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Turkey: Tenth Review Under the Stand-By Arrangement—Staff Report; and News Brief on the Executive Board Discussion

In the context of the Tenth Review Under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Tenth Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 28, 2001,** with the officials of Turkey on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 21, 2001**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a News Brief summarizing the **views of the Executive Board as expressed during its November 28, 2001 discussion** of the staff report that completed the review.

The documents listed below have been separately released.

Letter of Intent sent to the IMF by the authorities of Turkey*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

TURKEY

Tenth Review Under the Stand-By Arrangement

Prepared by European I Department in Consultation with Other Departments

Approved by Susan Schadler and Liam P. Ebrill

November 21, 2001

- Discussions for the tenth review under the Stand-By Arrangement (SBA) with Turkey were held in three stages: a staff team visited Ankara and Istanbul during September 6–19; the authorities visited Fund headquarters during September 30–October 5; and the staff team returned to Turkey for a November 4–14 visit.

- The staff participating in the missions comprised Messrs. Kähkönen (head), Aitken, Griffiths, and Rossi (all EU1), Mr. Flanagan from FAD, Mr. Thorne (in September) and Ms. Lim (in November) from ICM, Mr. Josefsson, Ms. Basu (in September), and Ms. Gutierrez (in November) from MAE, and Mr. McGettigan from PDR. Mr. Brekk, senior resident representative, and Mr. Piñerúa, MAE resident representative assisted the missions, and the missions cooperated closely with World Bank staff on structural issues. Mr. Çakir, Advisor to the Executive Director for Turkey, attended several meetings.

- The missions met with the State Minister for Economic Affairs, Mr. Derviş; the State Minister for Foreign Trade, Mr. Toskay; the Minister of Finance, Mr. Oral; the Minister for Privatization, Mr. Karakoyunlu; the Minister for Transportation, Mr. Vural; the Undersecretary of the Treasury, Mr. Öztrak; the Governor of the Central Bank of Turkey, Mr. Serdengeçti; the Chairman of the Bank Regulation and Supervision Agency, Mr. Akçakoca; and other senior officials; as well as representatives of the private banking and business communities.

- The Turkish authorities intend to allow the publication of the staff report.

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I. Introduction

1. **The Fund supports Turkey's economic program under an SBA covering 2000-02** (Table 1). The arrangement was augmented with resources under the Supplemental Reserve Facility in December 2000, and under the credit tranches in May 2001. The ninth review under the program was completed on August 3, allowing a purchase in an amount equivalent to SDR 1.2 billion. The next purchase, in an amount equivalent to SDR 2.4 billion, is contingent on the completion of this review. Under the Fund's safeguards assessment policy, the external audit assessment was completed on August 21, 2001 (Appendix I and Section IV). The World Bank supports Turkey under a country assistance strategy envisaging overall lending of up to US$6.2 billion during FY2001–03.

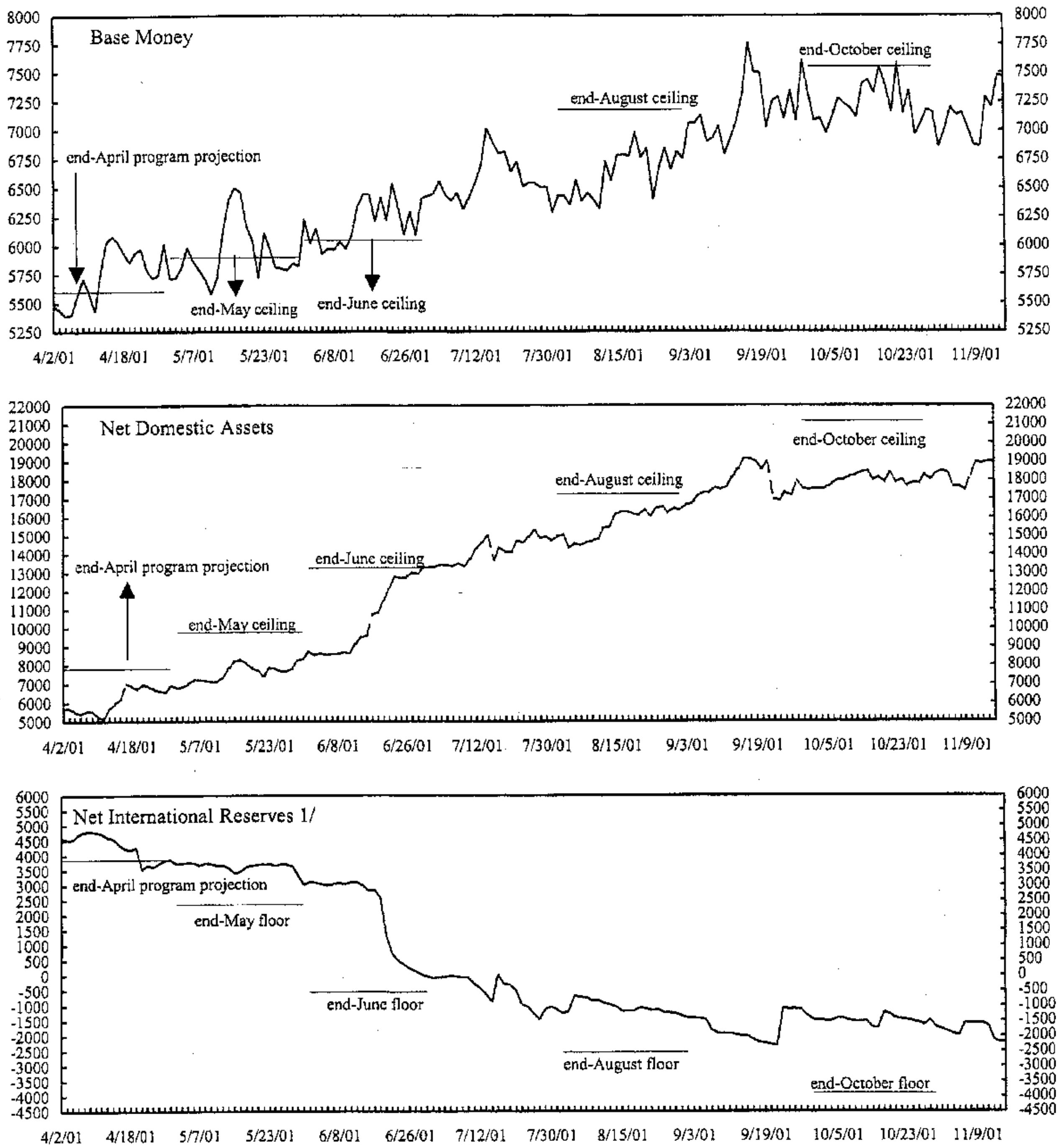
2. **In the attached letter, the authorities review developments and policies under their program, and request the modification and setting of several performance criteria and the completion of the tenth review.** They request a modification of the ceiling for the performance criterion on the cumulative primary expenditure of the central government for end-December 2001, reflecting higher inflation than envisaged at the time of the ninth review. In addition, they request the setting of the performance criterion on the change in net international reserves for end-December to allow full carryover of the unused portion of the previous period's limit. Such a move would permit the CBT to use the (delayed) tenth review disbursement of Fund resources to sterilize the on-lending of external resources to the Treasury. Moreover, to strengthen their disinflation effort, the authorities request the conversion of the end-December indicative ceiling for base money into a performance criterion. Finally, the authorities request that the net domestic assets of the Central Bank of Turkey (CBT), an indicative target for end-December, be measured using a fixed U.S. dollar/TL exchange rate.

3. **In the letter, the authorities also indicate their intention to adopt a new medium-term economic program, for which they seek international financial support.** Although the current program was showing signs of beginning to work from late August, the repercussions of the September 11 events on Turkey are likely to be severe, giving rise to additional external and fiscal financing needs. To ensure debt and balance of payments sustainability, any such financing will need to take place in the context of a new strengthened medium-term program, which the authorities plan to present to the Fund by end-2001.

II. Performance under the Program

4. **Since the ninth review, the authorities have kept macroeconomic policies in line with the strengthened program adopted in May.** All performance criteria for the tenth review have been met, as have those for the eleventh review (Annex A in the Attachment). Fiscal performance has been strong, with the authorities fully on track to meet this year's ambitious public sector primary surplus target of 5½ percent of GNP. The CBT has kept monetary aggregates in line with program targets, although the moderation in base money growth also reflects increased demand for foreign currency deposits (Figure 1). Uncertainty

Figure 1. Turkey: Monetary Developments, 2001
(In trillions of TL)



Source: Data from the Turkish authorities.

1/ In millions of U.S. dollars.

over the exchange rate regime has abated since early August, following the CBT's announcement that it would strictly limit its discretionary intervention. Consistent with the CBT's mandate for price stability, interest rate decisions have made increasing reference to the need to contain inflation.

5. **The authorities have continued with structural reform, although steps to encourage foreign direct investment have been tentative, and there has been limited progress toward divesting large enterprises:**

- **The program's structural conditionality is being met.** The end-October structural benchmark on appointing advisors for Türk Telekom was observed, and actions on two other benchmarks (submitting a Public Procurement Law to parliament and supporting the draft 2002 budget with accounts and financial outlook for the various public sector entities) were completed with only a short delay (Annex B in the Attachment).

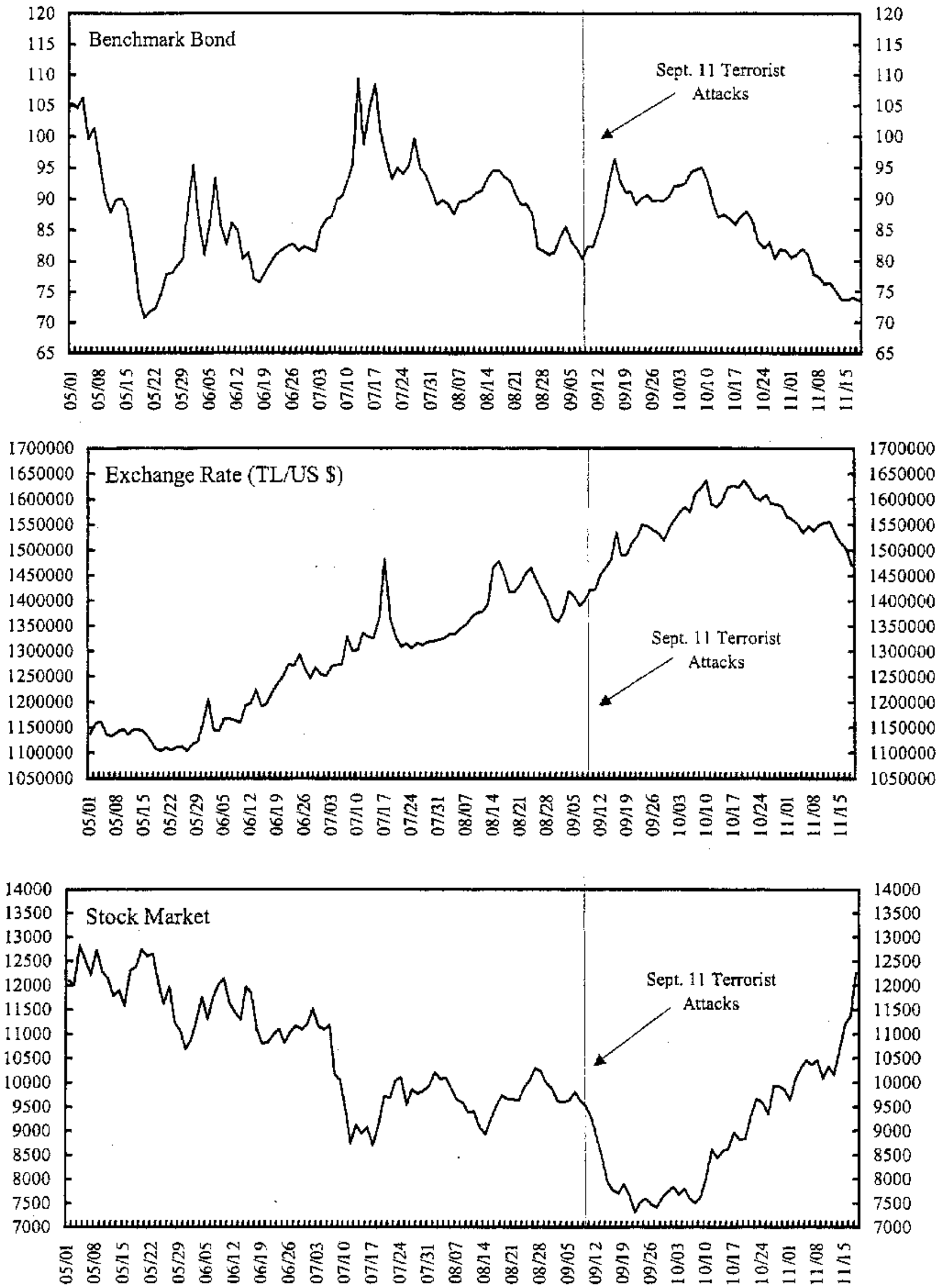
- **Although the banking system remains under strain, there has been significant progress in implementing financial sector reform.** State banks are being restructured, with the largest of them now among the most profitable in Turkey. The authorities have continued to press private banks into achieving and maintaining an 8 percent capital adequacy requirement, and to resolve the remaining intervened banks. However, the combination of economic recession, exchange rate instability, and high interest rates has placed the banking system under strain, despite these considerable reform efforts.

- **The agenda for encouraging foreign direct investment is gradually taking shape.** A mid-September conference on administrative barriers to investment formulated an action plan, which was submitted to the Council of Ministers in mid-November. A high level investor conference has, however, been postponed into next year.

- **Privatization is facing delays.** While the conditionality on Türk Telekom was met, legislative and administrative delays make it unlikely that the privatization plans for TEKEL (tobacco and alcohol monopoly) and ŞEKER (sugar company) will be ready by year-end. Moreover, the planned sales of shares in TÜPRAŞ (oil refinery) and POAŞ (petrol distribution) will not take place this year because of weak market conditions in the aftermath of September 11.

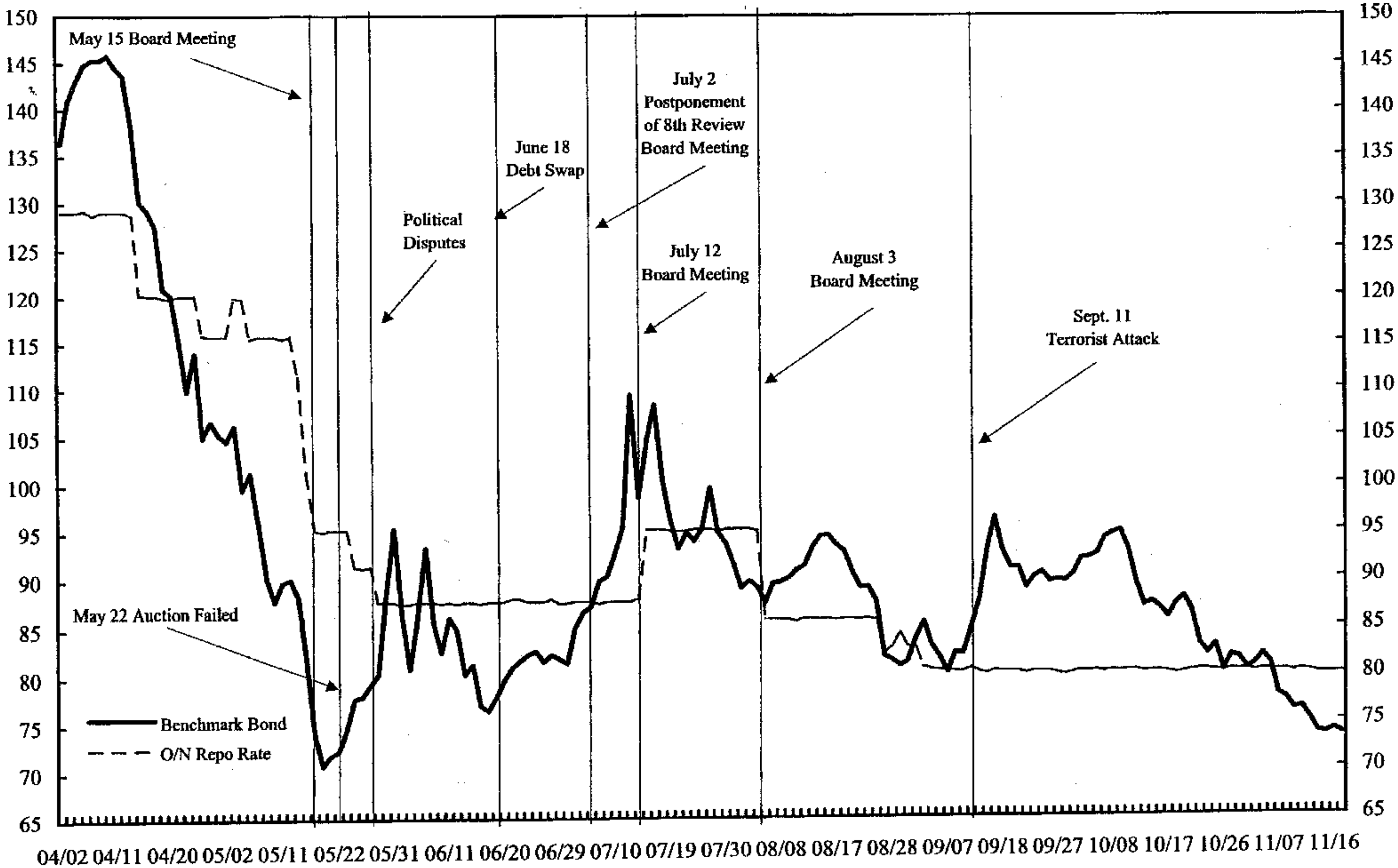
6. **After some initial problems with program implementation, the long-awaited decline in interest rates started toward the end of the summer** (Figures 2–3). The May program was designed to break a crisis of confidence, helping interest rates to decline and concerns about debt sustainability and rollover to diminish. However, amid delays in meeting the conditions for completing the ninth review, political disagreements over program implementation, and the lack of a nominal anchor, interest rates rose to more than 100 percent in July, adding to concerns over debt sustainability. But by late summer—after a

Figure 2. Turkey: Market Developments, 2001



Source: Data from the Turkish authorities.

Figure 3. Turkey: Interest Rates, 2001 1/



Source: Data provided by the authorities.

1/ Compounded interest rates.

period relatively free from political tension, the floating exchange rate being given a chance to work, and the ninth review completed (and the tenth review seemingly on track)—the benchmark bond rate had fallen to 80 percent, and the exchange rate was broadly stable. In addition, the voluntary debt swap in June, the measures introduced in July to encourage investments in government paper (including withholding tax reductions, partial remuneration of reserves, and the possibility of increased state bank participation) and increasing use of FX-linked borrowing all helped to ease the debt rollover problem for the remainder of 2001.

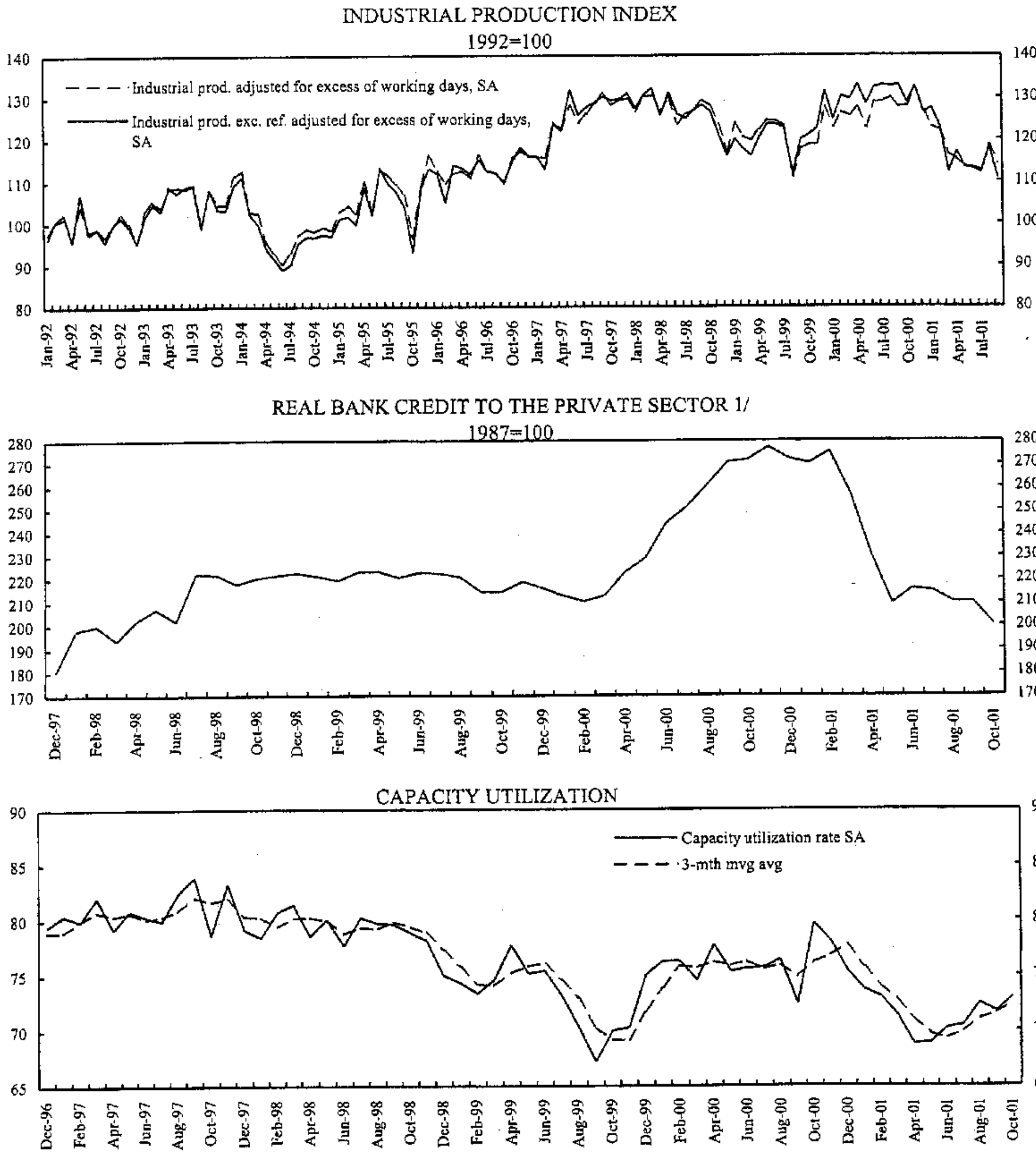
7. **Just as the program was beginning to show signs of working, the adverse economic effects of September 11 set back hopes of a rapid recovery.** Within days interest rates on the benchmark bond rate shot up by 15 percentage points, the stock market lost almost 20 percent of its value, and the exchange rate fell by 10 percent. In part this reflected investors' increased aversion to emerging market assets, in Turkey's case compounded by its vulnerability (in terms of indebtedness) and its location. This sizeable external shock is affecting the economy through many channels: lower partner country demand, loss of tourism receipts, reduced access to international financial markets, and weakened privatization and FDI prospects. All of these have increased the risk to the external position and fiscal sustainability (Table 2 and Appendix II). At the same time, the more depreciated exchange rate has also contributed to the recent rise in inflation (to over 66 percent year on year in October for CPI), despite the authorities' adherence to the monetary program.

8. **While confidence has returned in recent weeks, Turkey's reform program remains precariously, if auspiciously, poised.** While the challenges, most notably ensuring the sustainability and rollover of the government's domestic debt, remain serious, progress was being made pre September 11. Following weaker-than-projected growth in the first half of the year, there were signs that the economy was bottoming out (Figures 4–5). Export growth has also been strong, despite slowing world growth. And despite the immediate impact of the September 11 shock, in the last month market conditions have improved considerably, largely on the hope of international financial assistance from the official sector. In recent weeks, benchmark bond rates have fallen to around 75 percent, the exchange rate has appreciated somewhat, and the stock market has recovered strongly. Also, the spreads on Turkish bonds in the Euromarket have narrowed, despite developments in Argentina (Figure 6). Thus, while many challenges remain, the prospect of a virtuous spiral of improved confidence in rolling over the debt, lower interest rates, and exchange rate strengthening might once again take hold.

