December 2002
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Turkey: Third Review Under the Stand-By Arrangement—Staff Report; Staff Statement; and News Brief on the Executive Board Discussion

In the context of the third review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the third review under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **July 22, 2002,** 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 July 30, 2002**. 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 staff statement of **August 7, 2002** updating information on recent developments.

- a News Brief summarizing the **views of the Executive Board as expressed during its August 7, 2002 discussion** of the staff report that completed the review.

The documents listed below have been or will be 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.

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TURKEY

Third Review Under the Stand-by Arrangement

Prepared by European I Department in Consultation with Other Departments

Approved by Michael Deppler and Liam P. Ebrill

July 30, 2002

- Discussions for the third review under the Stand-by Arrangement with Turkey were held in Ankara and Istanbul during July 10–22, 2002.

- The staff participating in the mission comprised Messrs. Kähkönen (head), Aitken, Griffiths, and Rossi (all EU1), Mr. Flanagan (FAD), Ms. Lim (ICM), Mr. Laryea (LEG), Messrs. Marston and Josefsson (MAE), and Mr. McGettigan (PDR). Mr. Brekk, senior resident representative, and Mr. Piñerúa, MAE resident representative, assisted the mission, and the mission cooperated closely with World Bank staff on structural issues. Mr. Kiekens, Executive Director for Turkey, attended several meetings.

- The mission met with Prime Minister Ecevit, Deputy Prime Minister Yilmaz, Deputy Prime Minister and Foreign Minister Gürel, State Minister for Economic Affairs Derviş, State Minister for Foreign Trade Toskay, Minister of Finance Oral, Minister for Privatization Karaköyunlu, Treasury Undersecretary Öztrak, Finance Undersecretary Dikmen, Central Bank of Turkey Governor Serdengeçti, Bank Regulation and Supervision Agency Chairman Akçakoca, other senior officials, and representatives of the private banking and business communities.

- Under the Stand-by Arrangement approved on February 4, 2002, the Central Bank of Turkey (CBT) was subject to a full safeguards assessment. This was completed on April 4, 2002. In the first program review, completed on April 15, 2002, some of the actions identified in the safeguards assessment were included under Fund conditionality. The structural performance criterion relevant for this review was met on July 5, when the CBT issued an external auditor's report reviewing the consistency between the program data reported to the IMF and the audited financial statements of the CBT (see paragraph 27 of the attached Letter of Intent).

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

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I. Introduction

1. **The Fund is supporting Turkey's economic program under a Stand-By Arrangement (SBA) covering 2002–04, approved by the Executive Board on February 4, 2002.** Total access under the arrangement is SDR 12.8 billion, or 1,330 percent of quota, of which SDR 9.1 billion has been purchased so far (Table 1 and Appendix I). The next purchase, in an amount equivalent to SDR 867.6 million, is contingent on the completion of this review. The World Bank supports Turkey under a Country Assistance Strategy envisaging lending of up to US$6.2 billion during FY2001–03 (Appendix II). Of this amount, the Bank has so far committed US$4.5 billion. World Bank disbursements to Turkey in FY2001–02 amounted to US$2.5 billion.

2. **In the attached letter, the authorities review developments and policies under the program, and request the completion of the third review under the SBA** (¶5).[1] The authorities also request a waiver of nonobservance for the end-June 2002 performance criterion on the closure of 800 state bank branches, which was missed by a small margin. In addition, they request that indicative quantitative targets for the second half of 2002 be converted into performance criteria. Finally, to facilitate closer monitoring of fiscal performance over the remainder of the year, the authorities request the setting of indicative targets for the cumulative primary balance of the consolidated government sector for end-September and end-October 2002, and a performance criterion on the cumulative primary balance of the consolidated government sector for end-December 2002.

II. Performance under the Program

3. **Through April, the program outperformed expectations** (Table 2, and Figures 1–5). With strong policy implementation, economic and financial indicators outperformed financial market expectations and program projections. Having started the year at about 70 percent, the benchmark bond rate fell to almost 50 percent, and the Treasury was able to borrow funds in excess of redemptions, thus building up a financing cushion. Helped by solid export growth and ready access to international capital markets, the balance of payments was stronger than expected, with the currency stabilizing in the range of TL 1.3–1.4 million to the U.S. dollar and international reserves being kept well above the program's floors. Inflation fell sharply, and by early May inflation expectations for end-year had declined to 35 percent, the program target. The real economy started a strong recovery, with GNP in the first quarter of 2002 rising by a seasonally adjusted 7 percent from the weak last quarter of last year.

4. **Since early May, however, the political environment has been a source of uncertainty.** In May and June, concerns about the Prime Minister's health and differences over reforms needed for meeting the EU's Copenhagen criteria called into question the

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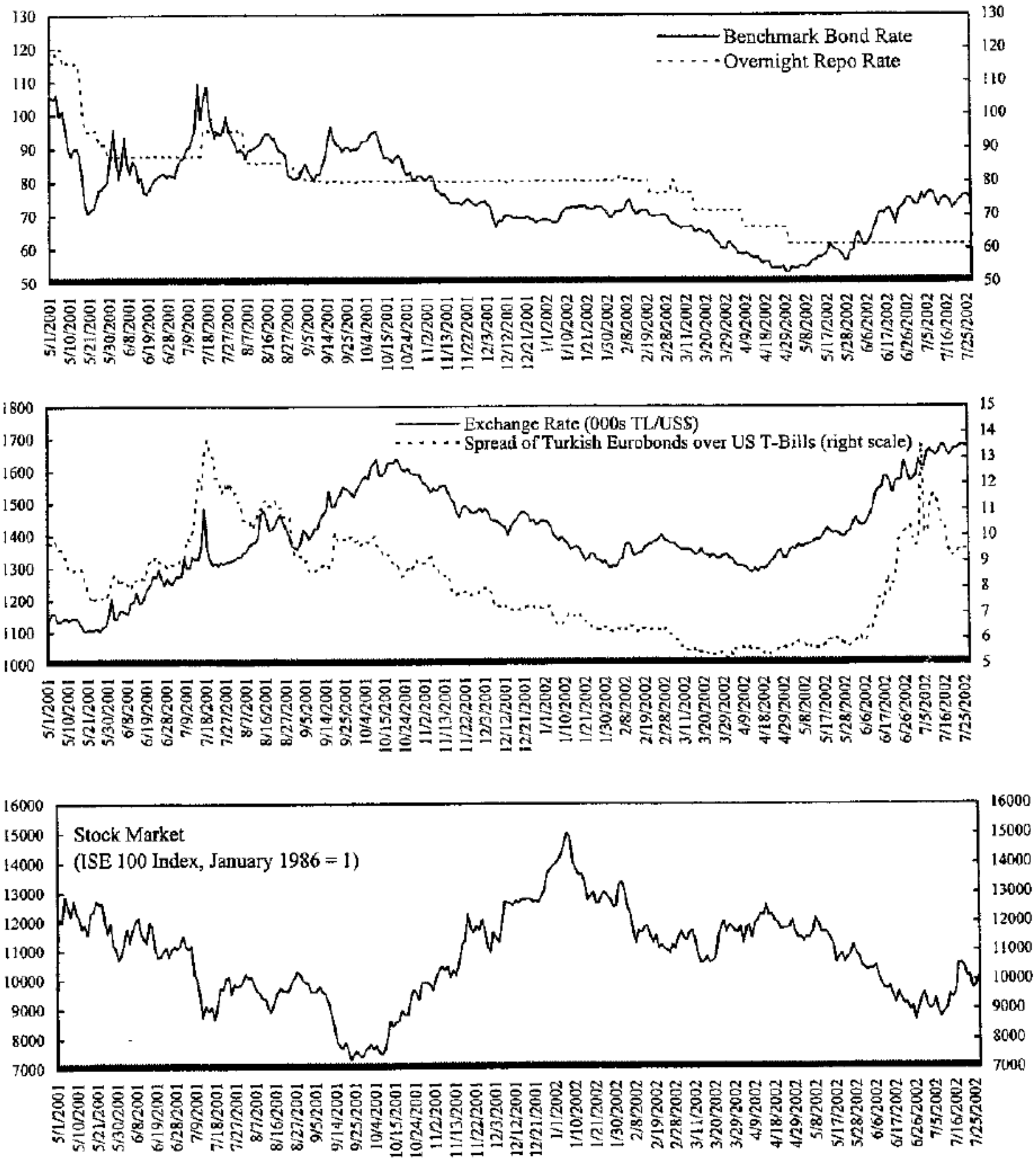
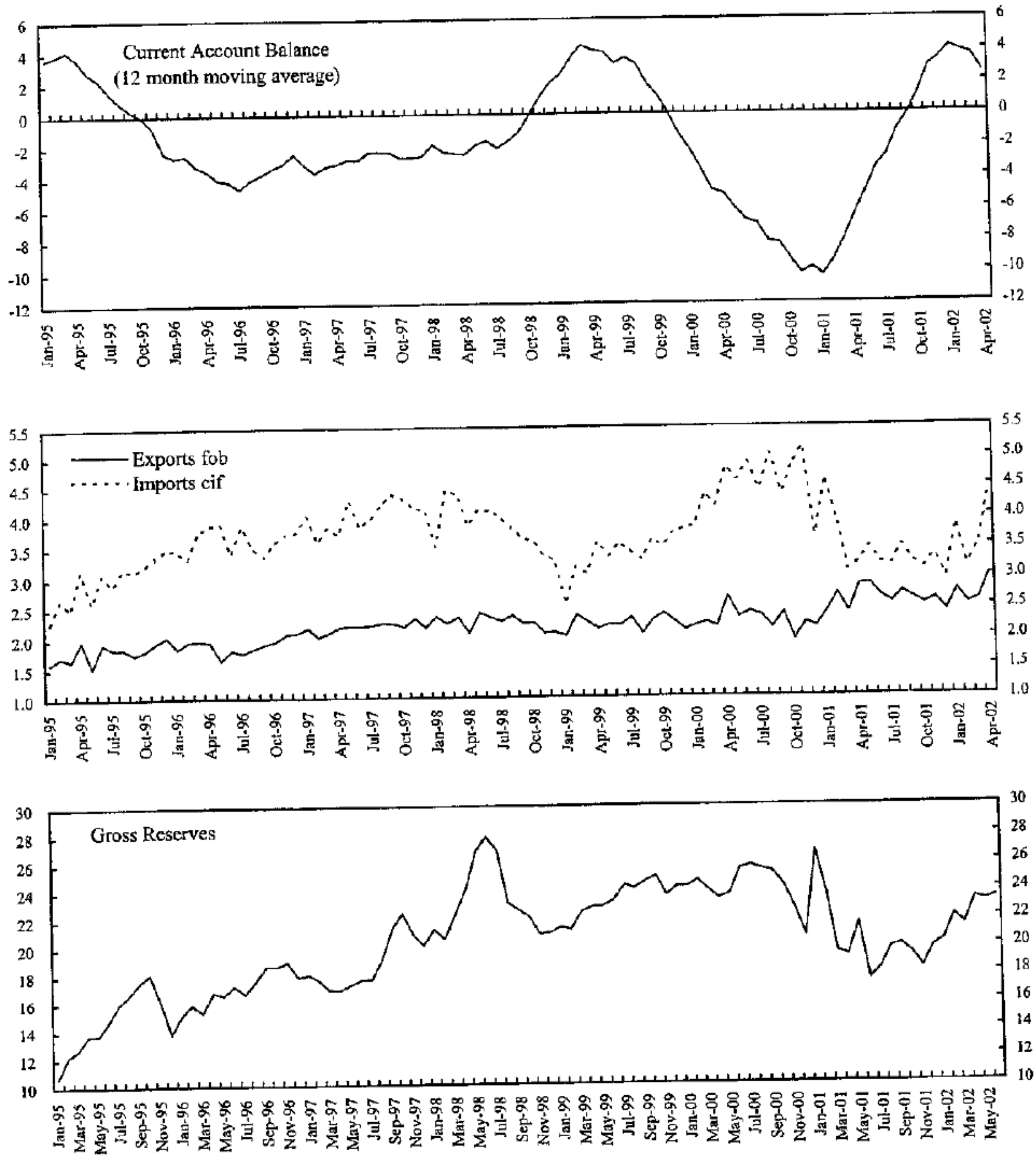
[1] ¶ refers to the relevant paragraph in the attached Letter of Intent.

Figure 1. Turkey: Market Developments, 2001-02
(in percent; unless otherwise indicated)



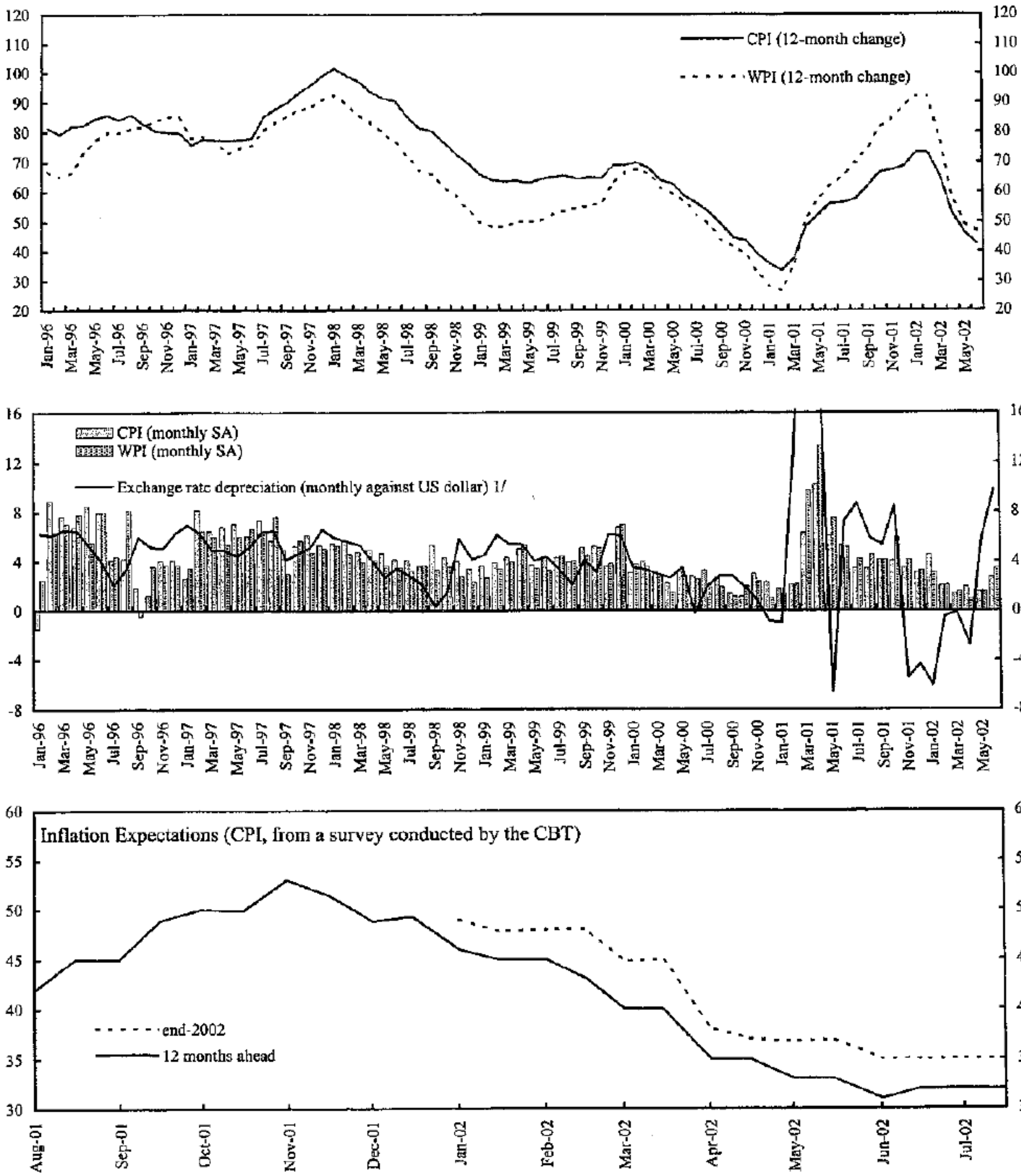
Source: Data from the Turkish authorities.

Figure 2. Turkey: Balance of Payments Indicators, 1995-2002
(in billions of U.S. dollars)



Sources: State Institute of Statistics; and IMF, *International Financial Statistics*.

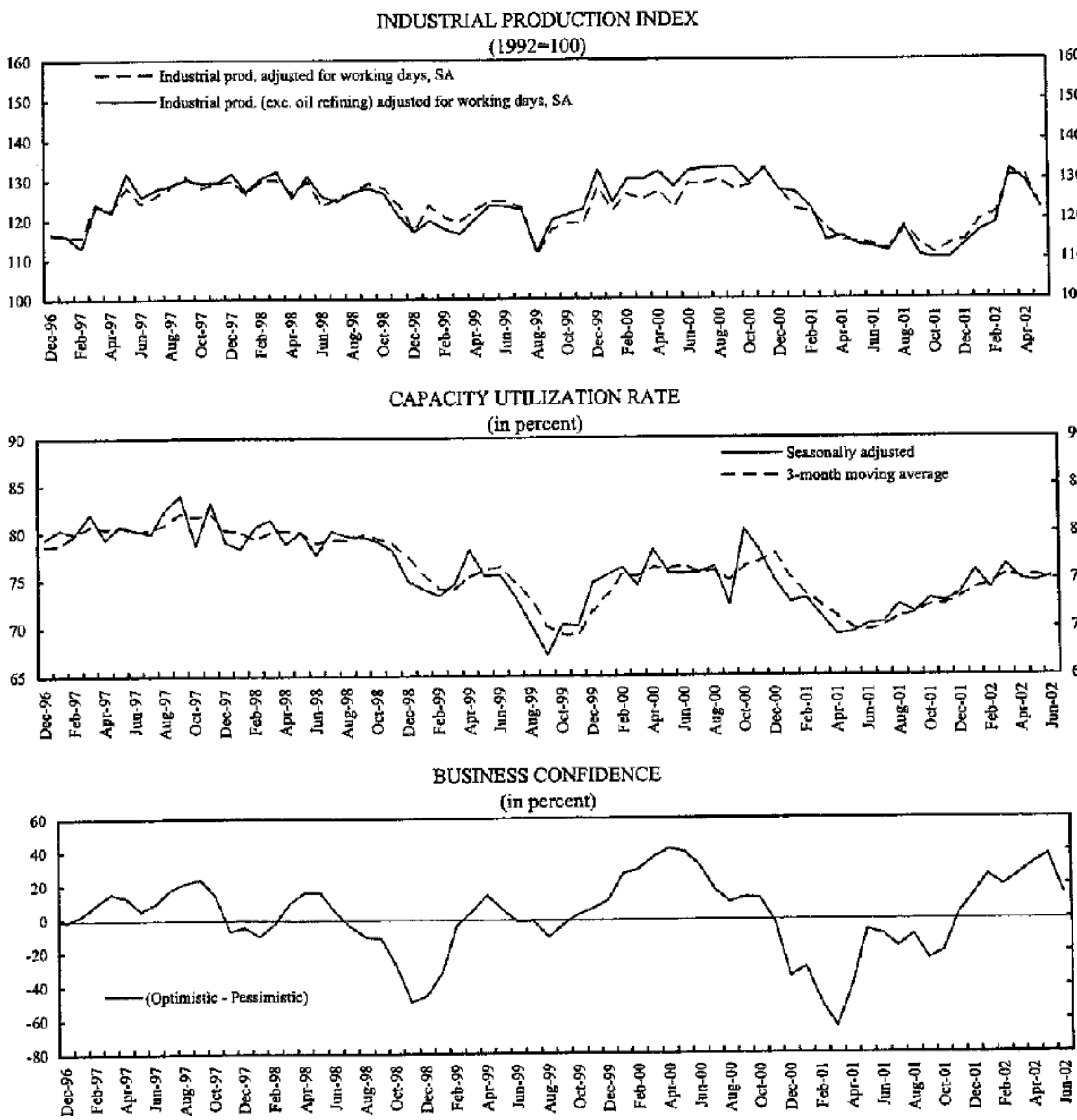
Figure 3. Turkey: Inflation, 1996-2002
(in percent)



Source: Data provided by the Turkish authorities.

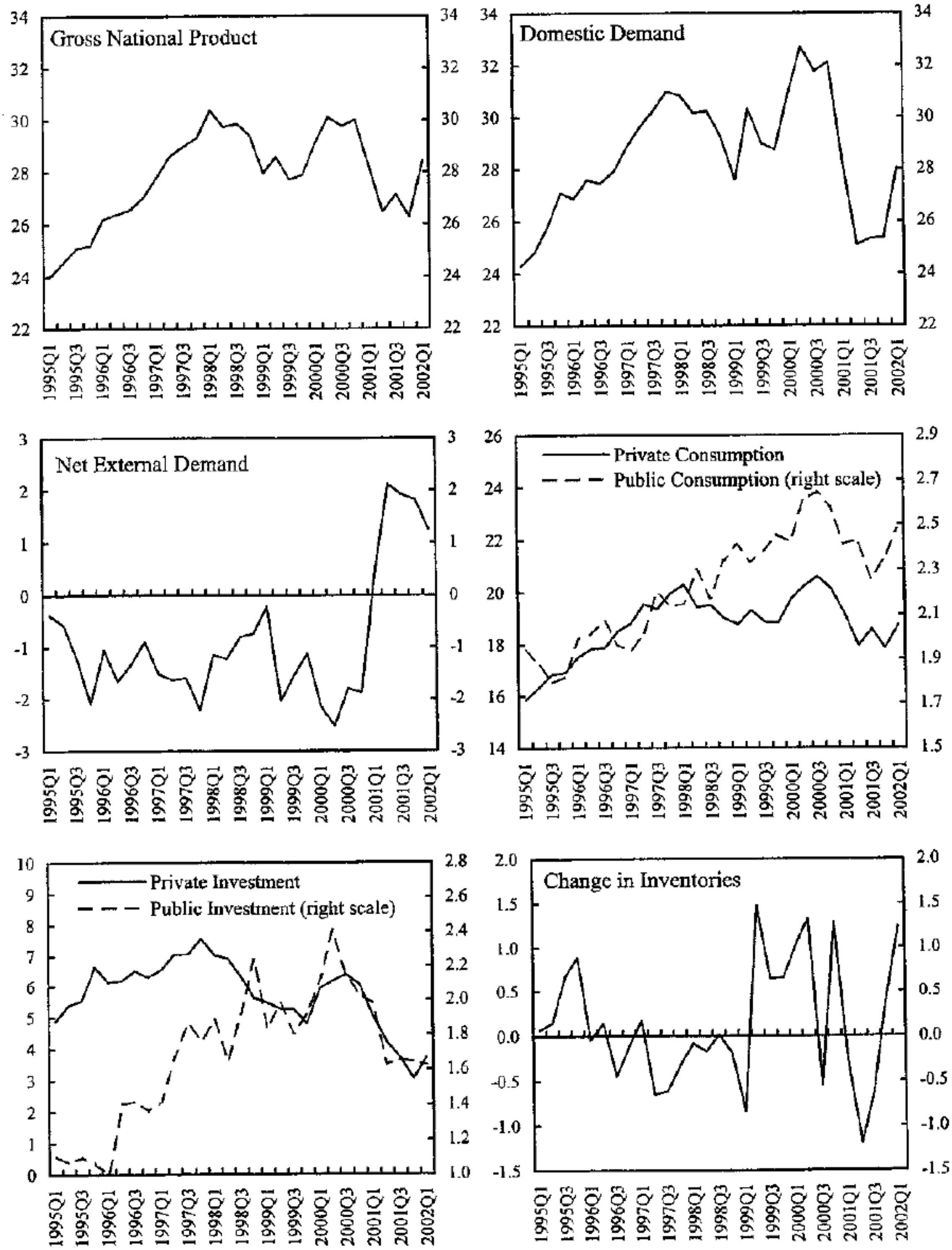
1/ In April 2001, the TL/US dollar exchange rate depreciated by 29.5%.

Figure 4. Turkey: Output and Demand, 1996-2002



Source: Data provided by the Turkish authorities.

Figure 5. Turkey: Aggregate Demand, 1995-2002
(seasonally adjusted; in trillions of Turkish liras at 1987 prices)



Source: State Institue of Statistics

stability of the ruling coalition. In July, following significant defections from the Prime Minister's party, the coalition lost its majority in parliament. Parliament reconvened on July 29 to decide on early elections, which are being proposed for November 3.

5. **The political uncertainty has resulted in a substantial weakening of financial market indicators.** Between end-April and end-June the benchmark bond rate rose by 21 percentage points, stock prices fell by 18 percent, and the currency weakened by 15 percent against the U.S. dollar. On the external side, interbank credit lines held up well. However, Eurobond spreads widened by more than 500 basis points, in part reflecting contagion from other emerging markets. In July, with signs that the political uncertainty would be resolved, financial market conditions stabilized. The benchmark bond rate and the exchange rate moved back to their late June levels of 75 percent and TL 1.65 million to the U.S. dollar, the stock market recovered moderately, and the Eurobond spread fell back somewhat. While interest rates are only slightly higher than original program projections (and the exchange rate is actually stronger), the persistence of the current political shock has interrupted the gradual decline in interest rates built into program projections.

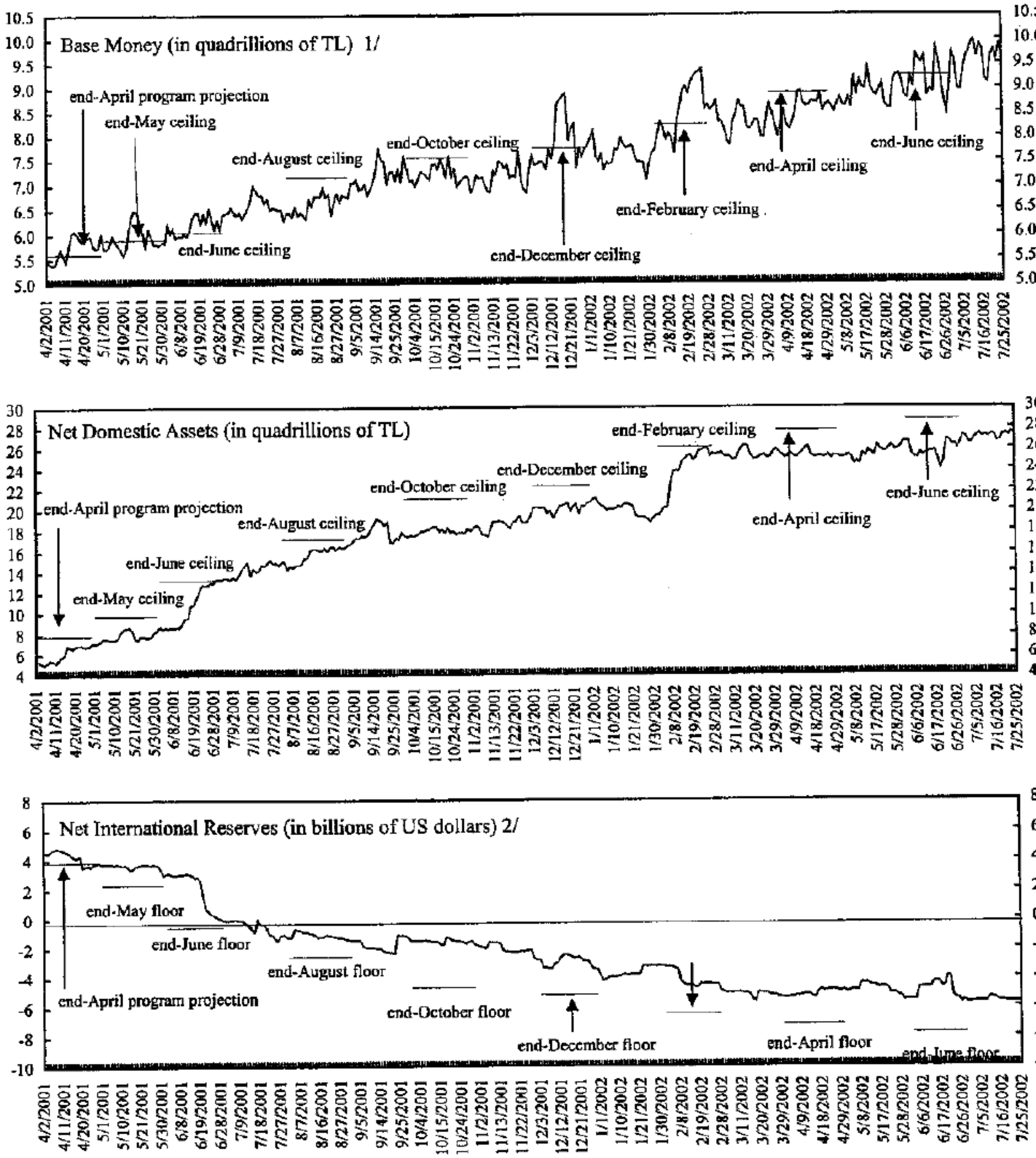
6. **The financial market turbulence notwithstanding, growth and disinflation remain well on track.** With continued low monthly inflation in the second quarter, consumer prices increased by only 12 percent in the first half, well within this year's 35 percent target. Growth is also on course to reach the 3 percent target: following the strong first-quarter performance, in April–May industrial production rose 13 percent year on year, and tourism and exports have been stronger than programmed.

