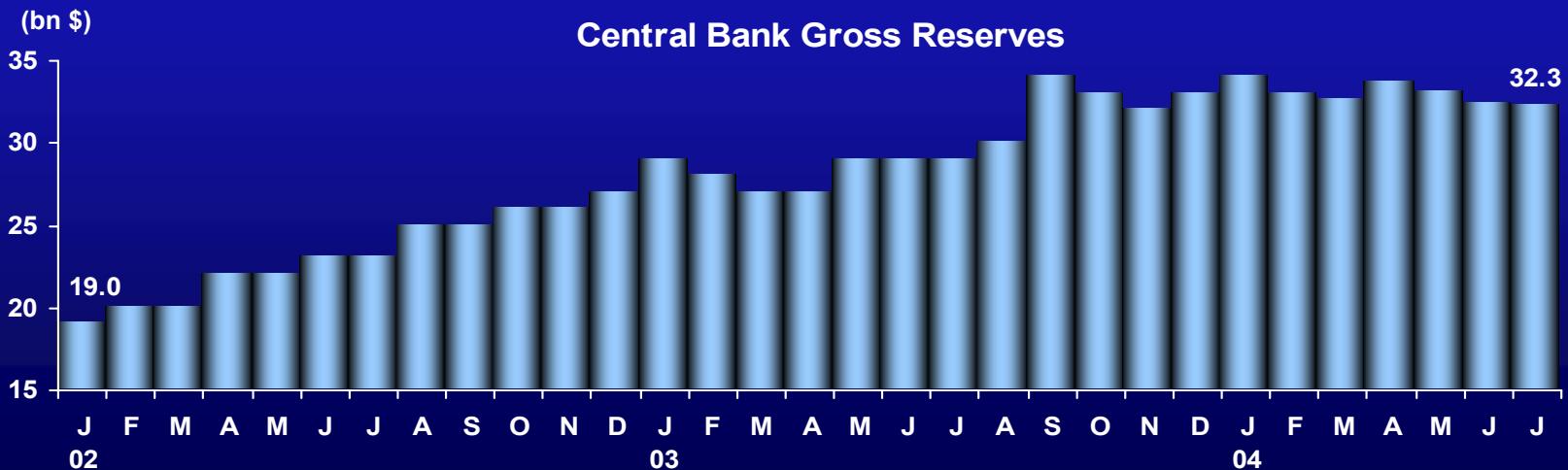
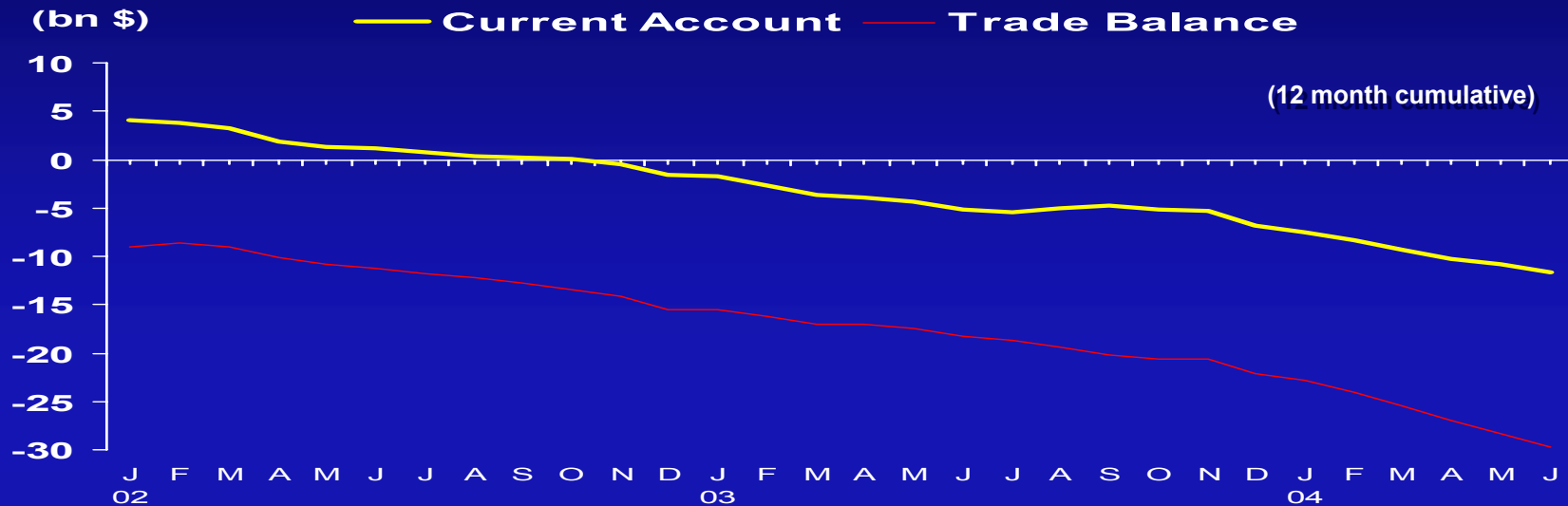
**Inflation Expectations and CPI Target for 2003**