III. Report on the Discussions

9. **Initially straightforward discussions for the tenth review had to be adapted following the events of September 11.** During the September 6–19 discussions, the staff confirmed that all performance criteria relevant for the review had been met, but understandings could not be reached on an ambitious inflation target for 2002, or on measures to reach the 2002 fiscal targets. On top of this, the events of September 11 argued for a shift in focus. Subsequent discussions in Washington and Ankara covered not only the

Figure 4. Turkey: Output and Demand, 1992-2001

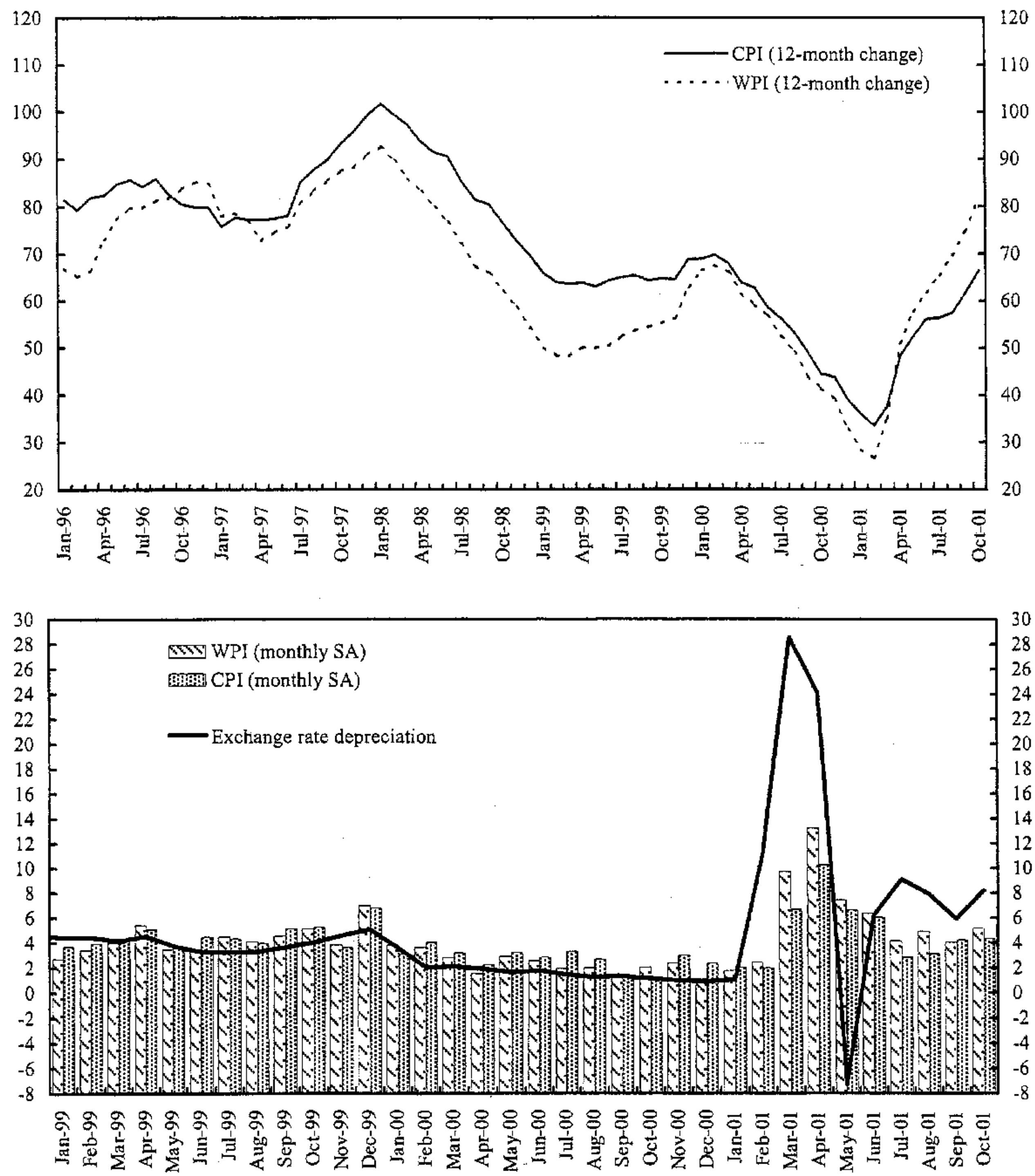


Source: Data provided by the Turkish authorities.

1/ The stock of loans has been adjusted for the shift to nonperforming loans of the loans of the banks taken over in December 1999 by the Saving Deposit Insurance Fund.

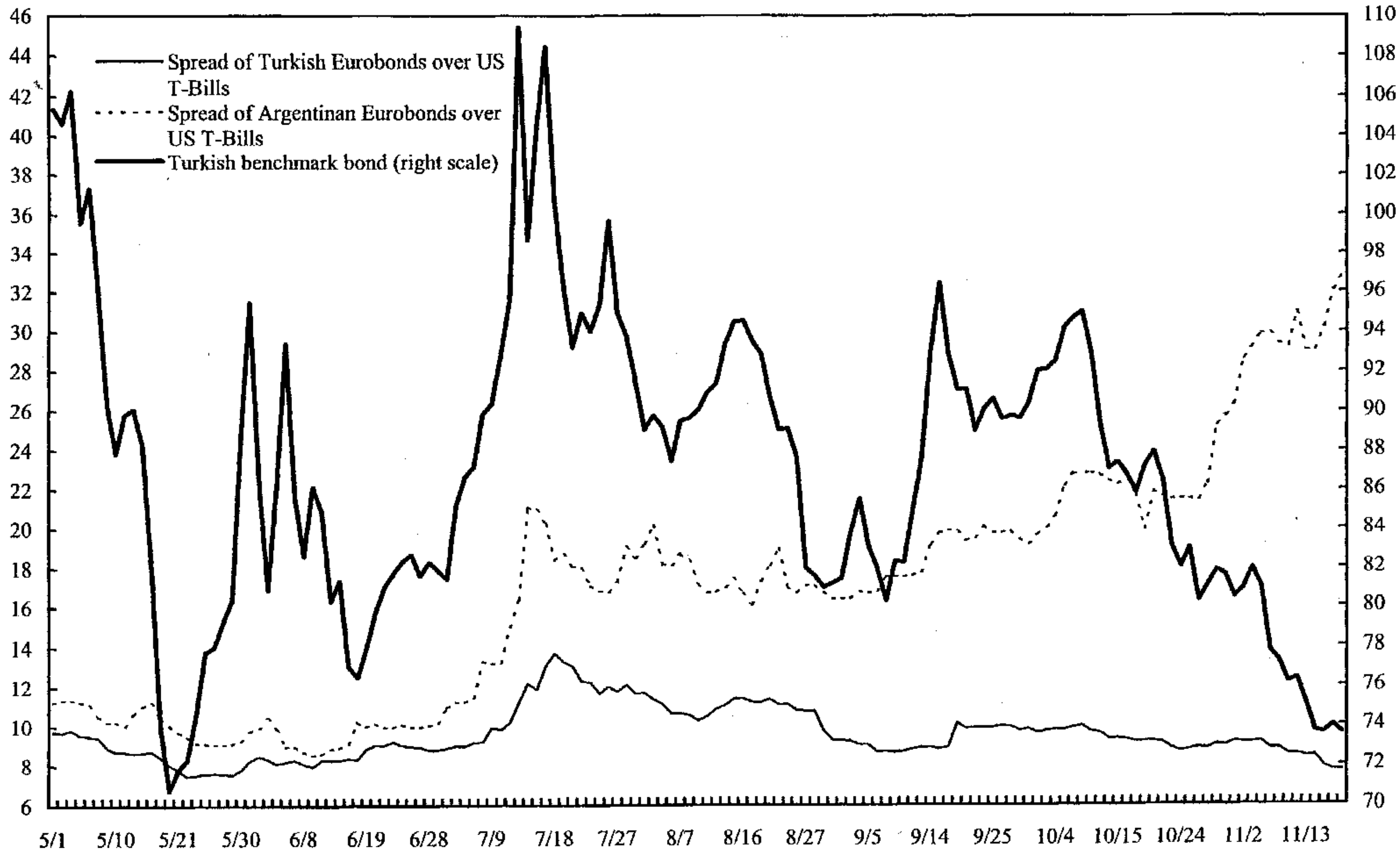
2/ Seasonally adjusted; the total VAT has been adjusted for tax changes.

Figure 5. Turkey: Inflation, 1996-2001



Source: Data provided by the Turkish authorities.

Figure 6. Turkey: Bond Spreads, 2001
(Percentage Points)



Source: Data provided by the authorities; and Bloomberg.

measures required to conclude the tenth review but also the additional financing and policy requirements in light of changed circumstances. This section reports on discussions on all these topics.

A. Macroeconomic Outlook and Financing Needs

10. **Reflecting developments through the third quarter, including the events of September 11, the authorities and staff agreed to revise the macroeconomic framework (¶8 and Table 3):**[1]

- **The delayed impact of the May program and the events of September 11 justified downward revisions to GNP projections for this year and next.** The decline in GNP was revised to 8½ percent for 2001, compared with the 5½ percent decline envisaged at the time of the ninth review. Even before September 11, a steeper-than-expected decline in GNP in the second quarter and weaker-than-envisaged prospects for agricultural production had suggested that economic recovery would be delayed. The worsened external environment in the aftermath of the events of September 11 compounded this delay. It was expected, however, that as the program took hold, the economy would rebound toward the end of the year, with real GNP growth of 4 percent forecast for 2002, mainly as a result of stock building and a modest increase in private consumption.

- **The inflation targets for 2001–02 were raised.** While seasonally adjusted monthly inflation had declined to 3 percent in July–August, it rose to over 4 percent in September–October, in large part owing to faster-than-projected currency depreciation after September 11. With little scope for a substantial tightening of monetary policy in light of debt rollover concerns, and thus the risk that currency depreciation might ensue, it was the joint assessment of the staff and authorities that CPI inflation would likely reach 65 percent by year-end, up from 58 percent projected at the time of the ninth review. As for 2002, the staff initially argued for a target closer to the 20 percent envisaged in the May program but, given the events of September 11, the deeper than expected recession, and the continued concerns about domestic debt rollover, in the end accepted the authorities' 35 percent target.

- **In light of the increased uncertainty created by the events on September 11, the macroeconomic framework was, however, seen to be subject to risks.** In the staff's view, the risks for growth in 2001–02 were mainly on the downside, while inflation in 2001 could end up above the present projections. While acknowledging the risks, the authorities argued that revision of the macroeconomic framework should await forthcoming data (such as figures for GNP in the third quarter and inflation in

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[1] ¶ refers to the relevant paragraph in the attached Letter of Intent.

November which will be out by early December) for confirmation of these risks. The authorities indicated their readiness to take additional measures as needed to reach the fiscal targets should the macroeconomic framework change.

11. **As regards the balance of payments, the authorities and staff estimated that, following September 11, Turkey was likely to face an external financing gap of about US$10 billion in 2001–02.** (This gap and its sources are discussed in detail in Appendix III; the detailed balance of payments projections are shown in Table 4). Both sides stressed that these projections were subject to much uncertainty, and that employing a range of US$8-12 billion was, therefore, appropriate. On the current account, it was a common view that travel receipts would be particularly adversely affected (with a projected decline of US$2 billion in receipts next year), given Turkey's location. On the capital account, despite the recent € 500 million Eurobond issue, the authorities indicated that issuance would be constrained in the post-September 11 environment to about US$2 billion next year (compared with a pre-September 11 plan for issuance of US$3.5 billion or more). And, while net banking sector outflows were expected to moderate significantly compared with 2001, it was agreed that net outflows of about US$5 billion next year were likely unless international market confidence was restored quickly, or the program contained a strong external private sector involvement (PSI) element. Regarding the latter, it was noted that the experience with PSI had so far been disappointing—despite meetings with international banks in December 2000 and June 2001 on maintaining their exposures to Turkey, outflows of some US$7 billion had been recorded under interbank credit lines during 2001 so far—and that successful external PSI would only occur if explicitly supported by the appropriate authorities in those countries whose banks are the major players.

12. **Although rollover prospects through end-2001 looked reasonable, the September 11 shock made the task of rolling over domestic debt more challenging next year:**

- **The staff commended the authorities for their flexible management of domestic debt during August and early September, which put the Treasury in a comfortable cash position and helped to cushion the impact of the shock on the public finances.** The larger-than-programmed primary surpluses and the measures introduced in July to increase the demand for government paper had ensured good prospects for a smooth rollover for the remainder of 2001 (¶10). In managing the rollover in 2002, the authorities stressed that they would continue to respond flexibly to changes in market conditions, exploring ways of lengthening maturities while meeting the balance sheet concerns of investors through instruments such as fx-linked securities and floating rate notes (¶11). They had also established an interagency committee to assist the Treasury in the formulation of its borrowing policy (¶12).

- **The shock had worsened budget financing prospects for 2002, with well over half of the additional external financing in 2002 being needed for the budget to support a smooth rollover of domestic debt.** Financial market conditions abroad had worsened prospects for Eurobond issues and privatization proceeds, which in the absence of additional external financing would increase the financing to be raised domestically—mainly from the banking sector. While stable deposit growth and the strong financial position of state banks should allow them to contribute significantly to financing the budget, the remaining financing needed from private banks would be well in excess of what they could absorb without unduly crowding out private sector credit growth (Table 5). While this risk would very much depend on the quality of policies and the circumstances of the moment, projected balance sheet developments for public and private banks suggest that over half of the additional external financing would need to go to the budget to ensure that the private sector rollover rate was held to credible levels (around 85 percent). A full analysis will be provided in the documentation supporting the new stand-by arrangement.

13. **In the staff's assessment, with additional external financing of US$10 billion in 2001–02 and continuation of strong policies, Turkey's debt and balance of payments could be sustainable over the medium term:**

- **Provided the additional US$10 billion is of medium- or long-term maturity and confidence in Turkey's assets returns, the external position should be sustainable for the next several years—that is, current account positions should be financed with identified inflows while reserves remain at safe levels** (Appendix III, Tables 15 and 16). Medium- and long-term financing would help lower the ratio of short-term debt (by remaining maturity) to reserves—widely acknowledged to be the most helpful single external reserves indicator—to less than 150 percent through end-2004. Although under conservative assumptions the ratio would begin to pick up in 2005, reserves would likely turn out to be much higher in the medium term than currently projected if the program succeeds in restoring market confidence as intended. The current account is projected to record moderate deficits of about US$2 billion (1 percent of GNP) over the medium term. These projections imply broadly unchanged shares of exports, imports, and services in GNP from 2002 onward. At the same time, the capital account balance is projected to move from a US$3 billion deficit in 2002 to a surplus of US$3–6 billion over the medium term, reflecting an improvement in confidence. More than half of the turnaround reflects the assumption that banks will begin to secure modest net capital inflows, with the remaining improvement accounted for, in declining order of importance, by better international capital market access by the Treasury, a turnaround in net international corporate sector lending, and a gradual improvement in net portfolio flows.

- **With over half of the additional external financing going to the budget, Turkey's public debt would remain sustainable in the medium term—that is, it would shift to a declining trend relative to GNP—provided real interest rates converge to program levels and the primary surplus remains strong** (Table 6). The sharp increase in the public sector's net debt-to-GNP ratio expected for 2001 (to some 95 percent from last year's 57 percent) mostly reflects the one-off factors of the costs of bank recapitalization, the fall in output, and the real depreciation of the exchange rate. With US$5–7 billion in additional external financing, and with conservative (high) estimates of real interest rates, the public sector debt-to-GNP ratio is expected to fall by about 10 percentage points in 2002. Assuming a continued strong public sector primary surplus, a recovery of growth to 5 percent, and a small real appreciation, the debt-to-GNP ratio is projected to fall further to about 75 percent in 2003 and continue falling over the medium term.

B. Fiscal Policy

14. **The authorities were fully on track to meet their 2001 public sector primary surplus target of 5.5 percent of GNP (¶16 and Tables 7–9).** In the authorities' assessment, revenue overperformance and delays in investment expenditure in the broader public sector would more than offset higher spending in the central government generated by indexed wages and pensions. The authorities also insisted that expenditure arrears were being minimized by exerting tight control, and by handling any excess commitments, revealed via regular surveys of key ministries, through the contingency. The staff expressed concern that a properly formulated and comprehensive arrears survey be undertaken as soon as possible. The staff nonetheless recognized the strong overall budget performance, and argued that the actual outturn could be even stronger, due to conservatively forecast revenues. If this was the case, the authorities agreed to save any overperformance in central government revenues given the government's financing needs. The authorities requested a modification of the end-December performance criterion on primary expenditure, to reflect the impact of higher than programmed inflation on indexed wages and pensions. In view of the likely overperformance on the primary balance, and since expenditures for the year will still decline by 4½ percent in real terms, the staff supports the authorities' request.

15. **For 2002, the authorities faced the task of taking major further measures to meet their 6.5 percent of GNP public sector primary surplus target for 2002 (¶18–22).** The staff noted that substantial fiscal effort would be required given the loss of a number of temporary revenue sources (for example, interest income taxes, set to decline along with interest rates), a cut in unemployment insurance premia (to stimulate employment), and the introduction of new spending programs (including unemployment benefits). To offset these, the authorities chose to tightly restrain expenditure ceilings in the budget, with primary spending slated to fall by over 3 percent in real terms. They also specified 2 percent of GNP in fiscal measures, directed at the central government's budget, the social security institutions, and state economic enterprises (SEEs). The central government is thus projected to achieve a primary surplus of 5.6 percent of GNP, up from about 5 percent forecasted for 2001, while the primary surplus in SEEs would climb from 0.2 to 0.8 percent of GNP.

16. **The authorities planned to support their fiscal adjustment in 2002 with policy measures aimed at a lasting improvement of the fiscal position.** These included: (i) moves to a more sustainable revenue base; (ii) elimination of constraints on certain SEEs' revenue-raising capabilities; (iii) and a sharp downward adjustment in primary expenditures in the central government's budget (Box 1). At the same time, social spending would rise in real

terms, and the composition of expenditures would improve. An important aspect of the medium-term adjustment is retrenchment in public sector employment: the authorities indicated that they would reduce public sector staffing by 24,000, largely from SEE payrolls, by restricting the application of the decree forbidding forced retirement.[2] The staff urged—and the authorities acknowledged the need for—further efforts in 2002 to address overemployment in SEEs, consistent with targets in the World Bank's PFPSAL loan. The staff also endorsed the authorities' plan to protect the most vulnerable segments of society through a targeted real increase in social spending, in line with World Bank recommendations (¶21).

17. **Fiscal adjustment in 2002 and beyond would also be underpinned by improved budget management in a number of areas** (¶23):

- Implementation of the **taxpayer identification number program,** which started in September, would help support an expanded program of taxpayer audit, and a broader revenue base.

- By end-December, the authorities expected to have in place a **plan to reform the tax system**. The staff welcomed this, especially given the need to simplify the excise, VAT, and investment income taxation regimes, and the need for tax administration reform.

- **Expenditure management** would be improved, particularly through passage of the procurement bill which, once implemented, should significantly improve the efficiency of the public investment program and of SEE operations.

- **Fiscal transparency** would be strengthened. By 2003 the authorities planned to introduce accounting reforms to all units of general government on a pilot basis, enabling more frequent monitoring. However, the staff also urged that earlier efforts to reduce extrabudgetary and revolving funds be continued in the 2003 budget. Efforts were also needed to improve coordination in assembling public sector fiscal statistics, as recommended by a recent ROSC Data Dissemination Module mission.

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[2] Since primary spending on severance payments will extinguish a public sector liability, the public sector primary surplus would understate the government's true position in flow terms. To correct for this, the staff and authorities agreed that the primary surplus target would be adjusted for expected severance payments (amounting to about 0.1 percent of GNP).

Box 1. An Assessment of the 2002 Public Sector Fiscal Program

The 2002 public sector program aims to lift the primary surplus by about 0.8 percent of GNP. To this end, and in response to revenue weakness and expenditure pressures, the authorities have specified fiscal measures of 2 percent of GNP. Overall, the adjustment is expected to have several positive features:

- **Central government revenues are expected to shift to a more sustainable footing,** away from interest related taxation and toward excises. In 2001, withholding taxes on interest income, the banking and insurance transaction tax, and the windfall gains tax (introduced at end-1999) together accounted for 17.1 percent of tax revenue (3.6 percent of GNP); in 2002, with falling interest rates and the continued amortization of bonds subject to the windfall gains tax, they are expected to account for only 11.5 percent of tax revenue (2.4 percent of GNP). However, the share of excises in revenues will rise by 3.3 percent (from 5.8 to 6.4 percent of GNP). To achieve this goal, in November the authorities increased the excise on petroleum products, and extended it to natural gas. This year's fall in energy prices should largely offset the impact of these increases on inflation.

- **SEEs will see constraints on their revenue capabilities lifted.** Exemptions from charges and discounts are being eliminated at a long list of SEEs, including the coastal surveillance corporation, the railways, the airline, airports, the electricity company, and several agricultural enterprises. Comparatively low real prices for alcohol, tobacco, sugar and telecommunications are being increased. Finally, efforts are being made, through a program of metering and enhanced inspection, to address collection problems in the energy sector. To cement energy sector gains, prices will need to be raised to better reflect dollar-denominated input costs, consistent with targets agreed with the World Bank.

- **Central government expenditures will be reduced significantly.** These will fall by about 1 percent of GNP (excluding lower transfers to social security institutions due to revenue raising initiatives). Primary spending will fall by 3.2 percent in real terms. Key initiatives include an end to bank credit subsidies (saving 0.2 percent of GNP); rationalization of the regional operations of ministries (saving 0.1 percent of GNP); and lowering (regulated) profit margins for health care delivery (saving 0.1 percent of GNP). Other gains come from wage and employment restraint, more careful prioritization of operations and maintenance expenditures, and rationalization of the public investment program.

- **Public sector wages and employment will both be restrained.** For the central government, the wage bill will rise by 0.7 percent in real terms (and decline by 0.2 percent in terms of GNP). For SEEs, the wage bill will decline by over 14 percent in real terms (0.9 percent in terms of GNP). Civil servants' salaries are expected to rise by about 2 percent in real terms while public sector workers' real wages will decline by 7.7 percent in real terms. The latter reflects (i) the current wage contract (inflation above 20 percent is only compensated by 80 percent of the excess); and (ii) a measure which requires three unpaid days of leave per month. Negotiations on a new public sector wage agreement in the fall of 2002 will offer an opportunity to cement these gains. Civil service employment in general government units covered by the consolidated budget will grow in 2002, but only by the 20,000 redundant civil servants transferred from restructured state banks (who must by law be hired). However, (annual average) public worker employment in SEEs is expected to fall by 49,000, due to retrenchment and attrition.

- **Expenditures have been more carefully prioritized for 2002, and there are signs that the efficiency of the public investment program will be enhanced.** Despite overall expenditure restraint, total social spending will rise from 15.7 percent to 16.0 percent of GNP. Part of the rise in social spending reflects growing payments for Direct Income Support for farmers. This has replaced untargeted agricultural subsidies, and only two price premia will remain in 2002 (canola and soybeans, which together enjoy a modest TL 10 trillion allocation). For the public investment program, to date 700 projects have been identified for removal., implying a reduction in the time-to-completion of 15 percent. As average completion times still hover around 10 years, more remains to be done.

C. Monetary Policy

18. **The staff and the authorities agreed that the introduction of formal inflation targeting would be delayed into 2002 to allow the transition to take place under more favorable circumstances (¶13).** Although inflation targeting was to be introduced in the last quarter of this year, the staff questioned whether such a move was timely, given the enormous challenges that inflation targeting would face: a high initial inflation rate, deeply entrenched inflation expectations, fiscal dominance, banking sector weakness, pervasive dollarization, and economic recession. After discussions in early October, the authorities readily agreed that the introduction of formal inflation targeting would be delayed until next year, by which time the conditions should be more favorable for a successful transition.

19. **Despite this delay, the authorities remained committed to the adoption of inflation targeting as soon as conditions allow.** To this end, they were making all the necessary technical preparations. The CBT was improving its models and forecasts of inflation (with technical assistance from an MAE mission), had held initial meetings of the newly created Monetary Policy Council, and would publish a new Monetary Policy Report in November (the forerunner to a quarterly inflation report). The CBT agreed to direct monetary policy to a 35 percent end-year target for 2002 CPI inflation, and announced a medium-term path for disinflation, consistent with inflation targeting. In addition, while following the base money program, since July interest rate decisions have placed greater weight on future inflation. However, since inflation was running higher than projected, with the result that even the revised end-year 65 percent CPI target appeared challenging, the staff cautioned against further reductions in interest rates, until inflation was moving in a clear downward direction.

20. **In the meantime, the framework for monetary policy would remain unchanged, although the role of base money as the nominal anchor would be reinforced** (¶14 and Tables 10–11). The authorities accepted the mission's argument that a nominal anchor would be needed in the transition to inflation targeting. To this end, they agreed to convert the indicative limit on base money into a performance criterion.[3] However, they cautioned that meeting the end-year target would be difficult. First, the end-year and religious holiday (Bayram) effects would overlap this year, as in 2001, raising the demand for currency in circulation. Second, the shift of deposits away from SDIF banks (intervened banks under the control of the Saving Deposit Insurance Fund which face zero reserve requirements, and which are scheduled to be wound up by year-end) would raise the reserve component of the monetary base. The staff accepted these concerns, but noted that the existing base money target for December 31, 2001 already made some allowance for end-year effects (although

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[3] To avoid overdetermination, the ceiling on net domestic assets for end-December was kept as an indicative target. In this context, the staff supported the changes in the definitions of NDA and NIR, as described in paragraph 2 above.

these would be difficult to predict in advance). Second, the authorities' success in meeting the October target by a considerable margin already provided some additional cushion, including meeting banks' demand for additional currency reserves. Taking all these considerations into account, the authorities agreed to keep the existing end-December target, and committed to a reversal (by mid-January) of any overshoot in the base money target caused by end-year effects.

21. **The authorities indicated that they would further improve the working of the flexible exchange rate regime (¶15).** The staff commended the CBT for its move to daily preannounced auctions of foreign exchange and the virtual halt to discretionary interventions in August. These steps, together with the CBT's strong efforts to explain the floating exchange rate regime to the public, had paid off in the period immediately prior to September 11 in increased stability in financial markets. Looking ahead, the authorities agreed to continue to strictly limit discretionary intervention in the foreign exchange market, while taking additional institutional steps to improve the functioning of the foreign exchange market. These steps would include the development of hedging instruments and improved financial management in state enterprises to prevent their lumpy transactions from causing disruptions in the foreign exchange market.

D. Banking Sector Reforms

22. **The authorities were continuing to implement the program strategy for strengthening the private banking system (¶24).** The Bank Regulation and Supervision Agency (BRSA) had by early July agreed on recapitalization plans with a number of financially weak banks to make sure they would be in full compliance with the minimum capital adequacy ratio (CAR) of 8 percent by end-2001. Under these plans, banks had by end-October raised US$1.1 billion in new capital, the bulk of the US$1.3 billion due by year-end. However, given the difficult economic conditions, the first eight months of 2001 had seen a sharp drop in bank profitability (Box 2). In addition, although this was not yet fully borne out in the numbers, the quality of banks' loan portfolios had deteriorated, amidst declining economic activity, exchange rate instability, and high interest rates.

23. The authorities remained committed to resolving the remaining banks owned by the Savings Deposit and Insurance Fund (SDIF) before end-2001 either through sale or

Box 2. Condition of the Private Banking Sector

Two financial crises in less than four months, economic recession, exchange rate instability, and high interest rates have put enormous strains on the private banking sector.[1] In the first half of 2001, private banks reported net profits of about US$50 million (compared to US$1.4 billion during the first half of 2000), a return on assets of 0.1 percent, and a return on equity of 0.8 percent.[2] Bank capital has fallen, with the average risk weighted capital adequacy ratio (CAR) declining from 14.6 percent at end-March 2001 to 10.6 percent by end-June 2001 (Table12).