7. **This solid economic performance owes much to continued strong program implementation:**

- **Macroeconomic policies have remained in line with the program since the completion of the second review in June** (Figures 6–8). All quantitative performance criteria for end-May and end-June have been met (Annex A of the attached Letter of Intent). The Central Bank of Turkey (CBT) has kept monetary aggregates within program limits, and has maintained a higher-than-programmed reserve position. Fiscal outturns also remain on track. The end-May performance criterion on the cumulative primary surplus of the consolidated government sector was met by a margin of ¼ percent of annual GNP. Moreover, June data for the central government and the catch-up of price increases in state enterprises in May–June suggest that this overperformance was preserved through June.

- **The program's structural conditionality for this review has also been broadly met** (Table 3). Two of the three structural performance criteria for this review were observed fully (these were on issuing a revised International Accounting Standards regulation for banks, and issuing a report on the CBT's external audit for safeguards purposes). The third, on the closing of state bank branches, was missed by a narrow margin. By end-June, 788 branches had been closed, just short of the 800 target.

Figure 6. Turkey: Monetary Program, 2001-02

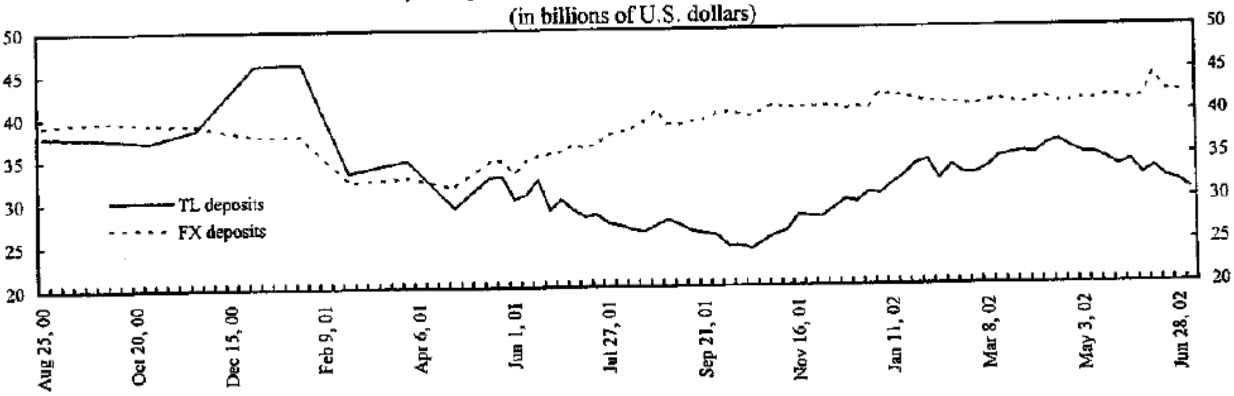


Source: Data from the Turkish authorities.

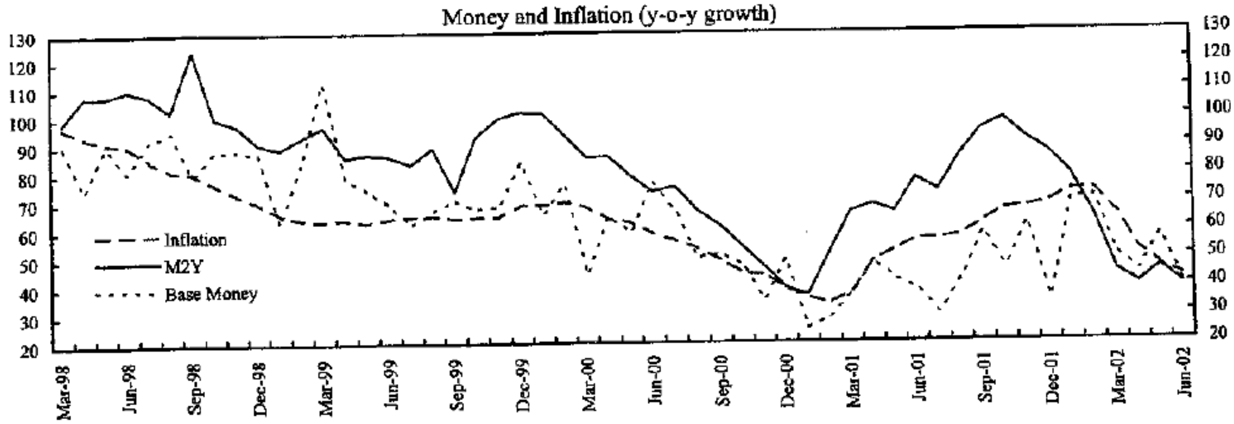
1/ As explained in Annex J of the Janury 18, 2002 Letter of Intent, the end-February test date was calculated as the four-day average of February 11-12 and March 11-12, to correct for the temporary increase in demand for base money due to the Bayram holiday. All monetary performance criteria and indicative ceilings were met.
2/ Data discontinuity at February 6, 2002 reflects the revised definition of NIR in the new program, which now includes the Treasury's NIR position, and which is calculated at new program cross exchange rates.

Figure 7. Turkey: Monetary Developments, 1998-2002

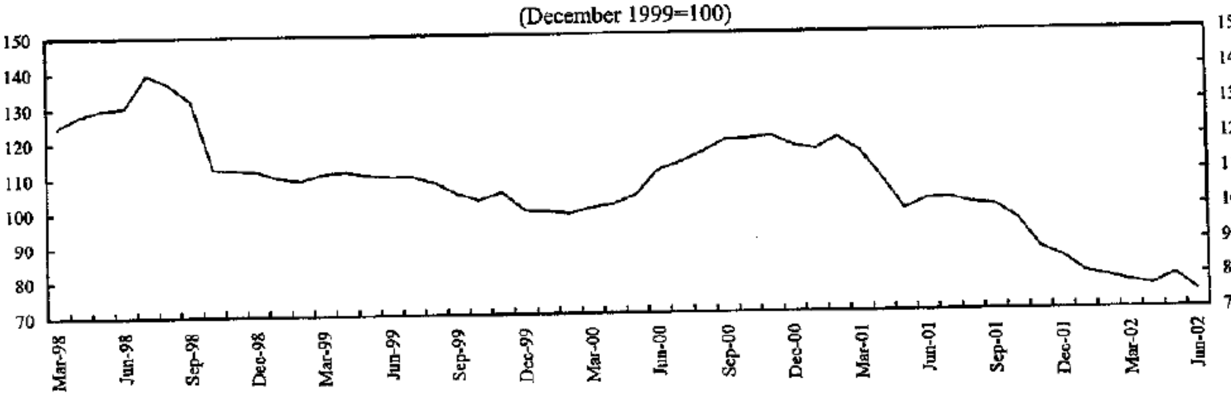
Currency Composition of Bank Deposits, August 2000-July 2002
(in billions of U.S. dollars)



Money and Inflation (y-o-y growth)



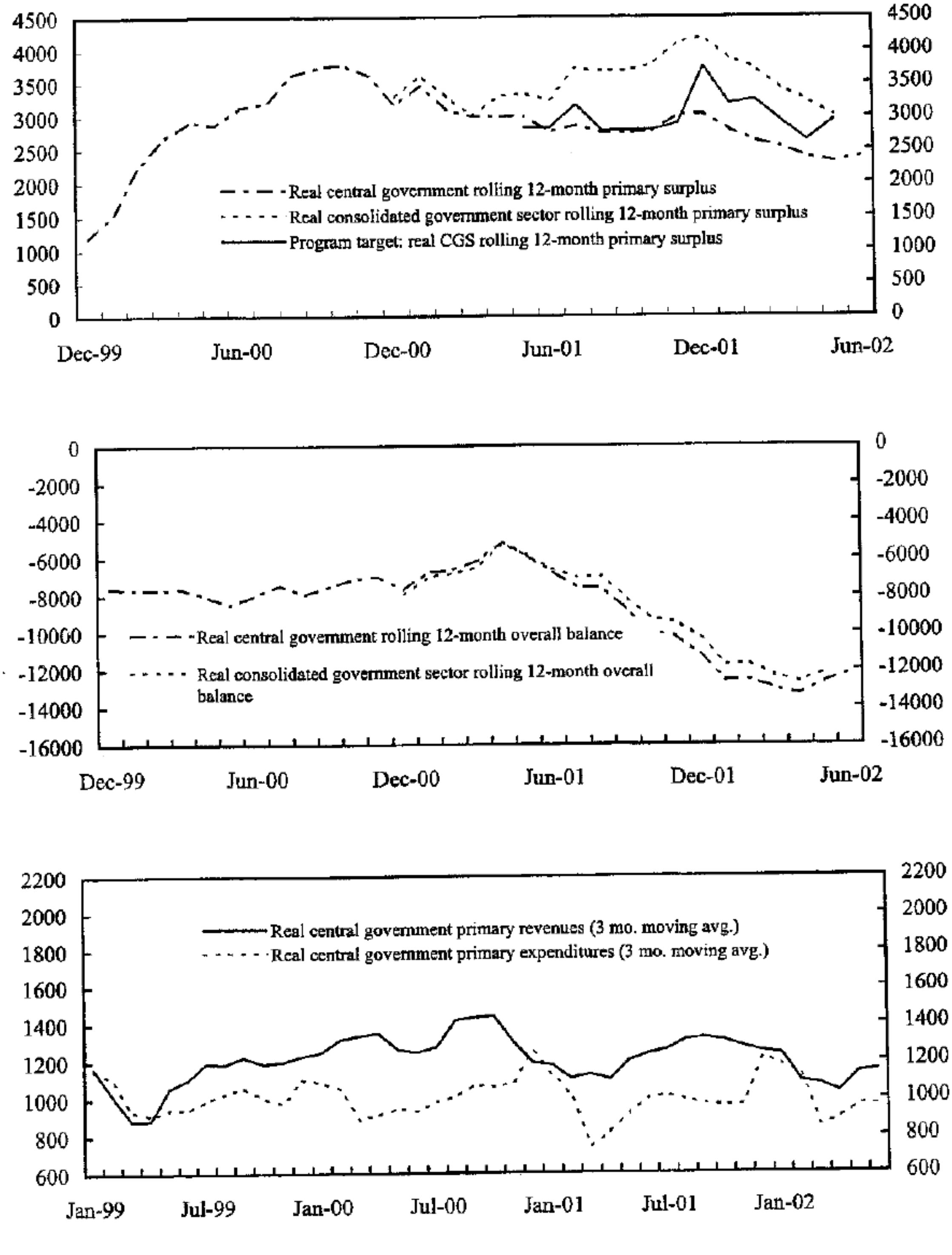
Real Bank Credit to the Private Sector
(December 1999=100)



Sources: Central Bank of Turkey; and State Institute of Statistics.

1/ Turkish residents' TL deposits.

Figure 8. Turkey: Fiscal Indicators, 1999-2002
(TL trillions; January 1999 prices)



Source: Data provided by the Turkish authorities.

Operational restructuring has since continued apace, with five more branches closed in July and staff reductions proceeding as targeted. As regards structural benchmarks, the submission of public financial management legislation to parliament (an end-June benchmark) was slightly delayed, and is now set to take place shortly as a prior action for this review. This legislation will also cover the extrabudgetary fund reforms called for under a July benchmark, originally intended to be passed as a separate law. Finally, the prior action on issuing a decree to implement the removal of the tax on foreign exchange transactions was met on July 30.

8. **The program has also strengthened Turkey's resilience to shocks.** Although marked, the reaction of financial indicators has been less pronounced than on earlier occasions. This is partly due to the floating exchange rate and the strength of the fiscal position. It is also due to the strengthened independence of key institutions, such as the CBT and the Bank Regulation and Supervision Agency (BRSA), which has made the economy more robust than before. At the same time, strict program implementation has helped to contain rollover concerns in an uncertain political environment, and has brought the financial sector back to soundness. Compared to last year, underlying economic imbalances have been reduced. The Treasury has built up a deposit cushion by overborrowing when market conditions were more favorable, and banks are less dependent on foreign banks for credit.

9. **Despite these achievements, the program remains vulnerable to a loss of market confidence** (Appendix III and Table 4). Uncertainty over the election result, delays in forming a new government, or doubts about any new government's commitment to continuing the program could all weaken financial markets. Financial markets could also react to any overrun in government spending during the run-up to elections, although the program's fiscal targets make this less of a concern than in the past. On the external side, abstracting from uncertainty over world economic conditions and financial market contagion, the main risk is the possibility of military action in the region. Given the need to roll over large gross redemptions of domestic debt, averaging the equivalent of US$6 billion per month in the remainder of 2002, loss of market confidence for any of the above reasons would leave the Treasury's borrowing program vulnerable.

III. Report on the Discussions

10. **Discussions focused on how to improve the program's prospects for success, given the background of political uncertainty and nervousness in financial markets:**

- **The authorities agreed that sticking to the current program strategy offered the best chance of rebuilding market confidence.** For its part, the CBT was confident that, by sticking to its prudent monetary policies, this year's inflation target would be met. The authorities also agreed to take further steps to secure the program's fiscal targets, and agreed to closer fiscal monitoring under the program in the remainder of the year. Moreover, the authorities noted that they would continue to press ahead with the program's ambitious structural policy agenda. All in all, the authorities expected strict program implementation to allow the favorable momentum to resume, once the political uncertainties were resolved.

- **The authorities also agreed to try their best to contain the fallout from political uncertainties (¶4 and Box 1).** Even with the best efforts of the economic officials in Turkey and the Fund, political uncertainty could undermine policy efforts. To help address political risks, the coalition leaders expressed publicly and in discussions with the mission their continued commitment to the program. This commitment is also underlined in the forthcoming letter of political support for the program, which the three coalition leaders have agreed to sign. Looking further ahead, government officials and private sector representatives were confident that, with no credible alternatives to the current approach, any new government would be expected to stay with the program strategy. The authorities did, however, acknowledge that early elections would likely mean that structural measures requiring parliamentary approval, such as tax and bankruptcy reform, would be delayed. But they were strongly committed to continued strict adherence to the program's remaining policies, which should help to safeguard the program's macroeconomic objectives.

A. Macroeconomic Framework and Debt Outlook

11. **The recent weakening of financial indicators does not compromise the program's macroeconomic targets (¶2):**

- Because of a stronger-than-expected economic recovery early in the year, the 3 percent GNP growth projection for 2002 should be comfortably met, even if economic activity were to soften somewhat in the period ahead. The first-quarter GNP outcome was so strong that, even if GNP remained unchanged (in seasonally adjusted terms) for the remainder of the year, growth would be 5 percent. In fact, with improved export and tourism performance, the net creation of 2,500 companies in May, and continued rise in capacity utilization (up by 6 percentage points in May–June year on year), economic recovery likely continued during the second quarter. Although there is a risk that domestic demand could stall later in the year, owing to the recent increase in interest rates, the 3 percent GNP growth projection for 2002 should be well within reach in light of the substantial carryover from the first quarter.[2]

- Similarly, although the currency depreciation of recent months will likely have further effects on inflation, the 35 percent target remained fully attainable. The

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[2] Reflecting these developments, over the last two months outside observers have raised their 2002 growth projections. The July consensus forecast is 2.6 percent, up from 2.2 percent in May. Participants in the July CBT business survey expected growth of 2.5 percent, up from 2.2 percent in May.

Box 1. The Political Context

In recent weeks the governing coalition has lost its parliamentary majority, and has joined the calls for early elections. Following the April 1999 elections, a three-party governing coalition was formed, with more than 60 percent of the seats in parliament. Recently, amid political uncertainty caused by Prime Minister Ecevit's ill health and divisions over EU reforms, more than 60 members of the Prime Minister's party (DSP) defected to a new left-of-center formation led by former Foreign Minister Cem and former Deputy Prime Minister Özkan. As a result, the governing coalition has lost its overall majority. With no clear alternative coalition able to command majority support, parliament reconvened on July 29, and is expected to decide in favor of early elections, which would probably be held November 3.

Turkey: Popularity of Major Political Parties

	Parliamentary Representation (Number of Seats)			Latest Opinion Poll	
	1999 Election	June 18, 2002	July 19, 2002	Share of Votes	Implied Seats
DSP (Democratic Left Party)	135	128	65	3	0
MHP (Nationalist Action Party)	127	126	127	5	0
ANAP (Motherland Party)	86	79	79	6	0
DYP (True Path Party)	89	85	85	8	0
AKP (Justice and Development Party)	111	53	53	21	550
SP (Felicity Party)		48	48	3	0
Other	2	18	80 1/	17	0
Vacant	...	13	13	...	...
Undecided / none of the above	...	...	...	38	...
Total	550	550	550	100	550
Of which, governing coalition:	348	333	271		

Notes: The parties (AKP and SP) have been formed out of the (now-outlawed) Virtue Party, which stood in the 1999 elections.
1/ Includes 63 DSP defectors.

The splintering of political parties, combined with Turkey's electoral system (which magnifies the influence of larger parties), makes the results of any election difficult to predict. To obtain parliamentary representation, parties must cross a threshold of 10 percent of the popular vote (independents are excluded from this requirement). This threshold, combined with the current splintering of political parties, could produce unpredictable results. Although in April 1999 parliamentary representation largely mirrored the popular vote, this was because five parties crossed the 10 percent threshold. Latest opinion polls, conducted before the emergence of the breakaway left-of-center grouping, suggest that only one party (the AKP) would cross the 10 percent threshold, giving it all 550 seats in parliament. Such an extreme scenario is unlikely, especially if the major parties pick up votes from the 40 percent of voters who are undecided or intend to abstain. However, unless the smaller (centrist) parties can consolidate before the elections, they are likely to be under-represented in parliament.

With parliament now in recess, and with early elections likely to be called soon, there is little scope for passing legislation needed for economic reform this fall. At the time of the elections, all legislation that has been sent to parliament or is in committee is automatically withdrawn. It would need to be resubmitted by the new government. Once elections are held, legislation and the economic reform program would likely be delayed another two to three months, given the time it takes to announce the results, select a parliamentary speaker, appoint the Prime Minister, and form a new government.

first half of the year saw cumulative consumer price increases of only 12 percent, mainly reflecting subdued food and agricultural prices. The authorities and the staff expected some impact over the next few months from the recent increases in public sector prices and the currency depreciation, but agreed that continued favorable food and agricultural prices (owing to a good harvest), a still large output gap, and sound policy implementation should ensure meeting the end-year inflation target.[3]

Balance of payments projections were also left broadly unchanged from the previous review (Figure 9 and Table 5). On the current account side, although worker remittances and other services receipts continue to disappoint, this is outweighed by better-than-expected export and tourism performance. The overall balance of payments outlook remains unchanged for 2002, however, following a modest downward revision in the projected capital account balance. The outlook for net private sector capital flows has now improved, both for banks, with interbank credit lines holding up well and a drawdown of correspondent account balances, and for corporates, which have experienced net new medium- and long-term borrowing. These positives are, however, more than outweighed by continued sluggish foreign direct investment, higher net purchases of international bonds by Turkish residents, and lower projected official loan disbursements.

12. **The program's baseline projections continue to show external and domestic debt sustainability, with only large shocks threatening the robustness of the projections.** Appendix IV presents the standardized framework for analyzing external and domestic debt sustainability recently adopted by the Board.[4] Consistent with previous staff analysis of public sector debt sustainability (see Box 2 in the staff report for the second program review, Country Report No. 02/229, 10/23/02), the framework shows that external and domestic debt sustainability is achieved under the baseline, and is robust to a series of plausible shocks to such parameters as growth, the primary surplus, interest rates, and the exchange rate. Also in line with the previous analysis, the framework shows that a combination of these shocks could produce an unsustainable debt path. Beyond this, the framework calls for an analysis of the impact of several extreme, but temporary, shocks, such as two years of double-digit output decline (which is implausible, given last year's 9 percent decline) and two years of zero primary surplus (which would follow this year's surplus of 6½ percent of GNP). Not surprisingly, these shocks would produce much higher medium-term debt ratios, although sustainability could still be attained in most cases, as long as the program's targets for the key macroeconomic variables are achieved in the medium term (Figure 10).

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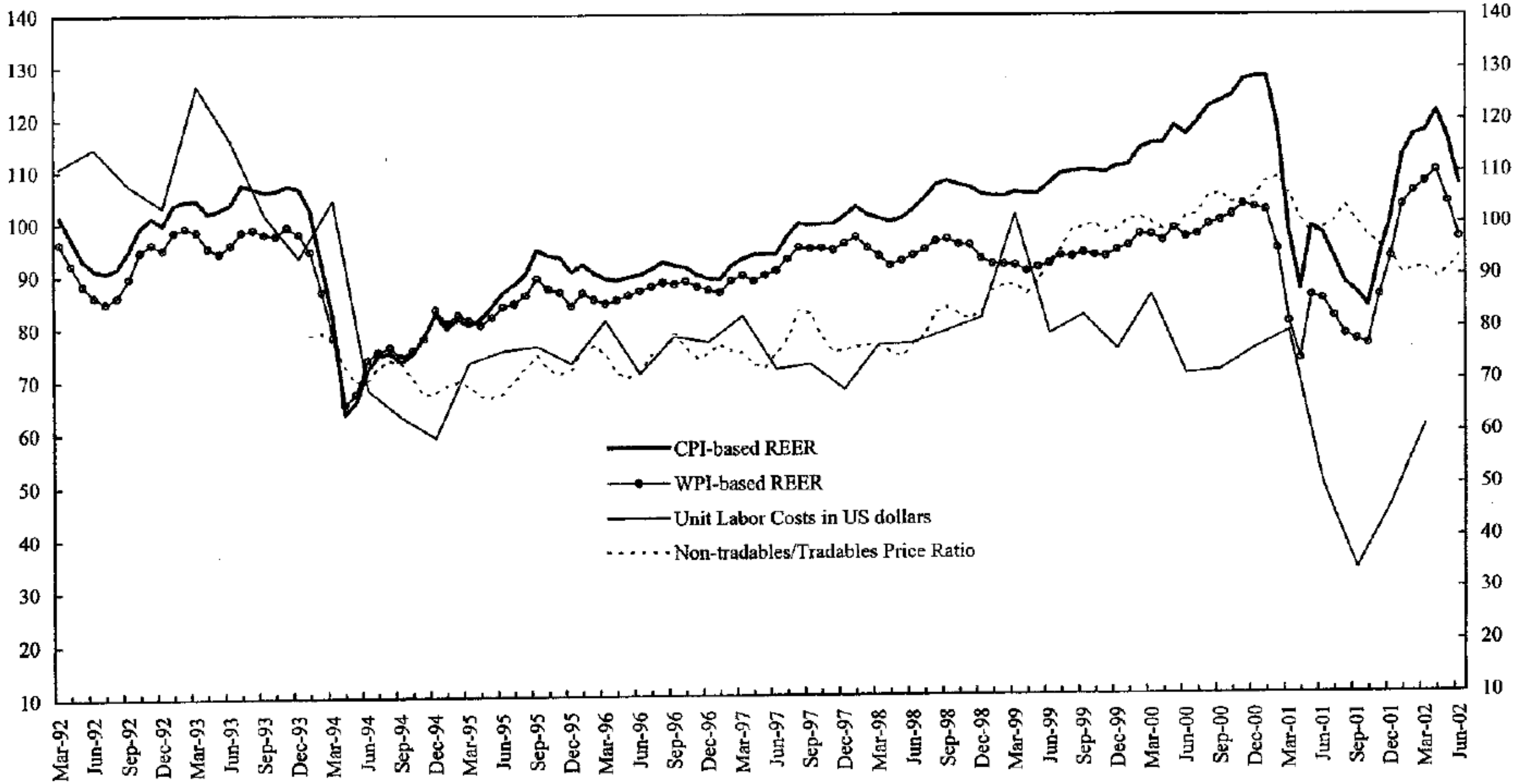
[3] For end-2002, the July consensus forecast is 34 percent, and the July CBT inflation survey shows a median inflation expectation of 35 percent.

[4] See SM/02/166 (5/28/02) for a description of the new standardized approach to analyzing debt sustainability.

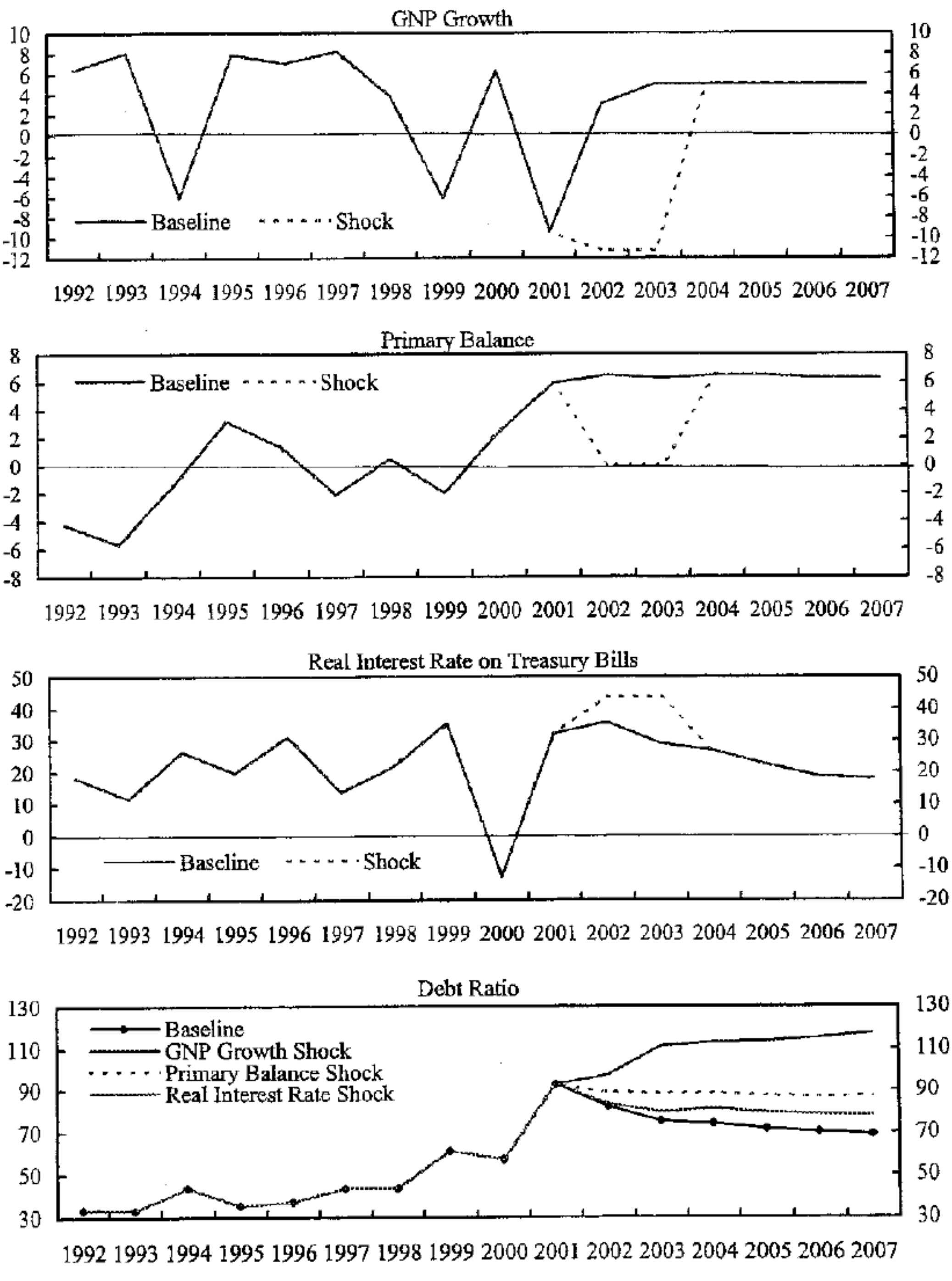
Figure 9. Turkey: Competitiveness Indicators, 1992-2002 1/
(indices, 1990=100)



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

1/ As of June 2002.

Figure 10. Turkey: Debt Sustainability under Extreme Shocks, 1992-2007



Source: Fund staff estimates and projections.

13. **Despite the recent adverse financial market conditions, the government has not so far had serious difficulty meeting its short-term financing needs**. The Treasury responded to the recent market turmoil by temporarily reducing both the maturity and volume of borrowing in Turkish lira, while financing the shortfall by drawing down its deposit buffer and issuing foreign exchange denominated debt. As a result, private sector rollover ratios for June–July have fallen to 90 percent from 120 percent in January–April, and the average maturity of newly auctioned Turkish lira debt has fallen to 5½ months from 10½ months.[5] The staff agreed that this was an appropriate first response, demonstrating the importance for debt management of maintaining a sizeable financing buffer.