**Inflation Expectations and CPI Target for 2004**



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



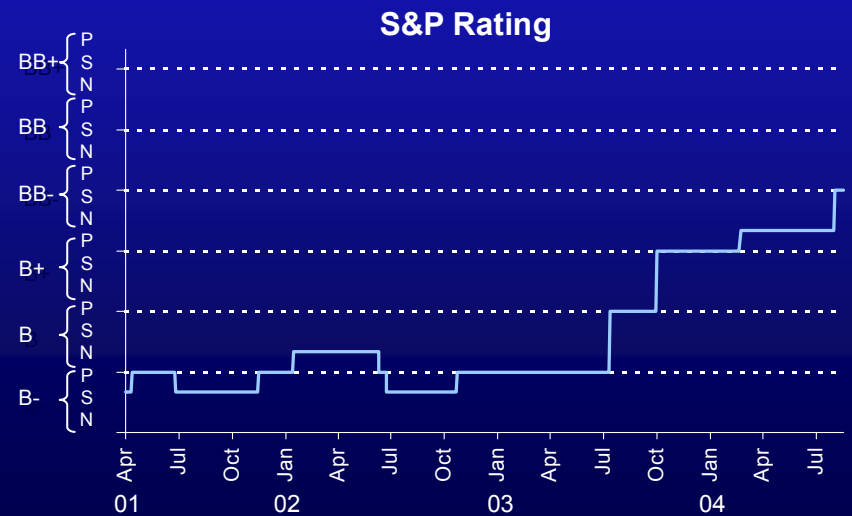
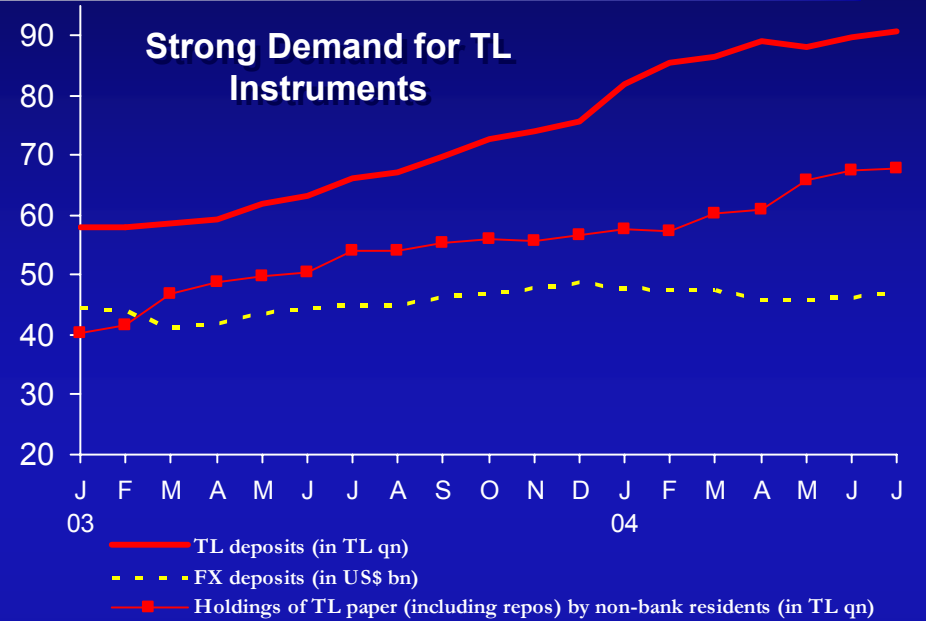
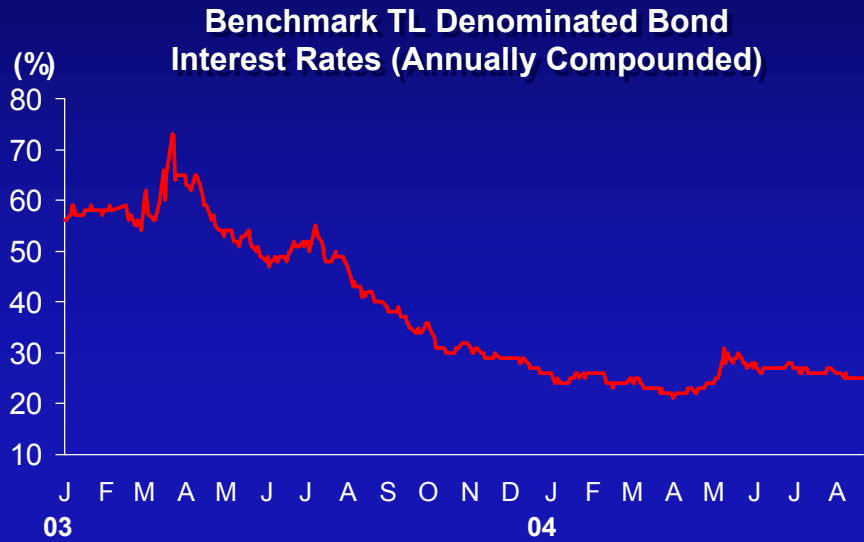
## **D. External Balance: Developments That Will Contain Widening Current Account Deficit**

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- ✓ **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