Three main factors have caused bank profitability to fall in 2001:

- The devaluation after the February crisis caused substantial foreign exchange losses. Although most banks' balance sheets showed their short foreign exchange positions fully-hedged with forward contracts, at maturity a significant proportion of these (in particular those with related counterparties) were not honored.[3] Although some banks were able to withstand these losses (in particular from profits on net lending to the state banks), in most cases these could not be covered from operational income.
- Banks that held a significant amount of their assets in government securities (funded mainly by leveraged positions) suffered market losses when interest rates rose and their portfolios had to be marked to market.
- The consumer loan portfolio, which expanded markedly in 2000 when interest rates were much lower, has yielded below-market rates because consumer loans by law cannot be repriced until maturity.

In addition, private banks now face the prospect of increasing credit losses, due to deterioration in their loan portfolio because of weaker corporate performance. While private banks continue to report non-performing loans (NPLs) at less than 5 percent of total loans, this figure likely understates the credit risk in banks' portfolios. First, legislation passed in mid-1999 gave banks up to four years to provision for nonperforming loans granted prior to enactment of the law. Second, loan classification and provisioning still tends to focus on collateral, rather than on the borrower's future cash flow prospects. Third, banks have still to fully recognize and provide for related party loans, many of which may be non-performing. Fourth, in economic downturns NPLs take time to materialize. These factors all suggest that banks will soon start to report higher NPLs, which will require increased provisioning, weakening the solvency and profitability of the private banking sector.

The authorities have taken steps to address these vulnerabilities, and strengthen the private banking sector, so that it can help revitalize the real sector. First, efforts are being made to ensure proper loss recognition by banks, through strengthened reporting practices and regulatory standards. Second, viable but undercapitalized banks are being required to raise capital, either through direct cash injections, mergers tied to operational restructuring, or sale to foreign investors, and will be intervened by the BRSA if they are unable to meet their commitments in this regard. Third, the authorities are looking at alternative approaches for resolving banks' NPLs (including establishment of an asset management company). Fourth, the authorities are committed to facilitating the process of corporate debt restructuring.

However, the persistence of the recession and the impact of external shocks have hampered these efforts. In particular, efforts to raise capital from existing owners have been undermined by the depreciation of the exchange rate and high real interest rates. Mergers with foreign partners have been more difficult after the events of September 11. Finally, in the short run at least, corporate debt restructuring will require further recognition of losses in the banking sector.

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[1]Defined to include the privately-owned domestic deposit-taking commercial banks, which accounted for about one-half of the banking system's assets and liabilities at end-August 2001.

[2]Preliminary numbers for end-August appear to show that profitability improved somewhat after June, but this mainly reflects a reduction in rates on government securities at end-August which allowed for a reduction in market losses on the banks' securities portfolios, and thus does not reflect an improvement in operational income.

[3]Any existing short foreign exchange position appears to have been closed after the debt swap implemented by the government in mid-June. In fact, most banks now show a long position even before including any forward coverage.

voluntary liquidation (¶25). Four banks were currently up for sale, including one that was being offered for a second time. Liquidation procedures would be started if the banks cannot be sold before end-2001. Two SDIF banks had their banking and deposit-taking licenses withdrawn, whereas for the other two remaining SDIF banks, liquidation seemed the likely outcome, although the authorities might convert one into a "bridge bank" (without the right to collect deposits) for asset management purposes. To complete the resolution, the authorities would auction any deposits that were unsold, along with matching government securities, to other operating banks. Since Ziraat (the largest state bank) had agreed in principle to act as the residual buyer, all SDIF bank deposits should be successfully sold and transferred, without having to directly pay out depositors in cash. Finally, any remaining assets and liabilities of the SDIF banks would be transferred to the Collection Department (COD), which the authorities were considering to merge with a possible bridge bank. The BRSA intended to hire international consultants to provide advice on the organizational structure and procedures for efficient loan recovery.

24. **Although there had been significant operational restructuring of the two large state banks (Ziraat and Halk), reform had slowed in recent weeks** (¶26). In the face of widespread public criticism over job losses and branch closures, further restructuring awaited official government instruction, now expected by mid-December 2001. By end-June 2002, restructuring was likely to result in the closure of some 850 branches, and the reduction of 14,300 staff. To minimize the loss of services, post offices would offer basic banking services, such as payments and cash withdrawals (ATMs). Currently both banks were performing well, particularly Ziraat. Although market conditions did not seem favorable, the privatization of Vakif Bank (the third state bank) was moving ahead, and could be completed by late May 2002.

25. **The authorities as well as the banking industry had recognized that restructuring the banking sector must go hand in hand with corporate sector restructuring.** Moreover, the rehabilitation of the corporate sector was essential for economic recovery and growth. In cooperation with the Turkish Bankers' Association, the authorities were launching a so-called "Istanbul approach" to corporate debt restructuring—a market based and voluntary approach, without the use of public funds and supervisory forbearance. The authorities were supporting the process by preparing a draft law, which, among other things, would give some exemptions for transactions taxes associated with restructuring, and also protect state bank board members from personal law suits when carrying out debt restructuring.

E. Structural Policies[4]

26. **The staff stressed the need to re-energize privatization efforts.** The authorities explained that following a major legislative drive in the first part of 2001, progress had been made in preparations for privatization, including the selection of advisors for Türk Telekom. However, the prospects for actual sales (including for Telekom and Turkish Airlines) had been worsened by the deterioration in the global economy and in individual sectors (¶27). Additional public offerings for TÜPRAŞ (oil refinery) and POAŞ (petrol distribution) had also been affected, while the sales of shares in TEKEL (the tobacco and alcohol monopoly) and ŞEKER (sugar refineries) required difficult political decisions, including layoffs. The staff underscored the importance of accelerating privatization, as this would send a positive signal of commitment to enhance the role of the private sector, and would ease the government's borrowing requirement.

27. **The mission urged further progress toward improving the business environment and enhancing transparency.** This would include timely enactment of a new Law on Public Procurement, steps to improve the investment environment, establishment of an Investor Council, and development of an anti-corruption strategy (¶28–29). As a step toward enhancing data transparency, a STA mission visited Ankara in October to conduct discussions for a ROSC Data Dissemination Module. The authorities indicated their intention to follow up on the mission's recommendations, including on public sector data.

28. **The government was putting in place a set of measures to assist viable companies that have been affected by the unexpectedly deep economic downturn (¶9).** It had set up a private-public sector working group to discuss and recommend policy actions in this area. The authorities and staff agreed that such measures must be consistent with the budget targets, not involve backtracking in reforms, and be well targeted. So far, two measures had been implemented (limited and temporary tax cuts to stimulate the consumer durables sector, costing less than 0.05 percent of GNP), and preparations for a private-sector led corporate debt restructuring under the Istanbul approach were underway (as described in paragraph 25 above).

F. The Road Ahead, and Financing Assurances

29. **The authorities and staff concurred that the repercussions of September 11 on the Turkish economy called for a strong policy response to ensure rapid growth and falling debt ratios in the medium term (¶5).** To this end, the authorities were formulating a strengthened program covering 2002–04. The staff welcomed the authorities' intention to

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[4] Box 3 provides a summary of the coverage and status of structural conditionality in the program, areas covered by World Bank lending and conditionality, and structural measures not included in the program.

Box 3. Structural Conditionality

Coverage of structural conditionality in the strengthened program approved in May 2001

To address the structural weaknesses that contributed to the recent economic crises and the abandonment of the crawling peg in February, the program approved in May 2001 places a heavy emphasis on several structural reform areas. (The program's structural conditionality is set out in Table 2 of the May 3 Memorandum on Economic Policies and Annex B of the Letter of Intent attached to this staff report.) The areas covered by the program's structural conditionality fall into two categories: (i) **measures with a direct and significant bearing on the attainment of macroeconomic stability**, which include extensive conditionality in the banking sector, the key source of weakness underlying the recent crises; and (ii) **measures that will improve medium-term growth prospects,** which, in addition to banking reforms, include measures to strengthen fiscal transparency and management, and to increase the role of the private sector in the economy. Since the problem in Turkey largely reflects a lack of confidence stemming from structural weaknesses in the economy, the credibility of the program depends fundamentally on the strength of the structural effort.

Status of structural conditionality from the strengthened program approved in May 2001

Many of the key structural conditions were prior actions for Board approval of the strengthened program, involving in particular fundamental reform of the banking sector. Following the May Board meeting, comprehensive structural reforms have continued in the areas of banking, fiscal transparency, private sector development and governance, while progress in privatization reform has been less rapid.

Structural areas covered by World Bank lending and conditionality

The key element of the World Bank's program lending in 2001 is the Public Sector and Financial Sector Adjustment Loan (PSFSAL) approved in July 2001. The PFPSAL program is focused on banking and public sector reforms to support the quality of fiscal adjustment and modernization of the public sector. A follow-up operation (PSFSAL II) is being prepared. The Bank's program lending also supports structural reform to promote private sector development and the strengthening of the social safety net. The Economic Reform Loan (ERL) covers reform of the energy, agricultural, and telecommunications sectors, as well as privatization and structural fiscal reforms. The Agricultural Reform Implementation Project (ARIP) supports implementation of the agriculture reform program, including the introduction of a direct income support program for farmers. The Social Risk Mitigation and Privatization Social Support projects help Turkey's efforts to improve its social protection system and alleviate the social costs of the crisis.

Other relevant structural conditions not included in the program

The May program contains conditions on preparing enterprises for privatization but, in contrast to some previous programs with Turkey, the structural conditionality does not emphasize the timetable for actual sales of enterprises. Fund and Bank staffs regard this as appropriate at present given the current unfavorable market conditions for many of the enterprises to be privatized. Instead, Fund and Bank conditionality is aimed at preparing the ground for rapid privatization once market conditions improve.

focus their medium-term structural efforts on completing bank restructuring, revitalizing private sector development, and improving efficiency and governance in the public sector. The staff also stressed the need to complement the reforms with continued large public sector primary surpluses and sustained disinflation efforts. In this regard, the authorities indicated their intention to maintain the primary surplus at 6.5 percent of GNP in 2003, and to pursue disinflation vigorously in 2002 and beyond, guided by inflation targeting.

30. **Financing assurances would be provided by a combination of strengthened policies and a firm expectation of additional financial support from the international community, including under a new stand-by arrangement.** Turkey is likely to face an external financing gap of US$10 billion in 2001–02. To help fill this gap, the authorities have committed themselves to seeking a new multi-year stand-by arrangement with the IMF in support of a strengthened policy package. The needed financing should then be available from a combination of augmented access to Fund resources and any additional support from the international community. Domestic and external PSI would help to provide further assurances. Under existing Fund commitments and any augmentation up to the amount of the identified financing gap, Turkey should be in a position to discharge its obligations to the Fund in a timely manner. Under existing access, total Fund credit outstanding will peak at some 24 percent of public sector external debt at end-2002 (Tables 13 and 14). An addition of US$10 billion, even heavily front-loaded, would increase this ratio to about 30 percent. A more detailed analysis will be prepared once the new financing package is finalized.

IV. Update on Safeguards Assessment

31. **The authorities were following up on the recommendations of the recent report on the CBT's external audit mechanism prepared by the Fund under the transitional procedures of safeguards assessments:**

- **The recently concluded external audit meets international standards.** Prior to January 1, 2000, the CBT did not produce externally audited financial statements. Pursuant to the Fund's safeguards initiative, the CBT appointed external auditors for financial year 2000. The audited financial statements, including the related audit report, are publicly available on the CBT website. In August 2001, the staff completed its review of the documentation provided by the central bank for the first-time external audit, and concluded that the audit meets international standards.

- **However, the external audit report is qualified for four reasons, including a scope restriction on the audit, and overstatement of the value of marketable securities.** Also, there is no active oversight of the external audit process by the CBT audit committee. Staff, therefore, recommended that the CBT take the following steps: (i) resolve the four issues giving rise to the qualified audit report in 2000 before finalization of the 2001 audit report; (ii) ensure that the audit committee proactively oversees all aspects of the audit process; and (iii) establish a policy of three to five year appointment terms for the external auditors. The authorities accepted these recommendations and informed staff that the necessary steps to implement them speedily are being taken. Specifically with regard to (ii) and (iii) above, they confirmed that the audit committee supervises the annual financial statements of the CBT and prepares a yearly report on the operation and accounts of the CBT, and that the external auditor is appointed for a maximum five-year period with a renewable annual contract.

- **In addition, staff identified certain weaknesses in other areas of the safeguards framework, notably in the CBT's financial reporting framework.** Staff, therefore, recommended the adoption of International Accounting Standards (IAS) for the 2001 financial year, and of strengthened procedures for reporting foreign reserves data, including full compliance with the IMF's data template. The authorities are acting upon these recommendations with a view to having these issues resolved shortly.

V. Staff Appraisal

32. **The Turkish authorities have built a solid track record in implementing their ambitious economic program under unfavorable circumstances.** Faced with an adverse political climate and resistance to reforms, the authorities have achieved a major correction in the fiscal position and generally maintained monetary restraint. They have also carried forward an ambitious legislative agenda aimed at ensuring the independence of the central bank, enhancing transparency in economic policy making, and laying the basis for privatization of large state enterprises. Important progress has been made in dealing with problems in the banking sector, both in private banks and state banks.

33. **However, the expected results had been slow to materialize, even before the September 11 events.** High interest rates and economic uncertainty contributed to a delay in the economic recovery. However, beginning in August, there were signs that the program was starting to work as intended, as financial markets stabilized and indicators suggested that the economic decline triggered by the crises was coming to an end. The September 11 events halted these favorable developments. And, although recent weeks have again seen some improvements in financial indicators, this appears to be largely based on expectations of a new financing package.

34. **Accordingly, the authorities' strong fiscal policy performance needs to be continued, to address concerns about the ability of the government to rollover and sustain its debt.** The government is to be commended for maintaining fiscal discipline in an adverse environment. This discipline, together with an active debt management policy, has helped allay concerns about the near-term outlook for domestic debt rollover. Looking ahead, the government's recognition that there is no alternative to fiscal restraint is welcome, and continued attention will need to be devoted, over the medium term, to the composition of fiscal adjustment, with reform of agricultural subsidies, retrenchment of public sector workers, and wage restraint key priorities. In the near term, the government will need to put in place all the measures planned to achieve the targeted public sector primary surplus of

6.5 percent of GNP in 2002. In this context, the government's keen attention to protecting spending on social services, education, and health services is welcome.

35. **Important progress has been made in improving fiscal transparency, although a large agenda remains.** The closures of budgetary and some extrabudgetary funds, and the merger of revolving funds, have already helped to simplify Turkey's complex budget structure. Also, the presentation to parliament of a new public procurement law in line with EU standards is a welcome step, which needs to be followed by an expeditious adoption and implementation of the law. The government should also press ahead with improvements in budget classification and accounting, budget control procedures, and budgetary statistics. Ultimately, putting in place a streamlined and transparent budgetary framework where decisions are based on clear priorities will be key to the success of Turkey's economic reform effort.

36. **The staff welcomes the CBT's moves to improve the functioning of the foreign exchange market.** As the program has progressed, the CBT has more fully embraced the floating exchange rate regime, by virtually abandoning discretionary foreign exchange market interventions, and by explaining the new regime to a (sometimes skeptical) public. This is a key precondition for the introduction of inflation targeting. However, the adjustment problems associated with the new floating rate regime still need to be addressed through the development of hedging instruments, and by greater liquidity in the foreign exchange market itself. Ultimately, the achievement of stable underlying economic conditions, notably a further decline in inflation, should help promote stability in the exchange rate and ease these transitional problems. The new base money targeting regime should provide an effective bridge to the move to formal inflation targeting.

37. **The staff acknowledges the need to delay the introduction of formal inflation targeting until 2002 in the present circumstances.** The staff shares the authorities' concern that the current conditions are not conducive to a successful introduction of formal inflation targeting. The program aims to improve the situation in this regard, as it is focused on further strengthening the budget situation, bringing down inflation, and addressing the problems in the banking system. A delay will also allow the technical and institutional preparations to progress ahead of the launch of formal inflation targeting. In the meantime, the staff supports the authorities' request to set performance criteria on base money. This will provide a much-needed nominal anchor during the transition to inflation targets, and help contain inflation expectations. That said, the introduction of formal inflation targeting in 2002 will give monetary policy a much needed and transparent anchor—the inflation target itself—and there should be no undue delay of this critical step.

38. **The authorities need to reinvigorate efforts to privatize large-scale enterprises and create an attractive environment for private enterprise.** The May program started with a big bang of legislative reforms to lay the foundation for an enhanced role for the private sector in the economy, but follow-up efforts have been less determined. In the coming months, these efforts need to be re-energized. In privatization, the government should push

ahead with sales in sectors where present market conditions allow, while at the same time formulating and putting in place the preparatory steps in other sectors. Rapid progress in privatization will not only alleviate the government's borrowing needs, but the main goal is to help improve economic efficiency and sever the links between government and business. This is an area where powerful vested interests are at play, and progress in privatization will be a key test of the government's ability to carry forward the economic reform agenda. In improving the business climate, an enhanced investor relations program and implementation of the action plan based on the review of administrative barriers to investment will be key.

39. **The BRSA's resolve will be tested further, as the problems in the banking sector are compounded by the weaker-than-expected economy.** The BRSA has continued its impressive effort in improving the regulatory environment, enforcing regulations, and dealing with problem banks. The banking system is now facing greater risks in the weak economic environment, and the agency will need to continue its vigilance in identifying problems in individual banks and putting in place appropriate measures. The management of state banks has been through a sea change, and their operations are being restructured rapidly; full political support to the joint board of the state banks for the continuation of these efforts will be needed to ensure the successful completion of the state bank reforms and the eventual privatization of these banks.

40. **The fallout of September 11—a shock that will likely severely impact Turkey despite its impressive achievements under the program—calls for an even stronger economic policy response, which deserves the support of the international community.** The staff welcomes the authorities' recognition that the effects on the Turkish economy of September 11 calls for a strong policy response, and agrees with the commitment to maintaining the public sector primary surplus at 6.5 percent of GNP in 2003 and the planned focus on banking sector reforms, public resource management, and private sector development. This general strategy will now need to be translated rapidly into specific steps under a new program that could be supported financially by the international community.

41. **The staff recommends the completion of the tenth review and the requested modification of relevant performance criteria.** The authorities have continued to observe the program's performance criteria and structural benchmarks, have adopted a macroeconomic framework for 2002 supported by ambitious government budget targets, and are committed to developing a new medium-term program in close consultation with the Fund. As for financing assurances, with a strengthened policy package and with additional medium- and long-term external financing, including under a new medium-term Fund-financed program, Turkey should be in a position to weather the impact of September 11 and continue on its path to medium-term sustainable growth. On this basis, the staff recommends the requested modification and setting of the relevant performance criteria and the completion of the tenth review.

Table 1. Turkey: Schedule of Purchases Under the SBA/SRF, 1999-2002

Date	Purchases under SBA		Purchases under SRF		Purchases under the Augmentation to SBA		Combined Purchases under SBA/ SRF		Conditions
	In millions of SDR	As a percent of quota (%)	In millions of SDR	As a percent of quota (%)	In millions of SDR	As a percent of quota (%)	In millions of SDR	As a percent of quota (%)	
Actual Purchases	1,773.8	184.0	5,205.6	540.0	2,356.7	244.5	9,336.0	968.5	
1999	221.7	23.0	-	-	-	-	221.7	23.0	
December 22, 1999	221.7	23.0	-	-	-	-	221.7	23.0	Board approval of SBA
2000	886.9	92.0	1,735.2	180.0	-	-	2,622.1	272.0	
April 29, 2000	221.7	23.0	0.0	-	-	-	221.7	23.0	First review; and end-Dec. 1999 performance criteria
July 6, 2000	221.7	23.0	0.0	-	-	-	221.7	23.0	Second review; and end-Mar. 2000 performance criteria
December 22, 2000	443.4	46.0	1,735.2	180.0	-	-	2,178.6	226.0	Third and fourth reviews; and end-Sept. 2000 performance criteria
2001 (January-August)	665.2	69.0	3470.4	360.0	2356.7	244.5	6492.2	673.5	
February 5, 2001	221.7	23.0	867.6	90.0	-	-	1,089.3	113.0	Fifth review; and end-Dec. 2000 performance criteria
May 15, 2001	-	-	1,446.0	150.0	1,554.0	161.2	3,000.0	311.2	Sixth and seventh reviews; end-Mar. 2001 performance criteria
July 14, 2001	221.7	23.0	578.4	60.0	401.3	41.6	1,201.5	124.6	Eighth review; end-May & end-June performance criteria
August 3, 2001	221.7	23.0	578.4	60.0	401.3	41.6	1,201.5	124.6	Ninth review; and relevant performance criteria 1/
Scheduled Purchases	1,118.2	116.0	578.4	60.0	4,005.7	415.5	5,702.4	591.5	
2001 (Nov.-Dec.)	221.7	23.0	578.4	60.0	4005.7	415.5	4805.8	498.5	
November 28, 2001	-	-	578.4	60.0	1,824.5	189.3	2,402.9	249.3	Tenth review; and relevant performance criteria 2/
December 21, 2001	221.7	23.0	-	-	2,181.2	226.3	2,402.9	249.3	Eleventh review; and relevant performance criteria 3/
2002	896.5	93.0	-	-	-	-	896.5	93.0	
February 15, 2002	221.7	23.0	-	-	-	-	221.7	23.0	Twelfth review; and end-Dec. 2001 performance criteria
May 15, 2002	221.7	23.0	-	-	-	-	221.7	23.0	Thirteenth review; and end-Mar. 2002 performance criteria
August 15, 2002	221.7	23.0	-	-	-	-	221.7	23.0	Fourteenth review; and end-June 2002 performance criteria
November 15, 2002	231.4	24.0	-	-	-	-	231.4	24.0	End-Sept. 2002 performance criteria
Total	2,892.0	300.0	5,784.0	600.0	6,362.4	660.0	15,038.4	1,560.0	
Memorandum items:									
2001	886.9	92.0	4,048.8	420.0	6,362.4	660.0	11,298.1	1,172.0	
Quota	964.0	100.0							

1/ End-May performance criteria on consolidated government sector primary balance and central government primary expenditure.

2/ End-August performance criteria on NDA and NIR; end-July performance criteria on consolidated government sector primary balance and central government primary expenditure; and end-June performance criteria on external debt.

3/ End-October performance criteria on NDA and NIR; end-September for all other performance criteria.

Table 2. Turkey: Indicators of External Vulnerability, 1997–2003 1/

	1997	1998	1999	2000	Projections 2001	2002	2003
CPI inflation (December-on-December)	99.1	69.7	68.8	39.0	65.0	35.0	20.0
Public sector borrowing requirement (percent of GNP)	13.2	15.4	24.2	19.1	19.5	12.3	7.3
Net debt of the public sector (percent of GNP)	42.9	43.7	61.0	57.4	93.5	82.0	72.1
Export volume (percent change)	21.6	5.8	0.7	7.8	15.1	4.4	6.5
Import volume (percent change)	19.5	0.6	-13.3	30.2	-21.6	8.6	9.5
Current account balance, in percent of GNP	-1.4	1.0	-0.7	-4.8	1.5	-1.2	-0.9
Capital account balance (in billions of US$)	8.7	0.2	5.4	12.8	-3.7	-6.8	1.3
Of which:							
Foreign direct investment	0.6	0.6	0.1	0.1	2.2	0.9	1.0
Foreign portfolio investment	-0.1	-6.1	0.2	-5.2	-5.1	-0.9	-0.2
Gross official reserves, in billions of US$ 2/	19.6	20.9	24.3	23.2	19.7	11.0	10.6
In months of imports of goods and NFS	3.8	4.1	5.3	4.1	4.3	2.2	1.9
In percent of broad money	32.3	28.1	30.0	25.5	0.0	0.0	0.0
Gross total external debt, in billions US$	84.9	96.9	103.0	114.3	114.3	107.6	108.1
In percent of GNP	43.7	47.1	55.0	56.6	76.5	68.8	61.0
In percent of merchandise exports	0.3	0.3	0.4	0.4	0.3	0.3	0.3
Gross short-term external debt, in billions US$ 3/	29.5	33.8	39.0	46.0	33.9	32.9	33.6
In percent of gross total external debt	34.7	34.9	37.9	40.2	29.6	30.6	31.1
In percent of gross official reserves	150.4	161.9	160.7	198.3	172.3	299.9	317.7
In percent of banking system gross reserves	74.7	88.4	88.7	106.2	154.1	...	...
Debt service 4/	21.2	26.0	34.1	37.3	43.6	40.3	40.6
REER appreciation (CPI based, period average) 5/	6.4	8.5	4.1	9.9	1.5	...	...
REER appreciation (CPI based, end of period) 5/	13.5	3.9	5.6	13.7	-24.3	...	...
Capital adequacy ratio 6/	12.6	12.4	9.1	17.3	20.3	...	...
State and SDIF banks	12.6	8.6	8.2	7.6	45.0	...	...
Private banks	11.9	12.0	9.0	18.3	10.6	...	...
Foreign banks	13.7	21.0	20.3	29.4	31.3	...	...
Nonperforming loans (in percent of total) 7/	2.1	6.7	9.7	9.2	16.0	...	...
Real broad liquidity, percentage change (CPI deflated)	13.9	3.7	16.6	0.9	12.0	2.8	5.8
Real credit to the private sector, percentage change 8/	18.2	17.7	-7.4	28.3	-22.8	...	...
Banks' net foreign asset position, in millions of US$	-889	-3,018	-3,176	-5,883	...	...	...
Banks' net open exchange position, in millions of US$	-1,922	-2,898	-2,608	-5,437	...	...	...
Spread of Turkish Eurobonds over U.S. T-bill (in basis points) 9/	...	548	550	443	707	...	...

Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.
1/ For 2001-03, program projections.
2/ As of end-June 2001, reserves stood at US$17.5 billion.
3/ By residual maturity.
4/ Interest plus medium- and long-term debt repayments as percent of current account receipts (excl. off. transfers).
5/ As of August 2001.
6/ As of June 2001.
7/ As of August 2001.
8/ Deflated by the WPI.
9/ For 2001, as of November 19.