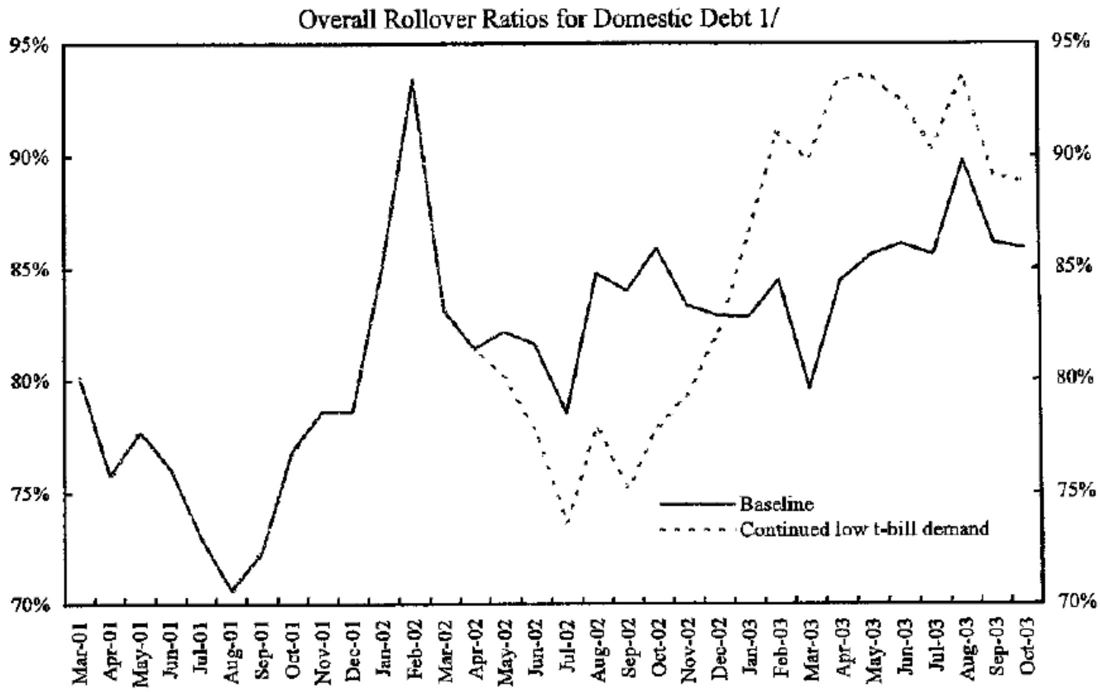
14. **Looking forward, debt management risks hinge on developments in confidence.** With the banking system remaining highly liquid, both the authorities and market participants (some of whom assume additional external financing next year) expected that the Treasury would not face major difficulties rolling over its debt in the next few months, barring additional major shocks. The staff shared this view, but noted that budget financing prospects for 2003 would depend critically on the impact of political developments on market confidence:

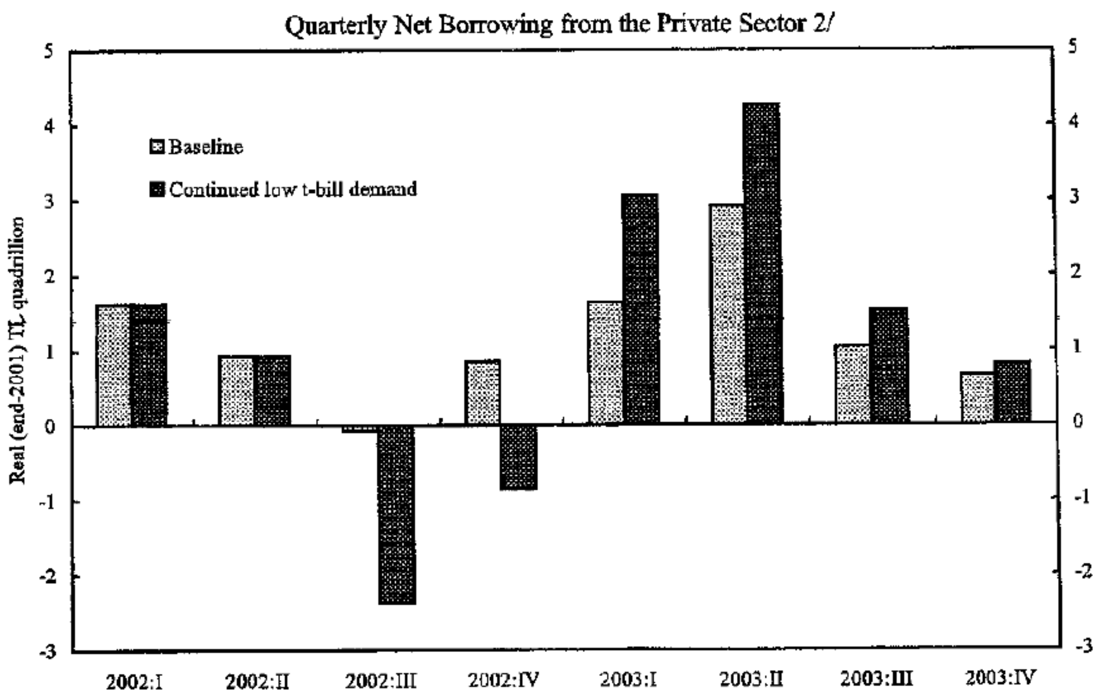
- If political uncertainties are resolved promptly and in a way that comforts markets, the demand for treasury bills could be expected to pick up sufficiently to ensure a smooth rollover in 2003. In a baseline scenario where full confidence is restored in the first quarter of 2003, and demand for treasury bills during the pre-election period is sufficient to allow the Treasury to rebuild some of the deposit buffer lost during May–June, albeit at relatively high interest rates (in the range of 70–75 percent), the 2003 budget could be financed with only a modest increase in appetite for government debt (Figure 11). Indeed, the staff and authorities agreed that a quick resolution of political uncertainty could result in rollover ratios higher than assumed in this scenario, and as high as those observed in the first few months of 2002.

- If, however, financial market turmoil persists, markets would increasingly question whether the increase in treasury bill demand required to finance the 2003 budget would materialize. This is illustrated in a scenario in which interest rates are assumed to remain high until the end of the year, maturities of new borrowing remain at six months, and the Treasury runs down the remaining deposit

[5] Rollover ratios are one measure of the absorption of government debt required to finance the budget. In this regard, with liquid and profitable state banks increasingly participating in the primary market for treasury bills (both directly and on behalf of clients), the distinction between private and overall rollover ratios is less meaningful than in the past. The private sector rollover ratio nevertheless gives an indication of the degree to which financing the budget relies on the willingness of private banks to maintain holdings of government debt.

Figure 11. Turkey: Indicators of the Government's Domestic Borrowing, 2001-03





Source: Fund staff estimates and projections.

1/ Defined as a centered moving average of gross borrowing over gross redemptions (including interest).

2/ Gross borrowing minus gross redemptions (including interest).

buffer to minimize its borrowing need. In this scenario, while financing in 2002 may be manageable, with the drawdown of deposits and the use of Fund disbursements allowing for quite low government debt rollover rates, financing the 2003 budget could be problematic. A sharp increase in demand for treasury bills would be required, similar in size to that which occurred post-September 11. However, this increase in treasury bill demand was achieved in large part because market confidence improved dramatically in anticipation of additional Fund financing. Without a clear and quick resolution of political uncertainty following the election, markets could regard the 2003 program as under-financed. This would keep interest rates high and maturities short, and could increase tensions in financial markets.

15. **Against this background, both sides agreed that to reduce rollover risk and improve the financing picture for 2003, every opportunity should be taken to build financing cushions by overselling government paper and accumulating reserves.** The Treasury reaffirmed its intention to build up buffers through overborrowing in auctions, as in early 2002, to the extent allowed by market conditions. At the same time, the Treasury and the CBT would explore ways to reduce rollover risk by offering Treasury instruments to attract a significant portion of the TL 10 quadrillion in short-term liquidity currently borrowed by the CBT through open market operations. Such borrowing would not be used for budget financing, but would be deposited by the Treasury at the CBT as a cushion to insulate Treasury's borrowing program against short-term rollover risk. The Treasury could draw down on these deposits in exceptional circumstances, although the monetary impact would need to be sterilized by the CBT.

16. **The Fund's exposure to Turkey under the program is very high, but the macroeconomic framework indicates that Turkey should be able to discharge its obligations to the Fund in a timely manner** (Tables 6 and 7). Turkey's unblemished record of payments to the Fund, the authorities' continued commitment to their reform program, and better-than-targeted reserves buildup all provide assurances in this respect. Turkey's obligations to the Fund will, however, continue to be substantial over the medium term, with payments to the Fund projected to peak at about US$9¾ billion, or 14 percent of exports of goods and nonfactor services, in 2006. The staff will therefore continue to monitor closely Turkey's capacity to repay the Fund, and will call for corrective measures if developments turn out less favorable than projected.

B. Fiscal Policy and Supporting Reforms

17. **Thanks to continuing measures, fiscal policy remains on course to achieve the 2002 public sector primary surplus target of 6.5 percent of GNP** (¶6 and Table 8). The staff welcomed the authorities' continued resolve to stick to the program's fiscal targets, as evidenced by the substantial catch-up in state economic enterprise (SEE) price increases in May–July. Nevertheless, the authorities agreed that unforeseen expenditure pressures and the impact of a lower-than-anticipated price level on tax revenue had worsened the fiscal outlook. Technical delays in transfer payments (which would shift some spending to 2003) would mitigate the impact somewhat, but a gap estimated at ½ percent of GNP remained. To

offset this, the authorities indicated that they would complete the catch-up in SEE prices by raising prices for alcohol, tobacco, sugar, tea, and telecommunications services prior to the Board meeting, with a further telecommunications price increase in October. These price hikes would add ½ percent to the CPI, but raise ¼ percent of GNP in SEE revenue. In addition, during the remainder of the year, the authorities would reduce spending in several budgetary funds (and transfer the savings to the budget), as well as reduce line agency discretionary spending.

18. **The authorities recognized that the prospective early elections would complicate the conduct of fiscal policy, but were determined to maintain the programmed fiscal stance in 2002–03** (¶7):

- **They would make every effort to ensure strict budget implementation in the remainder of this year.** The authorities argued that political support for strict fiscal policies, especially under current tight financing conditions, would help control spending in the run-up to the elections. They agreed, however, that tight monitoring of the fiscal situation was warranted, in the form of new monthly indicative targets and a new end-year performance criterion on the primary surplus of the consolidated government sector.

- **For 2003, the authorities reiterated their commitment to keeping the primary surplus at 6.5 percent of GNP.** They noted, however, that in the event of early elections, passage of the budget would likely be delayed until March 2003. Under such conditions, a provisional budget would cover spending during the first few months of 2003, and would limit it to no real increase over the same period in 2002, thereby safeguarding the programmed fiscal stance. In any case, preparations for a full-year budget would continue as envisaged, drawing on the recently issued High Planning Council decision, which establishes tight primary expenditure ceilings and calls for investment program rationalization. Overall, the authorities' 2003 strategy would be to reduce the tax burden, while implementing expenditure policy reforms, particularly in public sector wages and employment, and in public pension funds. They would also use tax arrears and debts on called guarantees to promote restructuring of state enterprises and control spending in local governments.

19. **The authorities would also move ahead vigorously with fiscal reforms, although legislative elements of the reform agenda would unavoidably be delayed in the event of early elections:**

- **Technical preparations for direct tax reform are on course (¶8).** The authorities reiterated their commitment to submit a direct tax reform package to parliament by end-October, with the main aims of reducing capital income taxation distortions and simplifying and rationalizing investment incentives. However, in the event of early elections, passage of these reforms would not be possible until after the beginning of the new tax year, delaying the full reform package by one year. The authorities stressed that, during preparation of the package, they would identify elements that could be implemented in early 2003 and reflect the cost of these initiatives in their 2003 fiscal framework.

- **The authorities have prepared a blueprint for the reorganization of the tax administration (¶8).** They indicated that activities would be organized by function (such as taxpayer services, collection, and legal unit), and that an internal audit unit would be established. While generally welcoming the new functional structure, the staff suggested that, in line with international best practice, the tax policy unit be kept separate from tax administration—a recommendation the authorities were considering to implement in the medium term. On strengthening audit and compliance control, the staff welcomed the planned issuance, by end-September, of a ministerial decision making the new audit coordination committee operational and spelling out the required contents of its annual audit plan. The tax administration indicated that they had already hired 250 new tax auditors (helping to reduce the estimated shortage of 3,000–4,000), but expressed concern that low salaries were impeding their efforts.

- **Retrenchment in state enterprises is continuing (¶9).** In May, the authorities had identified 45,800 redundant positions in SEEs, with the goal of removing two thirds of these by end-October 2002 and all of them by mid-2003. With 14,000 SEE workers having retired by late July, the authorities were broadly on track to achieve these goals. The authorities indicated that outside the SEE sector another 4,300 workers had accepted voluntary early retirement from consolidated budget agencies in the first half of 2002. To further reduce redundant positions in these agencies, the authorities were preparing legislation extending the retirement program to the civil service.

- **The authorities have drafted a new, significantly strengthened, budget systems law (¶10).** As indicated in the staff report for the second review (Country Report No. 02/229), the draft Public Financial Management and Internal Control Law is a crucial piece of legislation to address remaining fiscal management shortcomings. The authorities stressed that the bill they intended to shortly submit to parliament significantly expands the coverage of the central government budget, and lays the groundwork for consistent accounting and timely reporting across general government. It should thus support better fiscal control and enhance transparency. The bill also significantly reforms and decentralizes financial control. However, the draft bill does not address all of the staff's key recommendations: the authorities indicated that due to political sensitivities, they would not be able to deal with the fragmentation in budget preparation and execution (a separate agency manages the investment budget). Since the bill now covered two structural benchmarks which were slightly overdue (submitting this law to parliament was an end-June benchmark, and amending the legislation on extrabudgetary funds was a July benchmark), the authorities agreed to make its submission to parliament a prior action for this review, with passage a new benchmark for end-March 2003.

- **The authorities have also drafted legislation aimed at improving SEE governance** (¶11). The current draft of the law contains provisions to improve the oversight of state enterprises and their internal governance, and aims to protect enterprises from unfunded quasi-fiscal mandates. Both sides agreed that further efforts could be made to strengthen provisions dealing with reporting and oversight. The authorities agreed to submit the legislation to parliament by end-year, as a new structural benchmark.

- **The authorities continue to improve debt management** (¶12). To encourage participation at government debt auctions and enhance secondary market liquidity, the authorities will reinstate a primary dealer system ahead of schedule by mid-August. They are also taking steps to improve risk management and, in this context, have set up a strategy and risk control (or "middle") office within the Treasury and completed a study of Treasury operations. A communiqué defining the responsibilities of the middle office and of a new debt management committee will be issued by end-September 2002 (a new structural benchmark). Based on the study, the authorities are in the process of developing an action plan that will establish an integrated risk management system. In the meantime, borrowing decisions will be guided by simple benchmarks to monitor financial risk. The middle office is expected to be fully operational by end-2003.

C. Monetary Policy

20. **The staff commended the CBT on its continued prudent conduct of monetary policy** (¶13 and Tables 9–10). Unlike in previous periods of financial market turbulence, the international reserve position remained above target (by US$2 billion at end-June), and the authorities were well on track to meet the 35 percent inflation target. These achievements had greatly enhanced the central bank's credibility.

21. **The CBT intended to be cautious in reducing its overnight rate.** In February–April, with inflation and inflation expectations falling, the CBT had reduced the overnight rate by a total of almost 20 percentage points. Although headline inflation had dropped sharply in May and June (to 0.6 percent, month on month), inflation prospects for the remainder of the year had worsened somewhat, owing to the sharp currency depreciation and catch-up increases in public sector prices which had yet to fully pass through to consumer prices. Accordingly, the staff concurred with the CBT on its intention to postpone further interest rate cuts until financial market conditions settled.

22. **Despite the recent financial market uncertainty, the CBT stressed that monetary policy remained focused on attaining the inflation target.** The CBT was continuing its technical preparations for the move to formal inflation targeting. While it still hoped to move to the new regime before year-end, the precise timing could depend on the resolution of the political situation. To help achieve its end-year inflation target, the CBT reaffirmed its commitment to the program's base money targets for the remainder of the year (which have been converted from indicative targets to performance criteria). Although currency demand

was now strong, this reflected the normal seasonal pattern of strong tourism and agricultural demand, which had already been factored into the program. The CBT also noted that the move to two-weeks reserve-averaging had increased day-to-day volatility in bank reserves, which could complicate the task of hitting the base money targets. However, for confidence reasons both sides preferred to leave the targets unchanged.

23. **The staff commended the CBT for continuing to strictly limit its foreign exchange market discretionary intervention during the recent financial market turmoil (¶14).** Markets had received well the CBT's decision in late June to suspend pre-announced foreign exchange purchase auctions, in light of balance of payments developments and a return to currency substitution. However, given the CBT's long-term objective of strengthening its international reserve position, the CBT reaffirmed its commitment to resume the purchase auctions as soon as conditions improved. The CBT agreed that the floating exchange rate regime had considerably reduced the economy's vulnerability to shocks. The CBT argued, however, that given the illiquidity of the foreign exchange market moderate intervention could sometimes help stabilize expectations, but accepted that this should only take place in exceptional circumstances.

24. **The authorities are taking steps to manage the transition toward deeper money and securities markets, which has become more challenging in the current market environment (¶15).** The authorities' money market initiatives to date have led to positive results. Banks are now making increased use of the May 24 relaxation of the system of averaging reserve requirements to better manage daily liquidity demands. Interbank segmentation has declined markedly, following the extension of the withholding tax on interest payments to Takasbank. Deposit outflows from a few banks affected by the bank audit exercise have subsided, and were handled skillfully by the CBT within existing market arrangements, without the need to use the contingency credit window established in June. Following the removal of stamp duties on foreign exchange transactions in June, on July 30 the authorities issued a decree removing the transaction tax on foreign exchange, meeting a prior action for this review. Also, at the beginning of August, the Turkish Bankers' Association will launch the Turkish Lira Interbank Offer Rate (TRLIBOR), which will help define the yield curve by providing a reference rate for transactions of a specified size.

25. **The CBT, BRSA, and Treasury will continue to coordinate their activities in the money and government debt markets (¶15).** The authorities agreed that, as the CBT was gradually withdrawing from acting as a blind broker for banks by end-year, it was important for the CBT and the BRSA to cooperate in ensuring that only sound financial intermediaries were allowed to participate in money and foreign exchange markets. Coordination would also be important, and would extend to include the Treasury, in the context of the above-mentioned introduction of a system of primary dealers for government securities. The coordination arrangements would include monitoring the financial capacity of primary dealers, supervising designated securities dealings, and improving coordination between monetary and debt operations. The staff agreed that, together with the planned reduction of securities transaction fees on the Istanbul Stock Exchange, the primary dealer system should

improve secondary market activity, thereby increasing the effectiveness of monetary operations.

D. Financial Sector Reforms[6]

26. **The staff commended the authorities on their conduct of the bank recapitalization exercise, which is now nearing completion (¶16).** The authorities noted that bank shareholders had already raised the equivalent of US$700 million before the evaluation process was completed, meeting most of the estimated capital need (excluding the intervened Pamukbank) of about US$900 million. The remainder would come from the public capital support scheme. All new capital would be reflected in the banks' accounts by end-August 2002. No bank would need public Tier-1 capital support, and the BRSA confirmed that it would appoint a board member to any bank requesting Tier-2 capital support.

27. **The authorities have put the intervened Pamukbank up for sale, and are developing a strategy to resolve the ownership issues of its sister bank, Yapi Kredi Bank (¶16).** To prepare Pamukbank for sale, the SDIF changed its board and removed senior executives, restored its paid-in capital, and transferred nonperforming related-party loans to the SDIF. Following the intervention, the previous owners of Pamukbank are no longer deemed "fit and proper" to hold more than 10 percent of any bank, and so must divest their 45 percent stake in Yapi Kredi Bank. As a result, the BRSA has transferred the voting (but not dividend) rights of the Pamukbank owners' shares in Yapi Kredi Bank to the SDIF. In addition, Pamukbank holds another 10 percent of Yapi Kredi Bank shares directly. The staff welcomed the authorities' decision to quickly develop a strategy to resolve the ownership issues surrounding Yapi Kredi Bank.

28. **The staff agreed with the authorities that the recapitalization exercise had greatly strengthened Turkey's banking system.** The staff's stress test analysis indicated that the Turkish private banking system can now better withstand combined large (but

[6] Box 2 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 2. Structural Conditionality

Coverage of structural conditionality under the three-year Stand-By Arrangement

The program aims at reinvigorating structural reforms, while incorporating those policy actions that were already agreed under the previous program (as set out in Annex B of the Letter of Intent for the Tenth Review under the Stand-By Arrangement, November 20, 2001). The main areas covered by the program's structural conditionality continue to 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 tax policy and expenditure management, and steps to facilitate corporate restructuring and to enhance the role of the private sector in the economy. Since Turkey's problems largely reflect 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. **In addition, structural conditionality has been introduced in the context of the IMF safeguards assessment** to improve further the transparency and effectiveness of the CBT's control, accounting, reporting, and auditing systems.

Status of structural conditionality from earlier programs

Previous programs featured key structural conditions, many of which were prior actions for program reviews (see Table 2 of the Letter of Intent for the Sixth and Seventh Review under the Stand-By Arrangement, May 3, 2001). Comprehensive structural reforms focused on banking sector restructuring, fiscal transparency, private sector development, and governance. While privatization proceeded rather slowly, in part owing to weak market conditions, major progress was made in other areas. All key structural conditionality from previous programs has been met, except for the adoption of a privatization plan for Türk Telekom. This was set in the eighth review of the previous SBA as a structural benchmark for end-December, but has yet to be completed.

Structural areas covered by World Bank Lending and conditionality

The key element of the World Bank's program lending in 2001 was the Public Sector and Financial Sector Adjustment Loan (PFPSAL) 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 three-tranche operation (PFPSAL II) was approved in April 2002. 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 proposed program

An area that is not covered by program conditionality is trade regime and policy, given that Turkey's trade regime is only moderately restrictive. On privatization, the program does not include upfront conditionality on actual sales of specific enterprises. Instead, Fund and World Bank conditionality is aimed at preparing the ground for rapid privatization once market conditions improve. However, to help monitor overall progress in privatization, indicative targets have been introduced for privatization proceeds.

plausible) exchange rate, interest rate, and credit shocks.[7] Devaluation risk is much less of a concern since, in contrast to last spring, banks now have long foreign exchange positions. The impact of interest rate increases is also less, as short deposit maturities are now better matched by holdings of interest-sensitive government securities. Even so, a combined devaluation and interest rate shock would increase nonperforming loans, which could put banks with capital close to minimum requirements at risk.

29. **With the recapitalization exercise almost complete, the authorities are developing a strategy to dispose of assets arising from this and previous interventions** (¶17–18). The authorities noted that more than 80 percent of assets held by the SDIF's Collections Department (COD) are claims on former bank owners or large corporate customers. The stock of assets will increase further following the resolution of the SDIF's four remaining intervened banks. For Türk Ticaret, the authorities intend to commence liquidation proceedings shortly, barring legal obstacles. For Tarisbank, if no qualified investors are found by end-August, its license will be withdrawn and nonperforming loans transferred to the COD. In the case of Toprak bank, the staff agreed with the authorities' proposal to try to sell the bank one last time, but urged them not to delay in merging or liquidating the bank if bids are not acceptable. Bayindirbank's role as a bridge bank would be scaled back gradually. On institutional arrangements for resolving bad loans of the SDIF, the staff agreed with the authorities that establishing an Asset Management Company (outside the COD) could be ineffective, given that the COD's special powers against former bank owners would be lost. However, the staff supported the SDIF's intention to participate in a joint-venture AMC, up to the 20 percent stake allowed by law, if there was sufficient interest from private banks. The staff encouraged the authorities to accelerate loan sales.

30. **The authorities' reforms to improve transparency and prudential oversight are also on track** (¶22–23). The staff welcomed the BRSA's issuance of final regulations requiring full adoption of International Accounting Standards in banks' balance sheets by end-2002 (an end-June structural performance criterion). The authorities agreed that increased consolidated supervision and improvements in the monitoring of banks' operational risks could improve the regulatory environment. They also agreed that this would require internal reorganization of the BRSA, as well as some transfer of supervisory responsibilities from the Treasury.

31. **Sustained restructuring efforts have strengthened the operations of state-owned Ziraat and Halk banks** (¶21 and Table 11). Through July, about 800 branches have been

[7] The test simulates the banking system's resilience to a 30 percent devaluation of the Turkish lira, an interest rate increase to levels in the February–April 2001 crisis, and the reclassification of 10 percent of performing loans as nonperforming. Estimates use figures from banks making up 85 percent of the banking system. Data are from December 2001, adjusted to include the audit results, except for banks' net foreign open positions, which are updated to June 21, 2002.

closed, and staffing levels have been halved to almost 30,000. The authorities accepted that further branch and employment reductions might be needed, but stressed that these would reflect commercial principles. With the financial position and management of state banks now greatly improved, the staff agreed with the authorities' proposal to allow these banks to gradually re-enter the overnight money market, subject to prudent limits. The authorities would work with the World Bank and external advisers to privatize the two banks, with Halk bank's privatization slated for early next year. The authorities also pledged to work with the World Bank to resuscitate the sale of Vakif bank, and undertook to sell off Vakif bank's subsidiary operations in tourism, real estate, and energy to make it more attractive to investors.

32. **The Istanbul Approach to corporate debt restructuring is now operational (¶19).** Some 45 bank and nonbank financial institutions have already signed the Istanbul Approach framework agreement. The Turkish Industrial Development Bank has been appointed as the coordinating agency and the arbitration committee has been staffed. The Turkish Bankers' Association expects that the completion of these institutional components will facilitate new restructurings, following the first workout agreed in late June. The World Bank continues to act as lead agency for corporate restructuring, and a Bank staff mission will return to Turkey early August to resume discussions on a loan to support operation of the Istanbul Approach.

33. **The authorities' planned reform of the legal framework for bankruptcy will further support the out-of-court framework for corporate debt restructuring (¶20).** The Ministry of Justice has submitted draft legislation to the Council of Ministers to create intermediate courts of appeals in bankruptcy cases, and to speed up creditor enforcement actions. These proposals are part of the comprehensive reforms recommended in the World Bank's recent Report on the Observance on Standards and Codes (ROSC) on Insolvency and Creditor Rights Systems. The authorities have endorsed the ROSC recommendations and, with the assistance of Bank staff, the Ministry of Justice is working to include them in the reform proposals that it will formulate by end-September 2002 (structural benchmark).

E. Enhancing the Role of the Private Sector

34. **Privatization of companies already prepared for sale is being accelerated, and a renewed effort is being made to restructure and prepare those still in the pipeline (¶24–25).** The authorities stressed once again that unfavorable market conditions have contributed to delays in privatization, but agreed with the staff that progress in this area would send a strong signal to investors about the government's commitment to enhance the role of the private sector and to move ahead with fundamental reforms more generally. The authorities noted that the sale of the remaining state shares in POAŞ, the petroleum distribution company, to its existing majority shareholder was expected to be finalized in August. Looking further ahead, the authorities indicated that sales of public shares in petroleum and steel sectors in companies ready for sale would generate sufficient interest to meet the US$700 million indicative target on cumulative cash privatization proceeds for 2002. The authorities also indicated that progress is underway in bringing other key state-owned companies—such as Türk Telekom, TEKEL (the tobacco and alcohol monopoly) and

ŞEKER (sugar company)—to the point of sale, as planned. The authorities agreed with the staff on the need to handle all sales in a transparent manner.

35. **Implementation of plans to improve the business environment and enhance public sector transparency is underway (¶26).** Amid recent political developments, the authorities decided to postpone the inaugural meeting of the Investor Advisory Council scheduled for July 18, 2002. They did, however, confirm their determination to take further steps to improve the business climate. In this context, the staff welcomed the authorities' commitment to submit to parliament, early next year, two draft laws to streamline the company registration process and to combat smuggling. The staff also stressed the importance of maintaining momentum in the work of the Coordination Council for Improving the Investment Climate and of its nine technical committees, noting the private sector's willingness to become fully engaged in the process.

IV. STAFF APPRAISAL

36. **The Turkish authorities' perseverance with their economic program started to yield major gains in the first part of the year.** Through April, interest rates on domestic and foreign borrowing dropped rapidly, easing the government's debt situation. Continuing through midyear, Turkey has experienced a solid recovery in economic activity, a sharp drop in inflation, and a strong balance of payments performance helped by solid export growth and favorable access to international capital markets. These achievements were made possible by the authorities' strong program implementation. Following the successful completion of the first two program reviews earlier this year, the authorities have kept macroeconomic policies in line with the program, and continued to make substantial progress in structural reform.