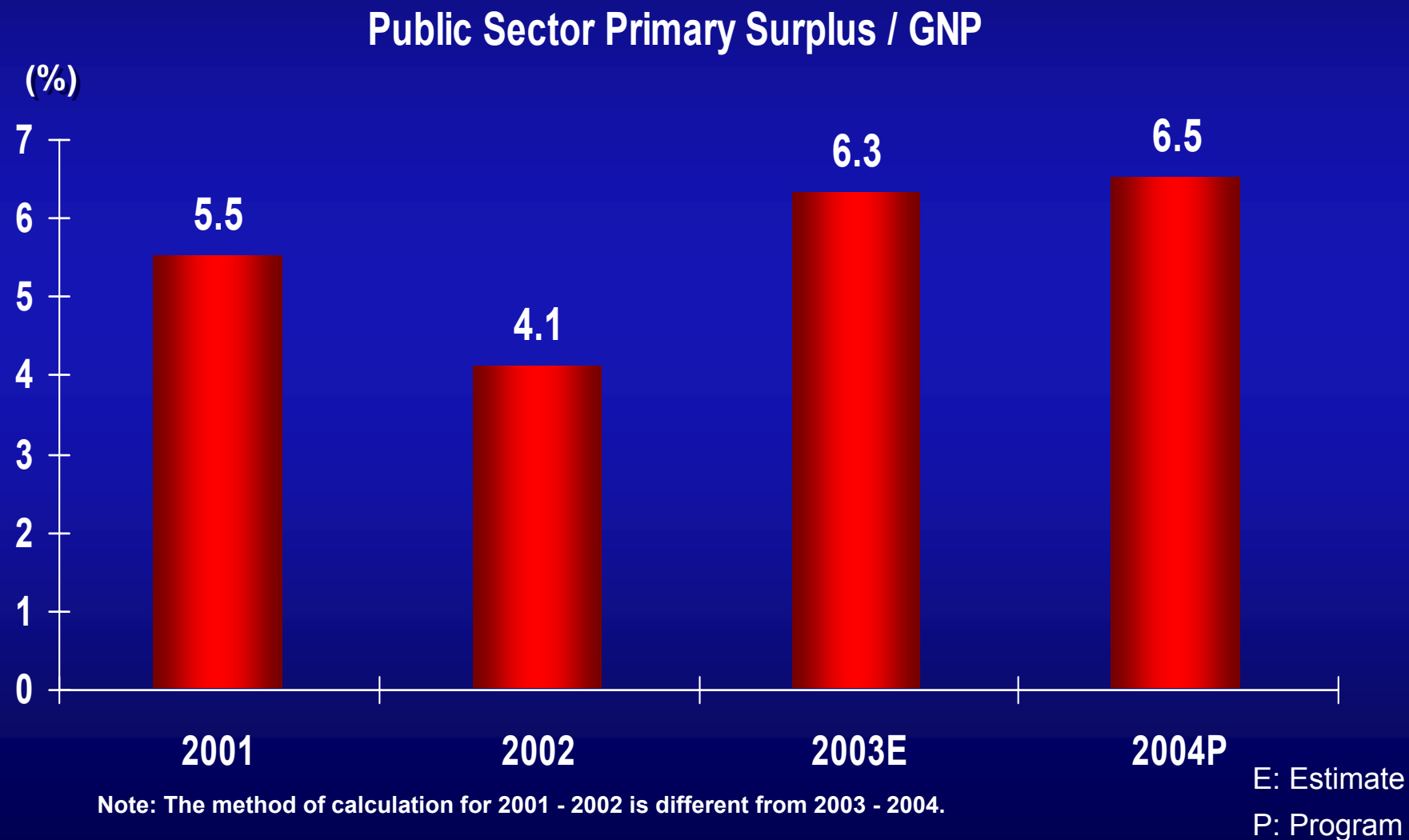




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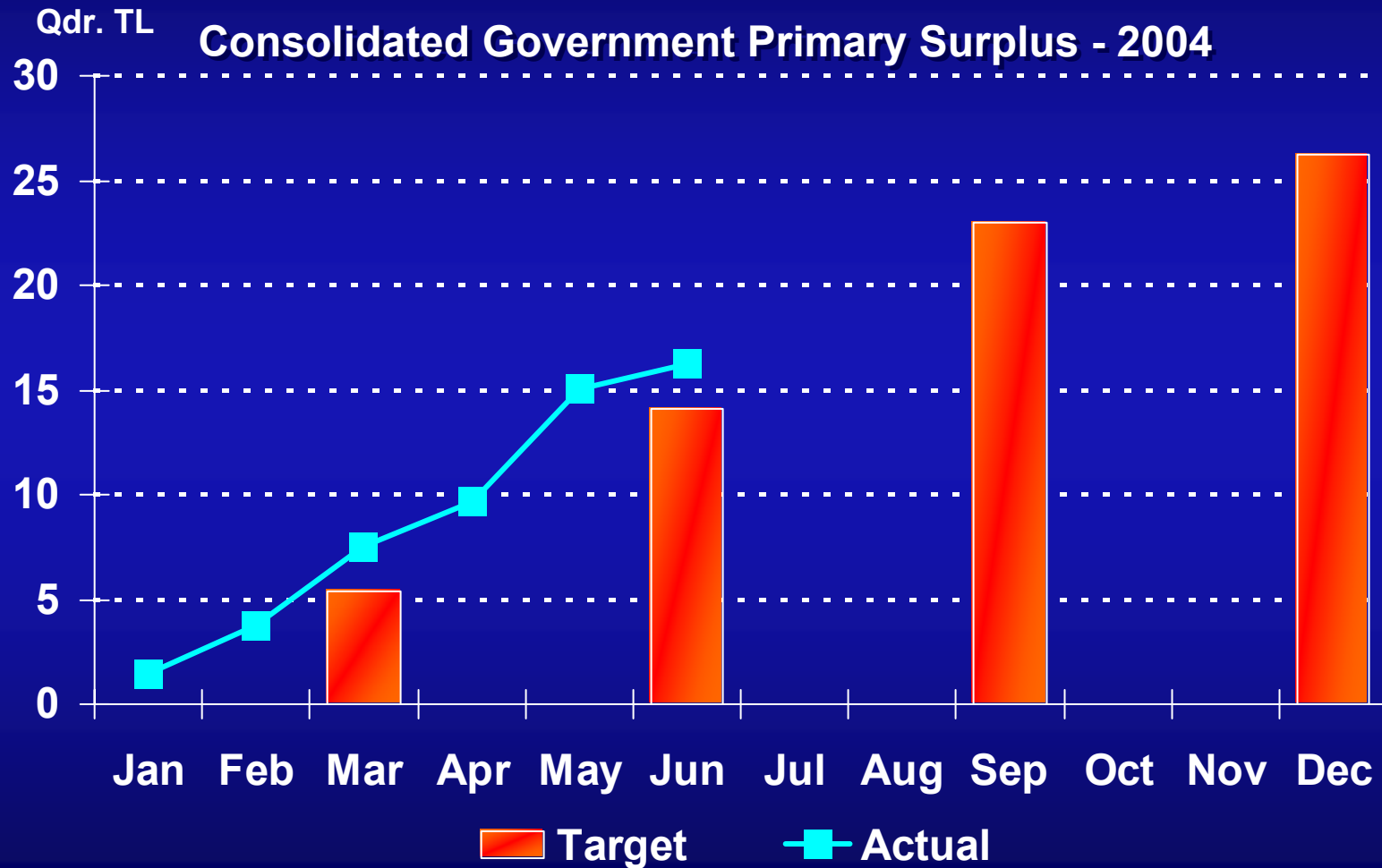
# **BUDGET AND DEBT DYNAMICS**