Table 3. Turkey: Selected Indicators, 2000-03

	2000	2001	2002	2003
	(In percent)			
Real sector				
Real GNP growth rate	6.1	-8.5	4.0	5.0
GNP deflator	51.6	60.3	46.0	24.9
Nominal GNP growth rate	60.9	46.7	51.9	31.1
WPI (12-month, end-of-period)	32.7	80.0	31.0	16.2
CPI (12-month, end-of period)	39.0	65.0	35.0	20.0
Average nominal T-bill interest rate	38.0	100.4	71.0	46.3
Average ex-ante real interest rate 1/	-9.2	35.4	34.3	29.1
	(In percent of GNP)			
Central government budget				
Primary balance 2/	4.6	5.2	5.6	5.6
Net interest payments 3/	15.8	23.5	20.6	15.1
Overall balance	-11.2	-18.3	-15.0	-13.0
Consolidated public sector				
Primary balance	2.8	5.5	6.5	6.5
Net interest payments 4/	21.9	25.0	18.8	13.8
PSBR (incl. CBT profits)	19.1	19.5	12.3	7.3
Net debt of public sector	57.4	93.5	82.0	72.1
Net external	18.3	39.6	37.9	30.9
Net domestic	39.1	53.9	44.1	41.2
Of which : Central government (gross)	40.9	70.5	61.0	57.3
Auctioned debt (incl. interest on recap debt)	23.4	24.1	25.7	27.9
Bank recapitalization	17.4	36.4	27.6	22.9
External sector				
Current account balance	-4.8	1.5	-1.2	-0.9
Gross external debt	56.6	76.5	68.8	61.0
Net external debt	37.0	51.8	50.7	45.3
Short-term external debt (by remaining maturity)	22.8	22.7	21.1	19.0
Monetary aggregates				
Seignorage 5/	1.8	0.9	1.0	0.7
Nominal growth of broad liquidity (in percent)	40.2	84.7	38.8	26.9
	(In billions of U.S. dollars, unless otherwise indicated)			
Privatization proceeds 6/	3.3	2.8	1.5	2.5
Net external financing of central government	4.1	-2.7	1.0	-1.0
Amortization	6.2	8.2	6.5	8.4
Gross borrowing	10.3	5.5	7.4	7.5
Of which : Eurobond issues	7.5	1.2	2.0	4.5
GNP	201.9	148.4	156.8	177.3
GNP (in quadrillions of Turkish lira)	126.0	184.8	280.6	368.0

Sources: Data provided by Turkish authorities; and Fund staff estimates.

1/ Average of monthly nominal interest rate divided by 12-month ahead CPI inflation.
2/ On a commitment basis, excluding profit transfers from the CBT, interest receipts, and privatization proceeds.
3/ Interest payments minus interest receipts plus profit transfers from the central bank, including receipts from revaluation accounts.
4/ Interest payments minus interest receipts plus CBT profits before transfers to the government.
5/ Change in reserve money in percent of GNP, where reserve money is defined as currency issued plus reserve requirements.
6/ For 2001 these include the privatization proceeds from the Privatization Administration's Portfolio.

Table 4. Turkey: Balance of Payments, 1998-2003
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Current account balance	2.0	-1.4	-9.8	2.3	-1.9	-1.7
Trade balance	-14.2	-10.4	-22.3	-5.3	-6.9	-8.5
Exports (fob)	31.2	29.3	31.2	34.5	36.7	39.6
Of which:						
Exports (fob) in trade returns	27.0	26.6	27.3	30.8	32.7	35.3
Shuttle trade	3.7	2.3	2.9	3.2	3.3	3.6
Imports (fob)	-45.4	-39.8	-53.6	-39.8	-43.6	-48.1
Of which:						
Imports (cif)	-45.9	-40.7	-54.0	-41.0	-44.5	-49.1
Energy imports (cif)	-4.5	-5.3	-9.3	-7.6	-6.8	-6.8
Services (net)	10.5	3.9	7.4	3.8	1.1	2.5
Services (credit)	25.8	18.7	22.3	18.8	16.8	20.0
Of which:						
Interest	2.5	2.4	2.8	2.7	1.7	1.8
Tourism receipts	7.2	5.2	7.6	8.0	6.0	8.4
Other receipts 1/	10.5	7.1	7.9	4.1	4.9	5.2
Services (debit)	-15.3	-14.8	-15.0	-15.0	-15.7	-17.5
Of which:						
Interest	-4.8	-5.5	-6.3	-7.7	-7.5	-8.3
Private transfers (net)	5.6	4.8	5.0	3.5	3.6	4.1
Of which:						
Workers remittances	5.4	4.5	4.6	2.9	3.0	3.4
Official transfers (net)	0.2	0.4	0.2	0.2	0.2	0.3
Capital account balance	0.4	4.7	9.4	-17.1	-2.7	2.9
(including errors and omissions)	-1.5	6.6	6.8	-19.2	-2.7	2.9
Direct investment 2/	0.6	0.1	0.1	2.2	0.9	1.0
Portfolio investment in securities 2/	-6.1	0.2	-5.2	-5.1	-0.9	-0.2
Public sector (central & local governments & EBFs)	-1.9	1.2	6.2	-2.8	1.1	-1.0
Bonds (net)	-0.3	3.1	6.1	-0.9	-0.1	0.6
Eurobond drawings	2.7	5.0	7.5	1.1	2.0	4.5
Eurobond repayments	-3.0	-1.9	-1.4	-2.1	-2.1	-3.9
Loans (net)	-1.7	-1.9	0.1	-1.8	1.2	-1.6
Loan disbursements	1.2	1.0	3.7	3.0	4.7	2.2
Loan repayments	-2.8	-2.9	-3.6	-4.9	-3.5	-3.8
Central Bank of Turkey, Dresdner (net)	0.7	-0.2	0.7	0.3	0.4	0.7
Domestic money banks (net)	1.9	0.5	2.1	-9.8	-4.7	1.1
Domestic money banks (FX deposits abroad, -: accumulation)	-0.8	-1.8	-1.9	-0.6	0.0	0.0
Domestic money banks (other, net)	2.7	2.4	4.0	-9.2	-4.7	1.1
Domestic money banks (medium and long-term, net)	0.5	0.2	-0.2	-0.9	-0.7	0.3
Domestic money banks (short-term, net)	2.2	2.2	4.2	-8.2	-4.0	0.8
Other private sector (net)	5.3	2.8	5.6	-1.9	0.6	1.3
Other private sector (medium and long-term, net)	4.2	2.3	4.9	-0.4	-0.3	0.0
Other private sector (short-term, net)	1.1	0.5	0.6	-1.5	0.9	1.3
Errors and omissions	-2.0	1.9	-2.7	-2.1	0.0	0.0
Overall balance	0.4	5.2	-3.0	-16.9	-4.6	1.2
Overall financing	-0.4	-5.2	3.0	16.9	4.6	-1.2
Change in net international reserves (+ denotes decline)	-0.4	-5.2	3.0	15.9	-4.4	-2.2
Change in gross official reserves (+ denotes decline)	-0.2	-5.9	-0.3	2.5	-0.3	-0.6
Change in reserve liabilities (IMF)	-0.2	0.7	3.3	13.4	-4.1	-1.6
Purchases	0.0	0.8	3.4	14.5	1.2	0.0
Repurchases	-0.2	-0.1	-0.1	-1.1	-5.3	-1.6
Exceptional financing (gap)	0.0	0.0	0.0	1.0	9.0	1.0

Table 4. Turkey: Balance of Payments, 1998-2003
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Memorandum items						
Trade in goods and services						
As percent of GNP						
Current account balance, incl. shuttle trade	1.0	-0.7	-4.8	1.5	-1.2	-0.9
Trade account balance, incl. shuttle trade	-6.9	-5.6	-11.1	-3.5	-4.4	-4.8
Exports of goods and non-factor services	26.5	24.4	25.1	33.9	33.1	32.6
Imports of goods and non-factor services	27.2	26.2	30.8	31.5	33.1	32.3
Percent change						
Value growth in exports of goods (incl. shuttle trade)	-4.4	-6.1	6.4	10.6	6.3	7.9
Value growth in exports of goods (excl. shuttle trade)	2.7	-1.7	4.4	10.8	6.5	7.9
Value growth in imports of goods	-5.3	-12.5	34.7	-25.7	9.5	10.3
Volume growth in exports of goods (excl. shuttle trade)	6.4	6.3	11.6	12.9	4.4	4.9
Volume growth in imports of goods	-2.5	-1.2	35.2	-20.2	9.1	7.4
Terms of trade	3.3	-4.2	-6.4	1.1	1.9	0.6
Reserve and debt indicators						
Gross foreign reserves (Central Bank of Turkey)						
US$ billion	20.9	24.3	23.2	19.7	11.0	10.6
Months of goods & NFS imports	4.1	5.3	4.1	4.3	2.2	1.9
External debt (end-of-period)						
US$ billion	96.9	103.0	114.3	114.3	107.6	108.1
Percent of GNP	47.1	55.0	56.6	76.5	68.8	61.0
Percent of exports of goods & NFS	177.7	225.3	225.5	225.9	208.0	187.2
Net external debt (end-of-period) 3/						
US$ billion	62.5	63.6	74.7	77.4	79.4	80.2
Percent of GNP	30.4	34.0	37.0	51.8	50.7	45.3
Short-term debt (end-of-period)						
US$ billion	21.2	23.5	28.9	18.3	15.4	17.5
Ratio to foreign reserves	101.6	96.7	124.6	93.2	140.1	165.1
Short-term debt plus MLT repayments						
US$ billion	33.8	39.0	46.0	33.9	32.9	33.6
Ratio to foreign reserves	161.9	160.7	198.3	172.3	299.9	317.7
Debt service ratio 4/	26.0	34.1	37.3	43.6	40.3	40.6

Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.
1/ The decline in other receipts between 1998 and 2000 partly reflects a methodological change in the compilation of this item.
2/ Including privatization receipts.
3/ Nonbank external debt less the NFA of the banking system.
4/ Interest plus medium- and long-term debt repayments as percent of current account receipts (excluding official transfers).

Table 5. Turkey: Government Borrowing and Bank Capacity, 2001-02

	2001	2002			
		With additional external budget financing of:			
		US$0 billion	US$5 billion	US$7 billion	
		(In quadrillion of Turkish lira)			
Banking sector absorptive capacity					
Change in net credit to government		23.2	23.2	19.1	
Public banks		12.9	12.9	12.9	
Private banks 1/		10.3	10.3	6.2	2/
Domestic borrowing requirement					
Total borrowing requirement 3/		43.6	33.2	29.1	
Banking sector		33.6	23.2	19.1	
Public banks		12.9	12.9	12.9	
Private banks		20.7	10.3	6.2	
Non-banks		10.1	10.1	10.1	
Memorandum items:					
		(In percent)			
Rollover ratios					
Total	73.0	90.7	82.5	78.9	
Private sector	83.0	100.6	89.6	84.8	
Auction debt to broad liquidity	38.9	49.0	42.1	39.5	

1/ Assuming private sector lending grows in line with nominal activity and, consistent with the balance of payments, external interbank borrowing declines by US$3 1/2 billion.

2/ Assumes higher than anticipated nonperforming loans and lower deposit growth.

3/ For comparability, includes valuation changes in the stock of debt.

Table 6. Turkey: Medium-Term Public Debt Sustainability, 2001-06 1/

(In percent of GNP)

	2001	2002	2003	2004	2005	2006
			(In percent of GNP)			
Primary balance	5.5	6.5	6.5	6.5	6.0	6.0
Interest	25.0	18.8	13.8	12.1	11.2	9.9
Overall balance	-19.5	-12.3	-7.3	-5.6	-5.2	-4.4
Privatization	0.8	0.4	1.0	0.5	0.5	0.5
Net debt	93.5	82.0	72.1	68.5	66.4	64.3
External debt	39.6	37.9	30.9	28.1	27.7	27.2
Domestic debt	53.9	44.1	41.2	40.4	38.7	37.1
			(In percent)			
Real GNP growth	-8.5	4.0	5.0	5.0	5.0	5.0
CPI inflation (end-period)	65.0	35.0	20.0	12.0	8.0	5.0
Nominal interest rate on TL debt	100.4	71.3	46.0	29.8	26.9	23.9
Real interest rate on TL debt 2/	27.0	25.0	21.0	18.0	18.0	18.0

1/ Assuming US$10 billion additional external financing in 2002, of which US$7 billion for budget financing.

2/ For projections, defined as an ex ante real interest rate using programmed CPI inflation, based on an average maturity of six months.

Table 7. Turkey: Central Government Primary Budget, 2000-02
(In percent of GNP)

	2000	2001			2002
	Est.	Prog.	Est.	Diff.	Est.
Total revenue	25.5	26.8	26.2	-0.6	25.5
Tax revenue	20.7	21.4	21.2	-0.2	20.7
Direct	8.3	8.0	8.5	0.5	7.2
Personal income	4.9	6.1	6.3	0.2	5.5
Corporate income	1.9	1.4	1.7	0.4	1.4
Motor vehicle and wealth	0.2	0.2	0.2	0.0	0.3
Windfall gains tax	1.3	0.3	0.2	-0.1	0.0
Indirect	12.4	13.4	12.7	-0.7	13.6
VAT	6.7	6.9	6.7	-0.2	6.9
Domestic transactions	3.6	3.8	3.9	0.1	4.0
Foreign transactions	3.1	3.1	2.9	-0.2	3.0
Petroleum excises	2.6	3.1	3.0	-0.1	3.8
Foreign trade (excluding VAT)	0.3	0.3	0.2	-0.1	0.2
Other indirect, incl. excises	2.9	3.2	2.8	-0.4	2.6
Non-tax revenue	4.8	5.4	5.0	-0.4	4.8
Budgetary funds	1.8	1.7	1.7	0.0	1.8
Education levies	0.4	0.5	0.4	0.0	0.2
Revenue from state property 1/	0.9	1.0	1.0	0.0	1.1
Other non-tax revenue	1.6	1.9	1.6	-0.3	1.6
of which: Interest receipts	0.3	0.3	0.2	-0.1	0.2
CBT profits	0.2	0.3	0.3	0.0	0.3
Annexed budget	0.1	0.2	0.2	0.0	0.1
Non-interest expenditure	20.8	20.9	20.8	-0.1	19.4
Personnel	7.9	8.2	8.1	-0.1	7.9
Civil servants	6.6	6.9	6.8	-0.1	6.7
Public workers	1.4	1.4	1.3	0.0	1.1
Other current	2.8	2.7	2.6	-0.1	2.6
Transfers	7.9	7.9	8.0	0.1	6.9
Social security, incl unempl. fund	2.6	3.1	3.3	0.1	2.7
Budgetary funds	1.6	0.5	0.5	0.0	0.1
Price Stabilization Fund	0.5	0.2	0.2	0.0	0.1
Other funds	1.1	0.3	0.3	0.0	0.0
Agricultural subsidies	0.3	0.6	0.5	-0.1	0.8
State participation (capital transfers) 2/	0.2	0.0	0.0	0.0	0.0
Transfers to SEEs	0.7	0.6	0.6	0.0	0.6
Banks' credit subsidies	0.1	0.2	0.2	0.0	0.0
Tax rebates	1.3	1.1	1.3	0.1	1.2
Other transfers	1.1	1.7	1.6	-0.1	1.5
Investment	1.8	2.1	2.0	0.0	2.0
Unallocated earthquake expenditures	0.3	0.0	0.0	0.0	0.0
Primary balance (authorities' definition) 1/	4.7	5.9	5.4	-0.5	6.1
Primary balance (IMF staff definition) 3/	4.3	5.3	4.9	-0.4	5.6
Memorandum:					
Monitorable earthquake expenditures	1.1	0.4	0.4	0.0	0.0
Primary expenditure excl. tax rebates	19.5	19.7	19.5	-0.2	18.2
Total revenue (IMF staff definition) 3/	25.0	26.2	25.7	-0.5	25.0

Sources: Data provided by Turkish authorities; and Fund staff estimates.

1/ Excluding privatization proceeds.

2/ Excluding recapitalization of state banks.

3/ Excluding privatization proceeds, CBT profits, and interest receipts.

Table 8. Turkey: Central Government Primary Budget, 2000-02
(In trillions of Turkish liras)

	2000	2001			2002
	Est.	Prog.	Est.	Diff.	Est.
Total revenue	32,112	48,114	48,426	311	71,658
Tax revenue	26,087	38,493	39,220	727	58,202
Direct	10,424	14,333	15,688	1,355	20,182
Personal income	6,212	10,965	11,664	699	15,486
Corporate income	2,357	2,484	3,229	744	3,940
Motor vehicle and wealth	214	399	415	15	724
Windfall gains tax	1,641	484	380	-104	33
Indirect	15,664	24,160	23,532	-628	38,019
VAT	8,379	12,388	12,454	66	19,484
Domestic transactions	4,487	6,807	7,142	335	11,114
Foreign transactions	3,892	5,581	5,312	-269	8,371
Petroleum excises	3,269	5,607	5,577	-31	10,533
Foreign trade (excluding VAT)	399	478	386	-92	603
Other indirect, incl. excises	3,617	5,686	5,115	-571	7,400
Non-tax revenue	6,025	9,622	9,206	-415	13,456
Budgetary funds	2,206	3,124	3,124	0	5,000
Education levies	513	828	828	0	700
Revenue from state property 1/	1,104	1,842	1,844	2	3,094
Other non-tax revenue	2,052	3,427	3,009	-418	4,362
of which: Interest receipts	332	561	415	-146	650
CBT profits	229	472	472	0	750
Annexed budget	151	401	401	0	300
Non-interest expenditure	26,148	37,508	38,419	911	54,525
Personnel	9,982	14,781	14,995	214	22,101
Civil servants	8,274	12,311	12,525	214	18,901
Public workers	1,708	2,470	2,470	0	3,200
Other current	3,520	4,800	4,800	0	7,292
Transfers	10,001	14,177	14,854	677	19,396
Social security, incl unempl. fund	3,321	5,612	6,032	420	7,589
Budgetary funds	1,995	866	866	0	300
Price Stabilization Fund	574	281	281	0	300
Other funds	1,421	585	585	0	0
Agricultural subsidies	359	1,060	938	-122	2,335
State participation (capital transfers) 2/	248	65	65	0	40
Transfers to SEEs	886	1,100	1,200	100	1,655
Banks' credit subsidies	145	400	415	15	0
Tax rebates	1,632	2,050	2,359	309	3,400
Other transfers	1,415	3,024	2,979	-45	4,077
Investment	2,251	3,750	3,770	20	5,736
Unallocated earthquake expenditures	395	0	0	0	0
Primary balance (authorities' definition) 1/	5,964	10,606	10,007	-600	17,133
Primary balance (IMF staff definition) 3/	5,403	9,573	9,119	-454	15,733
Memorandum:					
Monitorable earthquake costs	1,343	650	650	0	0
Primary expenditure excl. tax rebates	24,516	35,458	36,060	602	51,125
Total revenue (IMF staff definition) 3/	31,498	47,081	47,538	457	70,258
GNP	125,971	179,629	184,767	5,138	280,551

Sources: Data provided by Turkish authorities; and Fund staff estimates.

1/ Excluding privatization proceeds.

2/ Excluding recapitalization of state banks (for 2001 only).

3/ Excluding privatization proceeds, CBT profits, and interest receipts.

Table 9. Turkey: Public Sector Primary Balances, 2000-02

	2000	2001			2002
	Est.	Prog.	Est.	Diff.	Est.
	(In trillions of TL)				
Public sector	2,968	9,964	10,524	560	18,236
Central government 1/	5,350	9,573	9,119	-454	15,733
Total revenue	31,498	47,081	47,538	457	70,258
Tax revenue	26,087	38,493	39,220	727	58,202
Nontax revenue 1/	5,411	8,588	8,319	-270	12,056
Non-interest expenditure	26,148	37,508	38,419	911	54,525
Personnel	9,982	14,781	14,995	214	22,101
Other current	3,520	4,800	4,800	0	7,292
Transfers (excl. credit subsidies) 2/	10,250	13,777	14,439	662	19,396
Credit subsidies	145	400	415	15	0
Investment	2,251	3,750	3,770	20	5,736
Rest of the public sector	-2,383	391	1,405	1,014	2,503
EBFs	-225	-636	-168	468	-651
Unemployment insurance fund	334	1,151	1,134	-17	721
Local governments	-302	-215	33	248	59
SEEs 3/	-2,190	91	405	314	2,274
Social insurance institutions	0	0	0	0	0
Revolving funds 4/	...	...	...	...	100
	(In percent of GNP)				
Public Sector	2.4	5.5	5.7	0.1	6.5
Central government 1/	4.2	5.3	4.9	-0.4	5.6
Total revenue	25.0	26.2	25.7	-0.5	25.0
Tax revenue	20.7	21.4	21.2	-0.2	20.7
Nontax revenue 1/	4.3	4.8	4.5	-0.3	4.3
Non-interest expenditure	20.8	20.9	20.8	-0.1	19.4
Personnel	7.9	8.2	8.1	-0.1	7.9
Other current	2.8	2.7	2.6	-0.1	2.6
Transfers (excl. credit subsidies) 2/	8.1	7.7	7.8	0.1	6.9
Credit subsidies	0.1	0.2	0.2	0.0	0.0
Investment	1.8	2.1	2.0	0.0	2.0
Rest of the public sector	-1.9	0.2	0.8	0.5	0.9
EBFs	-0.2	-0.4	-0.1	0.3	-0.2
Unemployment insurance fund	0.3	0.6	0.6	0.0	0.3
Local governments	-0.2	-0.1	0.0	0.1	0.0
SEEs 3/	-1.7	0.1	0.2	0.2	0.8
Social insurance institutions	0.0	0.0	0.0	0.0	0.0
Revolving funds 4/	...	...	...	...	0.0
Memorandum item:					
GNP (in trillions of TL)	125,971	179,629	184,767	5,138	280,551

Sources: Turkish authorities; and staff estimates.

1/ Excluding privatization proceeds, transfers from the CBT, and interest receipts.

2/ Excluding recapitalization of state banks.

3/ Excluding severance payments for retirees amounting to TL 201 trillion (0.1 percent of GNP).

4/ Added to the public sector balance for 2002. In 2001they are expected to show a TL 40 trillion primary surplus.

Table 10. Turkey: Central Bank Balance Sheet, 2000-2001

	2000	2001						
	Dec.	March	June	September		October		December
	Actual	Actual	Actual	9th Review	Actual	9th Review	Actual	Proj.
	(In trillions of Turkish lira) 1/							
Net foreign assets	3,303	1,156	-5,528	-9,371	-10,221	-12,014	-11,167	-13,162
Net foreign assets	7,598	9,014	3,353	-571	417	-3,116	107	-4,014
Net international reserves (CBT definition)	12,480	14,454	10,251	6,265	10,935	3,794	10,905	3,092
Other foreign liabilities (net)	4,882	5,440	6,898	6,835	10,518	6,910	10,798	7,105
Banks deposits in foreign currency	4,295	7,858	8,882	8,801	10,637	8,898	11,274	9,149
Net domestic assets	2,485	4,422	11,940	16,781	17,831	19,543	18,324	20,927
Claims on central government (net)	397	-803	17,545	21,804	22,155	24,557	26,968	25,924
Claims on other public sector (net)	-333	-542	-690	-690	-744	-690	-1,147	-690
Claims on banks	5,719	10,777	540	2,722	2,325	3,272	404	4,369
Other items (net)	-3,298	-5,010	-5,455	-7,055	-5,905	-7,597	-7,902	-8,677
Other	-2,423	-3,630	-4,371	-5,910	-6,109	-6,458	-8,223	-7,555
Devaluation account	-875	-1,380	-1,084	-1,146	204	-1,139	322	-1,122
Of which: Amount monetized since March 2001	0	0	-275	-275	-275	-275	-275	-275
Net domestic assets (old program definition) 2/	2,485	5,802	13,299	18,202	17,902	20,958	18,277	22,324
Revised program targets (July 2001)	...	...	...	...	...	21,150	...	22,400
Net domestic assets (new program definition) 3/	...	...	...	...	16,428	...	16,594	22,400
Base money	5,788	5,578	6,412	7,410	7,611	7,529	7,157	7,765
Currency issued	3,772	3,587	4,403	5,188	5,076	5,205	4,716	5,318
Bank deposits in liras	2,015	1,991	2,009	2,221	2,535	2,324	2,441	2,447
Required reserves	1,404	1,162	1,273	1,407	1,429	1,472	1,468	1,550
Free reserves	611	829	736	814	1,106	852	973	897
	(In millions of U.S. dollars)							
Memorandum items:								
Gross international reserves	23,206	19,478	17,515	...	19,957	...	19,564	...
Of which: Defense Fund	426	426	426	...	426	...	426	...
International liabilities 4/	4,627	5,798	9,427	...	12,824	...	12,704	...
Short-term Dresdner deposits	640	599	571	...	621	...	611	...
Banks' foreign exchange deposits at CBT	6,394	7,438	7,008	...	6,939	...	7,092	...
CBT forward position	0	-251	-5	...	0	...	0	...
Net international reserves (program definition)								
At current cross exchange rates	11,118	4,967	78	...	-853	...	-1,269	...
At constant cross exchange rates (program)	10,497	4,693	-38	...	-1,317	...	-1,711	...
Exchange rate (TL per U.S. dollar)	671,765	1,056,544	1,267,415	...	1,532,969	...	1,589,727	...

Sources: Central Bank of Turkey; and Fund staff projections.

1/ All foreign currency aggregates are valued at current exchange rates.

2/ Excluding devaluation account, and including monetization of devaluation account since end-March 2001.

3/ Measured using the July 31, 2001 TL per US dollar exchange rate (see Annex C of the Tenth Review Letter of Intent), and current cross exchange rates.

4/ Mainly to IMF.