37. **Recent political developments have increased the program's vulnerability.** Starting in early May, heightened political uncertainty, prompted by the Prime Minister's illness and differences within the coalition over EU-related reforms, led to a marked worsening of domestic financial market indicators. Although markets settled somewhat in July, on hopes that early elections would resolve the political uncertainty, continued high interest rates have again called into question the sustainability of the government's debt position. Moreover, market concerns over election results could prove a new source of risk to the program. Early elections will also inevitably set back those structural reforms which require legislative action.

38. **So far, developments point to a pause in the momentum of strengthening economic fundamentals, rather than to any change in the underlying dynamics.** Political parties and the private sector generally acknowledge that the reform program has no alternative and needs to be supported. They also increasingly recognize that the program has succeeded in generating growth with disinflation, and is gradually replacing an economy prone to financial crisis with one that is more resilient and less prone to outside shocks. In such a setting, there is scope for the program's fundamentals to reassert themselves and for interest rates to decline rapidly once the political uncertainty is resolved.

39. **To ensure the success of the program, it is all the more essential that the authorities continue to implement program policies, to the fullest extent allowed by the electoral process.** Sticking to the program offers the best chance of allowing the early record of strong economic performance to continue. While certain legislative measures will inevitably be delayed in the event of early elections, the authorities' commitment to strictly adhere to those program policies not requiring parliamentary approval is important. To minimize uncertainty and calm market concerns, it will also be important for major political parties and private sector institutions to reaffirm their support for the program, so as to clarify expectations over the direction of economic policy after the elections.

40. **Specifically, the authorities need to remain vigilant in the program's most critical areas:**

Continued fiscal restraint is central to program efforts to strengthen long-term debt sustainability and credibility of economic policy. The exceptionally large fiscal adjustment in recent years has been one of the program's main achievements. It has been instrumental in keeping the government debt position manageable under difficult circumstances. In the remainder of this year and over the medium term, the authorities' continued adherence to the fiscal targets will be critical for the program's success.

To ensure that the fiscal adjustment is durable, fiscal restraint needs to be underpinned by budget reform. Direct tax reform will provide the opportunity to eliminate key tax distortions, and it will be important to implement as much as possible in this area in 2003. Budget restraint should focus on cutting unproductive spending, restructuring state enterprises, and strengthening tax administration. Success here will allow the overall fiscal targets to be achieved while lowering tax rates and restraining public sector price increases. These reforms need to be backed by institutional reforms, including continuation of the reforms in public financial management and tax administration, as well as steps to address remaining deficiencies, particularly the fragmentation of responsibilities for budget management and tax collection.

Monetary policy should continue to be implemented in an independent manner and remain focused on achieving the inflation target. The CBT's continued prudent conduct of monetary policy and its successful handling of the float are commendable. The recent suspension of foreign exchange purchase auctions was appropriate but, given the need to accumulate international reserves, should be reversed as soon as conditions allow.

Although the private bank recapitalization exercise is nearing completion, and operational restructuring of state banks is well advanced, the authorities must continue with financial sector reform. The SDIF needs to quickly resolve those intervened banks that remain under its control, including the recently intervened Pamukbank. With the SDIF's Collection Department now fully staffed, it needs to develop a sales strategy to quickly dispose of the assets under its control. The authorities also need to continue with the restructuring and preparation for the sale of the state banks. Finally, the authorities need to work closely with the World Bank to ensure the success of the Istanbul Approach to corporate debt restructuring. Planned reforms to the legal framework covering bankruptcy procedures should help in this regard.

Privatization and reforms to improve the business environment need to be reinvigorated. Privatization has been a weak area in the government's program. The authorities should make every effort to expedite the preparations for sale of key assets and to ensure transparency in the sales process. Although the delay to the inaugural Investor Council meeting is understandable, the authorities should make use of the extra time to finalize reforms that will mark a decisive improvement in the business environment to ensure that, when reconvened, the Investor Council is a success.

41. **In light of continued strong program implementation, the positive economic results achieved so far, and the broad-based support in Turkey to stay the course with the program strategy, the staff recommends the completion of the third review.** The program has been implemented well, and has shown that, with a supportive political and external environment, it can deliver strong economic performance, and establish the long-term credibility of economic policies that has so far eluded Turkey. Continued strong implementation and a resolution of current political uncertainty offer an opportunity for Turkey to break with the economic underperformance of the past. The coalition partners are committed to continue economic policies in line with the program, and the program strategy enjoys broad support among the political parties more generally, and in the private sector. On this basis, the staff supports the authorities' request for the completion of the third review and for the waiver of nonobservance for the performance criterion on state bank branch closures. The staff also supports the conversion of certain indicative quantitative targets to performance criteria for the second half of the year, and the setting of new indicative targets, and a new end-year performance criterion, on the consolidated government sector primary balance.

Table 1. Turkey: Schedule of Purchases Under the SBA, 2002–04

Date	Purchases: In millions of SDRs	In percent of quota	In billions 1/ of U.S. dollars	Conditions (As indicated in Letter of Intent)
Actual purchases	9,061.6	940.0	11.6	
2002 (January–June)	9,061.6	940.0	11.6	
February 4, 2002	7,326.4	760.0	9.3	Board approval of SBA
April 14, 2002	867.6	90.0	1.1	First review; end-January and end-February 2002 performance criteria
June 28, 2002	867.6	90.0	1.1	Second review; end-March and end-April 2002 performance criteria
Scheduled purchases	3,759.6	390.0	4.8	
2002 (July–December)	2,140.1	222.0	2.7	
August 9, 2002	867.6	90.0	1.1	Third review; end-May and end-June 2002 performance criteria
October 25, 2002	1,272.5	132.0	1.6	Fourth review; end-August and end-September 2002 performance criteria
2003	809.8	84.0	1.0	
January 24, 2003	202.4	21.0	0.3	Fifth review; end-November and end-December 2002 performance criteria
April 25, 2003	202.4	21.0	0.3	Sixth review; end-February and end-March 2003 performance criteria
July 25, 2003	202.4	21.0	0.3	Seventh review; end-May and end-June 2003 performance criteria
October 24, 2003	202.4	21.0	0.3	Eighth review; end-August and end-September 2003 performance criteria
2004	809.8	84.0	1.0	
January 23, 2004	202.4	21.0	0.3	Ninth review; end-November and end-December 2003 performance criteria
April 23, 2004	202.4	21.0	0.3	Tenth review; end-February and end-March 2004 performance criteria
July 23, 2004	202.4	21.0	0.3	Eleventh review; end-May and end-June 2004 performance criteria
October 25, 2004	202.4	21.0	0.3	Twelfth review; end-August and end-September 2004 performance criteria
Total purchases	12,821.2	1,330.0	16.3	
Memorandum items:				
2002	11,201.7	1,162.0	14.3	
2003	809.8	84.0	1.0	
2004	809.8	84.0	1.0	
Quota (in millions)	964.0	100.0	1,229.1	
US$/SDR			1.275	

1/ For illustrative purposes only, SDR amounts have been converted into U.S. dollars at an SDR/U.S. dollar exchange rate of 1.275.

Table 2. Turkey: Selected Economic Indicators, 1999-2004

	1999	2000	2001	2002	2003	2004
			(In percent)			
Real sector						
Real GNP growth rate	-6.1	6.3	-9.4	3.0	5.0	5.0
GNP deflator	55.8	50.9	57.8	48.6	26.2	13.4
Nominal GNP growth rate	46.3	60.4	42.9	53.1	32.5	19.0
WPI (12-month, end-of-period)	62.9	32.7	88.6	31.0	16.2	12.0
CPI (12-month, end-of period)	68.8	39.0	68.5	35.0	20.0	12.0
Average nominal treasury bill interest rate	106.2	38.0	99.1	69.2	47.1	32.4
Average ex-ante real interest rate 1/	32.0	-9.5	33.7	31.4	28.5	20.5
			(In percent of GNP)			
Central government budget						
Primary balance 2/	1.5	4.6	4.6	5.1	5.6	5.6
Net interest payments 3/	13.1	15.8	24.3	18.2	17.1	...
Overall balance	-11.6	-11.2	-19.7	-13.1	-11.4	...
Consolidated public sector						
Primary balance	-2.0	2.3	5.9	6.5	6.5	6.5
Net interest payments 4/	22.1	21.9	27.1	17.9	16.3	15.0
PSBR (including CBT profits)	24.1	19.6	21.2	11.4	9.8	8.5
Operational balance	-12.4	-6.9	-5.1	-2.7	-4.4	-4.6
Net debt of public sector	61.0	57.7	92.8	82.1	75.2	74.1
Net external	20.1	18.5	37.1	34.0	29.2	26.2
Net domestic	40.9	39.2	55.7	48.0	46.1	47.9
Net debt of public sector (in percent of centered GNP) 5/	48.6	51.5	73.1	70.7	68.6	...
External sector						
Current account balance	-0.7	-4.9	2.3	-0.8	-1.0	-1.0
Gross external debt	55.0	59.5	78.6	69.1	68.6	66.1
Net external debt	33.6	39.2	53.7	46.8	45.5	42.3
Short-term external debt (by remaining maturity)	20.5	22.7	21.7	18.3	18.2	18.5
Monetary aggregates						
Seignorage 6/	3.2	1.8	1.1	1.1	0.7	...
Nominal growth of M2Y broad money (in percent)	100.7	40.2	87.5	28.8	27.6	17.2
			(In billions of U.S. dollars, unless otherwise indicated)			
Privatization proceeds	0.1	3.3	2.8	0.7	2.5	...
Net external financing of central government	1.4	4.1	-2.0	-1.1	0.1	...
Amortization	6.0	6.2	7.8	6.7	8.3	...
Gross borrowing	7.4	10.3	5.8	5.6	8.3	...
Of which : Eurobond issues	5.0	7.5	2.2	3.0	4.5	...
GNP	187.4	201.3	146.5	...	...	...
GNP (in quadrillions of Turkish lira)	78.3	125.6	179.5	274.8	364.1	433.4

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

1/ Average of monthly nominal interest rate divided by 12-month ahead CPI inflation. With average maturity of newly issued debt less than one year, and with FRNs paying quarterly coupons, this measure overstates the effective real interest rate when inflation is declining.

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.

4/ Interest payments minus interest receipts plus CBT profits before transfers to the government.

5/ Defined as the sum of quarterly GNP in the last two quarters of the year and in the first two quarters of the following year.

6/ Change in reserve money in percent of GNP, where reserve money is defined as currency issued plus reserve requirements.

Table 3. Turkey: Prior Actions, Structural Performance Criteria and Structural Benchmarks for the Third Review

Action	Type	LOI Paragraph 1/	Status as of July 30, 2002
Banking reform			
By end-June 2002, reduce the number of state bank branches by 800. In this context also reduce staffing correspondingly.	PC	28	By end-June 2002, some 788 branches had been closed and staff reduced by 26,000. Significant further progress made in July.
By end-June 2002, the BRSA to evaluate the trial implementation of new accounting standards and issue a revised regulation to ensure that banks' end-2002 balance sheets comply with IAS.	PC	35	Met. Regulation issued on June 22.
Public sector reform			
Submit to parliament by end-June 2002 a Law on Financial Management and Internal Control consistent with best international practices.	BM	42	In final stages. Submission to parliament is **new prior action for this review.**
Amend by July 2002 the governing legislation for the remaining EBFs to require passage of their budgets by parliament, external audit of their accounts (reported to parliament), and monthly reporting of their accounts, on a consolidated basis, with the central government's accounts.	BM	42	Included with the Law on Financial Management and Internal Control.
Money market development			
Issue decree to remove foreign exchange transactions tax.	New prior action	15 of July LOI	Met. Decree issued on July 30.
Safeguards Assessment			
By May 15, 2002 the CBT to ask the existing audit firm to prepare such a report, to be issued by July 15, 2002.	PC (issuance of report)	April LOI	Completed. Issued July 5.

1/ Unless otherwise stated, paragraph numbers refer to the January 18 LOI.

Table 4. Turkey: Indicators of External Vulnerability, 1999–2004 1/
(In percent, unless otherwise noted)

	1999	2000	2001	Projections 2002	2003	2004
CPI inflation (end year)	68.8	39.0	68.5	35.0	20.0	12.0
Public sector borrowing requirement (percent of GNP)	24.1	19.6	21.2	11.4	9.8	8.5
Net debt of the public sector (percent of GNP)	61.0	57.7	92.8	82.1	75.2	74.1
Export volume (percent change)	0.7	9.5	15.2	6.0	6.5	6.4
Import volume (percent change)	-13.3	31.4	-23.2	10.9	8.9	7.7
Current account balance, in percent of GNP	-0.7	-4.9	2.3	-0.8	-1.0	-1.0
Capital account balance (in billions of US$)	6.6	6.8	-16.3	-2.3	4.2	6.9
Of which:						
Foreign direct investment	0.1	0.1	2.8	0.7	1.3	1.6
Foreign portfolio investment	0.2	-5.2	-4.6	-1.4	-0.5	0.7
Gross official reserves, in billions of US$ 2/	24.3	23.2	19.8	24.0	26.9	31.1
In months of imports of goods and NFS	5.3	4.0	4.4	4.9	4.9	5.2
In percent of broad money	32.2	27.4	26.7	32.3	32.7	35.1
Gross total external debt, in billions US$	103.0	119.7	115.1	120.8	125.0	129.1
In percent of GNP	55.0	59.5	78.6	69.1	68.6	66.1
In percent of exports of goods and NFS	225.2	234.0	228.1	234.9	218.4	209.6
Gross short-term external debt, in billions US$ 3/	38.5	45.7	31.8	32.0	33.2	36.1
In percent of gross total external debt	37.4	38.2	27.6	26.5	26.6	28.0
In percent of gross official reserves	158.5	196.9	160.6	133.4	123.3	116.2
Debt service 4/	34.1	37.0	43.2	39.9	40.2	36.1
REER appreciation (CPI based, period average)	4.1	9.9	-18.3	...	...	...
REER appreciation (CPI based, end of period) 5/	5.6	13.7	-21.3	9.6	...	...
Capital adequacy ratio 6/	...	17.3	16.8	...	...	...
State and SDIF banks	...	7.9	27.6	...	...	...
Private banks	...	18.3	10.9	...	...	...
Foreign banks	...	29.4	29.5	...	...	...
Nonperforming loans (in percent of total) 6/	...	9.2	12.9	...	...	...
Real broad money, percentage change 7/	18.9	0.8	11.2	-4.6	6.4	4.7
Real credit to the private sector, percentage change 7/	-10.7	24.5	-27.5	-18.7	6.4	4.7
Banks' net foreign asset position, in billions of US$	-2.9	-5.8	2.4	...	...	...
Banks' net open exchange position, in billions of US$	-2.6	-5.4	...	...	...	...
Spread on Turkish dollar Eurobonds (in basis points) 8/	550	443	718	949	...	...

Sources: Data provided by the Turkish authorities; and Fund staff estimates and projections.
1/ For 2002-05, program projections.
2/ As of end-June 2002, reserves stood at US$23.3 billion (at current cross exchange rates).
3/ By residual maturity.
4/ Interest plus medium- and long-term debt repayments as percent of current account receipts (excluding official transfers).
5/ For 2002, as of June 2002.
6/ As of September 2001; November 2001 for nonperforming loans.
7/ Deflated by the CPI.
8/ For 2002, as of July 19 2002.

Table 5. 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	3.4	-1.4	-1.8	-2.0	-2.1
Trade balance	-14.2	-10.4	-22.4	-4.5	-6.6	-8.1	-9.1	-10.3
Exports (f.o.b.)	31.2	29.3	31.7	35.3	37.4	41.1	44.5	48.3
Of which:								
Exports (f.o.b.) in trade returns	27.0	26.6	27.8	31.3	33.3	36.5	39.5	42.9
Shuttle trade	3.7	2.3	2.9	3.0	3.2	3.5	3.8	4.2
Imports (f.o.b.)	-45.4	-39.8	-54.1	-39.7	-44.1	-49.2	-53.6	-58.6
Of which:								
Imports (c.i.f.)	-45.9	-40.7	-54.5	-40.4	-44.6	-49.7	-54.1	-58.9
Energy imports (c.i.f.)	-4.5	-5.3	-9.5	-8.3	-8.2	-8.3	-8.3	-8.8
Services (net)	10.5	3.9	7.4	4.1	1.6	2.1	2.5	3.2
Services (credit)	25.8	18.7	22.3	17.9	15.9	18.6	20.2	21.6
Of which:								
Interest	2.5	2.4	2.8	2.8	1.9	2.4	3.1	3.5
Tourism receipts	7.2	5.2	7.6	8.1	7.5	8.1	8.5	9.0
Other receipts 1/	10.5	7.1	7.9	3.6	2.7	4.0	4.3	4.7
Services (debit)	-15.3	-14.8	-15.0	-13.9	-14.3	-16.4	-17.8	-18.4
Of which:								
Interest	-4.8	-5.5	-6.3	-7.1	-7.0	-8.2	-8.7	-8.6
Private transfers (net)	5.6	4.8	5.0	3.6	3.2	3.8	4.3	4.6
Of which:								
Workers remittances	5.4	4.5	4.6	2.8	2.6	3.3	3.7	4.0
Official transfers (net)	0.2	0.4	0.2	0.2	0.4	0.3	0.3	0.3
Capital account balance	0.4	4.7	9.4	-14.2	-1.3	4.2	6.9	8.2
(including errors and omissions)	-1.5	6.6	6.8	-16.3	-2.3	4.2	6.9	8.2
Direct investment 2/	0.6	0.1	0.1	2.8	0.7	1.3	1.6	1.9
Portfolio investment in securities 2/	-6.1	0.2	-5.2	-4.6	-1.4	-0.5	0.7	0.8
Public sector (central & local governments & EBFs)	-1.9	1.2	6.2	-1.9	0.1	0.3	0.5	1.0
Bonds (net)	-0.3	3.1	6.1	0.1	0.9	0.5	1.7	1.9
Eurobond drawings	2.7	5.0	7.5	2.1	3.0	4.5	4.7	5.0
Eurobond repayments	-3.0	-1.9	-1.4	-2.0	-2.1	-4.0	-3.1	-3.1
Loans (net)	-1.7	-1.9	0.1	-2.0	-0.8	-0.2	-1.1	-0.9
Loan disbursements	1.2	1.0	3.7	2.6	2.4	3.2	2.2	2.3
Loan repayments	-2.8	-2.9	-3.6	-4.6	-3.3	-3.4	-3.4	-3.2
Central Bank of Turkey, Dresdner (net)	0.7	-0.2	0.7	0.8	0.7	0.6	0.7	0.8
Domestic money banks (net)	1.9	0.5	2.1	-9.4	-1.8	1.0	1.6	1.4
Domestic money banks (FX deposits abroad, -: accumulation	-0.8	-1.8	-1.9	0.9	2.0	0.0	0.0	-0.1
Domestic money banks (other, net)	2.7	2.4	4.0	-10.3	-3.8	1.0	1.6	1.5
Domestic money banks (medium and long-term, net)	0.5	0.2	-0.2	-1.0	-1.1	0.4	0.8	0.5
Domestic money banks (short-term, net)	2.2	2.2	4.2	-9.3	-2.7	0.6	0.8	1.0
Interbank credit lines from foreign commercial banks	0.1	2.1	4.7	-7.1	-1.0	0.5	0.6	0.7
Other private sector (net)	5.3	2.8	5.6	-1.8	0.5	1.6	1.7	2.3
Other private sector (medium and long-term, net)	4.2	2.3	4.9	0.3	0.0	0.0	0.4	0.9
Other private sector (short-term, net)	1.1	0.5	0.6	-2.1	0.5	1.6	1.3	1.4
Errors and omissions	-2.0	1.9	-2.7	-2.1	-1.0	0.0	0.0	0.0
Overall balance	0.4	5.2	-3.1	-12.9	-3.8	2.4	4.9	6.1
Overall financing	-0.4	-5.2	3.1	12.9	3.8	-2.4	-4.9	-6.1
Change in net international reserves (+ denotes decline)	-0.4	-5.2	3.1	12.9	3.8	-2.4	-4.9	-6.1
Change in gross official reserves (+ denotes decline)	-0.2	-5.9	-0.2	2.7	-4.2	-3.0	-4.1	1.8
Change in reserve liabilities (IMF)	-0.2	0.7	3.3	10.2	7.9	0.6	-0.8	-7.9
Purchases	0.0	0.8	3.4	11.4	14.0	1.0	1.0	0.0
Repurchases	-0.2	-0.1	-0.1	-1.1	-6.1	-0.5	-1.8	-7.9

Table 5 (concluded). Turkey: Balance of Payments, 1998–2005
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003	2004	2005
Memorandum items:								
Trade in goods and services								
As percent of GNP								
Current account balance, including shuttle trade	1.0	-0.7	-4.9	2.3	-0.8	-1.0	-1.0	-1.0
Trade account balance, including shuttle trade	-6.9	-5.6	-11.1	-3.1	-3.8	-4.5	-4.7	-4.9
Exports of goods and nonfactor services	26.5	24.4	25.4	34.4	29.4	31.4	31.5	31.5
Imports of goods and nonfactor services	27.2	26.2	31.2	31.7	29.4	31.5	32.0	32.4
Percent change								
Value growth in exports of goods (incl. shuttle trade)	-4.4	-6.1	8.0	11.4	6.2	9.7	8.3	8.5
Value growth in exports of goods (excl. shuttle trade)	2.7	-1.7	6.1	12.2	6.2	9.7	8.3	8.5
Value growth in imports of goods	-5.3	-12.5	36.0	-26.5	10.9	11.6	8.9	9.3
Volume growth in exports of goods	5.8	0.7	9.5	15.2	6.0	6.5	6.4	6.7
Volume growth in imports of goods	0.6	-13.3	31.4	-23.2	10.9	8.9	7.7	7.1
Terms of trade	3.3	-4.2	-6.4	1.4	0.7	0.6	0.6	0.2
Reserve and debt indicators								
Gross foreign reserves (Central Bank of Turkey)								
In billions of U.S. dollars	20.9	24.3	23.2	19.8	24.0	26.9	31.1	29.3
Months of goods & NFS imports	4.1	5.3	4.0	4.4	4.9	4.9	5.2	4.6
External debt (end-of-period)								
In billions of U.S. dollars	96.4	103.0	119.7	115.1	120.8	125.0	129.1	127.0
In percent of GNP	46.8	55.0	59.5	78.6	69.1	68.6	66.1	60.2
In percent of exports of goods & NFS	176.7	225.2	234.0	228.1	234.9	218.4	209.6	191.1
Net external debt (end-of-period) 3/								
In billions of U.S. dollars	62.2	63.0	78.9	78.6	81.8	82.8	82.6	82.0
In percent of GNP	30.2	33.6	39.2	53.7	46.8	45.5	42.3	38.8
Short-term debt (end-of-period)								
In billions of U.S. dollars	20.8	22.9	28.3	16.2	14.7	17.1	19.4	22.1
Ratio to foreign reserves	99.5	94.4	122.0	82.1	61.2	63.4	62.5	75.5
Short-term debt plus MLT repayments								
In billions of U.S. dollars	33.4	38.5	45.7	31.8	32.0	33.2	36.1	38.9
Ratio to foreign reserves	159.8	158.5	196.9	160.6	133.4	123.3	116.2	132.9
Debt service ratio 4/	26.0	34.1	37.0	43.2	39.9	40.2	36.1	33.9

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 6. Turkey: Indicators of Fund Credit, 2000–06

	2000	2001	2002	2003	2004	2005	2006
Outstanding Fund credit (end of period)							
In billions of SDRs	3.2	11.2	17.5	17.9	17.3	11.2	3.7
In percent of quota	333	1165	1810	1856	1795	1165	383
In percent of exports of G&NFS	8	28	43	40	36	22	7
In percent of public sector external debt	7	20	28	29	28	19	7
In percent of overall external debt	3	12	18	19	17	12	4
In percent of foreign reserves	18	72	93	86	72	50	18
Debt service due to the Fund							
In billions of SDRs	0.1	1.2	5.9	1.3	1.9	6.2	7.6
In percent of quota	13	130	613	133	195	643	784
In percent of exports of G&NFS	0	3	15	3	4	12	14
In percent of public sector external debt service	0	4	28	7	9	30	34
In percent of overall external debt service	1	6	33	7	9	28	33
In percent of foreign reserves	1	8	32	6	8	28	37

Table 7. Turkey: External Financing Requirements and Sources, 1998-2006
(In billions of U.S. dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross financing requirements	27.3	35.1	48.5	42.5	33.6	34.1	35.5	38.6	41.3
Current account deficit (excluding official transfers)	-1.8	1.7	10.1	-3.2	1.8	2.1	2.3	2.4	2.4
Amortization on debt securities	3.3	2.0	1.7	2.1	2.5	4.2	3.1	3.6	3.4
Of which:									
Public sector	3.0	1.9	1.4	2.0	2.1	4.0	3.1	3.1	3.2
Deposit money banks	0.3	0.1	0.4	0.0	0.4	0.1	0.0	0.4	0.1
Medium- and long-term debt amortization	8.2	10.6	13.8	15.3	13.0	13.1	13.1	13.1	13.4
Of which:									
Public sector 1/	2.8	2.9	3.6	4.6	3.3	3.4	3.4	3.2	3.0
Private sector	3.0	5.2	7.9	8.9	8.1	8.8	8.8	8.8	9.0
Deposit money banks	2.3	2.4	2.3	1.9	1.7	1.0	1.0	1.2	1.4
Short-term debt amortization	17.6	20.8	22.9	28.3	16.2	14.7	17.1	19.4	22.1
Public sector 1/	0.9	0.9	0.7	1.7	0.6	0.9	0.9	1.0	1.0
Private sector	8.2	8.7	9.1	9.7	7.7	8.1	9.7	11.0	12.4
Deposit money banks	8.5	11.2	13.2	16.9	8.0	5.7	6.5	7.5	8.7
Available financing	27.3	35.1	48.5	42.5	33.6	34.1	35.5	38.6	41.3
Foreign direct investment (net)	0.6	0.1	0.1	2.8	0.7	1.3	1.6	1.9	2.4
Portfolio flows	-3.4	5.4	2.8	-2.5	1.6	4.2	5.6	6.1	6.2
Public sector	2.7	5.0	7.5	2.1	3.0	4.5	4.7	5.0	5.0
Deposit money banks	0.0	0.2	0.5	0.0	0.0	0.2	0.2	0.3	0.3
Private sector (net)	-6.1	0.2	-5.2	-4.6	-1.4	-0.5	0.7	0.8	0.9
Medium- and long-term debt financing	12.2	10.9	19.1	13.2	11.9	13.8	13.7	14.5	15.3
Of which:									
Public sector 1/	1.8	0.9	4.4	3.2	2.8	3.8	2.9	3.0	3.1
Private sector	7.2	7.5	12.8	9.2	8.1	8.8	9.2	9.6	10.1
Deposit money banks	3.1	2.6	1.9	0.9	1.0	1.3	1.6	1.8	2.0
Short-term debt financing	21.2	23.8	27.8	17.7	14.7	17.1	19.4	22.1	24.6
Official transfers	0.2	0.4	0.2	0.2	0.4	0.3	0.3	0.3	0.4
Other 2/	-3.0	-0.3	-4.5	-1.9	0.7	-0.2	-0.2	-0.3	-0.5
Accumulation of reserves net of IMF	-0.4	-5.2	3.1	12.9	3.8	-2.4	-4.9	-6.1	-6.9
Accumulation of gross reserves	-0.2	-5.9	-0.2	2.7	-4.2	-3.0	-4.1	1.8	2.9
IMF (net)/exceptional CBT financing	-0.2	0.7	3.3	10.2	7.9	0.6	-0.8	-7.9	-9.8
Purchases	0.0	0.8	3.4	11.4	14.0	1.0	1.0	0.0	0.0
Repurchases	0.2	0.1	0.1	1.1	6.1	0.5	1.8	7.9	9.8

1/ General government and Central Bank of Turkey.
2/ Errors and omissions.