## A. Fiscal Adjustment



## II. BUDGET AND DEBT DYNAMICS

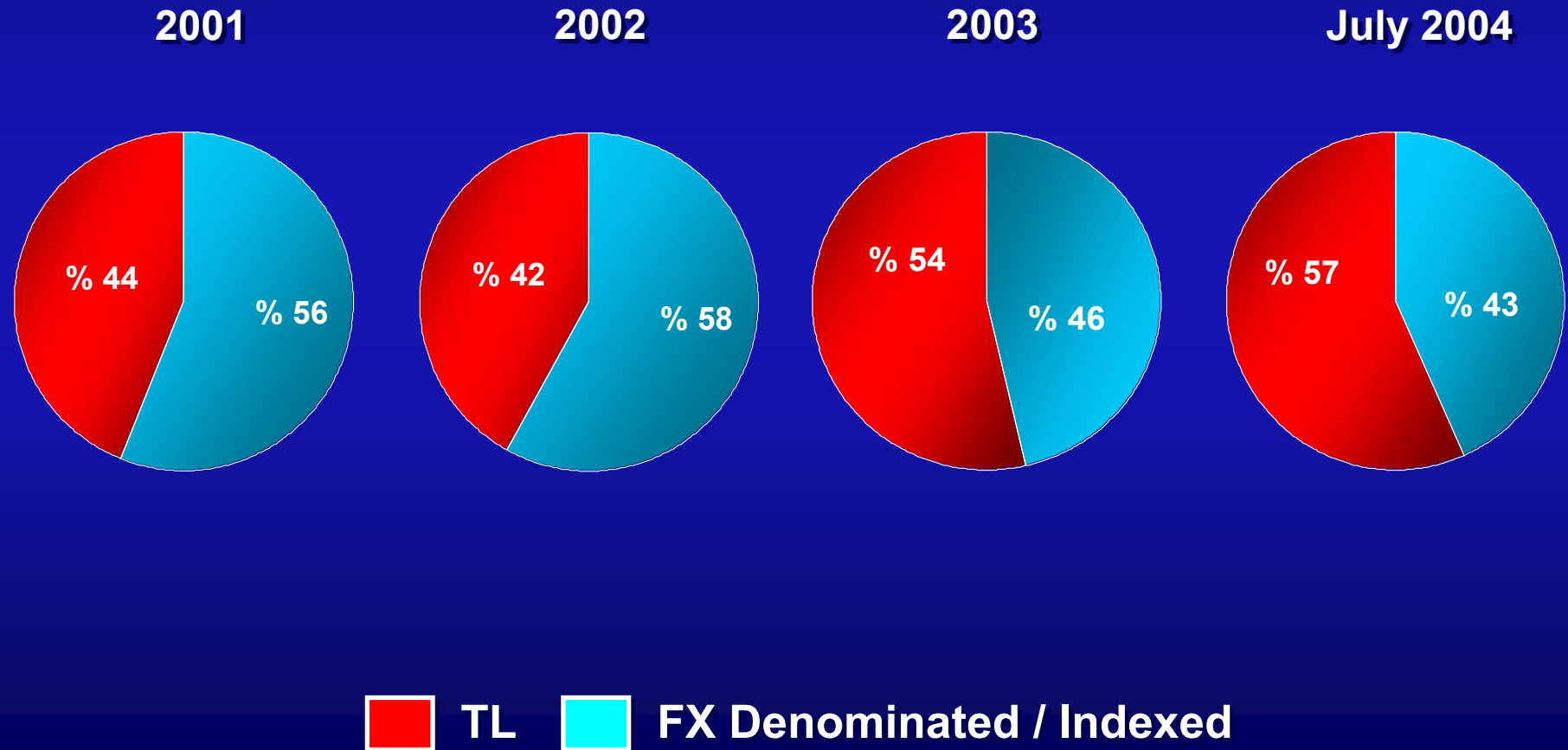
### B. Fiscal Targets Under the Program Overperformed in the First Half of 2004