Table 11. Turkey: Monetary Aggregates, 1999-2002
(In quadrillions of Turkish liras)

	1999	2000	2001				2002	Flow increase
			March Actual	June Actual	Sept. Est.	Dec. Proj.	Dec. Proj.	Dec 2001 to Dec 2002
Net foreign assets	6.0	2.8	1.0	-1.5	-3.6	-6.3	-0.8	5.5
(in billions of U.S. dollars)	11.0	4.1	1.0	-1.2	-2.4	-3.9	-0.4	3.5
CBT	7.5	6.6	5.7	0.0	-3.6	-6.3	-7.7	-1.4
(in billions of U.S. dollars)	13.9	9.9	5.6	0.0	-2.4	-3.9	-3.9	0.0
Deposit money banks	-1.6	-3.9	-4.7	-1.5	0.0	0.0	6.9	6.9
(in billions of U.S. dollars)	-2.9	-5.8	-4.6	-1.2	0.0	0.0	3.5	3.5
Net domestic assets	34.2	53.3	69.7	84.6	103.3	116.4	153.7	37.3
Net claims on government	17.0	30.9	38.9	61.6	79.4	86.7	112.7	26.0
CBT	-1.9	-0.2	-1.1	16.6	21.9	28.7	31.2	2.5
Deposit money banks	18.8	31.1	40.0	45.0	57.5	58.0	81.5	23.4
Claims on business sector 1/	18.3	31.2	33.7	34.7	37.5	43.3	58.0	14.6
Turkish lira claims	11.2	21.8	21.3	20.2	20.6	23.8	33.5	9.7
Foreign exchange claims (est.) 2/	7.1	9.4	12.4	14.5	16.9	19.5	24.5	4.9
Other items (net)	-1.1	-8.8	-2.9	-11.7	-13.7	-13.7	-17.0	-3.3
Broad money (M2Y)	40.2	56.0	70.7	83.2	99.7	110.1	152.9	42.8
Lira broad money (M2)	22.0	31.1	36.9	38.9	40.7	47.0	65.2	18.2
Foreign exchange deposits 2/	18.2	24.9	33.7	44.3	58.9	63.1	87.7	24.5
Repos	4.1	6.0	3.9	5.8	4.0	4.5	6.2	1.7
Broad liquidity	44.2	62.0	74.5	89.0	103.7	114.6	159.1	44.5
Reserve money	3.9	5.8	5.6	6.4	7.6	7.7	10.7	2.9
Memorandum items:								
Annual percent change								
Broad money (M2Y)	98.7	39.6	64.5	75.4	91.5	96.5	38.8	...
Lira broad money (M2)	92.5	41.5	68.7	62.2	56.9	51.0	38.8	...
Foreign exchange deposits 2/	106.6	37.3	60.1	88.8	125.9	153.2	38.8	...
Claims on business sector 1/	50 8	70.3	60.1	39.3	27.1	39.0	33.8	...
Net claims on government	134.2	81.7	97.6	206.8	284.8	180.9	29.9	...
In billions of U.S. dollars								
Broad money (M2Y)	74.3	83.4	69.2	66.4	65.6	68.7	77.9	9.2
Lira broad money (M2)	40.7	46.3	36.2	31.0	26.8	29.3	33.2	3.9
Foreign exchange deposits	33.6	37.1	33.0	35.4	38.8	39.4	44.7	5.3
Net claims on government	31.5	46.0	38.1	49.1	52.3	54.1	57.4	3.3
Credit to the private sector	33.9	46.4	33.0	27.7	24.7	27.0	29.5	2.5
Base money/GNP 3/	5.0	4.6	3.0	3.5	4.1	4.2	3.8	...
Broad money (M2Y)/GNP 3/	51.3	44.5	...	...	...	59.6	55.0	...
Lira broad money (M2)/GNP 3/	28.1	24.7	20.0	21.0	22.0	25.4	23.5	...
Money multiplier								
Broad money (M2Y)	10.4	9.7	12.7	13.0	13.1	14.2	14.3	...
Lira broad money (M2)	5.7	5.4	6.6	6.1	5.4	6.1	6.1	...

1/ Includes credit to local governments and state economic enterprises.
2/ Evaluated at current exchange rates.
3/ Evaluated as percent of annual average GNP.

Table 12. Turkey: Banking System--Selected Indicators, 1997-2001 1/

(In trillions of Turkish lira, unless otherwise indicated)

	1997	1998	1999	2000	2001		
	December				March	June	August
	Banking System						
Total Assets	22,759	41,969	82,371	119,202	131,448	165,984	171,356
Cash and claims on CBT	1,495	2,665	5,097	6,235	7,667	8,847	9,769
Claims on other banks	2,679	4,414	9,070	14,376	14,602	18,806	18,373
Securities portfolio	5,857	10,179	23,344	32,027	34,433	62,960	66,291
Loans, net	8,873	14,689	22,601	35,789	40,614	44,807	47,620
Other assets	3,855	10,024	22,258	30,775	34,133	30,563	29,304
Total Liabilities	22,759	41,969	82,371	119,202	131,448	165,984	171,356
Deposits	12,571	24,194	48,272	68,143	78,835	96,380	102,561
Borrowing from banks	2,556	4,663	10,070	15,996	20,786	23,376	21,772
Repos	3,139	4,644	8,950	13,620	11,128	13,492	12,890
Other liabilities	2,743	5,179	10,844	12,983	15,428	16,339	17,151
Shareholders' equity (incl. profits)	1,749	3,290	4,235	8,461	5,271	16,397	16,982
Memorandum items:							
Capital adequacy ratio (%)	...	...	...	17.3	7.7	20.3	...
NPLs (%) total loans	2.1	6.7	9.7	9.2	8.5	13.7	16.0
Provisions (%) NPLs	53.7	44.2	53.7	59.8	53.2	66.5	64.3
ROA (%)	2.1	1.8	-0.4	-0.7	-3.3	-3.0	-1.9
ROE (%)	27.4	23.1	-7.2	-10.5	-83.0	-30.0	-19.1
Share in assets (%)	100	100	100	100	100	100	100
Share in deposits and repos (%)	100	100	100	100	100	100	100
	Private Banks 2/						
Total Assets	10,361	18,826	37,170	54,978	68,353	80,893	84,022
Cash and claims on CBT	708	1,248	2,445	3,247	4,574	5,579	6,191
Claims on other banks	1,346	2,714	5,882	10,181	10,859	13,279	12,501
Securities portfolio	3,000	4,688	11,138	12,854	14,414	16,749	20,380
Loans, net	3,884	7,009	11,408	19,199	22,696	27,108	28,340
Other assets	1,422	3,167	6,297	9,498	15,809	18,178	16,610
Total Liabilities	10,361	18,826	37,170	54,978	68,353	80,893	84,022
Deposits	5,331	10,489	20,694	29,865	40,490	51,189	55,516
Borrowing from banks	1,421	2,492	5,716	9,708	12,750	14,137	14,631
Repos	1,600	1,646	2,761	3,581	1,708	2,939	3,120
Other liabilities	983	1,940	3,585	3,930	5,715	4,780	2,646
Shareholders' equity (incl. profits)	1,025	2,259	4,414	7,894	7,690	7,848	8,109
Memorandum items:							
Capital adequacy ratio (%)	...	...	...	18.3	14.6	10.6	...
NPLs (%) total loans	1.3	2.2	3.6	3.5	3.8	4.8	4.6
Provisions (%) NPLs	69.6	56.6	62.7	63.4	52.5	42.2	42.2
ROA (%)	3.8	4.3	3.9	2.6	0.3	0.1	0.7
ROE (%)	38.6	35.9	33.1	18.0	2.3	0.8	7.5
Share in assets (%)	45.5	44.9	45.1	46.1	52.0	48.7	49.0
Share in deposits and repos (%)	44.1	42.1	41.0	40.9	46.9	49.3	50.8

Table 12. Turkey: Banking System--Selected Indicators, 1997-2001 1/

(In trillions of Turkish lira, unless otherwise indicated)

	1997	1998	1999	2000	2001		
	December				March	June	August
	Public (state and SDIF) banks 3/						
Total Assets	10,733	20,472	39,250	55,877	53,047	73,899	75,149
Cash and claims on CBT	751	1,341	2,510	2,806	2,743	2,895	3,159
Claims on other banks	948	1,116	1,638	2,316	2,114	3,648	3,994
Securities portfolio	2,673	5,244	11,214	17,903	19,008	45,160	44,802
Loans, net	4,126	6,209	8,610	12,946	13,065	11,989	12,948
Other assets	2,236	6,562	15,278	19,907	16,118	10,206	10,247
Total Liabilities	10,733	20,472	39,250	55,877	53,047	73,899	75,149
Deposits	7,042	13,447	27,033	37,396	37,138	43,817	45,308
Borrowing from banks	416	911	1,685	2,495	3,691	4,893	2,796
Repos	1,469	2,940	6,077	9,834	9,318	10,330	9,549
Other liabilities	1,299	2,582	5,572	7,115	7,077	8,319	10,931
Shareholders' equity (incl. profits)	507	592	-1,116	-963	-4,177	6,539	6,566
Memorandum items:							
Capital adequacy ratio (%) 4/	...	...	...	7.6	-40.4	45.0	...
NPLs (%) total loans	2.9	12.6	19.0	18.8	18.0	33.3	39.4
Provisions (%) NPLs	61.8	41.5	50.0	59.1	58.9	73.2	68.9
ROA (%)	0.3	-1.0	-5.4	-4.7	-9.0	-7.4	-6.1
ROE (%)	5.9	-33.8	...	...	...	-83.2	-69.8
Share in assets (%)	47.2	48.8	47.7	46.9	40.4	44.5	43.9
Share in deposits and repos (%)	54.2	56.8	57.9	57.8	51.6	49.3	47.5
	Foreign and Investment Banks						
Total Assets	1,665	2,672	5,951	8,346	10,049	11,192	12,185
Cash and claims on CBT	36	75	143	182	350	373	419
Claims on other banks	385	584	1,550	1,878	1,629	1,878	1,878
Securities portfolio	183	247	992	1,271	1,011	1,051	1,109
Loans, net	864	1,471	2,583	3,645	4,853	5,710	6,332
Other assets	197	295	683	1,370	2,206	2,179	2,446
Total Liabilities	1,665	2,672	5,951	8,346	10,049	11,192	12,185
Deposits	197	258	546	882	1,207	1,374	1,737
Borrowing from banks	719	1,259	2,670	3,792	4,345	4,346	4,345
Repos	70	58	111	205	103	223	221
Other liabilities	462	657	1,687	1,938	2,636	3,239	3,574
Shareholders' equity (incl. profits)	217	439	937	1,529	1,758	2,010	2,307
Memorandum items:							
Capital adequacy ratio (%)	...	...	...	29.4	29.8	31.3	...
Provisions (%) NPLs	60.9	54.0	31.3	51.8	55.8	45.5	39.4
NPLs (%) total loans	1.8	2.1	2.1	1.8	2.1	2.8	2.9
ROA (%)	3.3	5.6	5.7	3.9	2.3	4.0	6.0
ROE (%)	25.1	34.1	36.3	21.4	13.2	22.2	31.7
Share in assets (%)	7.3	6.4	7.2	7.0	7.6	6.7	7.1
Share in deposits and repos (%)	1.7	1.1	1.1	1.3	1.5	1.5	1.7

1/ Includes off-balance sheet repos and reverse repos.

2/ Comprises the private (domestic) deposit-taking commercial banks.

3/ These include 3 state banks (Emlak Bank was closed and its assets and liabilities merged with Ziraat Bank) and 9 SDIF banks.

4/ CARs are reported on a quarterly basis.

Table 13. Turkey: External Financing Requirements and Sources, 1998-2004
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003	2004
Gross financing requirements	27.6	35.5	49.0	44.0	36.1	34.9	35.9
Current account deficit (excl. official transfers)	-1.8	1.7	10.0	-2.0	2.2	1.9	2.3
Amortization on debt securities	3.3	2.0	1.7	2.1	2.5	4.1	3.1
Of which:							
Public sector	3.0	1.9	1.4	2.1	2.1	3.9	3.1
Deposit money banks	0.3	0.1	0.4	0.0	0.4	0.2	0.0
Medium and long-term debt amortization	8.2	10.6	13.8	15.0	13.0	13.5	13.1
Of which:							
Public sector 1/	2.8	2.9	3.6	4.9	3.5	3.8	3.4
Private sector	3.0	5.2	7.9	8.6	8.5	8.8	8.8
Deposit money banks	2.3	2.4	2.3	1.6	1.0	1.0	1.0
Short-term debt amortization	18.0	21.2	23.5	28.9	18.3	15.4	17.5
Public sector 1/	0.9	0.9	0.7	1.7	0.6	0.7	0.7
Private sector	8.6	9.2	9.6	10.4	8.9	9.8	11.0
Deposit money banks	8.5	11.2	13.2	16.9	8.8	4.9	5.7
Available financing	27.6	35.5	49.0	44.0	36.1	34.9	35.9
Foreign direct investment (net)	0.6	0.1	0.1	2.2	0.9	1.0	1.2
Portfolio flows	-3.4	5.4	2.8	-4.0	1.1	4.5	5.7
Public sector	2.7	5.0	7.5	1.1	2.0	4.5	4.5
Deposit money banks	0.0	0.2	0.5	0.0	0.0	0.2	0.2
Private sector (net)	-6.1	0.2	-5.2	-5.1	-0.9	-0.2	1.0
Medium and long-term debt financing	12.2	10.9	19.1	12.2	13.9	12.8	13.2
Of which:							
Public sector 1/	1.8	0.9	4.4	3.4	5.0	2.8	2.4
Private sector	7.2	7.5	12.8	8.1	8.2	8.8	9.2
Deposit money banks	3.1	2.6	1.9	0.7	0.7	1.3	1.6
Short-term debt financing	20.6	22.0	26.5	18.5	15.3	17.5	19.1
Official transfers	0.2	0.4	0.2	0.2	0.2	0.3	0.3
Other 2/	-2.0	1.9	-2.7	-2.1	0.0	0.0	0.0
Accumulation of reserves net of IMF	-0.4	-5.2	3.0	15.9	-4.4	-2.2	-3.6
Accumulation of gross reserves (- denotes increase	-0.2	-5.9	-0.3	2.5	-0.3	-0.6	-1.9
IMF (net)/exceptional CBT financing	-0.2	0.7	3.3	13.4	-4.1	-1.6	-1.8
Purchases	0.0	0.8	3.4	14.5	1.2	0.0	0.0
Repurchases	0.2	0.1	0.1	1.1	5.3	1.6	1.8
Exceptional financing (gap)	0.0	0.0	0.0	1.0	9.0	1.0	0.0

1/ General government and Central Bank of Turkey.

2/ Errors and omissions.

Table 14. Turkey: Indicators of Fund Credit, 2000-06 1/

	2000	2001	2002	2003	2004	2005	2006
Outstanding Fund credit (end of period)							
In billions of SDRs	3.2	13.5	10.4	9.1	7.8	3.6	0.2
In percent of quota	333	1402	1075	946	805	378	24
In percent of exports of G&NFS	8	35	26	21	16	7	0
In percent of public sector external debt	7	24	19	17	15	8	0
In percent of overall external debt	4	15	13	11	9	4	0
In percent of foreign reserves	18	89	123	112	81	44	3
Debt service due to the Fund							
In billions of SDRs	0.1	1.2	5.2	2.2	1.9	4.2	3.4
In percent of quota	13	128	537	223	195	441	356
In percent of exports of G&NFS	0	3	13	5	4	8	6
In percent of public sector external debt service	0	4	24	11	10	21	16
In percent of overall external debt service	1	6	27	10	8	18	14
In percent of foreign reserves	1	8	61	26	20	51	40

Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.
1/ Under existing access.

TURKEY: FUND RELATIONS

(As of September 30, 2001)

I. **Membership Status**: Turkey became a member of the Fund on March 11, 1947. It has accepted the obligations of Article VIII, Sections 2, 3, and 4 as of March 22, 1990.

II. **General Resources Account:**	**Millions of SDRs**	**Percent of Quota**
Quota	964.00	100.0
Fund holdings of currency	10,548.77	1,094.3
Reserve position in Fund	112.78	11.7

III. **SDR Department:**	**Millions of SDRs**	**Percent of Allocation**
Net cumulative allocation	112.31	100.0
Holdings	2.31	2.1

IV. **Outstanding Purchases and Loans**:	**Millions of SDRs**	**Percent of Quota**
Stand-by Arrangements	9,336.04	968.5
First credit tranche	361.50	37.5

V. **Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
			In millions of SDRs	
Stand-By	12/22/99	12/21/02	15,038.40	9,336.04
Of which: SRF	05/15/01	05/14/02	5,784.00	5,205.60
Stand-By	07/08/94	03/07/96	610.50	460.50
Stand-By	04/04/84	04/03/85	225.00	168.75

VI. **Projected Obligations to Fund:** (In millions of SDRs; based on existing use of resources and holdings of SDRs)

	Overdue	**Forthcoming**				
	5/31/01	2001	2002	2003	2004	2005
Principal		867.6	3,759.6	1,802.3	2,246.0	1022.1
Charges/Interest		134.6	385.8	170.7	85.6	18.2
Total		1,002.2	4,145.4	1,973.0	2,331.6	1040.3

VII. **Safeguard Assessments**:

Under the Fund's safeguards assessment policy, the Central Bank of Turkey is subject to the transitional procedures with respect to the SBA approved on December 22, 1999, which is scheduled to expire on December 21, 2002. The transitional procedures require a review of only the CBT's external audit mechanism. This assessment determines whether the CBT publishes annual financial statements that are independently audited in accordance with internationally accepted standards.

The External Audit assessment was completed on August 21, 2001. The assessment concluded that the Central Bank of Turkey's current external audit mechanism may not be adequate in certain respects and appropriate recommendations have been made to the authorities, as reported in section IV of this report.

VIII. **Exchange Rate Arrangement**:

For the period January 1, 2000–June 30, 2001, the lira was to have depreciated against a basket comprising US$1 and € 0.77 along a daily path preannounced by the central bank. The preannouncement was for the 12-month period, and was updated quarterly. There would not be an exchange rate band around the preannounced path during the first 18 months of the program. Thereafter—that is, from July 1, 2001—a symmetrical intervention band was to have been introduced around the central parity rate, with the total width of the band increasing gradually at a rate of 15 percentage points per year. On February 22, 2001, the government decided to float the currency.

IX. **Article IV Consultations**:

The 1999 Article IV staff report (EBS/99/225) was issued on December 10, 1999, the accompanying Selected Issues and Statistical Appendix (SM/99/294) was issued on December 14, 1999. Board discussion took place on December 22, 1999 at EBM/99/137.

X. **ROSCs**

Standard Code Assessment	Date of Issuance	Document Number
Fiscal Transparency	June 26, 2000	SM/00/139
Data Dissemination	Under preparation	

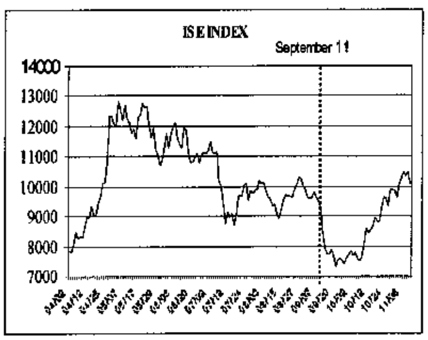
XI. **Technical Assistance:** (1993–present)

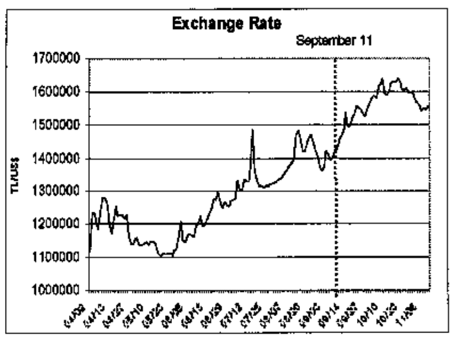
Department	**Timing**	**Purpose**
MAE	July 1994	Banking sector reform
MAE	July 1995	Inflation accounting
FAD	September 1995	Taxation of petroleum products
FAD	October 1995	Assistance to IBRD-supported Public Financial Managing Project; eight FAD missions since 1994, assignment of five resident experts, mainly focused on customs modernization
STA	February 1997	Balance of payments compilation
PDR/EU1/MAE	December 1998	Short-term debt monitoring
MAE	June 1999	Basel Core Principles
MAE	August 1999	Debt management policies
MAE	October 1999	Banking sector reform
MAE	March 2000	Banking sector reform
FAD	April 2000	Fiscal transparency
FAD	April 2000	Tax policy
MAE	April 2000	Banking sector reform
MAE	May 2000	Banking sector reform
MAE	July 2000	Inflation targeting
STA	September 2000	Balance of payments statistics
MAE	Sept. 2000–April 2001	Banking sector reform
MAE	April 2001	Debt management
FAD/STA	May 2001	Fiscal accounting and reporting
MAE	September 2001	Inflation targeting

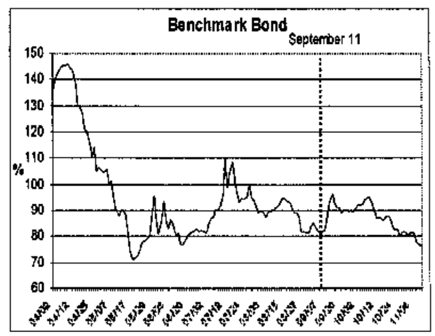
Turkey: Indicators of External and Financial Vulnerability

While financial indicators have improved since mid-October, Turkey is faced with considerable vulnerabilities. Recent movements in financial indicators have been associated closely with expectations about additional funding from official external sources, and the indicators improved markedly in late October and early November as the expectations of new financing increased. The main vulnerabilities relate to a weakened economic outlook, and its implications for the government budget and debt position and for the quality of the balance sheets of banks, as well as to a high ratio of short-term external debt to official international reserves.

Financial and monetary indicators: The weakening in financial indicators in the first half of October was followed by a strong recovery in the second half of the month and in early November. The compounded interest rate on the benchmark bond declined from close to 90 percent in mid-October towards the 75 percent range in mid-November, while the exchange rate appreciated from TL/US$1,600,000 at mid-October to about TL/US$1,500,000 in mid-November (see table below; the "latest" column refers to November 11). In parallel to these developments, the stock market recovered by some 20 percent between mid-October and mid-November. These developments were driven mainly by the expectations concerning additional funding from the IMF and/or G-7 countries, although lessened concerns about military action in the region and the approval on October 11 by the High Planning Council of budgetary targets for 2002 in line with the economic program may also have helped.







	FINANCIAL AND MONEY MARKET INDICATORS (*)										
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Latest
1. Bond Yield (% Compound)	53.6	157.6**	140.5	106.7	95.5	81.9	91.5	81.4	89.6	81.6	76.2
Volume (TL Tr.)	41.8	0.4**	3.9	2.5	188.7	8.8	144.5	48.0	112.3	38.8	5.2
2. O/N Interest Rate (% simple)	54	121	83	77	63	63	67	61	59	59	59
3. Treasury Eurobond Spreads (2010 maturity) (basis pts.)											
Denominated in US$	733	1026	1130	902	873	888	1105	957	997	919	..
Denominated in Euro	471	553	577	522	488	477	676	588	695	670	..
4. ISE 100 Index (1986=1)											
TL Based	10685	8792	8023	12367	10880	11204	9914	9879	7626	8577	10081
US$ based	916	556	458	633	525	521	436	424	292	313	..
5. NDA of CBT (Tr. TL)	236	3897	5802	6907	8357	13299	14703	16380	17902	18277	17672
6. Gross Reserves of CBT (US$ Mil.)	24518	21270	18822	18461	20621	17279	17606	18790	18882	18637	18618
7. Base Money (TL Tr.)	4506	5071	5578	6022	5822	6412	6285	6752	7611	7157	7017

(*) End-month data, except for the latest

(**) Benchmark bond was not traded on the last day of the month. Figures are for Feb. 27th

	REAL SECTOR AND GOVERNMENT BUDGET INDICATORS									
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct
1.CPI (monthly % change)	2.5	1.8	6.1	10.3	5.1	3.1	2.4	2.9	5.9	6.1
2.WPI (monthly % change)	2.3	2.6	10.1	14.4	6.3	2.9	3.3	3.5	5.4	6.7
3. Inflation Expectations***	25.0	35.0	55.0	59.6	56.5	55.8	56.7	57.6	60.7	..
4. Industrial Production Index (1997=100)	91.4	88.5	85.9	87.1	93.4	93.6	90.1	92.8	95.2	..
5. Capacity Utilization of Private Manuf. Ind. (%)	68.3	65.5	61.8	63.8	62.3	66.3	65.4	64.9	66.8	..
6. Production Expectation Survey (%)****	10.2	19.8	18.1	-5.6	37.5	34.5	23.7	33.2	39.3	10.3
7.Consolidated Gov.'t Primary Balance (Tr. TL.)	1292	2306	1122	1326	1084	509	670	1921	853	..
8. Gov 't domestic debt service next month (TL. tr.)	..	..	..	..	..	5150	6400	7200	6700	7800
9.Bid/cover ratio in TB auctions	1.64	1.61	2.5	1.25	1.65	1.26	2.08	1.17	2.14	1.59

(***) Percent change expected in WPI in the subsequent 12 months

(****) Difference between the percentage of respondents expecting a higher production vs.lower production in the present month (data are collected in the previous month)

Real Sector and Government Budget Indicators: The September and October ***inflation*** outcomes were worse than expected. September inflation figures may have reflected a revival in domestic demand, as CPI inflation exceeded WPI inflation in spite of the larger pass-through effect on the WPI of the exchange rate depreciation. However, in October WPI inflation surpassed CPI inflation, as the surge in the WPI was concentrated in the higher-than-expected inflation of 7.6 percent in private manufacturing prices. Similarly, indicators of ***economic activity*** suggest that a turnaround was under way ahead of the September 11 events: (i) government tax collection data for September indicated an improvement in domestic demand, with VAT revenues from domestic activities rising by 11 percent; (ii) the industrial production index continued to rise in August; and (iii) the capacity utilization rate in private manufacturing industry rose by 2 percentage points in September. Forward-looking economic indicators point to a sharp deterioration in market sentiment after September 11: The production expectation survey of SIS suggests a deterioration in production in October. The Economic Tendency Survey of the CBT indicates a similar deterioration on the domestic demand side: net positive expectations in September for domestic sales and new orders from the domestic market over the next three months deteriorated by 12.7 and 14.1 percentage points, respectively. The data in the same survey covering expectations about the overall economic trend point to a deterioration in September. On the ***government budget*** side, continued fiscal efforts resulted in a cumulative primary surplus of the consolidated budget being close to 2001 end-year target by September; while financial market sentiment for the rollover of government debt in the rest of 2001 has improved, the government's ability to rollover the domestic debt in early 2002 remained a major source of vulnerability.