Table 8. Turkey: Public Sector Primary Balances, 2000–02

	2000	2001	2002 1/	
		Est.	Prog.	Est.
	(In trillions of TL)			
Public sector	3,532	10,715	17,954	17,862
Central government 2/	5,830	8,364	14,648	14,103
Total revenue	31,978	47,684	71,873	72,306
Tax revenue	26,514	39,768	62,038	61,825
Nontax revenue 2/	5,463	7,916	9,835	10,481
Noninterest expenditure	26,148	39,321	57,224	58,203
Personnel	9,982	15,204	22,453	22,485
Other current	3,520	5,023	7,283	7,403
Transfers 3/	10,395	15,192	21,588	22,415
Investment	2,251	3,902	5,900	5,900
Rest of the public sector	-2,298	2,351	3,305	3,759
EBFs	-225	149	-789	-526
Unemployment insurance fund	334	1,104	958	979
Local governments	-302	69	126	209
SEEs 4/	-2,211	1,025	2,957	3,006
Social insurance institutions	-6	-50	0	0
Revolving funds	112	54	54	90
	(In percent of GNP)			
Public sector	2.8	6.0	6.5	6.5
Central government 2/	4.6	4.7	5.3	5.1
Total revenue	25.5	26.6	26.0	26.3
Tax revenue	21.1	22.2	22.5	22.5
Nontax revenue 2/	4.4	4.4	3.6	3.8
Noninterest expenditure	20.8	21.9	20.7	21.2
Personnel	7.9	8.5	8.1	8.2
Other current	2.8	2.8	2.6	2.7
Transfers 3/	8.3	8.5	7.8	8.2
Investment	1.8	2.2	2.1	2.1
Rest of the public sector	-1.8	1.3	1.2	1.4
EBFs	-0.2	0.1	-0.3	-0.2
Unemployment insurance fund	0.3	0.6	0.3	0.4
Local governments	-0.2	0.0	0.0	0.1
SEEs 4/	-1.8	0.6	1.1	1.1
Social insurance institutions	0.0	0.0	0.0	0.0
Revolving funds	0.1	0.0	0.0	0.0
Memorandum items:				
GNP (in trillions of TL)	125,596	179,480	276,230	274,802
Military expenditure (in percent of GNP)	4.4	4.4	4.4	4.5
Social spending (in percent of GNP) 5/	14.2	15.7	16.4	16.4

Sources: Turkish authorities; and Fund staff estimates.

1/ 2002 program figures reflect the revised figures after the Second Review and the 2002 estimated figures reflect the revised figures after the Third Review.

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

3/ Excluding recapitalization of state banks.

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

Table 9. Turkey: Monetary Aggregates, 1999–2002
(In quadrillions of Turkish Lira)

	1999	2000	2001			2002	
	Dec.	Dec.	March Actual	June Actual	December Actual	March Actual	June Proj.
Net foreign assets 1/	6.0	2.8	1.0	-1.5	-1.9	-5.1	-4.5
(in billions of U.S. dollars)	11.1	4.1	0.9	-1.2	-1.3	-3.8	-2.8
Net domestic assets	34.6	54.1	71.2	86.1	108.5	108.2	121.5
Net claims on government	19.3	31.6	40.2	62.9	89.7	100.7	106.9
Claims on business sector 2/	18.3	31.7	34.4	35.5	38.7	36.5	36.4
Turkish lira claims	11.2	22.3	22.0	21.0	23.1	22.6	20.4
Foreign exchange claims (est.) 1.	7.1	9.4	12.4	14.5	15.6	13.9	16.0
Other items (net)	-3.0	-9.1	-3.4	-12.3	-20.0	-29.0	-21.9
Memorandum items:			(Annual percent change)				
Broad money (M2Y)	100.7	40.2	66.0	76.5	87.5	42.7	38.2
Lira broad money (M2)	96.1	42.5	71.5	64.7	48.0	28.7	30.6
Foreign exchange deposits 1/	106.6	37.3	60.1	88.8	137.9	58.8	45.1
Claims on business sector 2/	50.8	73.0	63.7	42.3	22.3	5.9	2.6
Base money	83.8	49.2	36.6	38.5	34.8	51.1	40.8
			(In billions of U.S. dollars)				
Broad money (M2Y)	75.4	84.6	68.3	66.8	74.0	77.3	73.0
Lira broad money (M2)	41.6	47.5	36.4	31.9	32.8	37.2	32.9
Foreign exchange deposits	33.7	37.1	31.9	34.9	41.2	40.2	40.1
Net claims on government	35.8	47.0	38.1	49.7	62.3	75.6	66.7
Credit to the private sector	34.0	47.1	32.6	28.0	26.9	27.4	22.7
			(In percent share)				
Base money/GNP 3/	5.0	4.6	3.1	3.6	4.3	3.1	3.3
Broad money (M2Y)/GNP 3/	51.8	45.3	40.2	47.2	59.4	37.5	42.6
Lira broad money (M2)/GNP 3/	28.6	25.4	21.4	22.5	26.3	18.0	19.2
Foreign currency deposits/M2Y	44.8	43.9	46.7	52.3	55.7	52.0	54.9
Money multiplier							
Broad money (M2Y)	10.5	9.8	12.9	13.2	13.7	12.2	13.0
Lira broad money (M2)	5.8	5.5	6.9	6.3	6.1	5.9	5.8

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

Table 10. Turkey: Central Bank Balance Sheet, 2000-02

	2000	2001	2002							
	Dec.	Dec.	February		April		June		Sep.	Dec.
	Actual	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prog.
Central Bank balance sheet	(In quadrillions of Turkish lira) 1/									
Net foreign assets	3.3	-12.8	-2.5	-1.7	-1.9	0.1	-1.1	-0.2	-0.6	0.0
Gross foreign assets	15.6	28.5	29.9	31.2	30.6	33.4	31.4	32.0	32.1	32.8
Gross foreign liabilities	12.3	41.2	32.4	32.9	32.5	33.2	32.5	32.1	32.7	32.8
International reserve liabilities	3.1	20.7	11.7	11.9	11.7	11.9	11.7	11.5	11.7	11.7
Other reserve liabilities 2/	4.9	10.1	10.1	11.6	10.1	11.5	10.1	11.4	10.1	10.1
Banks' foreign exchange deposits with CBT	4.3	10.4	10.6	9.4	10.7	9.8	10.7	9.3	10.9	11.0
Net domestic assets	2.5	20.6	10.7	10.3	10.8	8.6	10.4	9.2	11.2	10.9
Claims on central government (net)	0.4	31.6	22.6	25.8	22.6	25.2	22.6	24.9	22.6	22.6
Claims on other public sector (net)	-0.3	-1.0	-1.0	-0.8	-1.0	-1.2	-1.0	-1.0	-1.0	-1.0
Claims on banks	5.7	-2.0	-3.1	-5.0	-3.3	-5.2	-3.9	-7.9	-3.5	-4.2
Other items (net)	-3.3	-8.1	-7.8	-9.7	-7.5	-10.1	-7.3	-6.9	-6.9	-6.5
Base money	5.8	7.8	8.3	8.6	8.9	8.7	9.2	9.0	10.6	10.9
Currency issued	3.8	5.3	5.6	5.9	6.0	5.7	6.3	6.6	7.4	7.3
Bank deposits in liras	2.0	2.5	2.7	2.7	2.9	3.0	3.0	2.4	3.2	3.6
Required reserves	1.4	1.6	1.8	1.7	1.9	1.8	2.0	1.4	2.1	2.3
Free reserves	0.6	0.9	0.9	1.0	1.0	1.2	1.0	1.0	1.1	1.2
Memorandum items:	(In billions of U.S. dollars)									
Gross international reserves	23.2	19.8	20.8	21.7	21.8	23.2	22.3	22.2	22.8	22.8
Gross international liabilities	18.3	28.6	22.5	22.9	22.6	23.1	22.6	22.3	22.7	22.8
Net foreign assets	4.9	-8.9	-1.7	-1.2	-1.3	0.1	-0.8	-0.1	-0.4	0.0
plus CBT forward position	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
plus other reserve liabilities	7.3	7.1	7.1	8.1	7.1	8.0	7.1	7.9	7.1	7.1
minus Dresdner one-year deposits	0.6	0.7	0.7	0.9	0.7	1.0	0.7	1.1	0.7	0.7
minus defense fund	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Net international reserves 3/	11.1	-3.0	4.2	5.6	4.6	6.7	5.1	6.3	5.5	5.9
Definitions in the 2002 program (CBT plus Treasury)	(In billions of U.S. dollars)									
Net international reserves (Treasury) 4/ 5/	...	-1.3	-10.7	-10.5	-11.8	-11.6	-12.9	-12.0	-14.0	-15.6
Net international reserves (Treasury plus CBT) 4/	...	-4.2	-6.5	-4.9	-7.2	-4.9	-7.8	-5.8	-8.5	-9.7
	(In quadrillions of Turkish Lira, program exchange rate)									
Net foreign assets (Treasury)	...	-1.8	-15.4	-15.1	-16.9	-16.7	-18.5	-17.3	-20.1	-22.4
Net foreign assets (Treasury plus CBT)	...	-14.6	-17.8	-16.8	-18.8	-16.5	-19.7	-17.5	-20.7	-22.4
Net domestic assets (Treasury) 6/	...	1.8	15.4	15.1	16.9	16.7	18.5	17.3	20.1	22.4
Net domestic assets (Treasury plus CBT)	...	22.4	26.1	25.4	27.7	25.2	28.9	26.5	31.3	33.3
Base money (Treasury plus CBT)	...	7.8	8.3	8.6	8.9	8.7	9.2	9.0	10.6	10.9
Exchange rate (TL per U.S. dollar, in millions)	0.67	1.44	1.44	1.40	...	1.33	...	1.60	...	...

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

1/ Consistent with program assumptions, all foreign currency aggregates are valued at current exchange rates through end-2001, and at the program exchange rate of TL 1.44 million per U.S. dollar thereafter.

2/ Mainly Dresdner deposit liabilities.

3/ At current cross exchange rates.

4/ At end-December 2001 cross exchange rates (i.e. cross exchange rates for the 2002 program).

5/ Equals borrowing from IMF plus short-term foreign currency denominated liabilities.

6/ Since the Treasury cannot create base money, equals negative of Treasury net foreign assets.

Table 11. Turkey: Banking System—Selected Indicators, 1998–2002 1/
(In trillions of Turkish lira)

	1998	1999	2000	2001				2002
				Mar.	Jun.	Sep.	Dec.	Feb.
				Banking System				
Total assets	40,988	79,763	117,649	132,292	164,580	180,709	182,265	169,795
Cash and claims on CBT	2,665	5,097	6,235	7,788	8,847	10,895	12,699	11,651
Claims on other banks	3,923	7,766	13,599	13,701	18,015	17,584	17,342	12,746
Securities portfolio	9,688	22,040	31,251	35,089	62,170	68,643	70,779	68,336
Loans, net	14,689	22,601	35,789	41,043	44,713	51,525	49,217	47,304
Other assets	10,024	22,258	30,775	34,670	30,835	32,063	32,228	29,758
Total liabilities	40,988	79,763	117,649	132,292	164,580	180,709	182,265	169,795
Deposits	24,194	48,272	68,143	80,277	96,380	113,128	117,150	111,707
Borrowing from banks	4,663	10,070	15,996	21,126	23,376	24,091	18,202	16,801
Repos	4,153	7,645	12,843	11,210	12,702	10,979	10,674	2,689
Other liabilities	4,689	9,539	12,207	14,571	15,726	16,898	19,477	22,412
Shareholders' equity (including profits)	3,290	4,235	8,461	5,108	16,397	15,613	16,762	16,185
Memorandum Items:								
Capital adequacy ratio (in percent)	...	...	17.3	7.7	20.3	16.8	...	...
NPLs (in percent) total loans	6.7	9.7	9.2	8.7	13.6	15.6	12.6	14.3
Provisions (in percent) NPLs	44.2	61.9	59.8	58.2	67.4	65.4	65.7	64.3
Net profit (loss) after tax	760	-305	-888	-4,663	-4,925	-5,107	-3,546	576
ROA (in percent)	1.9	-0.4	-0.8	-3.5	-3.0	-2.8	-1.9	0.3
ROE (in percent)	23.1	-7.2	-10.5	-91.3	-30.0	-32.7	-21.2	3.6
Share in assets (in percent)	100	100	100	100	100	100	100	100
Share in deposits and repos (in percent)	100	100	100	100	100	100	100	100
				Private Banks 2/				
Total Assets	23,596	42,165	56,179	66,338	79,903	93,741	99,946	93,777
Cash and claims on CBT	1,514	2,707	3,362	4,574	5,579	6,844	8,537	7,686
Claims on other banks	2,688	5,386	9,769	9,851	12,695	10,712	10,352	6,602
Securities portfolio	6,478	14,335	13,491	13,407	16,165	23,178	27,494	28,465
Loans, net	8,793	12,445	19,587	22,696	27,014	31,939	31,781	31,125
Other assets	4,124	7,292	9,971	15,809	18,449	21,068	21,782	19,899
Total Liabilities	23,596	42,165	56,179	66,338	79,903	93,741	99,946	93,777
Deposits	13,652	23,160	30,827	40,490	51,189	63,659	71,361	65,876
Borrowing from banks	3,006	6,508	10,045	12,750	14,137	13,586	11,769	10,964
Repos	2,633	4,654	3,918	700	2,355	2,820	1,758	1,822
Other liabilities	1,894	3,036	3,503	4,708	4,374	5,057	5,391	5,600
Shareholders' equity (including profits)	2,411	4,806	7,886	7,690	7,848	8,619	9,667	9,515
Memorandum Items:								
Capital adequacy ratio (in percent)	...	...	18.3	15.9	10.6	10.9	...	...
NPLs (in percent) total loans	6.9	3.5	3.5	3.8	4.5	4.4	5.3	7.2
Provisions (in percent) NPLs	41.2	62.2	63.0	52.5	45.4	45.2	46.1	43.2
Net profit (loss) after tax	660	1,618	1,276	181	66	755	1,166	345
ROA (in percent)	2.8	3.8	2.3	0.3	0.1	0.8	1.2	0.4
ROE (in percent)	27.4	33.7	16.2	2.4	0.8	8.8	12.1	3.6
Share in assets (in percent)	57.6	52.9	47.8	50.1	48.5	51.9	54.8	55.2
Share in deposits and repos (in percent)	57.4	49.7	42.9	45.0	49.1	53.6	57.2	59.2

Table 11. Turkey: Banking System—Selected Indicators, 1998–2002 1/
(In trillions of Turkish lira)

	1998	1999	2000	2001				2002
				Mar.	Jun.	Sep.	Dec.	Feb.
				State Banks 3/				
Total Assets	14,150	27,104	40,655	42,052	47,911	51,710	57,676	57,844
Cash and claims on CBT	1,067	1,999	2,588	2,670	2,761	3,167	3,544	3,505
Claims on other banks	652	1,088	1,639	1,835	2,427	4,227	4,693	3,752
Securities portfolio	2,660	4,671	8,139	11,551	26,386	27,732	32,791	34,865
Loans, net	4,267	6,521	10,025	10,744	9,662	10,428	10,006	9,602
Other assets	5,503	12,825	18,265	15,253	6,675	6,156	6,641	6,121
Total Liabilities	14,150	27,104	40,655	42,052	47,911	51,710	57,676	57,844
Deposits	9,838	19,204	27,606	29,219	29,294	33,479	37,905	39,440
Borrowing from banks	368	630	1,339	2,207	1,621	1,812	1,865	1,989
Repos	1,284	1,922	4,949	6,191	7,995	5,566	3,844	842
Other liabilities	2,116	4,317	5,659	6,025	6,737	6,692	9,513	10,836
Shareholders' equity (including profits)	544	1,031	1,101	-1,591	2,263	4,161	4,549	4,737
Memorandum Items:								
Capital adequacy ratio (in percent)	...	...	7.9	-1.6	26.8	26.8	...	...
NPLs (in percent) total loans	5.3	9.1	11.1	12.2	22.3	28.1	29	30
Provisions (in percent) NPLs	30.2	35.1	30.3	42.7	59.1	50.8	66	68
Net profit (loss) after tax	78	284	-177	-3028	-955	-407	-21	173
ROA (in percent)	0.5	1.0	-0.4	-7.2	-2.0	-0.8	0.0	0.3
ROE (in percent)	14.3	27.6	-16.1	...	-42.2	-9.8	-0.5	3.7
Share in assets (in percent)	34.5	34.0	34.6	31.8	29.1	28.6	31.6	34.1
Share in deposits and repos (in percent)	39.2	37.8	40.2	38.7	34.2	31.5	32.7	35.2
				SDIF Banks 4/				
Total Assets	667	5,480	12,912	14,037	25,916	22,399	11,736	6,035
Cash and claims on CBT	9	248	103	194	134	125	89	38
Claims on other banks	47	211	535	479	1,186	501	893	785
Securities portfolio	351	2,511	8,572	9,212	18,738	16,744	8,883	3,571
Loans, net	158	1,052	2,533	2,750	2,327	2,314	656	553
Other assets	102	1,458	1,169	1,402	3,531	2,716	1,214	1,089
Total Liabilities	667	5,480	12,912	14,037	25,916	22,399	11,736	6,035
Deposits	446	5,363	8,827	9,361	14,523	14,157	5,475	3,974
Borrowing from banks	29	263	819	1,824	3,272	3,767	396	279
Repos	226	1,426	3,993	4,307	2,299	2,524	5,023	9
Other liabilities	69	968	1,329	1,294	1,546	1,400	884	2,574
Shareholders' equity (including profits)	-104	-2,540	-2,056	-2,749	4,276	551	-43	-801
Memorandum Items:								
Capital adequacy ratio (in percent)	...	...	...	...	72.3	30.0	...	...
NPLs (in percent) total loans	49.7	61.9	41.4	36.8	59.2	68.7	64.9	70.0
Provisions (in percent) NPLs	80.9	75.3	80.3	77.2	85.8	86.5	89.1	89.1
Net profit (loss) after tax	-127	-2,547	-2,314	-2,048	-4,483	-6,172	-5,112	-15
ROA (in percent)	-19.0	-46.5	-17.9	-14.6	-17.3	-27.6	-43.6	-0.2
ROE (in percent)	...	...	...	...	-105	-1,120	...	...
Share in assets (in percent)	1.6	6.9	11.0	10.6	15.7	12.4	6.4	3.6
Share in deposits and repos (in percent)	2.4	12.1	15.8	14.9	15.4	13.4	8.2	3.5

Table 11. Turkey: Banking System—Selected Indicators, 1998–2002 1/
(In trillions of Turkish lira)

	1998	1999	2000	2001				2002
				Mar.	Jun.	Sep.	Dec.	Feb.
				Foreign and Investment Banks				
Total Assets	2,576	5,014	7,903	9,864	10,850	12,860	12,908	12,139
Cash and claims on CBT	75	143	182	350	373	759	530	423
Claims on other banks	536	1,082	1,657	1,537	1,707	2,143	1,403	1,607
Securities portfolio	199	523	1,049	919	880	989	1,610	1,436
Loans, net	1,471	2,583	3,645	4,853	5,710	6,844	6,774	6,024
Other assets	295	683	1,370	2,206	2,179	2,124	2,591	2,649
Total Liabilities	2,576	5,014	7,903	9,864	10,850	12,860	12,908	12,139
Deposits	258	546	882	1,207	1,374	1,832	2,409	2,418
Borrowing from banks	1,259	2,670	3,792	4,345	4,346	4,926	4,173	3,569
Repos	10	-357	-17	11	52	69	48	16
Other liabilities	609	1,218	1,716	2,544	3,068	3,750	3,689	3,403
Shareholders' equity (incl. profits)	439	937	1,529	1,758	2,010	2,283	2,589	2,734
Memorandum Items:								
Capital adequacy ratio (in percent)	...	...	29.4	29.8	31.3	29.5	...	...
NPLs (in percent) total loans	2.1	2.1	1.8	2.1	2.8	2.9	6.6	7.1
Provisions (in percent) NPLs	54.0	31.3	51.8	55.8	45.5	45.6	81.0	82.9
Net profit (loss) after tax	150	340	328	231	447	717	420	73
ROA (in percent)	5.8	6.8	4.1	2.3	4.1	5.6	3.3	0.6
ROE (in percent)	34.1	36.3	21.4	13.2	22.2	31.4	16.2	2.7
Share in assets (in percent)	6.3	6.3	6.7	7.5	6.6	7.1	7.1	7.1
Share in deposits and repos (in percent)	0.9	0.3	1.1	1.3	1.3	1.5	1.9	2.1

1/ Includes off-balance sheet repos and reverse repos. Data for Dec. 2001 and Feb. 2002 do not incorporate the results of the audits conducted during the first half of 2002.

2/ Comprises the private (domestic) deposit-taking banks, and refers to the pre-audit and pre-recapitalization figures.

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

4/ In Mar. 2001, three SDIF banks did not report. End- December data is reported for these three banks.

TURKEY: FUND RELATIONS
(As of June 30, 2002)

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	100.00
Fund holdings of currency	15,361.69	1,593.54
Reserve position in Fund	112.78	11.70

III. **SDR Department:**	**Millions of SDRs**	**Percent of Allocation**
Net cumulative allocation	112.31	100.00
Holdings	28.44	25.33

IV. **Outstanding Purchases and Loans:**	**Millions of SDRs**	**Percent of Quota**
Stand-by Arrangements	14,148.96	1,467.73
First credit tranche	361.50	37.50

V. **Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
			In millions of SDRs	
Stand-By	02/04/02	12/31/04	12,821.20	8,194.00
Stand-By	12/22/99	02/04/02	15,038.40	11,738.96
Of which: SRF	12/21/00	12/20/01	5,784.00	5,784.00
Stand-By	07/08/94	03/07/96	610.50	460.50

VI. **Projected Obligations to Fund:**
Under the Repurchase Expectations Assumptions[1]
(In millions of SDRs; based on existing use of resources and holdings of SDRs)

	Forthcoming				
	2002	2003	2004	2005	2006
Principal		1,223.90	6,122.50	6,031.30	1,132.70
Charges/Interest	337.60	660.70	530.10	199.60	12.70
Total	337.60	1,884.60	6,652.60	6,230.90	1,145.40

[1] Disbursements made after November 28, 2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayments under the Supplemental Reserve Facility are scheduled to be repaid on the expectations schedule.

VII. **Safeguard Assessments**:

Under the Fund's safeguards assessment policy, the Central Bank of Turkey was subject to the transitional procedures with respect to the SBA approved on December 22, 1999, which was 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 Country Report No. 02/21.

Under the new SBA, approved on February 4, 2002 the CBT was subject to a full safeguards assessment, which entails two phases. Stage One (off-site assessment) was completed on February 25, 2002 and recommended completion of Stage Two (on-site assessment). The latter was completed on April 4, 2002 ahead of the Board discussion on the First Review under the program as mandated by the Fund's safeguards assessment policy. The conclusions of the on-site assessment are reported in Section IV of Country Report No. 02/137.

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 ε 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. This exchange rate arrangement was in place until February 22, 2001, when the government decided to float the currency.

IX. **Article IV Consultations**:

The 2002 Article IV staff report (Country Report No. 02/137) was issued on July 5, 2002, and the accompanying Statistical Appendix (Country Report No. 02/138) was also issued on July 5, 2002. Board discussion took place on April 15, 2002.

X. ROSCs

Standard or Code Assessed	Date of Issuance	Document Number
Fiscal Transparency	June 26, 2000	SM/00/139
Corporate Governance (prepared by the World Bank)	December 11, 2000	
Data Dissemination	March 14, 2002	Country Report No. 02/55

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 Public Financial Managing Project; 8 FAD missions since 1994, assignment of 5 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

Department	Timing	Purpose
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/RES	September 2001	Inflation targeting
STA	April 2002	National accounts statistics
MAE/RES	April/May 2002	Inflation targeting
STA	July 2002	Public finance statistics

TURKEY: RELATIONS WITH THE WORLD BANK GROUP

I. LENDING ASSISTANCE

A. IBRD

1. **The World Bank Group's assistance program to Turkey is guided by the revised Country Assistance Strategy (CAS) discussed by the Bank's Board of Directors in July 2001.** The revised CAS includes additional IBRD support on Special Structural Adjustment Loan (SSAL) terms of up to US$1.2 billion, for a total possible lending of US$6.2 billion in the period FY2001–03, of which US$4.5 billion has been committed to date. Delivery of the Bank's assistance program is broadly on track. Over the FY01–02 period, the Bank disbursed a total of US$2.5 billion to Turkey. Policy based lending in the revised CAS is centered around the Programmatic Financial and Public Sector Adjustment Lending (PFPSAL) program, which focuses on structural and institutional reforms in the banking and public sectors. The first PFPSAL of US$1.1 billion was approved by the Bank's Board and disbursed in a single tranche in July 2001. The second PFPSAL in the amount of US$1.35 billion was approved in April 2002. The second PFPSAL is designed as a three-tranche operation. Follow-up programmatic operations to support continuation of the Government's financial sector reform and public sector reform programs are envisaged during the remainder of the current CAS period. The World Bank Group is preparing a new CAS (for FY2003–05), which will be completed in the fall of 2002.

2. **The revised CAS also features increased support for social protection in response to the economic crisis.** It includes the US$250 million Privatization Social Support project approved in December 2000, the US$500 million Social Risk Mitigation project approved in September 2001, and additional lending for health, education, community development and watershed protection. The second US$300 million tranche of the Adaptable Program Loan (APL) in support of Turkey's basic education reform was approved on July 16, 2002.

3. **The IBRD lending program also includes sustained support for structural reforms to promote private sector development.** It comprises the US$375 million second tranche of the Economic Reform Loan and the US$600 million Agriculture Reform Implementation project approved in July 2001.

B. IFC

4. **The IFC maintains a strong investment presence in Turkey.** It accounts for about 4.5 percent of the total IFC portfolio. The total IFC own-account held portfolio in Turkey is currently US$649 million and the outstanding balance of syndicated loans mobilized by IFC is US$177 million. IFC has also invested over US$150 million in Turkish companies outside of Turkey in neighboring countries of the CIS and the Balkans.

C. MIGA

5. **The activities of MIGA are a key element of the World Bank Group's assistance program.** Turkey's share of MIGA's portfolio is about US$165 million (gross), representing approximately 4 percent of the total portfolio. While MIGA's exposure is currently concentrated in the financial sector, the agency continues efforts to extend coverage to infrastructure and services projects.

II. Nonlending Assistance

6. **The World Bank Group has a very active nonlending services program in Turkey.** Major economic and sector work recently undertaken include the Country Economic Memorandum on Structural Reform for Sustainable Growth completed in 2000, as well as the Public Expenditure and Institutional Review, the Country Procurement Assessment Report and the Country Financial Accountability Assessment, all completed during the Summer of 2001. The World Bank finalized a Corporate Assessment, which has contributed to the development of the authorities' strategy ("Istanbul approach") on corporate sector restructuring. A Non-Bank Financial Institutions study and a new Country Economic Memorandum are currently under preparation. The World Bank sponsored an international conference on good governance and combating corruption in September 2001, and a second international conference on public expenditure management was held in December 2001. The Foreign Investment Advisory Service (FIAS) carried out a Diagnostic of the Foreign Investment Climate in Turkey and an Administrative Barriers Study during the course of 2001. The World Bank is assisting the Government in the creation of an Investor Council.