## II. BUDGET AND DEBT DYNAMICS

## C. Improved Debt Structure (1)

## Total Debt Stock



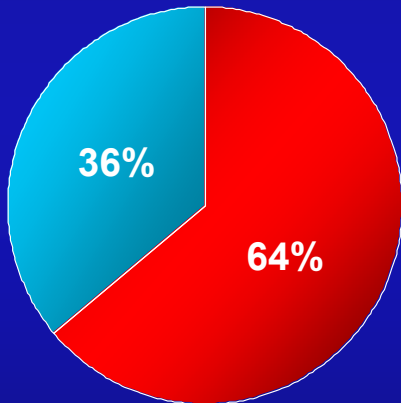
## II. BUDGET AND DEBT DYNAMICS

## C. Improved Debt Structure (2)

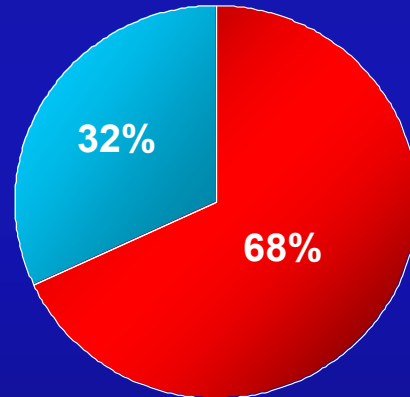
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### Domestic Debt Stock