Banking and financial sector indicators: The higher ratios of NPLs-to-credit to private sector recorded since August point to credit risk as a source of increasing vulnerability in the banking sector. Moreover, SIS data indicate that the number of firms put into bankruptcy increased by 146 percent (year-on-year basis) in September and 184 percent in October. The share of FX deposits in total deposits (measured in TL) continued to rise mainly due to depreciation and also a marginal rise in FX deposit stock in U.S. dollar terms in October. Parallel to rising FX liabilities of banking sector, the share of FX denominated government papers in the total securities portfolio of domestic deposit money banks rose to almost 27 percent in October from 18 percent in July. However, the overall short open foreign exchange position of the banking sector as a whole remained stable and moderate, and the maturity gap increased marginally. Having posted a sharp rise in September, the external loans of banks falling due next month declined steeply in October, reaching their lowest level since the beginning of the year. While Etibank and Iktisat Bank were re-offered to sale, the sale process of Sitebank continued with some delay. The merger between Garanti Bank and Osmanli Bank should help increase confidence in banking sector.

	BANKING AND FINANCIAL SYSTEM INDICATORS									
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct
1. Capital Adequacy Ratio										
Total			7.8	..	..	20.2	..	..	..	
Excl. SDIF			13.3	..	..	14.3	..	..	..	
2. NPLs / Credit to Private Sector (%)										
Gross	11.0	11.3	11.9	13.1	14.4	15.7	14.4	19.4	18.2	18.0
Net (of Provisions)	4.0	4.3	4.5	4.9	4.5	4.5	3.3	6.9	7.5	7.7
3. Open FX Position / Capital Base										
Total										
Total Net FX Position (US$ Million)	-5324	-4310	-5149	-5336	-803	-242	-766	-724	-695	..
Open FX Position/ Capital Base (%)	-66	-77	-88	-122	-20	-5	-12	-7	-7	..
Excl. SDIF										
Total Net FX Position (US$ Million)	-1012	-765	-479	-517	-159	317	78	508	464	..
Open FX Position/ Capital Base (%)	-8	-10	-6	-8	-2	5	1	6	6	..
4. Proxy for Av. Maturity Gap (months) (*****)	3.5	2.8	3.0	3.0	3.5	3.4	3.6	..	..	
5.Deposits (Tr. Tl.)	57,051	63,063	71,518	74,697	75,248	83,605	85,412	91,844	100,082	104,429
TL/Total (%)	55.0	50.8	51.5	48.0	48.6	45.7	42.0	41.6	39.2	38.4
FX/Total (%)	45.0	49.2	48.5	52.0	51.4	54.3	58.0	58.4	60.8	61.6
6. Credit to Private Sector (TL.tr.)	32,404	34,502	35,947	37,909	37,016	39,972	40,480	43,682	46,221	47,051
7. Credit to Private Sector / Deposits (%)	56.8	54.7	50.3	50.7	49.2	47.8	47.4	47.6	46.2	45.1
8.External Loans due next month (US$ Mil.)	6490	5765	5515	5591	4242	5291	1383	1520	1744	598

(*****) The difference between the average (weighted) maturities of assets and liabilities

External Indicators: The current account surplus reached US$1.8 billion in January–August 2001 compared with a deficit of US$6.6 billion in the same period of 2000. The turnaround reflected a major improvement in the trade balance (by 57.8 percent), as a result of sharp import contraction, a large rise in tourism revenues, and an increase in shuttle trade. The real exchange rate continued to depreciate in September and October 2001, and the preliminary export figures of Union of Turkish Exporters for September and October suggest continued strong export growth (year-on-year growth figures of 13.0 and 20.4 percent, respectively). Looking ahead, while imports are expected to remain weak, the trade balance will likely suffer from the fallout on Turkish exports and tourism revenues of the September 11 events. In this regard, the latest Economic Tendency Survey of the Central Bank suggests a sharp deterioration in the expectations both for new export orders and for the volume of sales in export markets in the next three months. The capital account continues to be vulnerable; total short-term debt-to-reserves ratio stood at 110 percent in August (compared with 132 percent in June), with a more pronounced decline in total short term debt (mainly due to decline in FX credits obtained by banks) in July and improvement in reserve position during July–August. The return of leading Turkish Banks (Isbank, Finansbank, Kocbank, and Akbank) to international markets for syndications continued in October and early November.

	EXTERNAL INDICATORS									
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct
1. REER (WPI) (1987=100)	109.8	102.7	87.5	81.1	92.5	90.6	86.6	82.7	82.0	80.5
2. Exports (US$ million)	2236	2516	2546	2607	2884	2553	2482	2576	..	..
3. Imports (US $ million)	3985	3513	3087	3013	3537	3267	3354	3385	..	..
4. Current Account (US $ million)	-674	-96	234	629	333	190	392	804	..	..
5. Change in foreign banks exposure (US $ million)	-280.6	-1525.2	-933.2	-172.2	-884.6	-1841.1	-2000.7	117.8	-246.3	180.8
6. Short-term external debt/reserves	1.18	1.29	1.42	1.43	1.19	1.32	1.18	1.10	..	..

Turkey—External Financing Gap, 2001–02

1. **The staff estimates that Turkey is facing an external financing gap of US$8–12 billion in 2001–02 (with a baseline of US$10 billion).** The latest post-September 11 balance of payments projections indicate that Turkey's gross official reserves would decline by US$3½ billion in 2001 and US$8¾ billion in 2002 without additional external financing (Table 13). For prudential reasons, the staff feels that Turkey's gross reserves should not fall by more than US$2½ billion this year (leaving a gap of US$1 billion in 2001), and should at least remain constant, if not increase slightly, in 2002, leaving a gap of US$9 billion in 2002 (Table 14). Depending on the depth and length of the September 11 shock, the projections are subject to upside and downside risks, with US$8–12 billion a prudently estimated range for the gap.

2. **Updated post-September 11 macroeconomic assumptions are used throughout when projecting the current and capital accounts.** The current account projections are based on the latest WEO global economic assumptions and the macroeconomic framework underlying Turkey's Fund-supported program (see Table 13, memorandum items, for a description of the main assumptions used). For example, oil prices are projected at US$21 a barrel, real GNP is assumed to rise by 4 percent next year following a decline of 8½ percent this year, and the average real exchange rate is expected to remain broadly unchanged. As regards capital flows, the underlying premise is that international capital markets will remain difficult to tap, at least through mid-2002, for highly indebted emerging market countries such as Turkey.

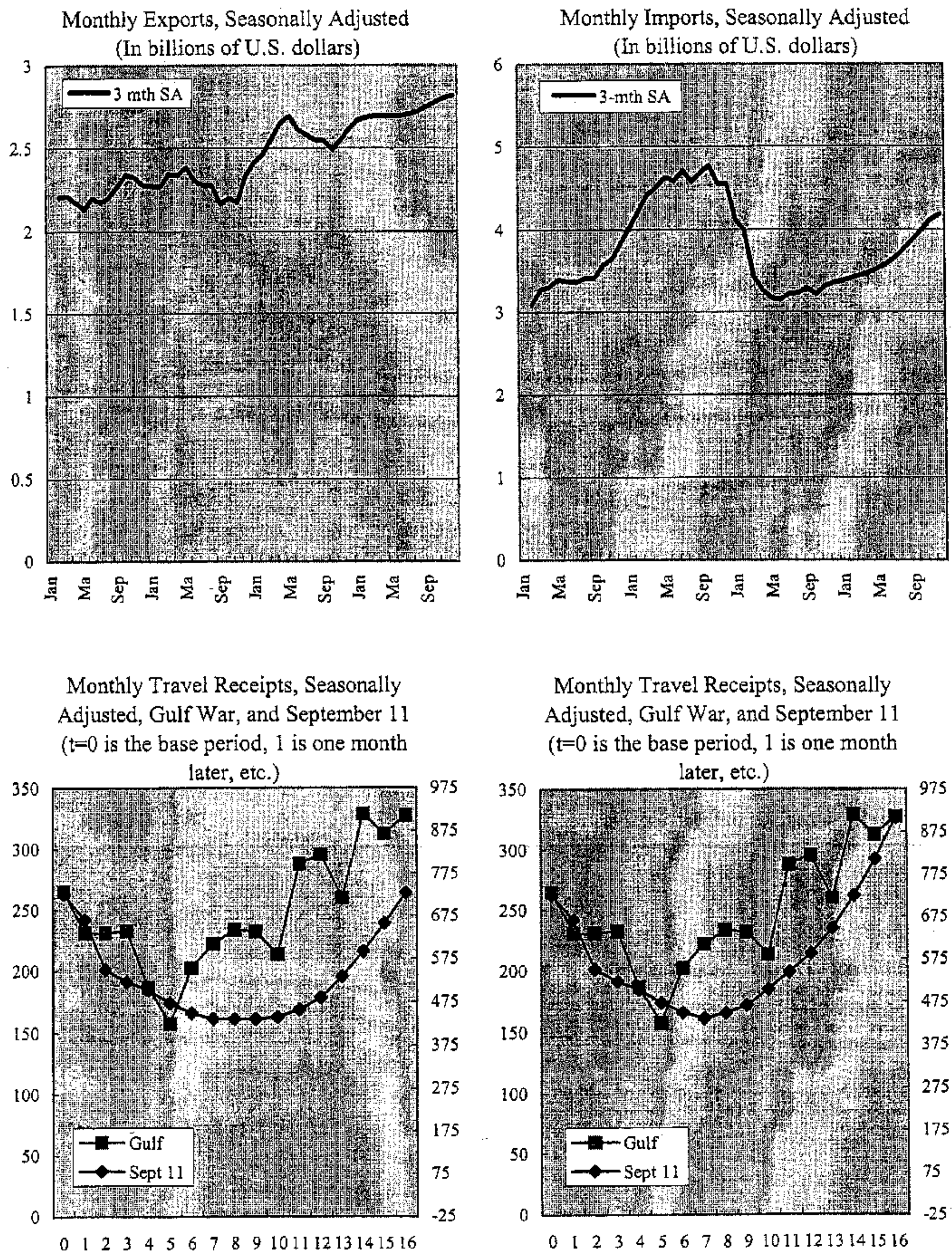
A. Baseline Balance of Payments Projections for 2001–02

Current account

3. **The current account balance is projected to move from a projected surplus of US$2¼ billion (1½ percent of GNP) in 2001 to a deficit of US$2 billion (1¼ percent of GNP) in 2002.** Although lower oil prices should help Turkey, tourism is expected to be hard hit given Turkey's location. Exports, which have grown rapidly so far in 2001 owing to the large real depreciation and weak domestic demand, will also be adversely affected.

4. **Following the strong growth this year, in 2002 exports are projected to increase by 6.3 percent in U.S. dollar terms and 4.4 percent in volume terms.** Export volume is determined by growth in foreign trading partner import demand (4.4 percent), on the assumption that Turkey's market share remains constant. As shown in Figure 7 (upper left panel), export growth is expected to pick up modestly through the first few months of 2002

Figure 7. Turkey: Exports, Imports, and Tourism, 2001-02



Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.

on account of the lagged impact of past real exchange rate movements[1], then to become flat until the final quarter, by which time world growth is expected to contribute to a renewed upturn in exports.

5. **After this year's sharp drop, in 2002 imports are projected to increase by 8.5 percent in both U.S. dollar and volume terms.** This is driven by projected GNP growth of 4 percent in 2002, of which a large part is expected to come from import-intensive stock-building activities. Moreover, the dampening impact of this year's real exchange rate depreciation on imports is only projected to last through the first few months of 2002 (upper right panel of Figure 7).

6. **Travel receipts are projected to fall to US$6 billion, a decline of 25 percent over the record performance of 2001.** Indicators such as cancellations and tourist arrivals since September 11 indicate that Turkey's travel industry is likely to be badly hit, just as it was during the Gulf War period. The baseline projection assumes that the decline in seasonally adjusted travel receipts from the peak pre-shock base period—about 40 percent—is the same as during the Gulf War period, although the recovery is assumed to be more delayed this time round, beginning in mid-year (lower left panel of Figure 7).

Capital account

7. **Net FDI is projected to reach US$0.9 billion next year, compared with US$2.2 billion in 2001.** The anticipated decline reflects weakened privatization prospects. In April 2001, a one-off US$1.4 billion was received in connection with the GSM license. While sales of entities such as TUPRAS (oil refinery) and POAS (petroleum distribution company) are expected in 2002, any FDI component of such sales is likely to be minor.

8. **The large portfolio outflows in 2001 are not expected to be repeated in 2002.** The US$5 billion outflow this year has reflected a withdrawal of foreign investors from Turkey's stock and government securities markets, leaving existing holdings relatively small. The net portfolio outflow of US$0.9 billion projected for 2002 comprises a US$0.7 billion increase in Turkish resident holdings of securities abroad, and a US$0.2 billion decline in nonresident holdings of equities and paper. Holdings of securities abroad by Turkish residents (mainly banks) have increased by US$1 billion on average over the last five years. Next year the

[1] Under the program's macroeconomic framework, the average real exchange rate is expected to remain constant next year. Although there are likely lagged benefits from past exchange rate depreciation, these are assumed to be offset by structural problems in Turkey's exports, particularly the continued stagnation of the clothing sector (accounting for a quarter of overall Turkish exports), and the expected deceleration in automobile exports (with domestic demand plummeting, these exports rose rapidly in 2001 to account for a tenth of total exports, but are unlikely to expand in 2002 when domestic demand is expected to pick up).

figure is projected to be slightly lower on the assumption that more foreign exchange linked paper is issued domestically. The projected US$0.2 billion decline in foreign holdings of Turkish equities and government paper is modest as (i) the outstanding stock of holdings is estimated to be low (US$4 billion of equities and US$0.5 billion of paper), and (ii) foreign holdings of Turkish equities have been resilient in real dollar terms over the past few months.

9. **Eurobond drawings, which were expected to reach US$3.5 billion in 2002 in the pre-September 11 scenario, are now projected at just US$2 billion.** The September 11 shock already forced the authorities to scale down their Eurobond issuance program for the remainder of 2001, with this year's drawings totaling only US$1.1 billion. Turkey has not, however, lost access to the Eurobond market completely, as the successful issuance of 500 million euros in October showed, making a borrowing target of US$2 billion in 2002 feasible.

10. **A modest increase of US$0.4 billion is projected in so-called Dresdner deposits, similar to the estimated outcome in 2001.** Dresdner deposits are deposits at the Central Bank of Turkey from migrant workers abroad, especially in Germany.

11. **Net banking sector outflows are expected to decline from almost US$10 billion this year in 2001 to less than US$5 billion next year.** The details of the 2002 projections are as follows:

- **Most important, the net decline in short-term FX credits of foreign commercial banks is projected to be almost halved, to US$3.5 billion.** In 2001, interbank credits are estimated to fall by US$6½ billion, despite agreements in December 2000 and June 2001 by foreign banks to maintain exposure. The projected US$3.5 billion outflow in 2002 represents a rollover ratio of about 60 percent, about the same as this year's estimated outcome.

- **Banks' FX reserve holdings in correspondent accounts abroad are projected to remain unchanged rather than increasing as in previous years.** The staff does not project a further buildup as banks are assumed to have additional channels in which to invest their foreign exchange holdings should Treasury debt management practices lead to additional issues of domestic foreign exchange-linked paper. (Banks generally attempt to minimize their holdings in correspondent accounts abroad given the low returns relative to funding costs.)

- **Banks' medium- and long-term net outflows are projected to reach US$0.7 billion in 2002.** These outflows comprise (i) a net bond issuance of minus US$0.4 billion, and (ii) net medium- and long-term debt outflows of US$0.3 billion. The rollover on these loans is projected to be about 70 percent in 2002, compared with about 45 percent in 2001.

- **FX deposits of foreign residents are assumed to decline by about a third, or US$0.4 billion.** This compares with a projected decline of 60 percent in such deposits in 2001.

12. **Private sector rollover of medium- and long-term loans is assumed to remain at about 95 percent in 2002, giving a net outflow of US$0.3 billion, while short-term flows are projected to increase from a net outflow of US$1.5 billion in 2001 to a net inflow of US$0.9 billion in 2002.** The short-term turnaround is accounted for by a projected improvement in trade credits to more normal levels, following the large decline in 2001, which was associated with declining imports.

B. Sensitivity Analysis

13. **The baseline scenario is subject to both upside and downside risks.** On the upside, both lower oil prices and a shorter-lived impact of the current hostilities on the travel industry would help reduce the financing gap. As for the capital account, if current adverse international conditions abate by early next year, Eurobond issuance may be higher. The early return of global market confidence would also increase net interbank credit and net portfolio inflows as non-residents begin to return to emerging markets such as Turkey. On the downside, lower world growth and higher oil prices (considerable uncertainty surrounds current projections) would hit the current account, as would an appreciation of the real exchange rate. On the capital account side, higher net interbank and portfolio ouflows are always possible if confidence is not restored after any new program. Moreover, under such conditions, private non-financial sector rollovers may not be as high as assumed and further unrecorded domestic capital flight (reflected in errors and omissions) could also occur. These risks suggest a prudent margin for the external financing gap of ±US$2 billion around the baseline estimate.

14. **Changes to global economic parameters can have a significant impact on Turkey's current account balance.** Should external demand turn out to be lower than projected, the current account would worsen as Turkish exports and net services receipts would be hit. Every percentage point decline in foreign partner GNP growth would worsen Turkey's current account balance by about US$1 billion. Lower Turkish domestic demand growth has roughly an equal and opposite impact. The risks associated with higher oil prices are significant: every US$1 a barrel increase in the oil price worsens the current account by US$0.3 billion. Should the real exchange rate appreciate next year this will also lead to a worsening of the external current account. On the exchange rate side, it is estimated that the external current account balance would worsen by almost US$1 billion for every four percentage point appreciation in the real exchange rate. Finally, as regards tourism, if travel activity rebounds as early as next April, travel receipts could be as high as US$7 billion, although such a scenario is not used as a baseline (lower right panel of Figure 7). Of course, the impact of the current shock could be larger than that observed during the Gulf War episode, especially if hostilities are prolonged.

15. **The uncertainty on the capital account side is, if anything, even greater.** Net portfolio outflows might be much different than projected. Should confidence be slow to materialize, existing foreign holdings of securities could decline further than projected. However, given small existing foreign holdings of Turkish instruments, the upside potential is larger, as foreigners may return to the domestic market should confidence materialize rapidly after a new program is agreed. Net interbank credit lines are difficult to predict, and could vary significantly from current predictions. A successful start to the new program would obviously help improve net interbank flows relative to the baseline. A strong external PSI element would also help in this regard, but only with strong backing by industrial country governments and firm commitments by banks: the December 2000 and June 2001 agreements with foreign commercial banks (which were not firm commitments) have not been encouraging. On the other hand, should confidence be slow to materialize, net outflows could be even larger. It is also possible that banks may begin to repatriate funds from correspondent accounts held abroad, especially if debt management practices result in additional foreign exchange linked domestic paper issuance next year. Turkish private sector rollover of medium- and long-term debt may not continue at the same high rate observed in 2001 and there is also a risk that trade financing will not rebound to normal levels next year. On the Eurobond side, should current adverse international conditions abate by early next year, the issuance figure could be higher than projected. Finally, unrecorded capital flight (reflected in negative net errors and omissions) may not abate, as currently assumed.

Table 15. Turkey: Balance of Payments, 1998-2005
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003	2004	2005
Current account balance	2.0	-1.4	-9.8	2.3	-1.9	-1.7	-2.0	-2.3
Trade balance	-14.2	-10.4	-22.3	-5.3	-6.9	-8.5	-9.3	-10.8
Exports (fob)	31.2	29.3	31.2	34.5	36.7	39.6	42.6	45.9
Of which: Exports (fob) in trade returns	27.0	26.6	27.3	30.8	32.7	35.3	38.0	41.0
Imports (fob)	-45.4	-39.8	-53.6	-39.8	-43.6	-48.1	-51.8	-56.7
Of which:								
Imports (cif)	-45.9	-40.7	-54.0	-41.0	-44.5	-49.1	-52.9	-57.0
Energy imports (cif)	-4.5	-5.3	-9.3	-7.6	-6.8	-6.8	-6.8	-7.2
Services (net)	10.5	3.9	7.4	3.8	1.1	2.5	2.4	3.3
Services (credit)	25.8	18.7	22.3	18.8	16.8	20.0	21.9	23.8
Of which: Tourism receipts	7.2	5.2	7.6	8.0	6.0	8.4	8.8	9.4
Services (debit)	-15.3	-14.8	-15.0	-15.0	-15.7	-17.5	-19.5	-20.4
Private transfers (net)	5.6	4.8	5.0	3.5	3.6	4.1	4.6	4.8
Official transfers (net)	0.2	0.4	0.2	0.2	0.2	0.3	0.3	0.3
Capital account balance	0.4	4.7	9.4	-17.1	-2.7	2.9	5.6	6.1
(including errors and omissions)	-1.5	6.6	6.8	-19.2	-2.7	2.9	5.6	6.1
Direct investment 1/	0.6	0.1	0.1	2.2	0.9	1.0	1.2	1.5
Portfolio investment in securities 1/	-6.1	0.2	-5.2	-5.1	-0.9	-0.2	1.0	1.1
Public sector (central & local governments & EBFs)	-1.9	1.2	6.2	-2.8	1.1	-1.0	-0.1	0.0
Bonds (net)	-0.3	3.1	6.1	-0.9	-0.1	0.6	1.5	1.4
Eurobond drawings	2.7	5.0	7.5	1.1	2.0	4.5	4.5	4.5
Eurobond repayments	-3.0	-1.9	-1.4	-2.1	-2.1	-3.9	-3.1	-3.1
Loans (net)	-1.7	-1.9	0.1	-1.8	1.2	-1.6	-1.6	-1.3
Loan disbursements	1.2	1.0	3.7	3.0	4.7	2.2	1.8	1.9
Loan repayments	-2.8	-2.9	-3.6	-4.9	-3.5	-3.8	-3.4	-3.2
Central Bank of Turkey, Dresdner (net)	0.7	-0.2	0.7	0.3	0.4	0.7	0.7	0.8
Domestic money banks (net)	1.9	0.5	2.1	-9.8	-4.7	1.1	1.4	0.7
Domestic money banks (FX deposits abroad, -: accumulation)	-0.8	-1.8	-1.9	-0.6	0.0	0.0	0.0	-0.3
Domestic money banks (other, net)	2.7	2.4	4.0	-9.2	-4.7	1.1	1.4	1.0
Domestic money banks (medium and long term, net)	0.5	0.2	-0.2	-0.9	-0.7	0.3	0.8	0.4
Domestic money banks (short term, net)	2.2	2.2	4.2	-8.2	-4.0	0.8	0.6	0.6
Interbank credit lines from foreign commercial banks	0.1	2.1	4.7	-6.3	-3.5	0.5	0.5	0.5
Other private sector (net)	5.3	2.8	5.6	-1.9	0.6	1.3	1.4	2.1
Other private sector (medium and long term, net)	4.2	2.3	4.9	-0.4	-0.3	0.0	0.4	0.9
Other private sector (short-term, net)	1.1	0.5	0.6	-1.5	0.9	1.3	1.0	1.2
Overall balance	0.4	5.2	-3.0	-16.9	-4.6	1.2	3.6	3.7
Overal financing	-0.4	-5.2	3.0	16.9	4.6	-1.2	-3.6	...
Change in net international reserves (+ denotes decline)	-0.4	-5.2	3.0	15.9	-4.4	-2.2	-3.6	...
Change in gross official reserves (+ denotes decline)	-0.2	-5.9	-0.3	2.5	-0.3	-0.6	-1.9	...
Change in reserve liabilities (IMF)	-0.2	0.7	3.3	13.4	-4.1	-1.6	-1.8	-5.4
Purchases	0.0	0.8	3.4	14.5	1.2	0.0	0.0	0.0
Repurchases	-0.2	-0.1	-0.1	-1.1	-5.3	-1.6	-1.8	-5.4
Exceptional financing (gap)	0	0.0	0.0	1.0	9.0	1.0	0.0	...
Memorandum items:								
Real GNP growth (in percent)	3.6	-6.1	6.1	-8.5	4.0	5.0	5.0	5.0
Real exchange rate (year-on-year change, in percent)	8.5	4.1	9.9	-24.3	0.0	7.7	2.2	0.4
Terms of trade (year-on-year change, in percent)	3.3	-4.2	-6.4	1.1	1.9	0.6	0.7	0.1
Oil price (U.S. dollars a barrel)	13.1	18.0	28.2	25.0	21.0	20.0	19.0	19.0
Partner country GNP growth	2.1	2.4	4.1	2.3	2.3	3.5	3.6	3.6

Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.

1/ Including privatization receipts.

Table 16. Turkey: Prudential Reserve Indicators, 1998-2005
(In billions of U.S. dollars, except where otherwise stated)

	1998	1999	2000	2001	2002	2003	2004	2005
With external gap financing of:	0	0	0	0	0	0	0	0
Gross foreign reserves	20.9	24.3	23.2	19.7	11.0	10.6	12.4	10.8
Short-term debt by remaining maturity	33.8	39.0	46.0	33.9	32.9	33.6	36.0	37.8
Ratio to foreign reserves	162	161	198	172	300	318	289	350
With external gap financing of:	0	0	0	1	9	1	1	0
Gross foreign reserves	20.9	24.3	23.2	20.7	21.0	21.6	24.4	22.8
Short-term debt by remaining maturity	33.8	39.0	46.0	33.9	32.9	33.6	36.0	37.8
Ratio to foreign reserves	162	161	198	164	157	156	147	166

Sources: Data provided by the Turkish authorities; and Fund staff estimates.

Ankara
November 20, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C., 20431, U.S.A.

Dear Mr. Köhler:

1. **Under our strengthened economic program adopted in May, we have made major strides in stabilization and reform.** Owing to our strong fiscal efforts, the public sector now has a large primary surplus, compared with a large deficit only two years ago. Important structural reforms to lay the foundation for a more competitive economy have been launched, with emphasis on increased transparency and greater separation between politics and the management of economic institutions. Key laws relating to banking reform, fiscal transparency, deregulation, and the independence of the Central Bank of Turkey (CBT) have been enacted.