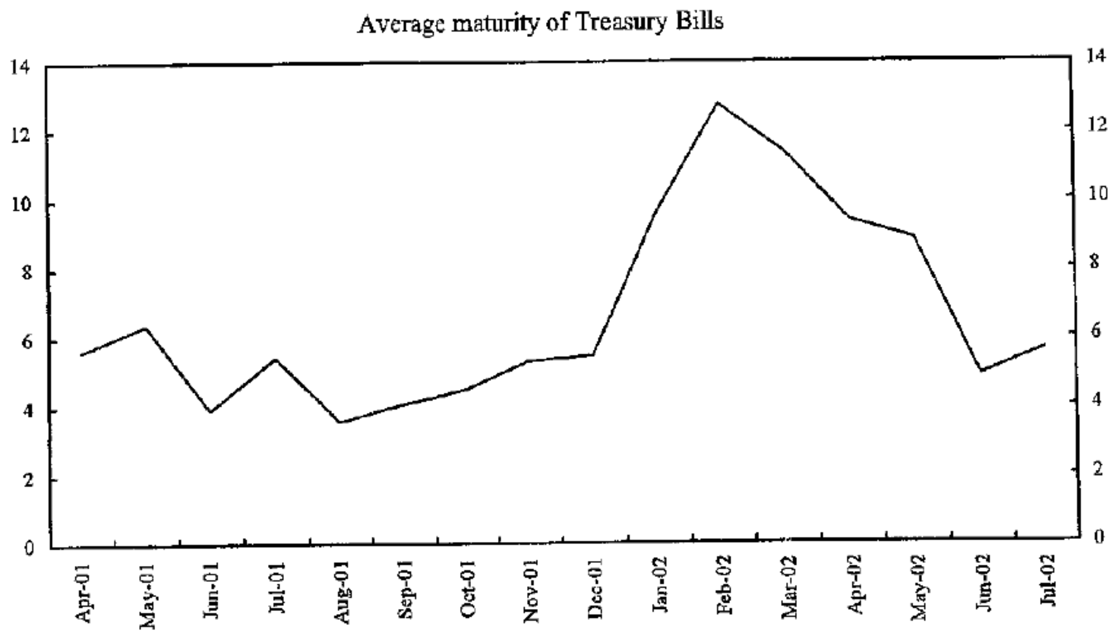
TURKEY: RECENT DEVELOPMENTS IN EXTERNAL AND FINANCIAL VULNERABILITY

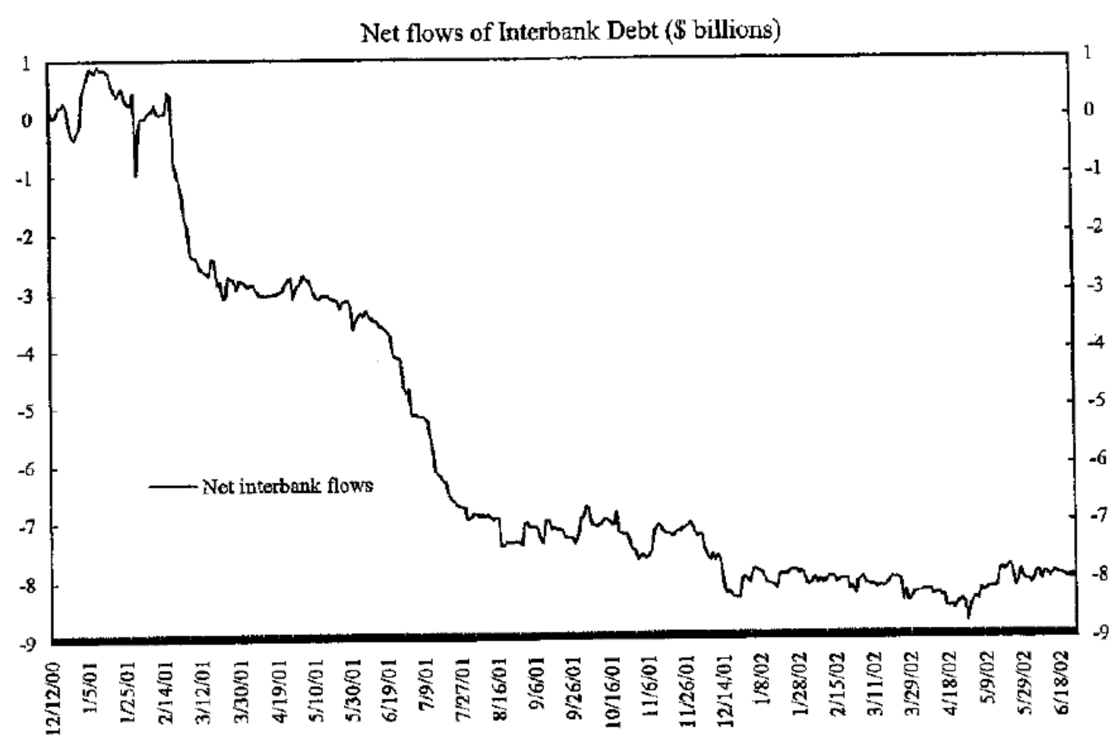
Access to international and domestic capital markets had been better than expected through early May, but then worsened owing to political uncertainty (Tables 12–13, and Figure 12). Until early May, Turkey had tapped international capital markets for US$2.2 billion, covering more than 70 percent of the programmed issuance of sovereign debt for the whole year. At the same time, in domestic debt auctions, private sector rollover had been well over 100 percent, much higher than originally envisaged under the program. Both domestic and sovereign issues had seen a marked reduction in their yields, and this had been accompanied by a lengthening of maturities. Following political uncertainty, this was reversed in May and June: the private sector rollover rate dropped below 100 percent, maturities shortened and yields increased, and the central government's financing buffer (its deposits at the CBT) fell. However, with political conditions clarifying, there has been some improvement in July, with the rollover rate increasing in the most recent auctions, allowing government deposits to be rebuilt back above TL 3 quadrillion. Access to international capital markets by the private sector continues to be maintained through the stabilization of external interbank credit lines, following a decline of some US$8 billion in 2001. External loans due over the next month by Turkish banks have been falling, and foreign banks' exposure has been broadly maintained. After a gradual reversal earlier in the year, dollarization of the economy has modestly increased in recent months.

Recent political developments have also led to a sharp reversal of the improvement in financial indicators achieved earlier this year, although markets have stabilized in July (Figures 13–14). Since October 2001, the term structure of interest rates has gradually shifted downward and become flatter, reflecting falling inflation expectations and risk premia as program credibility gathered strength. Reflecting recent political uncertainties, however, the yield curves for May, June, and July have moved upward and turned steeper, and exchange rate volatility has increased substantially in June to levels not seen since September 11 last year. Spreads on Eurobonds have also widened substantially to reach almost 12 percent in early July, offsetting earlier gains. At the same time, the performance of the stock market, after a surge in late 2001 and early this year, has deteriorated substantially. However, the recent call for early elections has helped clarify somewhat the political outlook, reducing bond spreads and raising stock prices to some extent.

Banking sector indicators have been mixed (Table 14). Net foreign exchange open positions have been gradually closed, and remain well within prudential limits. Nonperforming loans (NPLs) have increased over the last few months, mainly in non-SDIF banks, and a smaller percentage of them has been provisioned for. (These figures do not incorporate the outcome of the audits under the private bank recapitalization exercise. The post-audit NPL ratios are considerably higher.) Over the same period, the ratio of net (provisioned for) nonperforming loans to credit to the private sector has also increased, and credit to the private sector as a share of total deposits has slightly dropped.

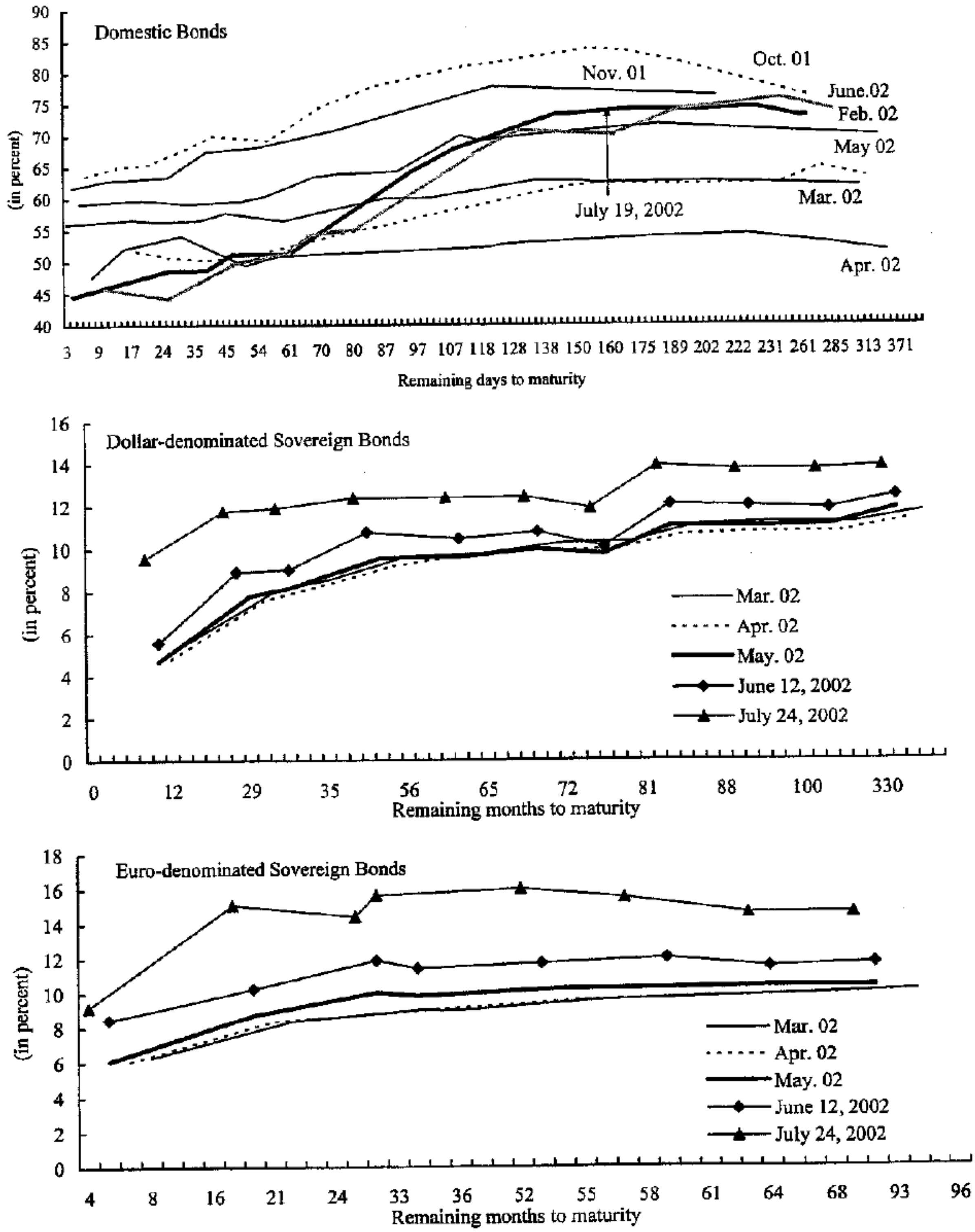
Figure 12. Turkey: Indicators of Access, 2000-02





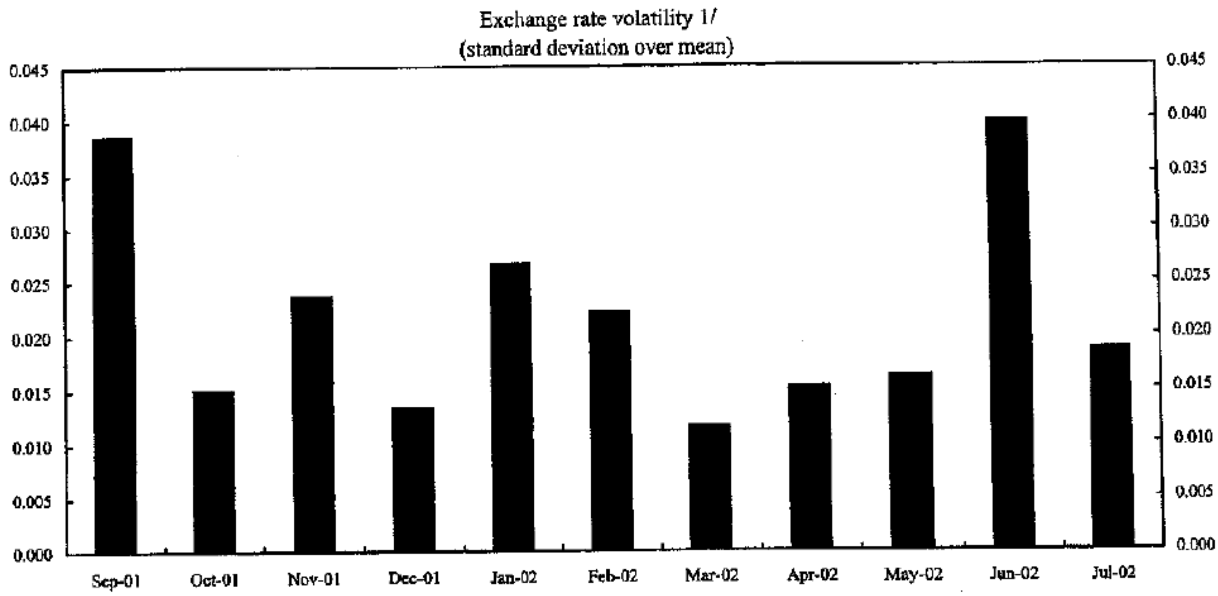
Source: Central Bank of Turkey.

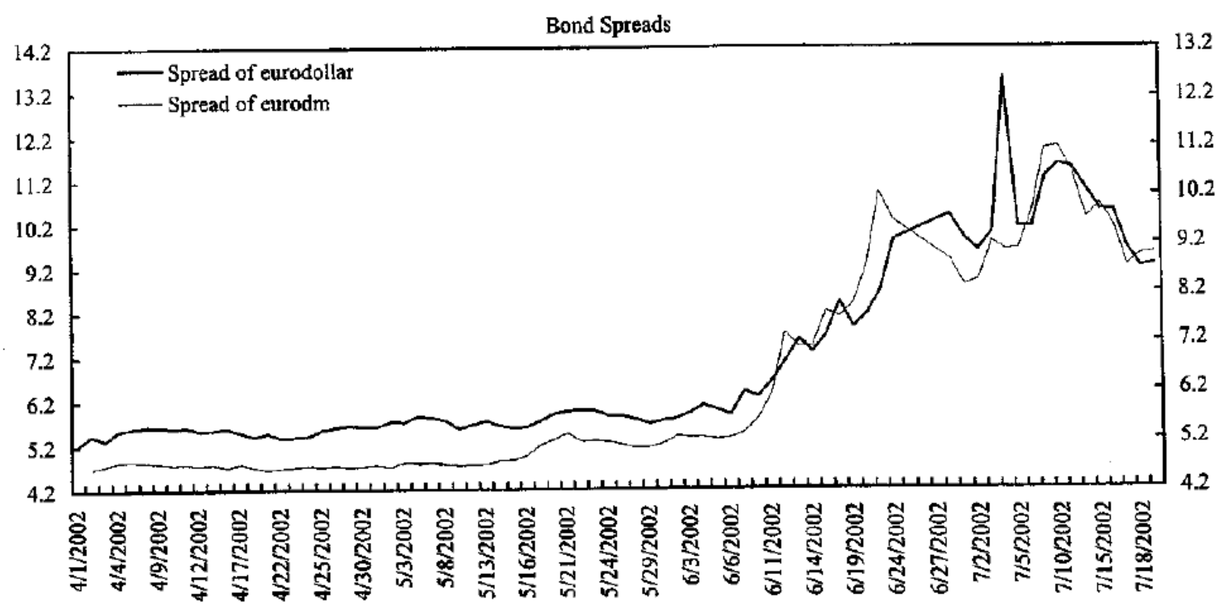
Figure 13. Turkey: Term Structure of Interest Rates, 2001-02



Source: Data from the Turkish authorities; Bloomberg; and Fund staff estimates.

Figure 14. Turkey: Recent Financial Market Developments, 2001-02





Source: Central Bank of Turkey; and Bloomberg.

1/ For July 2002, up to July 19.

Table 12. Turkey: Public Sector Financing Indicators, 2001 – 02

	2001	2002						
		January	February	March	April	May	June	Cumulative
				(In millions of U.S. dollars)				
External								
Sovereign bond issuance	2,200	600	250	600	0	700	...	2,150
Euro denominated	...	0	0	0	0	700	...	700
U.S. dollar denominated	...	600	250	600	0	0	...	1,450
Cumulative sovereign issuance as share of total program issuance 1/	...	20	28	48	48	72	...	72
				(In quadrillions of Turkish lira, unless otherwise indicated)				
Domestic								
Central Government deposits at the Central Bank Turkey	2.6	2.9	3.2	3.2	5.3	4.0	2.9	
New domestic borrowing/redemptions (including interest)								
Total (in percent)	76	99	61	96	104	73	93	
Private sector (in percent)	97	114	101	117	131	87	98	
Bid-cover ratio in discount auctions	154	126	195	131	141	120	111	
Gross monthly redemptions (constant end-2001)	7.0	7.6	4.3	5.6	7.6	8.9	9.6	

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

1/ Program projection for sovereign issuance in 2002 is US$3 billion.

Table 13. Turkey: Banking Sector External Indicators, 2001-02

	2001												2002						
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July
	(In millions of US dollar, unless otherwise indicated)																		
Banks external loans due next month	6,490	5,765	5,515	5,591	4,242	5,291	1,383	1,520	2,555	1,073	1,743	1,106	700	765	318	252	..	..	..
Change in foreign banks exposure 1/	-281	-1,525	-933	-172	-885	-1,841	-2,001	423	-285	-1,000	597	-820	-604	188	156	-279	479	134	-30
Credit lines roll-over ratio (in percent) 2/	98.8	97.1	95.7	97.3	96.2	91.9	76.2	98.9	96.3	93.3	105.7	89.9	98.8	98.1	98.4	95.4	110.0	101.3	101.5
	(In percent)																		
Ratio of fx deposits to total deposits (in percent) 3/	45.0	49.2	48.5	52.0	51.4	54.3	58.0	58.4	60.8	61.6	59.4	56.6	55.0	55.5	53.6	53.5	54.7	57.0	57.9

Sources: Data provided by the Central Bank of Turkey; the BRSA; and Fund staff estimates.

1/ For July 2002, as of July 23.
2/ For July 2002, as of July 18.
3/ For July 2002, as of July 5.

Table 14. Turkey: Banking Sector Indicators, 2001–02

	2001												2002						
	Jan.	Feb.	March	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	Apr.	May	June	July
	(In millions of U.S. dollar, unless otherwise indicated)																		
1. Net foreign exchange open position 1/																			
Banking sector																			
Net foreign exchange open position	-5,324	-4,310	-5,149	-5,336	-803	-242	-766	-724	-695	-880	-695	-129	11	-192	-67	271	710	572	..
as percent of capital base	66.0	76.6	87.9	121.6	20.2	4.7	11.8	7.4	7.2	10.1	9.3	1.7	-0.1	1.7	-1.0	2.0	6.0	5.0	..
SDIF banks																			
Net foreign exchange open position	-4,312	-3,546	-4,670	-4,819	-645	-559	-844	-1,199	-1,165	-1,199	-1,029	-441	-365	-648	-656	-85	95	93	..
as percent of capital base	106.8	179.2	219.4	196.0	17.5	33.4	260.5	76.0	50.6	83.8	-522.3	-70.6	67.4	78.7	-122.0	-23.0	28.0	-16.0	..
Non SDIF banks																			
Net foreign exchange open position	-1,012	-765	-479	-517	-159	317	78	475	470	319	333	312	376	456	589	356	615	479	..
as percent of capital base	8.1	10.1	6.0	7.6	2.1	4.7	1.1	5.8	6.4	4.4	4.3	3.8	4.1	4.3	5.0	3.0	6.0	4.0	..
	(In trillions of Turkish lira, unless otherwise indicated)																		
2. Nonperforming loans 2/ 3/																			
Banking sector																			
Gross NPLs	3,566	3,897	4,270	4,978	5,320	6,261	5,840	8,488	8,974	8,906	7,752	6,757	6,997	7,460	7,444	6,844	6,789	8,204	8,254
monthly change (in percent)	...	9.3	9.6	16.6	6.9	17.7	-6.7	45.3	5.7	-0.8	-13.0	-12.8	3.6	6.6	-0.2	-8.1	-0.8	20.8	0.6
provisions as percent of gross NPLs	63.6	61.9	62.5	62.3	68.4	71.1	76.9	64.3	65.4	63.6	60.3	65.5	66.4	64.2	66.4	63.9	58.1	57.5	54.4
SDIF banks																			
Gross NPLs	1,576	1,825	1,917	1,987	2,119	2,794	3,040	3,610	3,913	3,650	2,561	989	987	980	914	688	149	566	568
monthly change (in percent)	...	15.8	5.1	3.6	6.7	31.9	8.8	18.8	8.4	-6.7	-29.8	-61.4	-0.2	-0.8	-6.6	-24.8	-78.3	279.1	0.4
provisions as percent of gross NPLs	80.7	79.6	81.8	82.7	81.6	85.9	86.4	87.3	86.7	85.4	82.6	88.8	88.8	90.0	93.6	89.5	45.6	34.3	34.5
Non SDIF banks																			
Gross NPLs	1,990	2,073	2,353	2,991	3,201	3,467	2,800	4,878	5,061	5,257	5,192	5,767	6,010	6,481	6,530	6,157	6,640	7,638	7,686
monthly change (in percent)	...	4.2	13.5	27.1	7.0	8.3	-19.2	74.2	3.7	3.9	-1.2	11.1	4.2	7.8	0.8	-5.7	7.8	15.0	0.6
provisions as percent of gross NPLs	50.1	46.3	46.8	48.8	59.7	59.1	66.7	47.3	48.8	48.4	49.2	61.5	62.7	60.3	62.6	61.1	58.4	59.2	55.9
3. Deposits 2/	57,051	63,063	71,518	74,697	75,248	83,605	85,412	91,844	100,082	104,429	101,862	103,768	100,102	101,184	102,111	104,157	108,655	115,556	115,156
	(In percent)																		
4. Ratio of net NPLs to private sector credit 2/ 3/ 4/																			
Banking sector	4.0	4.3	4.5	4.9	4.5	4.5	3.3	6.9	6.6	6.8	6.9	5.5	5.6	6.2	5.9	5.9	6.5	8.0	8.6
Banking sector (excluding SDIF banks)	3.2	3.4	3.7	4.3	3.7	3.8	2.5	6.4	6.0	6.2	6.3	5.3	5.4	6.1	5.9	5.8	6.3	7.2	7.8
5. Ratio of private sector credit to deposits 2/	56.8	54.7	50.3	50.7	49.2	47.8	47.4	47.6	46.8	45.5	43.6	41.1	42.3	42.4	41.7	40.5	40.2	37.9	38.2
	(In months)																		
6. Average maturity mismatch 5/																			
Banking sector	3.5	2.8	3.0	3.0	3.5	3.4	3.6	4.0	3.7	4.5	3.5	4.0	4.4	6.2	...	...	...	...	...
Banking sector (excluding SDIF banks)	3.0	3.1	2.6	2.8	2.6	2.6	3.2	3.6	3.3	4.1	3.3	3.9	4.2	6.3	...	...	...	...	...

Sources: Data provided by the Central Bank of Turkey; the BRSA; and Fund staff estimates.

1/ For June 2002, as of June 7.
2/ For July 2002, as of July 5.
3/ These figures do not incorporate the outcome of the audits under the private bank recapitalization exercise.
4/ Net NPLs are measured as gross NPLs minus provisions.
5/ Average weighted maturity of assets minus average weighted maturity of liabilities.

TURKEY: ASSESSING SUSTAINABILITY IN TURKEY

Past staff reports have included assessments of public debt sustainability under various medium-term scenarios (see, for example, EBS/02/109, 6/20/02). This Appendix extends this analysis to include external sustainability, applying the framework recently adopted by the Board (SM/02/166) to the staff's baseline scenario, and considers the impact of several shocks proposed as part of this framework.[1] The analysis shows that external and domestic debt sustainability (indicated by falling or stable debt ratios over the medium term) is achieved under the baseline, and is robust to a series of plausible shocks, but that a combination of large shocks could jeopardize sustainability. These results are consistent with previous staff assessments of public sector debt sustainability. The framework also calls for an analysis of the impact of several extreme, but temporary, shocks. This analysis shows that Turkey, emerging from a deep crisis, would have difficulty achieving sustainability in the face of some of these extreme shocks, but could weather others with stable or falling debt ratios, provided the program's targets for the key macroeconomic variables are achieved in the medium term.

Public sector debt sustainability

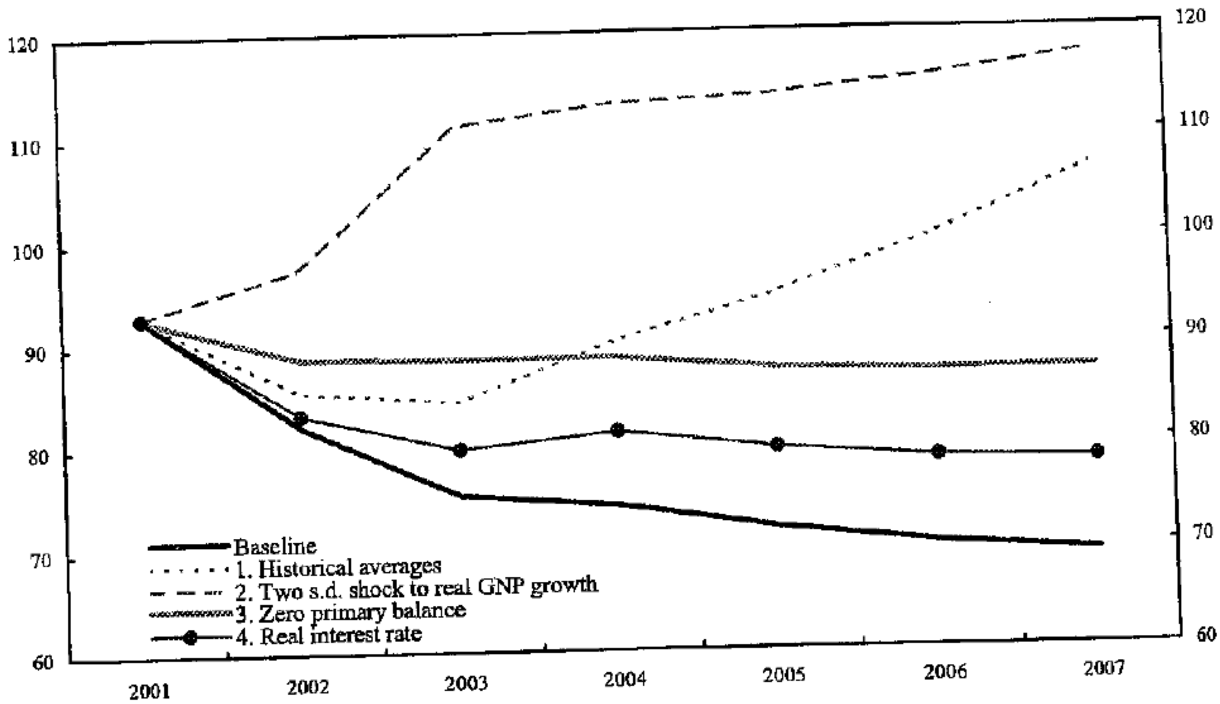
1. **Under the program's baseline projections, Turkey's public sector debt ratio declines over the medium term** (Table 15 and Figure 15). After rising sharply to 93 percent at end-2001, the debt-to-GNP ratio is set to fall considerably in 2002–03, and to decline gradually thereafter. As highlighted in previous staff reports, the substantial fall in the debt ratio in 2002 largely reflecting the one-time effect of the nominal depreciation in 2001.[2] With the depreciation during May–July of 2002, part of this decline has been pushed into 2003 in the current baseline.

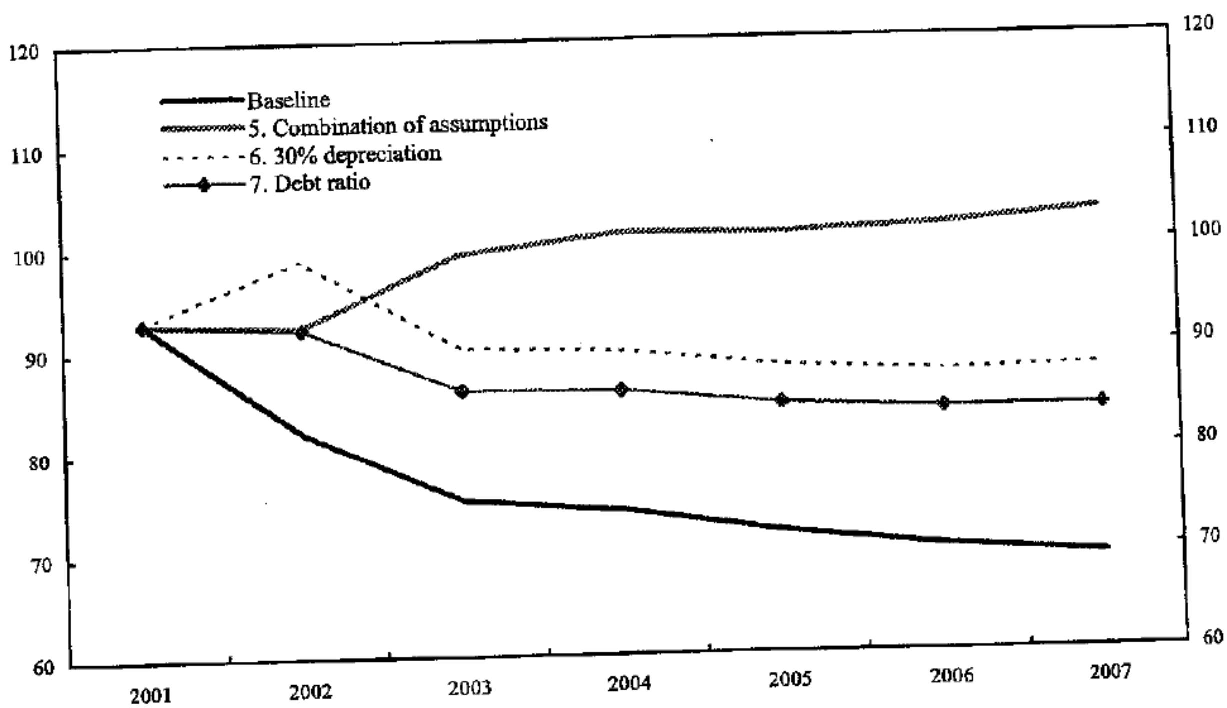
2. **Under the first standard sensitivity test, which sets key parameters to their historical averages, Turkey's public sector debt burden increases to unsustainable levels over the medium term** (Table 15, first item in bottom panel). With real GNP growth set at the average for the past ten years (2.7 percent), a primary surplus of 3¼ percent (one half of the target), and the real benchmark bond rate set at the maximum level over the last

[1] It should be noted that this standard framework was primarily designed to test countries' ability to withstand outside shocks, in terms of external and domestic debt sustainability. In Turkey's case, application of this framework involves superimposing severe shocks on an economy that is already in crisis. The probability of such a sequence of shocks is likely to be considerably lower than for the typical country to which this standard framework is applied.