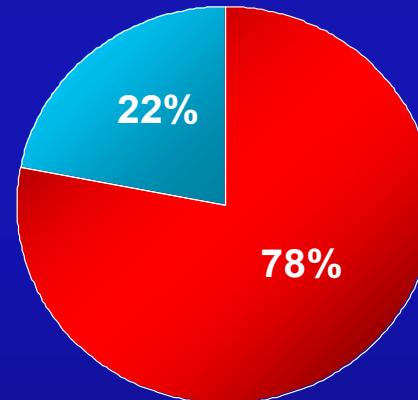
2001



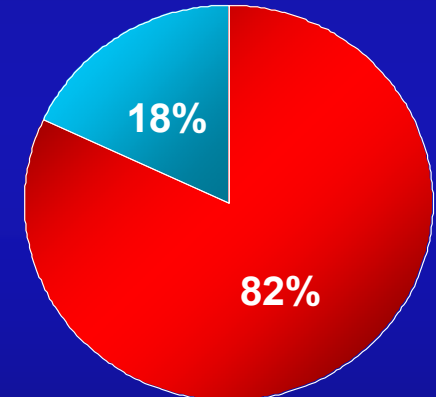
2002



2003



July 2004



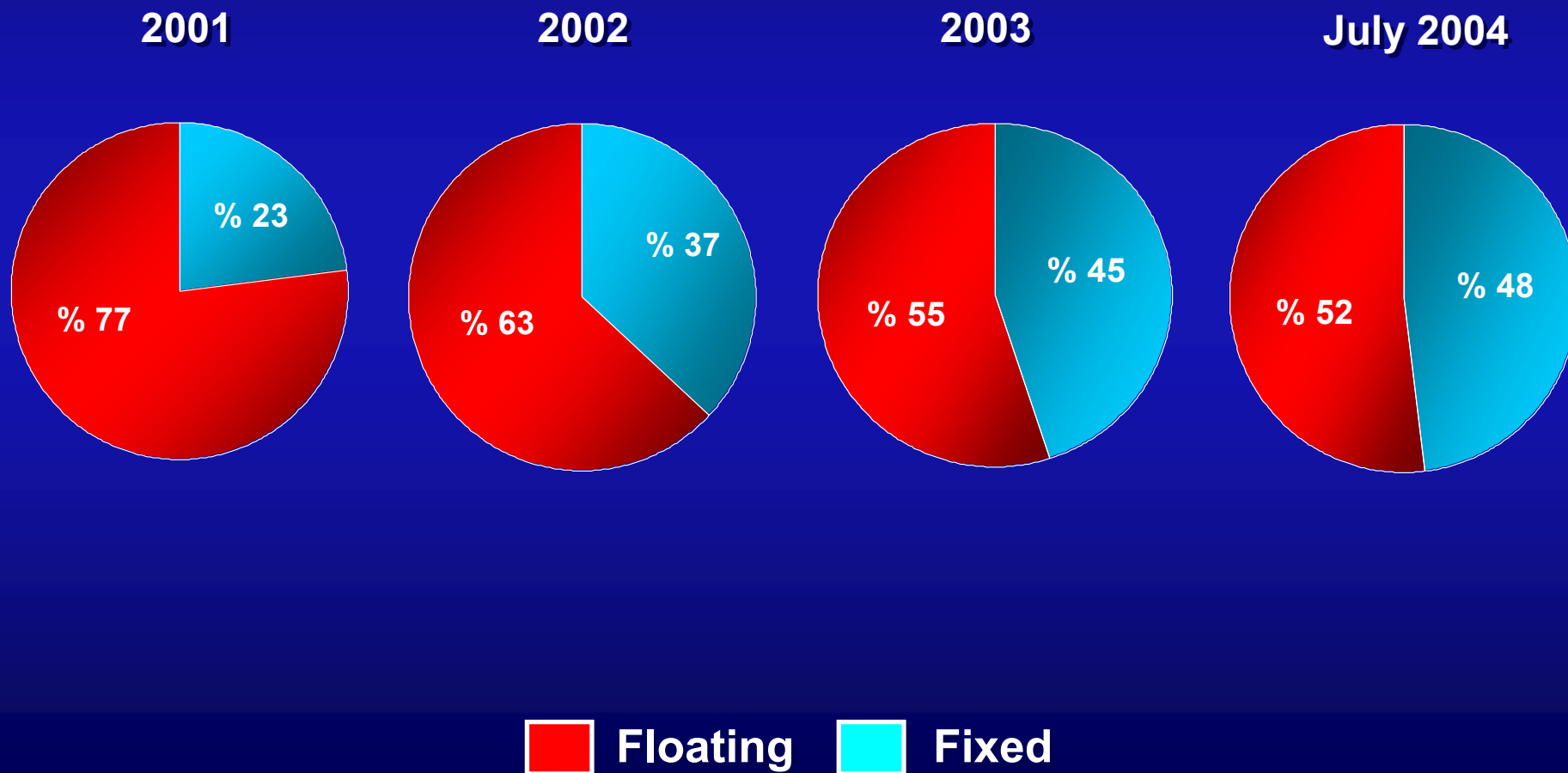
TL



FX Denominated / Indexed

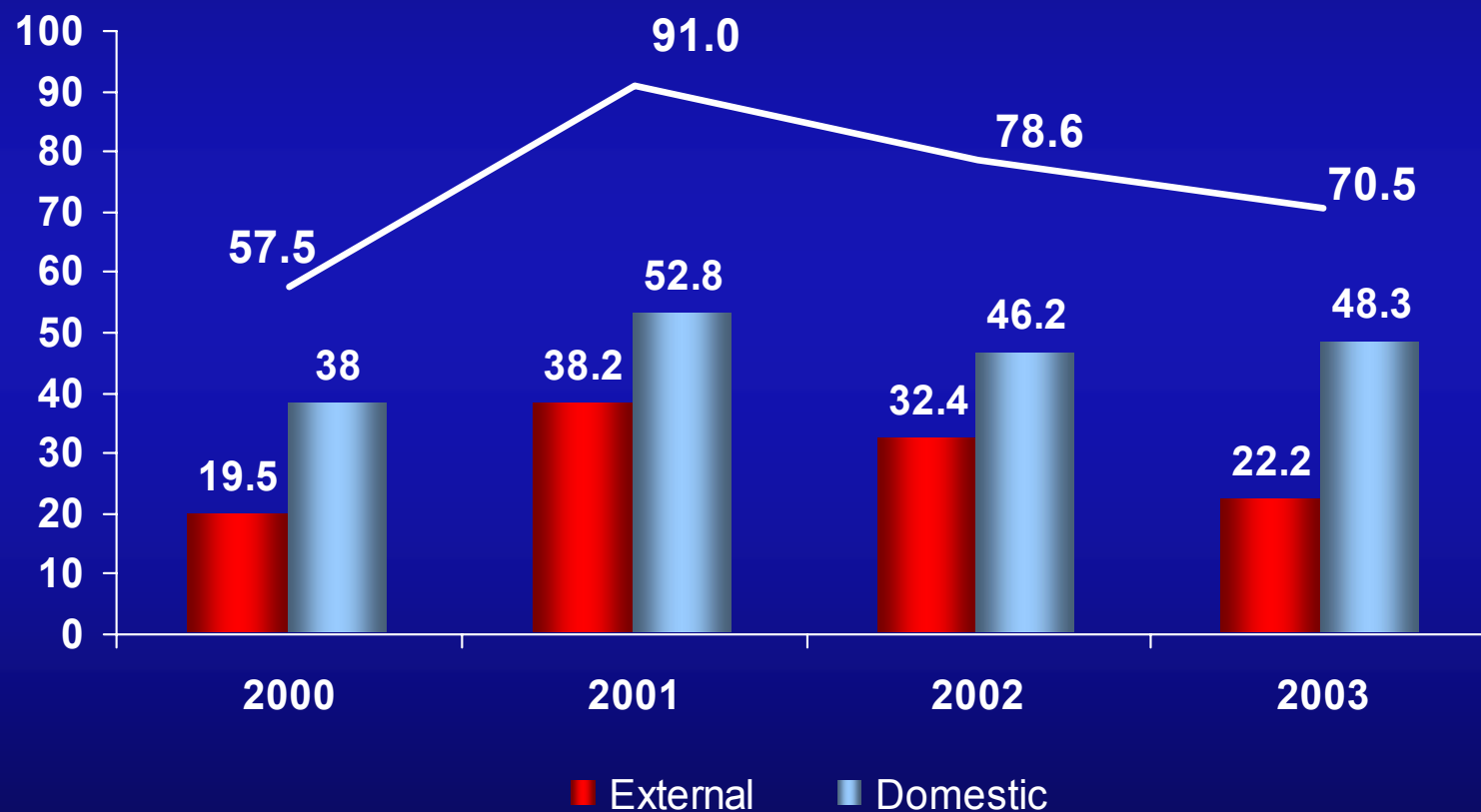
## C. Improved Debt Structure (3)