2. **Despite occasional domestic disagreements, not surprising given the far-reaching nature of the reforms, these efforts started to bear fruit toward the end of the summer.** The stabilization and reform process has been challenging and far reaching. At times, public debates concerning agricultural support prices, public sector wages, and the preparations for privatization in key sectors, including telecoms, interrupted the improvements in financial indicators. Nevertheless, by early September, inflation had declined, the external current account had moved into surplus, and interest rates on government securities were on a downward trend. The floating exchange rate regime had started to function more effectively, and the value of the Turkish lira had stabilized in the foreign exchange market. Also, there were signs that the economic downturn triggered by the crisis was coming to an end.

3. **The tragic events of September 11 disrupted the positive momentum in the economy and worsened the outlook.** In the immediate aftermath, financial markets reacted strongly: interest rates on governments securities rose by 10–15 percentage points, stock prices fell sharply, and the Turkish lira depreciated substantially. While financial indicators have since recovered because of the expectations of further financial support from the international community, the adverse effects on the economy more generally are only beginning to show. Tourism receipts are taking a hit, and exports, which had performed well in the first eight months, will be affected, delaying the start of economic recovery and weakening the external current account. Capital inflows are diminishing, as Turkey's access to the international capital markets has become more limited and investors' appetite for Turkish assets has weakened.

4. **Nevertheless, we have continued the firm implementation of our economic program.** Since the completion of the ninth review under the stand-by arrangement, we have

made further progress in key areas, notably bank restructuring, fiscal adjustment, and monetary policy. All performance criteria relevant for completion of the tenth review have been met (Annex A). We have also observed three key structural benchmarks, namely the appointment of advisors to help develop the corporatization plan for Türk Telekom, submission to parliament of a Public Procurement Law strengthening transparency and efficiency and in line with EU standards, and accompanying the draft 2002 budget by accounts and financial outlook for the various public sector entities (Annex B).

5. **In response to the worsened outlook following the September 11 events, we are now formulating a strengthened program for 2002–04, and we are seeking further financial support from the international community.** This medium-term program will build on the progress we have already made in macroeconomic and financial stabilization, while taking decisive steps to complete banking reform, revitalize privatization and private sector development more generally, and improve governance and efficiency in the public sector. We expect to finalize this program and present it to the Fund before the end of this year.

6. **Meanwhile, we are already taking measures to alleviate the impact of the September 11 events on Turkey.** In particular, we are introducing urgent initiatives to allow us to meet the ambitious fiscal targets for 2002, and to support viable real sector enterprises facing temporary difficulties as a result of the current situation. We will continue to communicate these and other policy measures to the Turkish people and domestic and international investors, to broaden support for our economic program.

7. **On this basis, we request completion of the tenth review under the stand-by arrangement.** We also request modifications of the program's monetary performance criteria and indicative targets for end-2001, as set out in paragraph 14 below. In particular, to anchor monetary policy, we propose converting the end-2001 indicative ceiling on base money into a performance criterion. We also request modification of the end-December 2001 performance criterion on the primary expenditure of the central government, as discussed in paragraph 17 below. We believe that the policies and measures described in this letter are adequate to achieve the objectives of the program, but we stand ready to take additional measures if necessary to keep the program on track, in close consultation with the Fund.

Macroeconomic framework

8. **The worsened external environment is delaying the economic recovery, complicating our disinflation efforts, and weakening the external current account.** A steeper-than-expected decline in the second quarter had already suggested a need to revise downward our earlier projection of real GNP growth of –5.5 percent in 2001. The September 11 shock has further delayed the recovery, and we now estimate real GNP to decline by 8.5 percent this year. While we continue to expect a recovery in 2002, we have lowered our growth projection by one percentage point, to 4 percent. As regards inflation, the further currency depreciation suggests that our end-year CPI inflation projection needs to be increased from 58 to 65 percent. This still implies a substantial moderation in annualized

inflation, from 75 percent in the first half of 2001 to 56 percent in the second half. For next year, based on the advice of the Monetary Policy Council, the government and the CBT have set an inflation target of 35 percent. Finally, the economic slowdown and the depreciation of the Turkish lira have led to a marked turnaround in the external current account in 2001, with a surplus of US$2¼ billion projected for the full year despite the anticipated loss of tourism and export receipts in the last quarter. For 2002, we project a current account deficit of almost US$2 billion, reflecting the combined effect of the September 11 shock, the economic recovery, and a more stable real exchange rate after the large real depreciation in 2001. We are well aware that in the present circumstances our projections are subject to considerable uncertainty, and we stand ready to adjust our policies should changes in the macroeconomic framework warrant this.

9. **Given the depth of the recession, extra attention must be given to the supply side of the economy, while maintaining our strong fiscal stance.** In August, we established a high level private sector led committee to review and propose possible measures in this area. Any measures to support the economic recovery will be market based, transparent, and consistent with budget targets. Two types of initiatives have been identified to date. First, to help ensure that viable firms receive the credit necessary for their operation, we will facilitate private sector-led corporate debt restructuring, while refraining from using public funds for this purpose (see paragraph 24 below). Second, we have adopted two temporary and narrowly-targeted tax reductions (in the supplementary motor vehicle purchase tax and the VAT rate on consumer durables) to last only until end-2001, with the objective of reducing a large accumulation of stocks in the consumer durables sector. The VAT tax rates had of course been increased for the great majority of goods and services in June, and our fiscal policy targets will not allow any further temporary or other reductions in 2001 or 2002.

Debt management

10. **Our strong budget implementation and measures to increase demand for treasury bills introduced in late July have secured the prospects for a comfortable domestic debt rollover for the coming months.** As a result, the rollover ratio required of the private sector for the remainder of 2001 has fallen appreciably. To ensure a smooth rollover, we will continue to closely coordinate the government's borrowing strategy with restructuring of the public banks. In line with the program's strategy for bank restructuring, the Treasury has serviced in cash the recapitalization bonds held by state and SDIF banks (intervened banks controlled by the Saving Deposit Insurance Fund) to allow these banks to reduce their short-term liabilities and to provide for any migration of deposits to private banks. During the latter half of 2001, this policy has facilitated a sharp reduction in public banks' short-term liabilities, as their deposit base has been stable. Looking ahead, we will ensure that any liquidity of public banks in excess of that required to meet deposit outflows will be utilized to reduce the Treasury's borrowing requirement from the private sector. We expect that the strong financial position of state banks and continued growth in their deposits should give considerable scope for state banks to participate in the rollover.

11. **We will take additional steps to further ease the rollover of government debt in 2002.** The potential for participation of the state banks in the rollover as discussed above, together with additional external support to the budget, should limit the borrowing required from the private sector in 2002 to manageable levels. This will ease the rollover, and help to bring about a reduction in real interest rates. To further improve the prospects for a smooth rollover, we will take the following steps:

- We will make every effort to lower the domestic borrowing requirement. To this end, we will issue Eurobonds to the extent demand from investors allows. We will also pursue privatization vigorously (see paragraph 27 below).

- We will issue a broad range of instruments aimed at lengthening maturities of domestic debt in a manner that meets market demand. In this context, we will continue to issue fx-denominated and fx-indexed bonds, while keeping in mind the need to limit the government's foreign exchange exposure. We are also considering the issuance of floating rate notes (FRNs). To this end, we will take steps to improve the liquidity of the FRN market by encouraging the use of standard methods of price and yield calculations, and by ensuring that their interest rate risk is measured accurately for regulatory, collateral valuation, and other official purposes.

- We will supplement the regular program of auctions with continued direct public offerings of government instruments, to widen the demand base beyond banks and to make it more stable. We will also intensify our dialogue with domestic investors to ensure that we have identified and met the demand of the widest range of investors.

12. **We have further strengthened the Treasury's borrowing strategy by improving the flow of information from the banking system.** To this end, we have established a special committee that meets weekly. It consists of representatives from the Treasury, the CBT, the Banking Regulation and Supervision Agency (BRSA), the SDIF, the Capital Markets Board, and the state banks. The improved exchange of information, including a weekly report circulated to the heads of the participating institutions, will assist the Treasury in the formulation of its borrowing strategy.

Monetary policy

13. **We have decided to postpone the introduction of inflation targeting until next year, when we expect the conditions for a successful launch to be in place.** We remain determined to make inflation targeting our nominal anchor as soon as conditions allow. However, the pass-through to domestic prices from recent exchange rate weakness associated with September 11 would have given the new regime, which we had intended to launch in the last quarter of this year, an unduly difficult start. The delay will also give us time to make progress in stabilizing government finances and further strengthening the banking sector, improving the prospects for the new regime. Ahead of the move to formal inflation targeting in 2002, we have announced a medium-term disinflation path, with an end-year target for CPI inflation of 35 percent in 2002, and projections of 20 percent in 2003 and 12 percent in

2004. We are also continuing our technical preparations for inflation targeting, with publication of a quarterly Monetary Policy Report scheduled for November. This report is the forerunner to an inflation report, which we intend to start publishing when we adopt inflation targeting. The newly created Monetary Policy Council (MPC) is responsible for formulating the principles and strategy of monetary policy, guided by the CBT's primary objective of price stability. It has already held its first meetings, and, as part of our effort to enhance transparency, will start issuing press releases after its meetings. Our fight against inflation will also benefit from the amended CBT Law's prohibition against lending to the Treasury, which became effective on November 5. For its part, the government will contribute to the disinflation effort, by ensuring tight fiscal discipline. Moreover, in our ongoing discussions with social partners and in the next meeting of the Economic and Social Council (to be convened before the end of the year), we will encourage forward-looking price and wage-setting behavior consistent with the inflation target.

14. **In the interim, the existing monetary targets and overall implementation strategy remain in place.** Consistent with the eventual move to inflation targeting, recent interest rate decisions have placed increased weight on the inflation outlook. At the same time, we have comfortably met performance criteria for net domestic assets and net international reserves under the existing monetary program. The monetary base has also been kept well within its indicative ceiling. For end-2001, we propose keeping the indicative targets on net domestic assets (NDA) and on the change in net international reserves (NIR) unchanged, but converting the latter into a performance criterion. To strengthen the monetary program, and to ensure that a nominal anchor is in place during the transition to inflation targeting, we also propose converting the indicative targets on the monetary base into performance criteria. For 2002, the monetary program will keep base money growth in line with the growth of real output and target inflation. Targets for base money will be lowered if the share of foreign currency deposits were to increase, and raised if the share of Turkish lira deposits recovers, in line with increasing confidence.[1]

15. **We will further improve the working of our flexible exchange rate system.** We will continue to strictly limit discretionary intervention in the foreign exchange market, that is, CBT foreign exchange transactions outside pre-announced auctions. We are also taking additional institutional steps to improve the functioning of the foreign exchange market. To

[1] We also propose to modify the definitions of the NDA and NIR targets, for technical reasons (Annexes C and D). First, although base money is on track, depreciation beyond what had been projected under the program is artificially boosting NDA (because of the valuation effect on the CBT's foreign currency loans to the government). To remedy this, we request that NDA will now be calculated using the exchange rate as of end-July 2001 (when the monetary program was last revised), and not the current exchange rate. Second, concerning changes in NIR, we propose that any unused portion now be fully transferable to the next period. This will allow CBT on-lending to more closely match the government's payments needs. However, the NIR performance criteria themselves remain unaltered.

enhance the development of forward and futures exchange markets, we will encourage the introduction of a Turkish Interbank Offer Rate, which should serve as a basis for pricing these financial instruments. In addition, we will clarify the taxation and accounting procedures of the futures contracts. This further development of the futures market will allow exporters and importers to hedge against exchange rate uncertainty. Also, the Treasury and the Privatization Agency are taking measures to improve financial management in the state economic enterprises, to prevent their lumpy foreign exchange transactions from causing disruptions to the foreign exchange market.

Fiscal policy

16. **Fiscal policy in 2001 remains well on track.** End-July and end-September performance criteria on the consolidated government sector primary surplus were met comfortably. Indeed, through end-September, the primary surplus stood at 5.6 percent of annual GNP, comfortably above the 3.4 percent program target. The overall balance of the consolidated government sector was also in line with the program at both dates (although the indicative floor for end-July was breached for technical reasons—see Annex E, which also includes a revised indicative floor for end-December 2001). The central government budget showed a strong primary surplus of 4.8 percent of GNP through end-October (almost 1 percent of GNP above expectations), owing to better than anticipated tax revenues and strict expenditure discipline (the end-June and end-September performance criteria on primary expenditure were both met).

17. **For 2001 as a whole, we expect to meet our end-year public sector primary surplus target of 5.5 percent of GNP, but central government primary spending is likely to exceed its target.** Adjusted for trend growth, this represents an impressive fiscal effort, on the order of 8 percent of GNP. While painful, it has helped Turkey restore confidence and lay the foundation for a rapid decline in the debt-to-GNP ratio starting next year. In the consolidated government sector, the impact of higher inflation on revenues, adherence to fixed budget expenditure ceilings, and postponement of investment spending at extrabudgetary funds (EBFs) and state economic enterprises (SEEs) will be more than sufficient to offset the impact of higher inflation on operating costs. However, in the central government, indexation of wages and pensions consistent with the higher inflation rate will produce higher expenditures, and we request modification of the end-December 2001 performance criterion on the primary expenditure of the central government by the corresponding amount (Annex F). Spending in other areas will be kept within the limits budgeted in nominal terms. In view of uncertainties about future revenue performance, and the need to secure our financing situation, we intend to save any possible overperformance. We will refrain from reducing tax rates or eliminating taxes beyond the two temporary cuts mentioned in paragraph 9 above.

18. **For 2002, the program target for the primary surplus of the public sector remains 6.5 percent of GNP.** Since we do not project a sharp rebound in public sector revenues and need to support some new programs, this requires a substantial effort on our part to identify measures. While economic conditions are adverse, we see no alternative to

this approach given the need to ensure debt sustainability. With the expected economic recovery and lower real interest rates, the targeted primary surplus should facilitate a decline in the public debt ratio over time. This in turn should lead to further declines in interest rates. The measures to reach our ambitious target are summarized in the next few paragraphs, and described in detail in Annex G.

19. **In the central government, we aim to increase the primary surplus to 5.6 percent of GNP in 2002.** To achieve this target, we aim to collect 25.0 percent of GNP in primary revenue, and to spend 19.4 percent of GNP, excluding interest payments. On the revenue side, we will avoid sharp increases in tax rates. Some tax increases are, however, necessary, including further real increases in the petroleum consumption tax and the motor vehicle tax. As regards expenditures, we will strictly limit personnel costs, and keep civil service and public sector hiring to a minimum. We will also make major strides in limiting non-wage spending, including by rationalizing our investment program and reorienting our agricultural support system.

20. **In the remainder of the public sector, we aim to achieve a primary surplus of 0.9 percent of GNP in 2002.** We expect the primary positions of social security institutions and local governments to remain broadly in balance. For EBFs we expect a small deterioration to a primary deficit of 0.2 percent of GNP (to accommodate increased social spending). This deficit however will be offset by a small surplus in the unemployment insurance fund (the decline vis-à-vis 2001 reflects the beginning of benefit payments in March, and a cut in premium payments in support of job creation). Hence, we expect the targeted primary surplus in the remainder of the public sector to come from SEEs. To accomplish this, we are taking a large number of measures, split roughly evenly between expenditures and revenues. On the expenditure side, our focus is on controlling the wage bill, and restructuring operations. The revenue measures include removal of exemptions and increases in enterprise tariffs. In support of these measures, we have assigned Treasury auditors to monitor performance and implementation on a quarterly basis.

21. **While our fiscal policy stance is tight, we will nevertheless increase real spending in the social sector, protecting the most vulnerable segments of society.** Overall social spending in the public sector in 2002—including education, health, and social protection (covering the Social Solidarity Fund, direct income support for farmers, and the social security institutions)—is expected to exceed the 14.5 percent of GNP benchmark set by the government under its expenditure management program supported by the World Bank's PFPSAL program. Additional social initiatives include the unemployment insurance system (which will start to make payments in early 2002); the programs of the Directorate for Social Services and Child Protection; and labor redeployment and reinsertion programs for workers laid off as a result of privatization (supported under the World Bank's Privatization Social Support Project).

22. **We will ensure that all the measures to reach the primary surplus target of 6.5 percent of GNP will be in place by January 2002.** The leaders of the coalition government have approved all the measures described in Annex G, and some have already

been implemented. We expect parliament to approve the central government budget along the lines discussed above by December 14. Other measures will be implemented upon passage of amendments to existing laws, issuance of various circulars, and, for state economic enterprises, also upon decisions by their Boards of Directors. Most of these actions will be completed by end-year, but because of our already full parliamentary calendar some measures requiring legal amendments will be dealt with in January 2002.We believe that the measures set out above will be sufficient to achieve our target. Should deviations emerge, including during the approval processes for budgets of broader public sector entities, we would take immediate steps in consultation with the Fund to meet the consolidated public sector primary surplus target.

23. **Our fiscal-structural agenda for 2001 remains on track:**

- Our efforts to improve **expenditure management** continue to show results. We have submitted to parliament the accounts and financial outlooks of various public sector entities (meeting a **structural benchmark**). On November 20, we submitted to parliament a new Public Procurement Law consistent with EU standards (**structural benchmark for October 15**). We are on track to halve the number of revolving funds by end-year (another **structural benchmark**).

- In early September, we took an important step to improve **tax administration**, when financial institutions began requiring tax identification numbers (TINs) for a wide range of transactions. TIN coverage will have increased markedly by early 2002, and will be used to enhance our audit program. We are concerned, however, that the growing stock of private sector tax arrears may exceed 2 percent of GNP by year-end (**structural benchmark**) largely due to the decline in the economy and the impact of high interest rates compounding the pre-existing stock. To help minimize new arrears our staff have been set strict time limits for following up non-filers and for collecting arrears, and we will monitor compliance.

Banking sector reform

24. **We are pressing ahead with our strategy to strengthen the private banking system, so as to underpin a return to rapid medium-term growth.** The central part of this strategy is to ensure that all private banks achieve and maintain a capital adequacy ratio of at least 8 percent by end-2001:

- Private banks continue to take steps to raise capital and improve their operations. The merger of Körfez Bank with Osmanli Bank was completed on August 31, 2001 and, as a second step, a merger with Garanti Bank is in progress.

- The BRSA has been closely monitoring compliance with the capital strengthening plans already in place for financially weak banks. It remains committed to promptly imposing the sanctions prescribed in the Banking Law on any bank that does not fully comply with its agreed plan.

- The BRSA will reassess agreed recapitalization plans for private banks based on end-September data, and, if needed, request banks to further strengthen existing plans. An assessment will also be made about the need to agree on recapitalization plans with additional banks.

- In view of possible vulnerability to credit risk arising from loan portfolio deterioration, the BRSA will make every effort to further strengthen the implementation of the loan classification and provisioning regulation. The BRSA will further focus on asset quality in its supervision, and make sure banks have identified all nonperforming loans (NPLs).

- In cooperation with the private sector, we are examining various alternatives for dealing with banks' NPLs, including the establishment of an asset management company (AMC). We will finalize the strategy for dealing with NPLs by January 2002. Were the strategy to involve the establishment of an AMC, we would seek to eliminate as soon as possible any legal or other policy impediments for the creation of such an institution. The AMC would be financed without recourse to public resources.

- Given that the NPL problem is inextricably linked to weakening corporate sector performance, and that addressing the latter is critical for the economic recovery, we are committed to facilitating the process of corporate debt restructuring. To this end, we are preparing a draft Law on Restructuring of Debts to the Financial Sector. This Law envisages a market-based approach under which debt restructuring will proceed without the use of public funds and without supervisory forbearance. We will also address any legal impediments to corporate debt restructuring in a prompt and decisive manner. In this context, we will submit an amended bankruptcy law to parliament by January 2002.

25. **With the restructuring of the SDIF banks moving ahead expeditiously, we are on target to complete the resolution of the remaining eight SDIF banks by end-2001, as planned:**

- The merged Sümerbank was sold to the Oyak Group on August 10, 2001, in line with the principles on bank resolution outlined in the July Letter of Intent.

- On the remaining SDIF banks, the sale of Demirbank to HSBC was completed on October 29. The sale process for Sitebank was initiated on August 8, a confidentiality agreement was signed with NovaBank S.A. on August 22, due diligence was completed in late October, and an offer submitted by NovaBank is now under study by the SDIF. The initial effort to sell Iktisat Bank was concluded without the presentation of a bid by the only interested investor. Similarly, the bid submitted for Etibank by Kocbank was declared inadequate, and the bank was re-offered for sale in mid-October. The sale process for Kent Bank was initiated on October 30. The remaining SDIF banks (Taris Bank, Bayindir Bank, and EGS Bank) will be resolved as planned before end-2001. Finally, Türk Ticaret, whose banking license was revoked as of July 1, 2001, will enter voluntary liquidation, once the legal appeal process has been completed.

- To finalize the resolution of SDIF banks, the BRSA will auction unsold deposits and matching assets of remaining SDIF banks to operating banks. Ziraat has agreed to buy any residual deposits and matching assets. Should Ziraat face unexpected liquidity needs because of deposit withdrawals, liquidity will be provided promptly by the central bank in its capacity as lender of last resort. The SDIF will decide by end-November 2001 whether to keep one of the intervened banks as a bridge bank for asset management purposes (such a bank would not be allowed to accept deposits).

- We will continue to ensure that the deposit rates offered by the SDIF banks are in line with rates offered by the private banks.

- As of end-October, close to 6,000 corporate loan files and about 36,500 consumer loan files had been transferred to the SDIF's Collection Department (COD). This is significantly more than the 1,200 files originally envisaged. The number will expand further with transfers from the remaining other SDIF banks through end-2001. The BRSA will ensure that the COD is properly staffed by end-2001 to handle such a large number of additional files. To ensure that procedures for efficient loan recoveries will be in place before end-February 2002, the BRSA invited six consulting firms to participate in a bidding process for providing advice to the SDIF. Three firms submitted bids, and the winning bid will be selected by end-November 2001.

26. **Further progress is being made with the restructuring of the state-owned banks, in preparation for their privatization:**

- In line with the operational restructuring plans for Ziraat and Halk aimed at eliminating losses and allowing these banks to better support economic activity, the total number of staff has been reduced by about 20 percent, from early April through late October. To date, 59 branches have been closed, which post offices in some areas taking over the nonbank activities of these branches. The joint Board for the two state banks has asked the government for an instruction to complete the rationalization by mid-2002. The government will issue such an instruction by mid-December. The medium-term goal remains privatization in line with the competitive advantage and business goals of these banks after the restructuring process makes this possible.

- Following the revocation of Emlak's license, the bank's assets and liabilities were split into bankable and nonbankable assets/liabilities. The bankable assets/liabilities were transferred to Ziraat, and the difference in value between the assets and the liabilities was made up through the issuance of TL 1.7 quadrillion of treasury bonds. The nonbankable assets were split into two categories: assets to be liquidated (where liquidators were appointed at the September 14 shareholder meeting), and others, including real estate assets, which have been taken over by the Housing Development Agency.

- The privatization process of Vakif has been initiated, and an investment bank to assist the bank was hired November 2. Letters will be sent to potential investors, which will be requested to indicate their interest in purchasing the bank by early 2002. Bids are to be requested by late April/early May, and the winning bid selected in late May.

Structural reforms

27. **We are continuing with the preparations for privatization of major state-owned companies.** Preparations for further public offerings of TÜPRAŞ (oil refinery) and POAŞ (petroleum distribution) were well advanced before September 11, but the weakened market conditions have forced us to postpone these offerings to early next year. We are restructuring ISDEMIR (steel plant), including through staff reductions, and merging it with ERDEMIR. We will subsequently reduce the state share in ERDEMIR below 50 percent. Operational restructuring of Turkish Airlines continues, although the worldwide slump in the airline industry has weakened the company's financial position and prospects for sale. The Tobacco Law has been re-submitted to parliament following the veto of the first draft by the President, and we expect parliament to enact it early in January 2002. The Privatization Administration is working to complete the privatization plan for TEKEL (tobacco and alcohol monopoly), as well as for ŞEKER (sugar factories), although the finalization of those plans may extend beyond the original deadline of end-2001 because of legislative delays. In the energy sector, we appointed the regulatory board on November 2. Moreover, we are preparing for the sale of power plants and distribution network (with the support of the World Bank), and have initiated the transfer of two gas distribution companies to the Privatization Agency. On October 31, the new Board of Türk Telekom chose advisors for its corporatization plan (meeting **a structural benchmark**). So far this year, we have raised US$2.8 billion in privatization receipts. In 2002, we expect to raise about US$1.5 billion.

28. **We are taking a number of steps to improve governance and attract FDI.** A key step, the submission to parliament of a new Public Procurement Law consistent with international standards, was already mentioned above. Beyond this, to increase the transparency of economic policies, we will reinforce our efforts to improve the quality of public sector data. To this end, and to enhance public sector resource management more generally, we will present to parliament a Public Finance Management and Internal Control Law by mid-2002. Moreover, a conference was held in Ankara in mid-September to review the recommendations from the study of administrative barriers to investment, carried out by the World Bank's Foreign Investment Advisory Service (FIAS). An action plan based on the conference's findings has been presented to the Council of Ministers. As a result, among other things, we intend to:

- submit to parliament by January 15, 2002 a new draft Law on Foreign Direct Investment in line with the findings of the FIAS study;

- submit to parliament by end-December 2001 a draft law on work permits;
- complete by end-January 2002 draft legislation reducing the number of documents needed to obtain investment incentives; and
- raise by end-January 2002 the minimum amount in VAT rebates that can be made without submitting examination reports and posting financial bond guarantees.

29. **Other measures to improve the business climate are under consideration.** We are in the process of reviewing the commercial law, the land development law, the tax law, and other legislation affecting the business environment. We are also working to identify further measures to combat corruption and incorporate them into an integrated and ambitious plan of action for better governance in the public sector. This plan will be ready before the end of 2001, and will be based on the findings of a series of anti-corruption conferences, the first of which was held on September 20–21. Moreover, we are preparing for an investor conference that will bring together major international business leaders. This will enhance our communication of our economic program to domestic and international financial markets, and encourage FDI.