[2] Conventional debt-to-GNP ratios overstate the rise in debt for the year of a devaluation (as in 2001 and during the spring of 2002). This is because the nominal depreciation instantaneously increases the Turkish lira value of foreign currency debt, but higher prices from the depreciation result in higher full-year nominal GNP only in the following year.

Figure 15. Turkey: Debt Sustainability: Alternative Scenarios, 2001-07 1/





Source: Fund staff estimates and projections.

1/ See Table 15 for detailed scenario assumptions.

ten years (34 percent), Turkey's debt ratio rises to over 100 percent by 2007.[3] This scenario is consistent with previous staff analysis which showed that, in a worse case scenario, a combination of poor fiscal performance, low growth, and high interest rates would produce an unsustainable path for public debt (Box 2 of Country Report No. 02/229).

3. **In many of the second set of sensitivity tests, which consider adverse temporary shocks to each of the key parameters, Turkey's public debt ratio falls or stabilizes over the medium term** (Table 15, items 2–7 in bottom panel):

- **A two-year shock to the primary balance would not by itself derail the medium-term debt dynamics.** In a scenario in which the primary surplus falls to zero for two years before returning to 6½ percent of GNP, the debt ratio would stabilize in the mid-80s. Such a shock would only materialize through a complete breakdown of fiscal order, which is unlikely given Turkey's recent adherence to fiscal prudence and the strengthening of the fiscal framework.

- **Debt ratios continue to fall even with high real interest rates continuing for two years.** Consistent with previous staff analysis, high real interest rates would not produce an unsustainable debt path provided that rates returned at some point to program levels.

- **A 30 percent depreciation in the real exchange rate at end-2002 would result in stable but high debt ratio over the medium term.** The depreciation would push the end-2002 debt stock to about 100 percent, although the ratio would fall to 90 percent in 2003 owing to the pass-through to GNP from previous nominal depreciations. With all other assumptions as in the baseline, the ratio would remain roughly at this level over the medium term.

- **Turkey's debt dynamics would be sustainable even with a one-time increase in the debt ratio by 10 percentage points.** With such an increase, which is intended to capture contingent liabilities such as financial sector restructuring costs, the debt ratio falls over the medium term, although at a substantially slower rate than in the baseline.

---

[3] Some of the assumptions suggested in the framework to define the magnitude of the shocks seem inappropriately pessimistic in Turkey's present situation. This is particularly true of the average primary balance of the last ten years, given the magnitude of recent fiscal adjustment. On the other hand, other assumptions seem too optimistic, such as using the average real interest rate over the last ten years, which is *lower* than that assumed in the staff baseline. In this Appendix, the staff has tried to strike a balance between presenting standardized shocks which would facilitate cross-country comparisons, and shocks which would be meaningful in the Turkish context.

4. **Other, more extreme, temporary shocks yield unstable debt dynamics:**

- **A two-year shock to real GNP growth produces an unsustainable debt path.** As noted above, however, the two standard deviation shock suggested in the sustainability framework implies a contraction in output of over 10 percent for two years in a row. Coming on the heels of a 9 percent output contraction in 2001, such a shock would be unprecedented.

- **A combined two-year shock of lower growth, high real interest rates, and a lower primary surplus would result in a rising debt ratio over the medium term.** This is consistent with previous staff analysis showing that medium-term sustainability may not be robust to a combination of shocks.

External sustainability

5. **Under the program's baseline projections, Turkey's external debt burden declines substantially over the medium term** (Table 16, top panel). By end-2001, Turkey's overall external debt-to-GNP ratio had increased to almost 80 percent, exacerbated by last year's deep recession and the large real depreciation of the lira. Under the program's medium-term projections, the external debt burden is set to decline to about 50 percent of GNP, assisted by an expected pickup in economic growth and a recovery of the lira.

6. **Under the first standard sensitivity test, which sets key parameters at their historical averages, Turkey's external debt burden rises to unsustainable levels over the medium term** (Table 16, bottom panel). With real GNP growth, world interest rates, the noninterest current account, and the U.S. dollar GNP deflator all set to their averages for the past ten years, Turkey's external debt burden increases to almost 100 percent of GNP by end-2007. However, this is largely the result of applying an overly pessimistic forecast of the deflator. Specifically, while program projections assume a 17 percent increase in the GNP deflator (measured in U.S. dollars) in 2002, the last 10 years have seen an average decline in this deflator, in large part because of last year's exceptional real depreciation, which resulted in a 20 percent decline in the GNP deflator (measured in U.S. dollars).

7. **In the second set of sensitivity tests, which assume extreme adverse shocks to each of the key parameters in turn, and one combined shock, the debt ratio falls or stabilizes in almost all cases:**[4]

[4] In line with the standardized framework for assessing external debt sustainability, these sensitivity tests consider adverse two-standard deviation shocks lasting two years to each of the key parameters in turn, and a one-standard deviation combined shock. An additional scenario is also considered in which there is a 30 percent real exchange rate depreciation in 2002.

- **The sustainability of external debt is robust to a shock to interest rates.** With interest rates already projected to increase next year under the baseline program assumptions, an interest rate shock has a negligible effect on the projected debt ratio.

- **With a two-year shock to real GNP growth, the external debt burden peaks at more than 95 percent of GNP at end-2003, before declining to 80 percent of GNP in 2007.** As noted above, such a shock would be extreme, with a cumulative loss of output to more than 30 percent in just three years. Nevertheless, the debt ratio would begin falling with the onset of the recovery.

- **Under a temporary shock to the U.S. dollar deflator, the debt ratio also falls in the medium term, although it remains at a high level.** In this scenario, the shock is rather extreme: the deflator declines by 27 percent in both 2002 and 2003, instead of rebounding by 14 percent under the baseline scenario, which builds in a reversal of last year's steep real depreciation. Hence, not surprisingly the debt ratio rises to as high as 150 percent, before falling moderately over the medium term.

- **Debt sustainability is only modestly affected by the current account shock, with the debt burden falling to about 67 percent of GNP by end-2007.**

- **A one-time 30 percent depreciation in 2002 leaves the external debt ratio at about 115 percent of GNP during 2002–04, before it declines to about 100 percent of GNP at end-2007.**

- **As would be expected, the combined shock shows a sharp increase in the external debt ratio.** Once again, this is driven overwhelmingly by the deflator component of the shock.

Table 15. Turkey: Public Sector Sustainability Framework, 1999-2007

					Projections					
		t-3	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5
		1999	2000	2001	2002	2003	2004	2005	2006	2007
I	Baseline medium-term projections									
2	Public debt/GNP (staff baseline)	61.0	57.4	92.8	82.1	75.3	74.1	71.8	70.2	69.3
3	Change in public debt/GNP	17.3	-3.6	35.4	-10.7	-6.8	-1.2	-2.3	-1.6	-0.9
4	Net debt-creating flows/GNP (lines 5+8+11)		-2.5	-0.1	-6.5	-2.6	-1.5	-1.9	-1.8	-2.4
5	Primary deficit/GNP	2.0	-2.4	-5.9	-6.5	-6.2	-6.5	-6.5	-6.3	-6.3
8	Minus net non-debt creating inflows/GNP		-0.8	-3.4	-1.9	-2.5	-1.8	-1.2	-1.0	-1.0
9	Change in reserve money/GNP		0.8	1.5	1.5	1.1	0.8	0.7	0.5	0.5
10	Privatization receipts/GNP		0.0	1.9	0.4	1.4	1.0	0.5	0.5	0.5
11	(r-g-(pi+gpi))/(1+g+pi+gpi))debt (lines 13/12)		0.7	9.2	2.0	6.1	6.7	5.7	5.5	4.9
12	Adjustment factor: 1+g+pi+gpi		1.6	1.4	1.6	1.3	1.2	1.2	1.1	1.1
13	(r-g-(pi+gpi))debt/GNP (lines 14+15+16)		1.2	13.2	3.1	7.9	8.1	6.7	6.2	5.5
14	r (interest rate) times debt/GNP		38.9	37.9	54.4	33.3	22.9	19.0	15.1	13.4
15	minus g (real GNP growth rate) times debt/GNP		-3.8	5.4	-2.8	-4.1	-3.8	-3.7	-3.6	-3.5
16	minus (pi+gpi) (pi = GNP deflator, growth rate) times debt/GNP		-33.9	-30.1	-48.5	-21.2	-11.1	-8.6	-5.3	-4.4
17	Residual, incl. change in assets/GNP (lines 3-4) 1/		-1.1	35.5	-4.3	-4.2	0.3	-0.4	0.2	1.4
	Memorandum items:									
	Real GNP growth	-6.1	6.3	-9.4	3.0	5.0	5.0	5.0	5.0	5.0
	Nominal GNP deflator (in local currency, change in percent per year)	55.8	52.3	57.9	50.7	24.6	14.0	11.1	7.0	6.0
	Effective nominal interest rate on government debt		63.8	68.4	48.9	32.2	28.7	22.6	19.5	18.7
	Benchmark bond rate	106.2	38.0	99.1	69.2	47.1	40.8	30.9	25.7	23.9
	Memo: Ex-ante real rate (using GNP deflator) 2/	35.4	-12.6	32.1	35.8	29.0	26.7	22.4	18.6	23.9
	Nominal TL rate on dollar debt		112.1	38.6	37.3	21.7	18.7	15.0	13.4	13.4
	Memo: Nominal dollar rate on dollar debt		8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
	Share of FX-linked debt (average)		34.8	50.7	63.6	59.0	54.4	52.2	50.6	49.7
	Effective real interest rate on government debt (using GNP deflator) 2/		3.7	11.7	19.5	15.9	15.9	14.6	12.7	13.0
II.	Sensitivity analysis for public debt-to-GNP ratio									
1	If real GNP growth rate is average of past 10 years, primary balance is 3.25 percent, and the real interest rate is maximum plus 10 points				85.4	84.3	90.1	94.5	100.0	106.7
2	If real GNP growth rate in year t and t+1 is average minus two standard deviations, others at baseline				97.4	111.0	113.0	113.7	115.3	117.6
3	If primary balance (in percent of GNP) is 0 percent in year t and t+1, others at baseline				88.6	88.5	88.5	87.3	86.9	87.1
4	If the real interest rate in year t and t+1 is 10-year maximum plus 10 points, others at baseline				83.1	79.8	81.2	79.5	78.5	78.1
5	Combination of 2-4 using one standard deviation for growth, and 3.25 percent for primary surplus, and maximum real interest rate.				92.3	99.4	101.2	101.0	101.7	103.0
6	One time 30% (end of period) depreciation in year t, others at baseline				99.0	90.1	89.7	88.1	87.4	87.7
7	If debt ratio in year t rises by 10 percent of GNP, others at baseline.				92.1	86.1	85.8	84.4	83.8	83.8

1/ For projections, the residual mainly reflects valuation effects from exchange rate changes. These effects are not correctly captured in the mechanical calculation of line 4 required by the Board's framework, but are fully reflected in the ratios shown.

2/ Calculated using the average nominal interest rate divided by the growth in the GNP deflator for the following year.

Table 16: External Sustainability Framework, 1997-2007

	Actual					Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline medium-term projections											
External debt/Exports of G&S	156.2	169.0	214.2	221.7	216.3	226.5	209.5	199.5	181.6	165.2	158.4
External debt/GNP	43.4	46.8	55.0	59.5	78.6	69.1	68.6	66.1	60.2	54.3	52.7
Change in external debt/GNP	0.5	3.4	8.1	4.5	19.1	-9.4	-0.5	-2.6	-5.9	-5.8	-1.6
Net debt-creating external flows/GNP (5+9+12)	-1.5	-1.8	4.3	3.3	20.8	-13.8	-1.4	-4.5	-4.8	-4.9	-2.7
Current account deficit, excluding interest payments/GNP	-1.0	-3.3	-2.2	1.8	-7.2	-3.2	-3.5	-3.5	-3.1	-2.8	-2.6
Deficit in balance of G&S/GNP	3.9	1.8	3.5	7.5	0.3	2.9	3.3	3.4	3.3	3.2	3.3
Exports of G&S/GNP	27.8	27.7	25.7	26.8	36.3	30.5	32.8	33.1	33.1	32.9	33.3
Imports of G&S/GNP	31.6	29.5	29.2	34.3	36.6	33.4	36.0	36.5	36.5	36.1	36.5
Minus net non-debt creating capital inflows/GNP	-0.7	1.7	-0.9	1.8	0.6	-1.1	-1.2	-1.4	-1.5	-1.6	-1.7
Net foreign direct investment, equity/GNP	0.4	0.5	0.4	0.5	2.0	0.9	0.9	1.0	1.2	1.3	1.5
Net portfolio investment,equity/GNP	0.3	-2.2	0.5	-2.3	-2.6	0.2	0.3	0.3	0.3	0.3	0.3
(r-g-(ρ+gρ))/(1+g+ρ+gρ))debt/GNP (14/13)	0.2	-0.2	7.4	-0.3	27.4	-9.4	3.4	0.3	-0.3	-0.6	1.6
Adjustment factor: 1+g+ρ+gρ	1.1	1.1	0.9	1.1	0.7	1.2	1.0	1.1	1.1	1.1	1.0
(r-g-(ρ+gρ))debt/GNP (15+16+17)	0.2	-0.2	6.8	-0.3	19.9	-11.4	3.4	0.3	-0.3	-0.6	1.7
r (interest rate) times debt/GNP	2.5	2.5	2.6	3.4	3.5	4.8	4.7	4.8	4.4	4.0	3.8
minus g (real GNP growth rate) times debt/GNP	-3.6	-1.7	2.8	-3.5	5.6	-2.4	-3.5	-3.4	-3.3	-3.0	-2.7
minus (r + gr) (r = US dollar value of GNP deflator, growth r	1.2	-1.0	1.3	-0.2	10.7	-13.8	2.2	-1.0	-1.4	-1.6	0.6
Residual, including change in gross foreign assets/GNP (3-4)	2.0	5.2	3.8	1.2	-1.7	4.3	0.9	1.9	-1.1	-0.9	1.0
Memorandum items: key macro and external assumptions											
Nominal GNP (in local currency, quadrillions of TL)	29.7	53.5	78.3	125.6	179.5	274.8	364.1	433.4	499.8	557.5	585.4
Nominal GNP (in U.S. dollars)	194.1	205.8	187.3	201.3	146.5	174.7	182.1	195.4	211.0	227.1	239.6
Real GNP growth (in percent per year)	8.3	3.9	-6.1	6.3	-9.4	3.0	5.0	5.0	5.0	5.0	5.0
Consumer price index (change, in percent per year)	85.7	84.6	64.9	54.9	54.4	47.1	28.6	14.4	9.8	6.2	5.0
Exchange rate (TL per U.S. dollar)	151,865	260,724	417,758	623,973	1,225,490	1,572,808	1,998,808	2,217,870	2,368,519	2,454,514	2,606,074
Nominal GNP deflator (in U.S. dollars, change in percent per year)	-2.7	2.3	-2.9	0.4	-19.9	17.1	-3.0	1.5	2.0	2.5	-1.1
External interest rate (in percent per year)	5.8	5.7	5.7	6.1	6.0	6.1	6.8	7.0	6.7	6.6	7.0
Growth of exports of G&S (in U.S. dollar terms, in percent per year)	14.5	5.8	-15.7	12.3	-1.5	0.2	11.9	8.5	8.0	6.8	6.7
Growth of imports of G&S (in U.S. dollar terms, in percent per year)	13.8	-1.1	-10.1	26.4	-22.4	8.9	12.5	8.7	7.9	6.4	6.9
II. Sensitivity analysis for external debt-to-GNP ratio						69.1	68.4	65.8	59.9	54.1	52.5
1. If interest rate, real GNP growth rate, US$ GNP deflator growth, noninterest current account, and nondebt flows (in percent of GNP) are at average of past ten years						84.8	87.8	92.1	93.6	95.4	99.2
2. If interest rate in 2002 and 2003 is average plus two standard deviations, others at baseline						69.4	68.7	66.2	60.3	54.4	52.8
3. If real GNP growth rate in 2002 and 2003 is average minus two standard deviations, others at baseline						80.3	95.8	93.4	87.4	81.3	80.4
4. If US$ GNP deflator in 2002 and 2003 is average minus two standard deviations, others at baseline						110.7	150.2	148.0	141.7	135.1	135.9
5. If noninterest current account (in percent of GNP) in 2002 and 2003 is average minus two standard deviations, others at baseline						75.7	82.4	79.9	74.0	68.0	66.8
6. Combination of 2-5 using one standard deviation shocks						105.9	137.7	135.4	129.2	122.8	123.2
7. One time 30% depreciation in year 2002 (-30% GNP deflator shock), others at baseline.						115.6	117.4	115.0	108.9	102.6	102.4

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

Ankara, July 30, 2002

Dear Mr. Köhler:

1. **Turkey has maintained the strong implementation of its economic program.** We met the end-May performance criterion for the consolidated government sector primary surplus, and the end-June performance criteria for base money and net international reserves (Annex A). We have also continued to make good progress in structural areas, including toward meeting prior actions and structural benchmarks (Annex B), although the end-June performance criterion on state bank restructuring has been missed by a small margin, as described below.

2. **This steadfast implementation has delivered positive results, with both the 3 percent growth target and the 35 percent inflation target for 2002 well within reach, even taking into account the effect of recent political developments.** Although the currency depreciation of recent months may still have further effects on prices, with annualized inflation of only 25 percent for the first half of 2002, our 35 percent end-year target remains readily achievable. The prospects for achieving the GNP growth target of 3 percent are also good: in the first three months of the year GNP grew by a seasonally adjusted 7 percent quarter on quarter, and more recent data on capacity utilization, industrial and agricultural production, exports, and tourism suggest that the economic recovery has continued in the second quarter.

3. **We remain fully committed to the program, and will make every effort to keep it on track, political uncertainties notwithstanding.** Even with the marked worsening of financial market indicators over the past few months, interest rates and the exchange rate remain broadly within our conservative program assumptions. And, with a floating currency, and our ongoing efforts in banking and other structural areas—facilitated by the strengthened independence of institutions, such as the Central Bank of Turkey (CBT) and the Bank Regulation and Supervision Agency (BRSA)—Turkey's economy is now more robust than before. We have also strengthened the program through introducing new structural commitments in key areas, including fiscal policy and banking reform. Moreover, continued broad support for the economic strategy from public opinion and civil society will also help ensure the program's continued strong implementation.

4. **While early elections could delay legislative reforms, the government remains committed to timely implementation of those aspects of our policy strategy that are the prerogative of the executive branch**. Parliament has been reconvened and is likely to set an election date of November 3. As a result, our legislative reforms will inevitably face some

delay. Even so, the government and its economic team are committed to completing all technical preparations for such legislation, and to submit such legislation to parliament, according to the timetable outlined in this letter. In addition, the vast majority of the program's policies (for example, monetary and fiscal policy, and a wide range of structural reforms) do not require the approval of parliament. We intend to implement these fully, thereby safeguarding the program's macroeconomic policies and objectives.

5. **On this basis, we request that the third review under the SBA be completed.** We also request a waiver of nonobservance for the end-June performance criterion on the closure of state bank branches, which was missed by a narrow margin (with 788 closures, we fell just 12 short of the 800 end-June target), as we continue to make good progress with the operational restructuring of state banks (as described in paragraph 21 below). Moreover, we request that the ceilings and floors for the quantitative performance criteria under the arrangement on (i) the cumulative primary balance of the consolidated government sector, (ii) contracting or guaranteeing new external public debt, (iii) short-term external public sector debt, (iv) net international reserves, and (v) base money will be set for the respective test dates through December 31, 2002 as set out in Annex A. These levels correspond to the indicative targets in the January 18, 2002 Letter of Intent. Finally, to facilitate close monitoring of fiscal performance in the remainder of the year, we propose establishing indicative targets on the cumulative primary balance of the consolidated government sector for end-September and end-October 2002, and a performance criterion on the cumulative primary balance of the consolidated government sector for end-December 2002, as also shown in Annex A.

Fiscal policy and public sector reforms

6. **We remain on track to achieve the public sector primary surplus target of 6.5 percent of GNP in 2002.** We have met all the performance criteria on the consolidated government sector primary surplus so far this year, including that for end-May. Moreover, preliminary data for June show that, cumulatively, the central government primary surplus remains TL 1.2 quadrillion (0.4 percent of annual GNP) above the program target. Finally, price hikes in state economic enterprises (SEEs) in June–July, particularly for telecommunications services, tobacco, alcohol, and natural gas, have helped to recover the bulk of the SEE revenue losses from earlier delays in raising prices. Looking forward, we expect tax revenue to be somewhat below our earlier projections due to lower-than-expected inflation and nominal income, tax rebates are expected to be well beyond program projections due to robust exports, and recent instability has led to some collection problems in social security institutions. In addition, health spending pressures have emerged, largely as a result of higher medicine prices, and we have had to allocate resources for election expenses. Partly offsetting these pressures, we expect higher grants, and some transfer payments will shift to 2003. To address the remaining gap, we will reduce this year's spending in selected earmarked accounts (which will allow us to transfer about TL 300 trillion to the budget), and we expect to achieve savings of about TL 100 trillion in discretionary budget spending due to a lower-than-expected price level. We will also complete all remaining real price increases necessary to fully offset earlier SEE revenue

losses. SEE prices will subsequently be changed broadly in line with the WPI, except in the energy sector, where we will continue to pass through world prices.

7. **We remain committed to keeping the public sector primary surplus at 6.5 percent of GNP in 2003, to help further improve public debt dynamics.** On July 16, the High Planning Council issued a decision setting guidelines for the 2003 budget consistent with our macroeconomic framework envisaging real GNP growth of 5 percent and inflation of 20 percent. This decision envisages that real primary spending in the public sector will remain unchanged in 2003, which would support our intention not to raise the already high overall tax burden (see paragraph 8). On the basis of this decision, the government intends to adopt by September 2002 an action plan leading to further reductions in the average project completion time in the public investment program by more than 3 percent annually in both 2003 and 2004. The action plan will include details on the 2003 public investment program and further steps for the 2004 program for which the details will be ratified by the High Planning Council in 2003. In addition to the framework laid out in the decision, our plans for 2003 include the following:

- Our **public sector wage policy** for 2003 will be guided by three considerations. Civil service salary increases will be in line with programmed inflation. In negotiating public worker wages, we will continue to strive to address the large wage premium over the civil service. Finally, we will aim to reduce backward indexation in all future civil service and public sector wage agreements.

- Our **public sector employment policy** will continue. Consolidated budget employment will not be increased, and in state enterprises, hiring will only be permitted (at a 10 percent replacement rate) for attrition in non-budget funded entities. Our retrenchment program will continue as programmed, and for this attrition there will be no replacement hiring.

- We will enforce financial discipline in **state enterprises and local governments.** Backed by the new Debt Management Law, we are pursuing repayment of local government arrears to Treasury on called guarantees. Moreover, we are preparing a comprehensive plan to address tax arrears (completing such a plan is a structural benchmark for September 15, 2002). This will entail financial and/or operational restructuring of certain state enterprises and municipalities.

- We will continue to implement our **pricing policy in state enterprises**. Price increases will be broadly in line with the WPI, and for the energy sector we will pass through world prices. We will aim for real reductions in prices where cost reductions permit.

- Finally, we will continue to implement the **pension reform** agenda for SSK and BK (the funds for wage earners and the self employed) as set out in 1999. To this end, we intend to pass legislation underpinning the necessary institutional and administrative reforms by end-2002. We will also prepare by end-year, with technical assistance as needed, a study of the solvency of our civil service pension fund, to prepare the ground for future reforms.

- In the event of elections this fall, we would issue a provisional 2003 budget to be in effect until the full budget could be passed. This provisional budget would provide for no real increase in appropriations over the same time period in 2002.

8. **We will continue to press ahead with our comprehensive overhaul of the tax system.** Having significantly simplified indirect taxation, we have now turned our attention to direct tax and revenue administration reforms:

- **Our plans for the direct tax reform are taking shape.** (The legislation for this second phase of tax reform is to be submitted to parliament by end-October 2002 as a structural benchmark, and is to be passed by parliament by end-March 2003.) In this reform, our two principal aims are to broaden the tax base (especially by rescinding exemptions and incentives), and to reduce key distortions (especially on capital income). To the extent our expenditure containment efforts allow, we will reduce the overall tax burden.

- **Our revenue administration reforms should help broaden the tax base in the medium term, creating room for reductions in tax rates.** In September 2002, we will approve a new functional structure, which includes units covering taxpayer registration (including tax office management), taxpayer services, audit, collection, legal affairs and procedures, tax policy, international tax relations, as well as units for support functions (budget, human resources, and information technology). In addition, an internal audit group will be established and will report directly to the General Director. In May, a high-level audit coordination committee was established in the Ministry of Finance, and a Ministerial decision, to be issued by end-September, will specify both how it will operate, and what the key elements of the annual audit plan will be. We have already hired 250 new auditors to help us implement our plan for 2003, which we expect to complete by end-November 2002.

9. **Public worker employment in SEEs and in other parts of the public sector is being rationalized, and we are working toward introducing a retirement program for the civil service as well.** Between end-January and end-June 2002, 11,342 public workers retired from state enterprises. There were no transfers of workers to the civil service during this period. In July so far, 2,580 additional public workers have retired from state enterprises. With this, we are on track to achieve the end-October 2002 structural performance criterion on reducing by two thirds the 45,800 state enterprise workers identified as redundant as of end-January. Outside the SEE sector, in the first half of 2002 4,280 public workers retired from consolidated budget agencies. We are also preparing legislation extending the retirement program to the civil service.

10. **We will shortly introduce ambitious public financial management legislation to help overhaul the budget process.** The new budget systems law (the Public Financial

Management and Internal Control Law) will set out a comprehensive framework for budget preparation, execution, accounting, reporting, and internal and external audit. Over many years, Turkey's fiscal system has become increasingly fragmented, undermining transparency and aggregate fiscal control. To address this, the law will consolidate revolving funds, extrabudgetary funds, and annexed and special budgets into one central government budget, under a common classification. It limits the scope for ad hoc policy initiatives which have fiscal consequences. The bill authorizes the Ministry of Finance to set standards for accounting, financial control, and reporting throughout the general government. The law also expands the coverage of Turkish Court of Accounts (TCA) audits to all of general government and provides for external audit of TCA's own expenditures. Finally, over time, it will allow the locus of financial control to shift to line ministries, removing the incentive for fragmentation and improving performance orientation in government agencies. More specifically, the TCA will lose its ex-ante control function, and internal audit units and ex-ante control functions will shift to line ministries. As indicated in our anti-corruption plan, we will prepare and submit to parliament an Inspection Law to achieve restructuring in all inspection units and begin implementing the inspection standards and establish the hiring and working principles for inspectors. The Public Financial Management and Internal Control Law, originally expected to be submitted to parliament by end-June (as a structural benchmark), and also covering reforms to extrabudgetary funds (whose passage by parliament was a structural benchmark for July), will be submitted to parliament as a **prior action for this review**, and its passage by parliament will be a new **structural benchmark** for end-March 2003.

11. **We are also preparing legislation to improve the governance of state enterprises.** This legislation will clarify state enterprise goals (including financial targets) and set new accountability standards. At the same time, the proposed law will enhance management autonomy and internal governance, preparing the ground for future privatizations. Specifically, it will address accounting, reporting and audit arrangements, and the role, responsibilities, and independence of state enterprise boards. We will submit this legislation to parliament by end-2002, as a new **structural benchmark.**

Debt management

12. **Our efforts to strengthen debt management are continuing.** We continue to improve our risk management capability and the coordination of our borrowing strategy. We will reintroduce a strengthened primary dealer system ahead of schedule by mid-August. The new system will aim to deepen the secondary market for government debt. It will also ensure that a significant share of treasury bills at auction will be placed through primary dealers. In line with the new Law on Debt Management, a communiqué will be published in the Official Gazette by end-September 2002 defining the responsibilities of the middle office and of a new debt management committee that will oversee the development of risk and debt management policy (a new **structural benchmark**). Based on our recently completed study of Treasury operations, which incorporates technical and financial assistance by the World Bank, by end-September 2002 we will formulate an action plan to establish an integrated risk management system to monitor financial risk across the government's debt portfolio. If

necessary, the Treasury will hire external consultants for the design of this system in the first half of 2003. In the meantime, we will develop simple benchmarks to monitor financial risk and to guide our borrowing decisions. By end-2003, the middle office will be fully operational.

Monetary and exchange rate policies

13. **Monetary policy will continue to focus on attaining our inflation target of 35 percent for 2002.** In the first half of the year, we have met all of our quantitative monetary program targets. By sticking to the monetary program, we have achieved significant reductions both in inflation and in inflation expectations. As a result, despite recent uncertainties, we are now fully on track to meet our end-year inflation target. For the second half of the year, we reaffirm our commitment to the monetary targets set out in the 2002 program, and are continuing technical preparations for the introduction of formal inflation targeting before the end of the year.