### TL Denominated Debt Stock



## D. Declining Debt Burden

### Net Public Debt Stock / GNP



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# STRUCTURAL REFORMS



### III. STRUCTURAL REFORMS: TAKING STOCK

## A. Substantial Progress in Structural Reforms

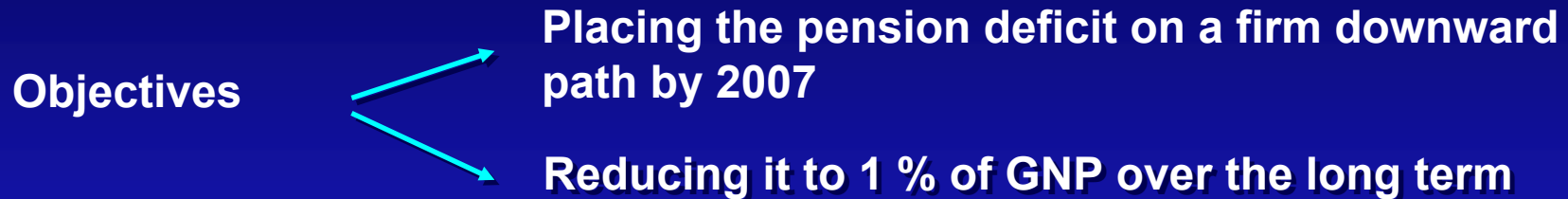
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- ✓ **Improving the Fiscal Administration**
- ✓ **Debt Management Reform**
- ✓ **Social Security Reform- The First Stage**
  
- ✓ **Banking Reform**
- ✓ **Independent Central Bank**
  
- ✓ **Agricultural Reform**
- ✓ **Opening Up Key Sectors To Competition**
- ✓ **Independent Regulatory and Supervisory Agencies**
  
- ✓ **Steps to Improve the Investment Environment**

### III. STRUCTURAL REFORMS: ONGOING

## B. Creating a Self Sustaining Social Security System

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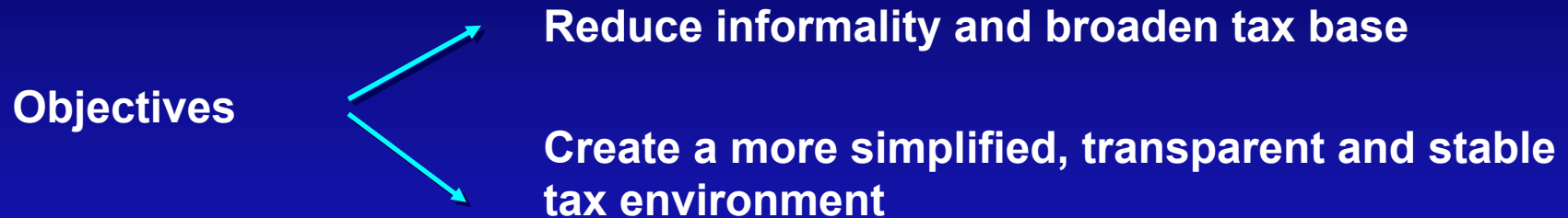
### Main pillars of the social security reform:

- ✓ **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

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### 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

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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

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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**

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# PROSPECTS

## IV. PROSPECTS

### A. New Economic Program

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- **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**

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- ✓ **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.**