30. **In structural and social issues we continue to work closely with, and expect the support of the World Bank.**

Very truly yours,

/s/	/s/
Kemal Derviş	Süreyya Serdengeçti
Minister of State for Economic Affairs	Governor of the Central Bank of Turkey

Table 1. Turkey: Quantitative Performance Criteria and Indicative Targets

	March 31, 2001		May 31, 2001		June 30, 2001		July 31, 2001			Sep. 30, 2001		Dec. 31, 2001
	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome		Ceiling/Floor	Outcome	Ceiling/Floor
I. Performance criteria												
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira)	1,850	3,560	3,250	6,288	...	...	4,250		7,330	6,200	10,301	9,250
2. Ceiling on contracting or guaranteeing of new external public debt (in millions of US$)	5,500	1,035	...	...	7,500	1,783	...	...	...	12,000	3,067	17,000
3. Ceiling on the stock of public short-term external debt outstanding (in millions of US$)	1,100	1,000	...	...	2,100	0	...	...	...	0	0	2,100
4. Ceiling on the cumulative primary expenditure of the central government (in trillions of Turkish lira)	5,830	5,480	11,400	10,950	...	...	17,450		16,890	24,150	22,961	36,050
							July-Aug., 2001			Sept.-Oct., 2001		Nov.-Dec., 2001
5. Floor on change in net international reserves (in millions of US$) 1/	...	...	-1,500	-838	-3,562	-3,059	-2,500		-1,370	-3,250	-304 2/	-3,546 3/
							Aug. 31, 2001			Oct. 31, 2001		Dec. 31, 2001 (indicative limit)
6. Ceiling on the stock of net domestic assets of the CBT 4/ 5/ (in trillions of Turkish lira)	0	5,117	9,750	7,942	13,250	12,943	17,250		16,437	21,150	17,933	22,400
II. Indicative targets												
1. Floor on the cumulative overall balance of the consolidated government sector (in trillions of Turkish lira)	-2,620	-1,945	-4,750	-4,398	...	...	-11,750		-12,074	-18,150	-18,025	-27,800
							Aug. 31, 2001			Oct. 31, 2001		Dec. 31, 2001 (performance criterion)
2. Ceiling on base money (in trillions of Turkish lira) 5/	...	...	5,900	5,815	6,050	6,247	7,175		6,748	7,550	7,141	7,750

1/ Floors correspond to changes in NIR during the period specified in Annex F of the Memorandum on Economic Policies attached to the May 3, 2001 Letter of Intent. Excludes any carryover from previous period.
2/ Includes $650 million carryover from previous period.
3/ Includes $2946 million carryover from previous period.
4/ Net domestic assets are defined as base money less the net foreign assets of the CBT valued in Turkish lira at end-July 2001 actual exchange rates.
5/ For end-December, the ceiling on net domestic assets will be an indicative target; the ceiling on base money a performance criterion.

Table 2. Turkey: Structural Policy Conditionality, 2001

Action	MEP Ref. 1/	Type of Action	Timing	Status, Nov. 20, 2001
Banking Sector Reform				
1. Reduce the SDIF and state banks' overnight position by at least two-thirds from the March 16, 2001 level	¶8	Condition for the completion of the 6th and 7th reviews		Done
2. Eliminate the SDIF and state banks' remaining overnight position	¶8	Condition for the completion of the 8th review		Done
3. The stock of repos of the SDIF and state banks with the CBT not to exceed TL 7 quadrillion	¶8	Condition for the completion of the 8th review	By end-May 2001	Done
4. Establish a common and politically independent board for Ziraat and Halk reporting to the treasury and appoint new management	¶10	Condition for completion of the 6th and 7th reviews		Done
5. Complete financial restructuring of state banks	¶10	Condition for completion of the 6th and 7th reviews		Done
6. Close Emlak Bank and transfer its liabilities and some of its assets to Ziraat Bank	¶11	Condition for completion of the 8th review	By end-May 2001	Done before 8th review
7. The SDIF to recapitalize Sümerbank to cover its negative net worth	¶12	Condition for completion of the 6th and 7th reviews		Done
8. Recapitalize the remaining seven SDIF banks to cover their negative net worth	¶13	Condition for completion of the 6th and 7th reviews		Done
9. Organize in a second transition bank or put into liquidation the four banks for which there were no bidders	¶13	Condition for completion of the 8th review		Done (3 banks merged; one bank entered into voluntary liquidation)
10. Sell, put into liquidation, or otherwise resolve the remaining SDIF banks	¶13	Condition for completion of the 12th review	End-2001	Expected to be completed by end-2001
11. (a) Presentation by all capital-deficient banks of detailed capital strengthening plans	¶15	Prior action for 6th and 7th reviews	By end-Apr. 2001	Done
(b) Finalization of commitment letters by the banks on recapitalization plans agreeable to Fund staff	¶12 2/ ¶16 3/	Condition for completion of the 8th review		Done

Action	MEP Ref. [1/]	Type of Action	Timing	Status, Nov. 20, 2001
12. Parliamentary approval of amendments to Banking Law	¶16	Condition for completion of the 6th and 7th reviews		Done
13. Adopt connected lending regulation	¶17	Benchmark	Within 1 month of approval of Banking Law	Done
14. Bring accounting standards for banks in line with international standards	¶17	Benchmark	From the beginning of 2002	Under preparation
Fiscal Transparency and Management				
15. Close the remaining 15 BFs (except DFIF) and 2 EBFs	¶19	Benchmark	End-June 2001	Done
16. At least halve the number of revolving funds	¶19	Benchmark	End-2001	
17. Submit to parliament a Law on Public Finance and Debt Management	¶19	Benchmark	End-June 2001	Done
18. Accompany the draft 2002 budget by accounts and financial outlook for EBFs and SSIs, revolving funds, contingent liabilities, SEEs, and local authorities	¶19	Benchmark		Done
19. Submit to parliament a Public Procurement Law in line with EU standards	¶19	Benchmark	By October 15, 2001	Done
Increasing the Role of Private Domestic and Foreign Capital in the Turkish Economy				
20. Parliamentary approval of legislation to facilitate Türk Telekom privatization	¶21	Prior action for 6th and 7th reviews		Done
21. Appointment of new professional board and management team for Türk Telekom	¶21	Condition for completion of 8th review		Done
22. Contract advisors to develop a corporatization plan for Türk Telekom	¶21[3/]	Benchmark	End-October 2001	Done
23. Complete privatization plan for Türk Telekom	¶21[3/]	Benchmark	End-2001	

Action	MEP Ref. 1/	Type of Action	Timing	Status, Nov. 20, 2001
24. Parliamentary approval of Tobacco Law	¶21	Condition for completion of 8th review	May 2001	Done (law vetoed by President, but was re-submitted to Parliament in November)
25. Passage by parliament of a law fully implementing the constitutional amendment on international arbitration	¶22	Benchmark	Before parliament's summer recess	Done
Fiscal Policy and Public Debt Management				
26. Approval of tax measures: (a) increase petroleum consumption tax by 15 percent in early May; (b) increase VAT rates (except the reduced 8 percent rate) by 1 percentage point; and (c) increase, as of April, the minimum contribution base relevant for social security payments in line with the existing regulations	¶30	Prior action for 6th and 7th reviews		Done
27. Approval of supplementary budget in line with program expenditure figures and offsetting budgetary measures listed in ¶6 of the June 26, 2001 Letter of Intent.	¶34	Condition for completion of 8th review		Done
28. Enact tax regulation to extend the use of tax identification numbers	¶34	Condition for completion of 8th review	End-May 2001	Done before 8th review
29. Reduce the stock of private sector tax arrears from the end-2000 level of 2 percent of GNP (including interest and penalties)	¶34	Benchmark	End-2001	

1/ Unless indicated otherwise, this refers to relevant paragraphs in the May 3 Memorandum on Economic Policies (MEP).

2/ Refers to the paragraph in the June 26, 2001 Letter of Intent

3/ Refers to the paragraph in the July 31, 2001 Letter of Intent

Table 3. Turkey: Performance Criteria and Indicative Targets for the Monetary Base of the Central Bank of Turkey 1/
(in trillions of Turkish Lira)

	Ceilings	Actual
Outstanding base money as of April 30, 2001	5,850	5,850
May 31, 2001 (indicative ceiling)	5,900	5,815
June 30, 2001 (indicative ceiling)	6,050	6,247
August 31, 2001 (indicative ceiling)	7,175	6,748
October 31, 2001 (indicative ceiling)	7,550	7,141
December 31, 2001 (performance criterion)	7,750	...

1/ These ceilings shall be based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.

1. Targets for net domestic assets and base money are unchanged from Annex D of the July 31, 2001 MEFP. However, the base money target will now be a performance criterion under the program. Correspondingly, net domestic assets (whose definition has been revised) has been made an indicative target.

2. The net domestic assets (NDA) of the Central Bank of Turkey (CBT) are defined as base money less the net foreign assets of the CBT valued in U.S. dollars at current cross rates, and the figures converted into Turkish lira at end-July 2001 exchange rates.

3. Base money is defined as currency issued by the CBT, plus the banking sector's deposits in Turkish lira with the CBT. Indicative ceilings for base money are shown in Table 4.a below.

4. Net foreign assets of the CBT are defined as the sum of the net international reserves of the CBT (as defined in Annex F of the May 3 MEP), medium-term and long-term foreign exchange credits (net), and other net foreign assets (including deposits under the Dresdner scheme of original maturity of two years or longer and the holdings in accounts of the Turkish Defense Fund, but excluding CBT's net lending to domestic banks in foreign exchange. As of March 31, 2001, net foreign assets of the CBT amounted to TL 9,012 trillion.

5. The cumulative net change in the devaluation account from its balance at end-1999 (excluding any distribution of unrealized foreign exchange profits, in cash or through the write-off of government paper held by the CBT, since end-March 2001), evaluated at end-July 2001 exchange rates, will be subtracted from end-period NDA stock as defined above. The balance of the devaluation account at end-March 2001 was TL-1,380 trillion.

6. NDA ceilings will be adjusted for any change in the definition of the aggregate to which the reserve requirement applies according to the following formula:

$$\Delta \text{NDA} = \text{R}^*\Delta\text{B},$$

where: R denotes the 4 percent reserve requirement plus the 2 percent liquidity requirement coefficient and ΔB denotes the change in base generated by a change in the definition of the reserve aggregate. The averaging period will not be changed during 2001.

7. NDA ceilings will be adjusted for any change in the reserve requirement coefficient according to the following formula:

$$\Delta NDA = B * \Delta R$$

where: B is the level of the base to which the reserve requirement applies on the test date and ΔR is the change in the reserve requirement coefficient and the liquidity requirement coefficient.

8. The NDA ceilings will be adjusted downward for any waiver of reserve requirements for any additional bank intervened by the BRSA. The adjustment will be equal to the existing reserve requirement coefficient times the amount of liabilities at these banks subject to reserve requirements.

Table 3a. Turkey: Performance Criteria and Indicative Targets on the Net Domestic Assets of the Central Bank of Turkey (in trillions of Turkish Lira) 1/

	Ceilings	Actual
Outstanding NDA as of April 30, 2001:	6,739	
May 31, 2001 (performance criterion)	9,750	7,942
June 30, 2001 (performance criterion)	13,250	12,943
August 31, 2001 (performance criterion)	17,250	16,437
October 31, 2001 (performance criterion)	21,150	17,933
December 31, 2001 (indicative target)	22,400	...

1/ The compliance with the performance criterion (indicative target) shall be based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.

Table 4. Turkey: Performance Criteria on Changes in Net International Reserves
(in millions of U.S. dollars)

	Floor on change in NIR 1/	Actual
Outstanding stock as of April 30, 2001:	3,860	
May, 2001 (performance criterion)	-1,500	-838
June, 2001 (performance criterion)	-2,900	-3,059
July-August, 2001 (performance criterion)	-2,000	-1,370
September-October, 2001 (performance criterion)	-2,600	-304
November-December, 2001 (performance criterion)	-600	...

1/ The change is computed as the difference in NIR stocks between the beginning and the end of each period. Figures exclude potential carryover from previous period (see paragraphs 6 and 7 below) – these need to be included when measuring compliance with performance criterion.

1. Net international reserves of the Central Bank of Turkey (CBT) comprise its gross foreign assets excluding encumbered reserves less its gross international reserve liabilities plus the net forward position of the central bank, denominated in U.S. dollars. Encumbered reserves are reserves that are not readily available.

2. For the purpose of the program, gross foreign assets are all short-term foreign (convertible) currency denominated claims on nonresidents, monetary gold valued at the November 30, 2000 average London fixing market price of US$269.05 per troy ounce, foreign bank notes, balances in correspondent accounts, and any reserve position in the IMF. At present encumbered reserves consist of foreign asset holdings in accounts of the Turkish Defense Fund (amounting to US$426 million on November 30, 2000). The special Dresdner portfolio (amounting to US$898 million on November 30, 2000) is also encumbered, but is not subtracted from foreign reserves given the overlap with one-year foreign currency denominated liabilities (see below). Reserve assets as of November 30, 2000 amounted to US$19,428 million.

3. Gross international reserve liabilities include all foreign currency-denominated liabilities (or TL-denominated liabilities indexed to any exchange rate) with an original maturity of up to and including one year (including reserves against foreign currency deposits of the banking sector), claims from central bank letters of credit, overdraft obligations of the central bank, and liabilities arising from balance of payments support borrowing irrespective of their maturity. On November 30, 2000 reserve liabilities thus defined amounted to US$8,331 million.

4. The net forward position is defined as the difference between the face value of foreign currency-denominated central bank off-balance sheet (forwards, swaps, options, and any future contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents. As of November 30, 2000 these amounts were zero.

5. All assets and liabilities denominated in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at the program cross rates specified.

6. The limits on the changes in net international reserves for June through end-October specified in the above table will be increased by either the unused portion of the limit on the change in net international reserves from the previous period, or by 25 percent of the limit during the current period, whichever is less.

7. The limits on the changes in net international reserves for end-December and subsequent periods specified in the above table will be increased by the unused portion of the limit on the change in net international reserves from the previous period.

8. The change in net international reserves will be evenly distributed within each period.

Table 5. Turkey: Indicative Floors on the
Cumulative Overall Balance of the Consolidated Government Sector

	Floor (In trillions of TL)
Cumulative overall balance from January 1, 2001 to:	
May 31, 2001 (indicative floor)	-4,750
July 31, 2001 (indicative floor)	-11,750
September 30, 2001 (indicative floor)	-18,150
December 31, 2001 (indicative floor)	-27,800

1. The indicative floor(for December 31, 2001) on the cumulative overall balance of the consolidated government sector has been revised. The revision reflects a technical error in the calculation of the overall balance for SEEs. The new target for December 31, 2001 is given in this table, which replaces Table 4 of Annex D of the May 3, 2001 MEFP (EBS/01/69).

2. The overall balance of the consolidated government sector (CGS), Table 5, comprises the primary balance of the CGS as defined in Annex B (EBS/01/69), the net interest payments of the consolidated central government and the unemployment insurance fund and gross interest payments of the EBFs, SEEs, and SSIs, and the overall balance of any new government funds and institutions established after March 31, 2001. The monitoring of the different components of the overall balance will be as indicated in paragraph 1 of Annex B (EBS/01/69). Revenues of the CVGS will be as defined in paragraph 2 of Annex B; i.e., excluding privatization proceeds.

3. All definitions and adjusters specified in Annex B to apply to the primary balance of the CGS will also apply to the overall balance of the CGS.

Table 6. Turkey: Performance Criteria on the Cumulative Primary Expenditure of the Central Government

	Ceilings (In trillions of TL)
Cumulative primary expenditure from January 1, 2001 through:	
May 31, 2001 (performance criterion)	11,400
July 31, 2001 (performance criterion)	17,450
September 30, 2001 (performance criterion)	24,150
December 31, 2001 (performance criterion)	36,050

1. The primary expenditure of the consolidated central government (Table 6) comprises the cumulative non-interest expenditure of the consolidated central government (consolidated budget). The quarterly ceilings will be monitored from above the line on a modified cash basis (the so-called consolidated budget adjusted non-interest expenditure).

2. For purposes of the program, primary expenditure (Table 6) will exclude tax rebates, transfers to Eximbank, treasury payments of guaranteed debt up to the quarterly baseline reported in Annex J of the May 3 MEP, and any payment related to bank recapitalization and to the restructuring of state banks.

3. The deficits of the social security institutions (SSIs) are covered by transfers from the central government budget. The ceiling on the primary expenditure of the central government (Table 6) will be adjusted downward for any increase in the expenditure arrears of the SSIs. Arrears of the SSIs are defined as those payments overdue by more than one month, and in the case of Bag Kur, exclude arrears to the common retirement fund. As of December 31, 2000, the stock of arrears of Bag Kur stood at TL 120 trillion, while the two other institutions had no expenditure arrears.

4. The ceiling on the primary expenditure of the central government (Table 6) will be adjusted downward for any off-budget expenditure of the central government.

Fiscal Measures

To help achieve our public sector primary surplus target of 6.5 percent of GNP in 2002, improve the cost-effectiveness of public administration, and reduce the weight of public expenditures on the real economy, we have specified TL 5.7 quadrillion (2 percent of GNP) in additional measures to be taken. The impact of the measures on the central government budget amounts to TL 3.1 quadrillion (about 55 percent) of the total; the remaining measures affect state economic enterprises (SEEs). For other parts of the public sector, we have specified our targets without recourse to new measures.

Central government budget (measures equivalent to 1.3 percent of GNP)

To enhance **revenues,** we have raised the petroleum consumption tax (PCT) by substantially more than the WPI in November. Looking forward, we will continue to index the PCT monthly for WPI inflation. We will also impose the PCT on natural gas at a specific rate of TL 12,500 per cubic meter (and index this rate to WPI subsequently); raise the special transactions tax by 50 percent and the motor vehicle tax by 75 percent (50 percent above the revaluation rate) in December 2001; and take measures to raise property tax revenues in large cities (while reducing the municipal tax share to 4.1 percent, to direct the additional resources to the budget). Together, we expect these measures to yield us TL 1.1 quadrillion (0.4 percent of GNP) in additional revenues. SEE price increases will yield an additional TL 0.5 quadrillion to the budget (0.2 percent of GNP), through Treasury shares, fund revenues and VAT.

To rationalize **personnel expenditures**, we will (i) reduce the replacement hiring ratio from 80 percent to 50 percent in the entire government budget except security, education, and health (total hiring, excluding transferred state bank workers, would be limited to total attrition); (ii) avoid new hiring of public sector workers (except in the military) and prevent any transfer of public workers from privatized institutions to consolidated budget agencies; (iii) restrict the applicability of the circular which states that retirement cannot be required to workers below 50, with expected wage savings in 2002 of TL 60 trillion; (iv) reduce labor costs for public sector workers in weakly performing enterprises by 10 percent; (v) require state banks to remit monthly to us funds sufficient to cover the cost of their redundant former civil servant employees, now paid by the budget (this payment would cease no later than the end of 2002); and (vi) increase rents for civil servants living in government housing. As regards civil service wage increases, our indexation methodology will remain the same as in 2001, and the upfront payment in January and July will be 10 and 5 percent respectively. Together, we expect these measures to yield us TL 0.5 quadrillion (0.2 percent of GNP) in cost savings.

To rationalize **benefit expenditures and transfers to our pension funds**, we will reduce regulated profit margins for medicine; tighten quality controls; limit prescriptions to amounts necessary and withhold a 10 percent co-payment; and pass by end-November the Bag-Kur reform bill, which will reorganize this institution and increase health premia for its members by 5 percent. Together, we expect these measures to yield us TL 0.5 quadrillion (0.2 percent of GNP) in cost savings. Given the impact of our retirement policy on the social security institution, the net impact of our public sector measures on benefits and pension transfers will be to achieve cost savings of TL 0.4 quadrillion (0.1 percent of GNP).

To improve the cost-effectiveness of **operations and maintenance expenditures**, we will immediately start the process of transferring obligations and resources from the central to the local level wherever appropriate. This process will continue and accelerate throughout 2002. We will eliminate the regions level administration; and gradually shift the workers, equipment and responsibilities of the Rural Affairs department, and of other central government departments and agencies, to the provincial administrations. Transfers to these ministries and agencies will be reduced by TL 0.3 quadrillion (efficiency gains, and additional revenues associated with revaluing properties for tax purposes by a factor of 9.5 should enable lower levels of government to cope with this burden). Together, we expect these measures to yield us TL 0.4 quadrillion (0.1 percent of GNP) in cost savings.

Finally, to help rationalize our system of **agricultural and other subsidies** we will eliminate all premia except those budgeted for soybean and canola (which together amount to TL 10 trillion). Also, reflecting price increases for sugar (see below), budgetary transfers to TSFAS will be reduced by TL 100 trillion. Consistent with earlier program commitments, we have eliminated all bank credit subsidies. Eliminating the premia payments and lowering transfers to TSFAS will yield us TL 0.3 quadrillion (0.1 percent of GNP) in cost savings.

State economic enterprises (SEEs) (measures equivalent to 1.1 percent of GNP)

To enhance SEE **revenues**, in November we raised the price of alcohol and tobacco products by 25 percent; prices at Telekom by 12 percent; and prices for sugar by 25 percent. We will undertake price increases netting us another TL 100 trillion by end-2001. During 2002, SEE prices will move in line with the WPI, or world market prices (where applicable). We will also eliminate discounts and exemptions granted by the coastal surveillance corporation, the airports, the railway, the airline, TEDAS (for induction furnaces and treatment plants), TIGEM and others. Finally, we have undertaken to reduce distribution losses in the energy sector by (i) installing and activating meters for those customers of TEDAS who currently receive electricity free of charge (this will require an amendment in the Construction Law, which we expect to be approved by end-December); and (ii) an enhanced program of on-site inspection, for which TL 27 trillion in funds have been allocated in TEDAS' budget. We expect these measures to yield us TL 1.6 quadrillion (0.6 percent of GNP) in additional SEE revenues.

To rationalize **personnel and benefit expenditures**, (i) we have imposed a hiring freeze for all budget funded SEEs and limited replacement hiring to 10 percent for all others (workers transferred from the PA portfolio will be counted in this 10 percent limit); (ii) we will reduce labor costs by 10 percent by methods appropriate to each enterprise at hand; (iii) following the restriction of scope of the circular preventing retirements (see above), we will pursue wage savings of TL 300 trillion in SEEs; (iv) we have eliminated overproduction premia for workers in idle units of SEEs; and (v) we will strictly limit overtime payments by reducing hours of overtime by 20 percent for public workers (compared to 2001), and 50 percent for others. Together, we expect these measures to net us TL 0.7 quadrillion (0.2 percent of GNP) in cost savings.

To reduce **non-wage operating expenses**, we will instruct SEEs to (i) lower their planned general administration expenses (including reduced advertising, promotion, and association memberships) by TL 100 trillion; and (ii) reduce their stock of inventories by TL 175 trillion, by selling metal items for scrap, and by tighter controls on raw material procurement. We will also eliminate 10 loss-making railroad routes; we will reduce airline branch offices abroad, eliminate unprofitable routes, and increased THY's reliance on travel agents; and we will close idle airports. Together, we expect these measures to yield us TL 0.3 quadrillion (0.1 percent of GNP) in cost savings.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/121
FOR IMMEDIATE RELEASE
November 28, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Approves US$3 Billion to Turkey Under Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the tenth review of Turkey's economic program supported by a three-year stand-by arrangement (see Press Release No. 99/66). The Board's decision will enable Turkey to draw SDR 2.4 billion (about US$3 billion) immediately from the IMF.

The stand-by arrangement was approved in December 1999 for SDR 2.9 billion (about US$3.6 billion). In December 2000, SDR 5.8 billion (about US$7.3 billion) in additional financial resources were made available under the Supplemental Reserve Facility (see Press Release No. 00/80). On May 15, 2001, the IMF approved the increase of the stand-by credit (see Press Release No. 01/23) by SDR 6.4 billion (about US$8.1 billion), bringing the total available resources from the IMF to SDR 15 billion (about US$19 billion). So far, Turkey has drawn a total of SDR 9.3 billion (about US$11.7 billion) from the IMF.

Following the Executive Board discussion on Turkey, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"Executive Directors commended the Turkish authorities on their continued strong implementation of a challenging economic reform program. The fiscal position has greatly improved and an ambitious legislative agenda has established central bank independence, enhanced transparency in economic policy making, and laid the basis for privatization of large state enterprises. In addition, important progress has been achieved in dealing with the problems of the banking sector.

"The results of this policy effort had begun to appear in August, when financial markets stabilized and the economy seemed to be bottoming out, but have been set back by the events of September 11. The authorities have appropriately recognized that the impact of the events on the Turkish economy calls for an even stronger policy response, including maintaining a high public sector primary surplus, and a renewed focus on banking sector reforms, public resource management, and private sector development. Directors agreed that an appropriately strong response would warrant additional support from the international community.

"Turkey's fiscal policy performance so far has been strong, and the closing of extra-budgetary funds and the new public procurement law submitted to parliament will help to improve fiscal transparency. It is critical that the authorities continue these efforts, and in particular reach the targeted public sector primary surplus of 6.5 percent of GNP in 2002, which will help ensure that the government debt position remains sustainable. Looking ahead, Directors saw a need for further reform of agricultural subsidies, retrenchment of public sector employment, and public sector wage restraint to underpin lasting fiscal adjustment over the medium term. They welcomed in particular the government's keen attention to protecting spending on social services, education, and health services.

"As current conditions are not conducive to the successful introduction of formal inflation targeting, the Fund agrees that a delay until 2002 is warranted. The authorities should use this additional time to extend the necessary technical work, further strengthen the fiscal position, bring down inflation, and resolve the remaining problems in the banking system, so that a successful launch of inflation targeting can take place at an early date. In the meantime, the program will continue to be anchored by base money, with firm implementation of the program providing a good basis for a reduction in interest rates.

"The authorities have made considerable progress in their ambitious structural reform agenda, including in bank restructuring. The banking supervision agency is making continued efforts to improve the regulatory environment, enforce regulations, and deal with problem banks, and the operations of state banks are being restructured rapidly under greatly improved management. Given the weak economic environment, the supervision agency will need to remain vigilant and put appropriate measures in place, if needed. Directors also looked forward to greater progress in privatization, and to more determined efforts to improve the business climate," Ms. Krueger said.