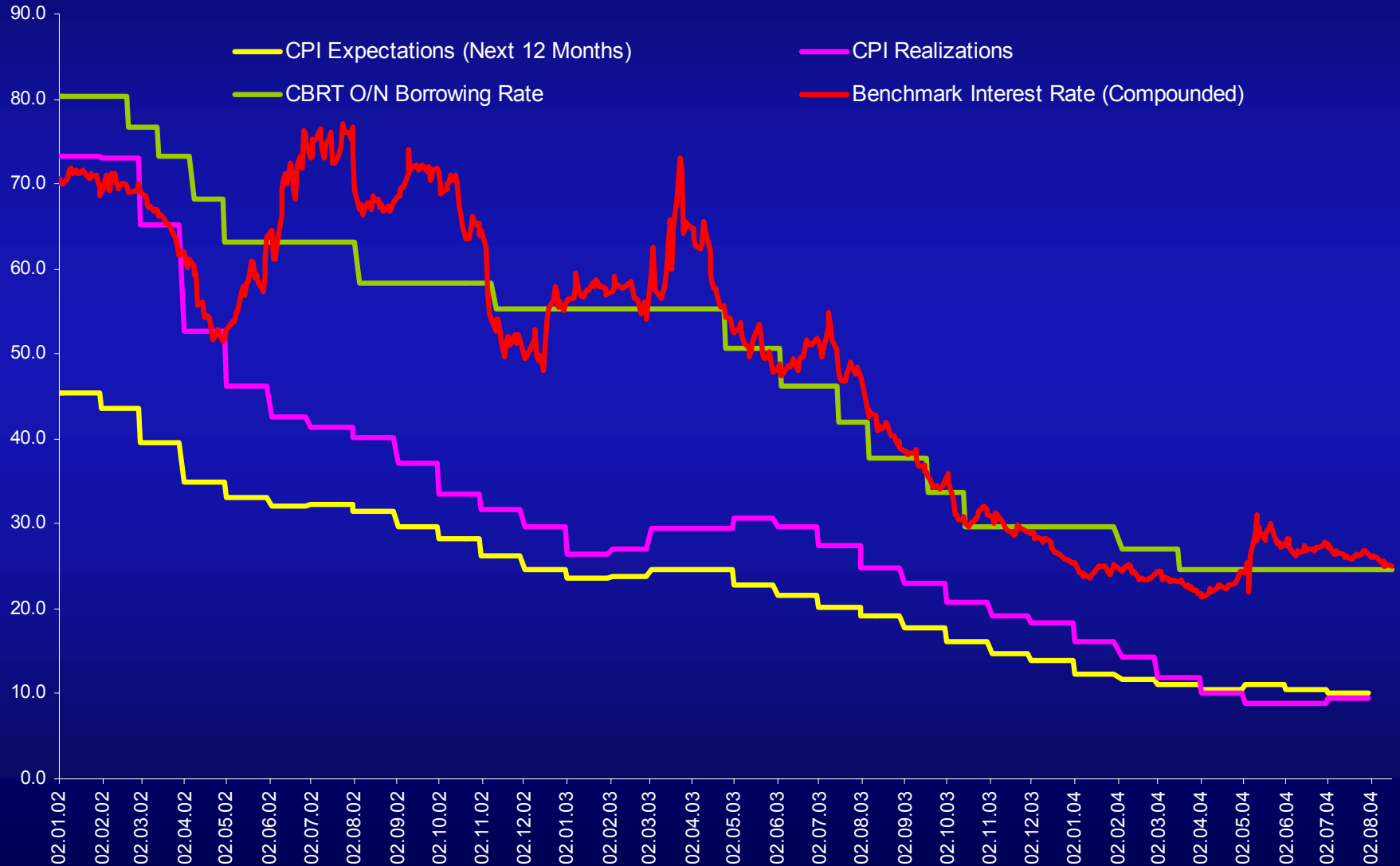
## V. GENERAL FRAMEWORK OF THE MONETARY AND EXCHANGE RATE POLICY

### A. Monetary Policy Framework Since 2002 (2)

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- ✓ 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)

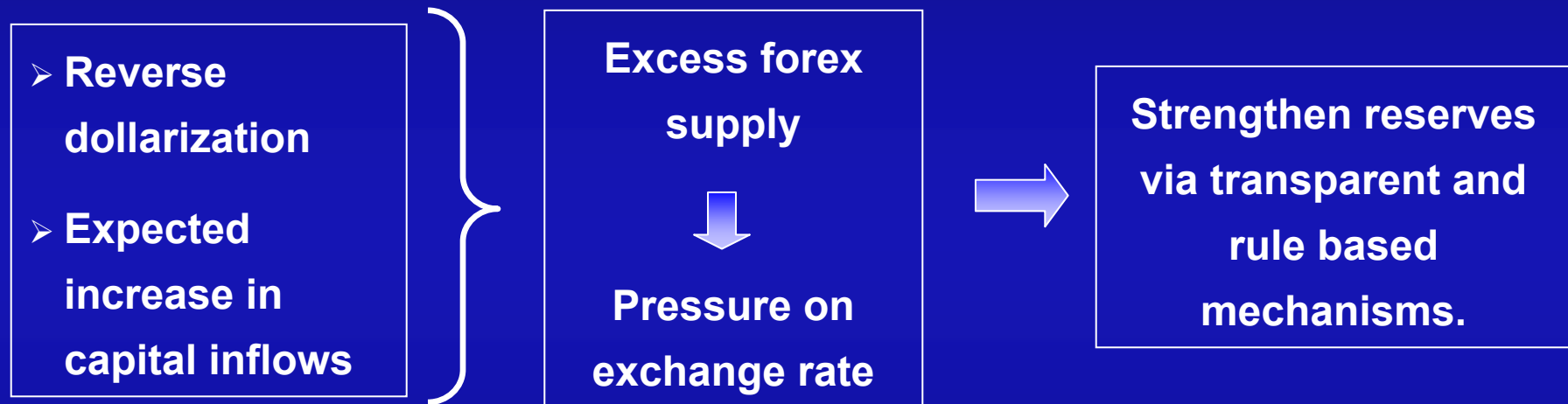
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### Floating Exchange Rate Regime

- ✓ 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