14. **We remain committed to the floating exchange rate regime**. However, as before, the CBT could intervene in the foreign exchange market in a strictly limited manner to dampen excessive volatility. Since recent developments have resulted in renewed currency substitution while the balance of payments position has remained comfortable, the CBT has temporarily suspended its daily foreign exchange purchase auctions. However, depending on developments in the balance of payments and currency substitution, the CBT stands ready to reintroduce these purchase auctions, given our longer-term objective of strengthening our international reserve position.

15. **The efforts to strengthen foreign exchange and money markets continue:**

- **Our earlier efforts are bearing fruit.** Banks are now making increased use of the May 24 relaxation of the system of averaging reserve requirements to better manage daily liquidity demands. Interbank segmentation has declined markedly, with the extension of withholding tax on interest payments to Takasbank. With parliament having passed the needed legislation, stamp duties on forward contracts were removed effective June 22. Moreover, the decree to implement the removal of tax on foreign exchange transactions was issued on July 30, meeting a **prior action for completing this review**. The CBT will continue its one-month deposit auctions, which have been well received by markets, and have helped define the yield curve. Deposit outflows associated with the results of the audit exercise have subsided and the CBT has not had to supply funds under its contingency credit window established on June 19.

- **We are also making further efforts.** The CBT's phased withdrawal as a blind broker for banks in the money and foreign exchange markets remains on schedule. The CBT and the BRSA have established high frequency coordinating arrangements (including daily information exchange) to ensure that only sound intermediaries participate in the money and foreign exchange markets. In this regard, state-owned banks, which have until now been excluded from the overnight markets, will be allowed to re-enter the market, but with exposure restricted to no more than 2 percent of deposits. On August 1, 2002, the Turkish Banks' Association will launch the Turkish Lira Interbank Offer Rate (TRLIBOR) which will provide an interbank reference rate for transactions of a specified size (TL 1 trillion). 13 banks, each with assets exceeding US$1 billion, will participate, with state banks as price takers.

Financial sector reform

16. **With the independent evaluation of banks' financial condition now completed, the BRSA is continuing to implement its strategy for strengthening the private banking system:**

- **We expect the recapitalization of the banks to be completed by end-August 2002.** A three-stage audit of 26 banks' financial condition was completed in June. All the banks were notified about the outcome of the process, which indicated that (excluding the intervened Pamukbank) the capital needed from banks with deficiencies amounted to TL 1,326 trillion. Of that amount the banks have already raised TL 1,102 trillion during the period of the evaluation process. To fill the remaining capital need, we expect requests from the Tier II public capital support scheme. Those banks that receive support will have representation by the BRSA or the Saving Deposit Insurance Fund (SDIF) on their boards.

- **We are taking steps to resolve the recently intervened Pamukbank.** The audit confirmed that Pamukbank was insolvent, and the acquisition proposal by Yapi Kredi Bank was not found feasible. As a result, in June the SDIF took over Pamukbank, restored its paid-in capital, changed its board and some senior executives, transferred its nonperforming related party loans to the SDIF's Collection Department, and put it up for sale. Potential bidders will have until September 27 to conduct due diligence, and must submit their bids by October 4, 2002.

- **We are taking steps to ensure that the intervention of Pamukbank does not interfere with the operations of Yapi Kredi Bank, which has a capital adequacy ratio above 8 percent and remains sound.** Pamukbank's previous owners also hold 45 percent of the shares of Yapi Kredi Bank and Pamukbank itself directly holds another 10 percent. With the intervention of Pamukbank, the previous majority owners were no longer allowed to exercise voting rights in Yapi Kredi Bank, which, as a result, have been transferred to the SDIF. However, dividends rights still remain with the owners. The BRSA and SDIF will in consultation with appointed independent advisors develop a strategy for resolving Pamukbank and the ownership in Yapi Kredi Bank by September 16, 2002 (a new **structural benchmark**)

- **Finally, the BRSA has continued its efforts to publicize and explain the results of the audit and recapitalization exercise.** It has published explanatory materials, including detailed reports on the exercise as a whole, and on the SDIF's intervention in Pamukbank. It has also held seminars to explain the process to market participants, investors, and media.

17. **We are also taking steps to complete the resolution of the four remaining intervened banks (besides Pamukbank):**

- On July 5, the SDIF received a bid for the purchase of **Toprak Bank.** The SDIF Board will make a final decision on this bid by end-July 2002. If this bid is not acceptable and the bank is not sold by September 16, 2002 the bank's license will be revoked by end-September 2002 and it will either be merged into another bank or liquidation procedures initiated (the revocation of the license is a new **structural benchmark**).

- On June 27, a court ruling was issued allowing the SDIF to proceed with the liquidation of **Türk Ticaret**, and its bank license was revoked. Liquidation will be started once the August 9 shareholders' assembly meeting has formally approved it.

- If by end-August 2002 no qualified investor has offered to purchase **Tarişbank**, its license will be withdrawn. Its nonperforming loans will then be transferred to the SDIF's Collection Department, and remaining liabilities and performing assets absorbed by Bayindirbank, the bridge bank established earlier this year, by end-2002.

- As part of the SDIF's strategy for resolution of assets in intervened banks, it is expected that **Bayindirbank**'s role as a bridge bank will gradually diminish.

18. **The BRSA is developing a strategy for dealing with the bad assets transferred to the SDIF's Collection Department, including the establishment of an asset management company (AMC).** The SDIF, with advice from independent consultants, will develop a detailed sale strategy for disposal of assets held by the Collection Department. This strategy will be announced by end-September 2002 (a new **structural benchmark**). By end-October 2002, the SDIF will also announce the sale of loan portfolios with a total face value of at least US$250 million (another new **structural benchmark**), with bids to be submitted by end-2002. If private banks or other entities were to express an interest in setting up their own AMC, the SDIF would be willing to participate and provide up to 20 percent of the capital needed as permitted by the law. Otherwise assets in intervened banks would be handled by the Collection Department (bad assets) and Bayindirbank (good assets).

19. **The "Istanbul Approach" for corporate debt restructuring is now operational.** Final institutional elements were put in place in July with the appointment of the Turkish Industrial Development Bank (TSKB) as the Coordinating Agency, the appointment of members of the Arbitration Committee, and the establishment of arbitration procedures. The first corporate debt restructuring agreement under the Istanbul Approach was concluded in late June by a consortium of credit institutions, including the IFC and the EBRD, restructuring debt of a conglomerate group. Negotiations for other corporate workouts are in progress.

20. **The Ministry of Justice is pressing ahead with the reform agenda on bankruptcy and foreclosure laws in consultation with the World Bank.** We have received the World Bank's Report on the Observance on Standards and Codes on Insolvency and Creditor Rights Systems, and endorse the Report's policy recommendations. Based on the recommendations, our aim remains to formulate comprehensive reforms by end-September (a structural benchmark) and enact them by end-January, 2003 (also a structural benchmark). Moreover, we have submitted draft legislation to the Council of Ministers for creation of intermediate courts of appeals in bankruptcy cases and for accelerated creditor enforcement procedures.

21. **Our restructuring of state banks is entering a new phase.** While operational restructuring will continue, the critical phase of major employment reductions and branch closures in Ziraat and Halk is almost complete. Although we have not quite met the target of 800 branch closures (structural performance criterion for end-June 2002), we closed 788 branches between April 2001 and June 2002. In July, we have closed 5 more branches, and expect the 800 target to be reached shortly. Between April 2001 and June 2002 we have reduced staffing by 26,000 employees. With an additional staff reduction of 3,000 in July 2002, the number of employees has been almost halved. Working with the World Bank, we will now prepare the banks for privatization. We hope to appoint an independent advisor on the privatization of Halk by end-September, and to put it up for sale in the first quarter of 2003. We will also seek outside assistance for the privatization of Ziraat, and to sell it later as conditions permit. To maximize the sales value of the two banks, we believe that it is essential that the banks present financial statements for at least one full year after the operational restructuring has been completed, before we complete the sales process. The planned privatization of Vakif Bank was not successful, as no bidder was willing to purchase the bank whole (a condition that had been set for acceptable bids). We will again work with the World Bank to ensure the success of this sale, by operationally restructuring the bank. We will also look into any legal obstacles to the privatization of Vakif Bank, and submit to parliament any needed legislative amendments by end-October 2002. We expect the bank to be put up for sale again in the second quarter of 2003.

22. **The implementation of International Accounting Standards (IAS) is proceeding as planned.** In June the BRSA issued the final regulation for the implementation of IAS (meeting a performance criterion for end-June 2002), which should be fully reflected in banks' balance sheets by end-2002.

23. **We will continue our efforts to strengthen supervision of financial institutions and to enhance consolidated supervision:**

- **We will transfer the supervision of non-bank financial institutions (excluding insurance companies) from Treasury to the BRSA.** At present, the Treasury is in charge of supervising these companies, even though banks own many of them. To better facilitate consolidated supervision, we will send a draft law to parliament by end-March 2003, which transfers supervisory responsibility to the BRSA effective July 1, 2003.

- **We will also strengthen the supervision of insurance companies, which the Treasury is also responsible for supervising, even though banks own some of these.** The Treasury will launch a study, with independent consultant advice, to be completed by end-2002 that will consider how best to strengthen the regulatory and supervisory framework of insurance companies. In addition, by the end of the year the Treasury will also send to the Council of Ministers a new draft law to regulate insurance companies in line with applicable EU Insurance Directives and IAIS Core Principles.

- **The BRSA is strengthening its banking supervision through introduction of risk-based supervision, including oversight of operational risks.** The BRSA may need to hire outside expertise to be able to carry out such supervision. In light of this, together with its increased supervisory responsibilities of non-bank financial institutions, the BRSA will complete a reorganization study to enhance its supervisory capacity. The study will be completed by end-2002 (a new **structural benchmark**).

Enhancing the role of the private sector

24. **We are making progress in the sale of companies that are ready for privatization.** In early July, the Privatization Agency (PA) announced a new strategy for reducing the public share in **TÜPRAŞ** (petroleum refinery) to below 50 percent: this will be done by end-2002 through a tender for a strategic partner, or the placement of exchangeable bonds, or both, since a public offering is not feasible under current market conditions. On July 16, the High Privatization Council authorized the sale of the remaining state share of 25.8 percent in **POAŞ** (petroleum distribution company) to the existing strategic investor. We expect the sale to be completed by mid-August 2002. On July 30, we reduced the public share in **ERDEMIR** (steel company) to below 50 percent through a sale to an investment fund. By October 2002, we will announce a block sale of at least 51 percent of the shares in **PETKIM** (petrochemical company). We are confident that these and other sales of state enterprises will bring in enough cash to meet the US$700 million indicative target on cumulative cash privatization proceeds for 2002.

25. **We are also pressing ahead with the preparation for the sale of other key SEEs.** Preparations for the privatization of **Türk Telekom** (TT) are proceeding according to the road map approved in May. The tender for an advisor on TT's revaluation was announced on July 8, and the advisor will be selected in August. Consultants to prepare the privatization plan for **TEKEL** (the tobacco and alcohol monopoly) were selected in July, and the plan will be submitted to the Council of Ministers in September. The High Privatization Council will approve shortly a road map for the privatization of **ŞEKER** (the sugar company). The road map envisages that 5 inefficient sugar factories will be closed and 7 factories converted into corporations by end-October 2002, and that preparatory work for privatization will be completed by end-2002. In the **electricity sector**, as planned, with the exception of the projects potentially eligible for Treasury guarantee, we will transfer all state-owned thermal generation and electricity distribution assets under the scope of privatization by end-July.

Pre-qualification tenders for these distribution assets would be launched by February 2003. We will also transfer two distribution subsidiaries of **BOTAŞ** (natural gas company) to the PA by end-August 2002, with a view to privatizing it in 2003.

26. **We are complementing privatization by other steps to improve the private business environment.** While our preparations for the planned July 18 inaugural meeting of a high-level Investor Advisory Council were well advanced, we decided not to hold the meeting at this time owing to the recent political developments. We remain, however, determined to hold this meeting at an opportune time in future. In the meantime, we are continuing to take steps to improve the business climate for both domestic and international investors. The Coordination Council for the Improvement of the Investment Climate will continue to hold regular meetings to assess private investors' needs and monitor the progress made by the nine technical committees established earlier this year. Specifically, by April 2003, we will submit to parliament (i) a new draft law on company registration to simplify and streamline the company registration process; and (ii) a new draft law on Prohibition and Prosecution of Smugglers.

Follow-up on safeguards assessment

27. **Building on our earlier efforts, we have further strengthened the transparency and effectiveness of the CBT's control, accounting, reporting, and auditing systems, including in the context of the IMF safeguards assessment, which is required for all new Fund-supported programs.** In particular, on July 5 we issued and posted on the CBT website the external auditor's report reviewing the consistency between the program data reported to the IMF and the audited financial statements. With this action, we met a structural performance criterion for July 15.

Very truly yours,

/s/
Kemal Derviş
Minister of State for Economic Affairs

/s/
Süreyya Serdengeçti
Governor of the Central Bank of Turkey

Turkey: Quantitative Performance Criteria and Indicative Targets for 2002

	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome
	March 31, 2002		May 31, 2002		August 31, 2002		November 30, 2002		December 31, 2002	
I. Performance criteria										
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira) 1/	2,847	2,924	4,714	5,365	9,600		14,900		16,050	
	February 28, 2002		April 30, 2002		June 30, 2002		September 30, 2002		December 31, 2002	
2. Ceiling on contracting or guaranteeing of new external public debt with original maturities of more than one year (in millions of US$) 2/	6,500	1,645	10,000	2,402	11,100	3,690	14,300		17,500	
3. Ceiling on the stock of external public debt with original maturities of up to and including one year (in millions of US$) 3/	1,000	0	1,000	0	1,000	0	1,000		1,000	
4. Floor on level of net international reserves of CBT and Treasury combined (in millions of US$)	-6,500	-4,907	-7,200	-4,926	-7,800	-5,755	-8,500		-9,700	
5. Ceiling on base money (in trillions of Turkish lira) 4/	8,250	7,823	8,900	8,680	9,250	9,009	10,600		10,850	
II. Indicative targets										
	May 31, 2002		August 31, 2002		September 30, 2002		October 31, 2002		November 30, 2002	
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira)	...		...		11,300		12,250		...	
2. Floor on the cumulative overall balance of the consolidated government sector (in trillions of Turkish lira)	-17,486	-16,367	-28,250		...		...		-39,750	
	February 28, 2002		April 30, 2002		June 30, 2002		September 30, 2002		December 31, 2002	
3. Floor on the cumulative primary balance of other public entities sector (in trillions of Turkish lira)	...		...		550		...		1,100	
4. Ceiling on the stock of net domestic assets of the CBT and Treasury combined (in trillions of Turkish lira) 4/	26,100	24,318	27,700	25,197	28,739	26,374	31,139		33,139	
5. Privatization proceeds (in millions of US$)	...		...		...		220		700	

1/ The target for end-March has been adjusted for expenditure arrears outstanding at Bag-Kur (a social security fund).

2/ Applies to nonconcessional external debt with an original maturity of more than one year. Excludes purchases from the IMF, adjustment lending from the World Bank, and other external program financing, long-term liabilities of the Central Bank and sales of treasury bills and bonds denominated in TL or Fx to nonresidents in either the domestic primary market or the secondary market.

3/ Stock of debt of maturity of one year or less, owed or guaranteed by the consolidated government sector. Excludes external program financing, sales of treasury bills denominated in TL or foreign exchange to non residents in either the domestic primary market or the secondary market, normal import-related credits, reserve liabilities of the Central Bank, and forwards contracts, swaps and other futures market contracts.

4/ Target for end-February calculated as four working day average of February 11-12 and March 11-12, 2002, to take account of the transitory impact of the Bayram religious holiday on currency demand. NDA targets for June onward have been lowered by TL 161 trillion compared to the January 18, 2002 Letter of Intent to reflect the drop in required reserves following the SDIF's intervention in Pamuk Bank.

Structural Policies, 2002–04

Action	Type	LOI Para[1/]	Status July 30, 2002
Fiscal policy			
1. Implement all further measures to reach the 6.5 percent primary surplus target that are technically feasible to put in place in January:	PA for SBA	13	
(i) Council of Ministers to approve a reduction in the share of central government tax revenues accruing to metropolitan municipalities to 4.1 percent			***Done.***
(ii) issue a circular to implement attrition rules			***Done.***
(iii) the Minister of Finance to approve a reallocation of spending to ensure adequate funding for DIS for agriculture			***Done.***
2. Increase the PCT (on items excluding natural gas) by 1 percent in real terms in early February		14	***Not done.*** Increase was equal to January WPI inflation.
3. By end-March (i) the Ministry of Finance to identify savings from closing regional administrations and other regional line agency offices, and block relevant budget appropriations in the budget, and (ii) SEEs to approve budgets in line with the cost reductions mandated	BM	14	***Not fully achieved.*** (i) In March, a decree regarding closure of regional administrations and other regional line offices was issued. Subsequently, line agencies were asked to block relevant appropriations. However, the measure did not yield the expected amount of savings. (ii) Most SEEs have approved budgets in line with cost reductions mandated and others have been instructed to correct their budgets.
4. Keep investment expenditure in SSK at the level originally planned in the investment program for 2002, implement generic drug purchase program in ES by end-April, and receive profit transfer of TL 180 trillion from Ziraat Bank		5 of April 2002 LOI	***Not fully complied with.*** SSK's investment is not expected to fall, since several of its projects fall outside of the annual investment program and are not subject to the limits therein. The Ministry of Health now aims to finalize the generic drug purchase program by end-2002. The profit transfer from Ziraat was received in April 2002.
5. Refrain from introducing any new tax exemptions or incentives, except those specified in the tax reform plan		14	***Not fully complied with.*** Payroll and personal income tax deferments were introduced in March 2002 as part of an effort to stimulate employment.

Action	Type	LOI Para[1/]	Status July 30, 2002
6. Refrain from introducing any new discounts or exemptions for SEEs, except those pursued for commercial reasons by enterprises' managements		14	***Done, but partially reversed.*** The president approved Law No:4736 on January 18, 2002 preventing any new discounts or exemptions for SEEs. However, some discounts for electricity were reintroduced in May, for phase out by end-2002.
Public debt management			
7. Continue to lengthen average maturity in Treasury bill auctions and public offerings to the extent demand allows and encourage a diverse range of investors		18	***Underway.***
8. Resume in January 2002 the program of FRN auctions. Before the first issue publicize a revised standard method of price and yield calculations, in line with international practice		19	***Done.***
9. Reintroduce a primary dealer program by end-September 2002	BM	19	A draft dealership contract has been prepared and will be discussed with candidate primary dealers in July. The system is expected to be reinstated ahead of schedule by mid-August.
10. Continue to issue, subject to market conditions, domestic FX denominated and FX indexed bonds, as well as international bonds		19	Taking into account redemptions and market conditions, FX denominated and FX indexed securities will be issued.
11. The Treasury to complete a study by end-June 2002 of its operational mechanisms, procedures, and structure to improve its risk and debt management, including through closer coordination between domestic and international borrowing. The recommendations of this study will be implemented during 2002		19	***Done.*** Based on the recommendations of the study, the middle office, which was recently established within the Treasury to coordinate the Treasury's domestic and external borrowing, will formulate an action plan by end-September 2002 to establish an integrated risk management system to monitor financial risk across the government's debt portfolio. In the interim period, the Treasury will develop simple benchmarks to monitor financial risk and to guide their borrowing decisions. The middle office is expected to be fully operational by end-2003.
12. Issue in June government communiqué that spells out details of the operations of the middle office that will formulate overall public debt strategy		6 of April 2002 LOI	A draft communiqué was completed and circulated internally for comments.

Action	Type	LOI Para[1/]	Status July 30, 2002
13. The Treasury to develop its cash management operations, acting in coordination with the CBT		19	The new Debt Management Law allows for the technical infrastructure for cash management operations in coordination with the CBT.
14. The Treasury to intensify its dialogue with the full range of investors, including bilateral contacts and group discussions with institutional investors and intermediaries, and enhanced retail outreach		19	With the target of broadening the investor base, discussions are ongoing on the conditions of a security which is planned to be issued for insurance companies. A series of meetings are being held with private banks, which provide feedback about market developments and specific concerns banks have.
15. By end-September 2002 publish in the Official Gazette, the communiqué defining the responsibilities of the middle office and of a new debt management committee that will oversee the development of risk and debt management policy	BM	12 of July 2002 LOI	The communiqué is being drafted.
Monetary and incomes policy			
16. Ensure that any new laws or regulations do not undermine the independence enshrined in the CBT law		21	***Done.*** All new laws and regulations are consistent with CBT independence.
17. CBT to continue its technical preparations for the introduction of inflation targeting, including improved modeling and forecasting of inflation		22	Work ongoing at the CBT covers short- and near- term forecasting, and development of the data base.
18. Move to inflation targeting		22	In addition to progress in establishing the necessary technical infrastructure, favorable developments in disinflation and inflation expectations, fiscal policy, and the banking sector are expected to allow the pre-conditions to be met to allow a move to formal inflation targeting by end-2002.
19. Seek a significant reduction of the ex-post indexation element contained in current wage contracts during the next public worker collective bargaining round and civil service salary adjustment, and use the Economic and Social Council as a forum for incomes policy discussions with the private sector		23	An exploratory meeting between labor unions and the authorities to achieve this goal was held in February.

Action	Type	LOI Para[1/]	Status July 30, 2002
20. a. Consider the possibility of reducing backward indexation of administered prices without compromising SEEs' financial conditions		23	***Partially done.*** Most SEE prices have not been changed from January to mid-May 2002, weakening the SEEs' financial conditions. Price increases resumed in late May and continued in June and July. All remaining real price increases necessary to fully offset earlier SEE revenue losses will be made shortly. Changes at discrete intervals, in line with the WPI, are expected in the remainder of the year.
b. In the ongoing negotiations on new two-year private sector wage contracts the government to stress to labor unions and employers the need to reduce backward indexation		14 of April 2002 LOI	
21. Encourage a successful conclusion by end-February 2002 of banks' discussions to establish interbank borrowing reference rates in Turkish lira out to at least three-month maturity to enhance money market liquidity and transparency, and to provide accurate reference rates for financial instruments		25	Measures have been taken to deepen the interbank money market. Turkish Bankers' Association will launch Turkish Lira Interbank Offer Rate (TRLIBOR) August 1, 2002.
22. The CBT to gradually end its practice of acting as a blind broker during 2002		25	The phasing out by end-2002 has been announced by the CBT.
23. Working group to facilitate the development of financial markets to identify concrete actions by end-January 2002 in the areas of taxation, accounting, and regulation. The first measures will be put in place by end-February 2002		25	Interagency committee chaired by CBT with membership from Banks Association of Turkey, BRSA, MOF and ISE, established and has held two meetings. Taxation of revaluation profits clarified in February, and prudential rules on market risks effective since January 2002.
24. The Privatization Agency to authorize companies in its portfolio to transact their foreign exchange business at the market rate (not at the CBT official rate). The oil and gas companies (TÜPRAŞ and BOTAŞ) to work with state banks to improve their foreign exchange practices, to minimize lumpy transactions in the foreign exchange market		25	***Done.***
25. To encourage development of the foreign currency market, eliminate stamp duties on forward contracts and remove the tax on interbank foreign exchange transactions by end May 2002		9 of April 2002 LOI	***Done.***
26. Require as of end-May withholding of interest earned through transactions intermediated through Takasbank		9 of April 2002 LOI	***Done.***

Action	Type	LOI Para[1/]	Status July 30, 2002
27. To rationalize the system of reserve requirements the CBT, effective from May 2002, to (i) increase the scope and length of the averaging of reserve requirements, and (ii) increase the remuneration of both Turkish lira and foreign currency reserves, linking remuneration to market rates		9 of April 2002 LOI	***Done.***
28. Multi-agency working group to continue to identify measures to ensure the successful development of money and foreign exchange markets		9 of April 2002 LOI	Multi-agency working group chaired by the CBT with the participation of Banks Association of Turkey, BRSA, MOF, ISE, IGE, Treasury, and CMB has held meetings related to the development of the derivatives markets and TL reference rate fixing. Taxation and accounting problems of the futures transactions have been solved by the MOF and BRSA, respectively.
29. Issue the decree to remove tax on foreign exchange transactions	PA	15 of July 2002 LOI	***Done***. Decree was issued on July 30, 2002.
Banking reform			
30. Pass necessary legal amendments, and issue a Council of Ministers Decree for staff reductions in state banks	PA for SBA	28	***Done.***
31. By end-June 2002, reduce the number of state bank branches by 800. In this context also reduce staffing correspondingly	PC	28	***Missed by a small margin.***788 branches had been closed by end-June 2002 and 26,000 staff was reduced. However, the process has continued in July with further closures of 5 additional branches.
32. For Vakif Bank privatization, bids to be invited from potential investors in May		28	No bids were received by the end-June deadline. It is expected that the bank will be put up for sale again in the spring of 2003.In the meantime, an evaluation will be made of the need to make legal amendments to remove any exiting obstacles to this sale.
33. BRSA to issue guidelines for targeted evaluations of private banks in preparation for the public support scheme for private banks	PA for SBA	30	***Done.***
34. The targeted evaluation of loan portfolios, collaterals, and certain other exposures to be performed by banks' existing external auditors to be completed by end-March		30	***Done.***

Action	Type	LOI Para[1/]	Status July 30, 2002
35. Third-party auditing firms to be appointed by the BRSA by end-March 2002 to verify that the guidelines have been followed, and to ensure the integrity of the process	BM	30	***Done.***
36. a. The BRSA to (i) complete the final interpretation of the evaluations by end-April and (ii) send letters to banks stipulating required actions on the basis of this interpretation by May 15	PA for second review (action # (ii))	30, 31	a. ***Done.*** (i) Auditing reports submitted to the BRSA by late May; (ii) Letters to 24 banks sent on June 12. Of the remaining two banks, one was intervened on June 19, and a letter was sent to the other bank the same day.
b. Evaluation results to be fully incorporated into banks' end-June 2002 financial statements			b. Evaluation results expected to be incorporated by end-August 2002.
c. Banks to apply for participation in the scheme before end-May 2002			c. Banks expected to apply by end-July.
d. Recapitalization scheme to be completed before end-June 2002			d. Completion expected by end-August 2002.
e. The BRSA to prepare prototype contracts to be signed between the Saving Deposit Insurance Fund (SDIF) and the majority shareholders on the pledging of shares, share buy-backs, and the conversion of Tier–2 capital into Tier–1 capital		10 of April 2002 LOI	e. ***Done.***
37. The legal framework and related regulations for the public support scheme for private banks to become effective in January 2002	PA for SBA	32	***Done.***
38. The BRSA to undertake legal consultations, as necessary, to ensure implementation of the public capital support scheme as planned		32	***Done.***
39. Resolve by end-2001 all banks taken over by the SDIF before November 2001, with the exception of two banks whose resolution has been halted by courts	PA for SBA	33	***Done.***
40. a. Determine final resolution method for Toprak bank taken over in November 2001 by February 2002		33	***Done.*** After no acceptable bids were received by the original sale deadline of April 9, the bank was reoffered for sale in mid-May. One potential bidder made an offer to the BRSA on July 5. The SDIF Board is expected to make a decision on this bid by end-July.
b. The SDIF to revoke Toprak's license by end-September 2002 if the bank is not sold by September 16, 2002.	BM	17 of July 2002 LOI	

Action	Type	LOI Para[1/]	Status July 30, 2002
41. The SDIF to prepare a monthly balance sheet starting end-March 2002 and become subject to annual external audits; the external audit for 2001 will be completed by end-April 2002	BM (the latter action)	34	***Done.***
42. Laws and regulations regarding loan classification, loan loss provisioning, and collateral valuation will be amended as necessary following the portfolio reviews by end-June 2002		35	***Done.***
43. Pass legal amendment in January 2002 to eliminate with immediate effect the existing four-year transition rule for loan loss provisioning	PA for SBA	35	***Done.***
44. Start trial implementation of new accounting system (for banks) in line with IAS in January 2002	PA for SBA	35	***Done.***
45. Following the trial implementation the BRSA to evaluate the experience and issue by end-June 2002 a revised regulation on the new accounting standards to ensure that banks' end-2002 balance sheets comply with IAS	PC for end-June	35	***Done.***
46. Improve reporting requirements based on the findings of the independent assessments, and strictly enforce the quality and timeliness of the reporting as of end-June 2002		35	***Underway.*** Quality and timeliness of reporting expected to be improved as of end-August 2002.
47. a. Off-balance sheet repos to be included on balance sheet as of February 1, 2002 b. Capital charges for market risks to be calculated on a solo basis as of January 1, 2002 and on a consolidated basis as of July 1, 2002 c. Regulation on monitoring of internal control and risk management systems to become effective January 1, 2002		35	***Done.***
48. The BRSA and SDIF in consultation with appointed independent advisors to develop a strategy for resolving Pamukbank and the ownership in Yapi Kredi Bank by September 16, 2002	BM	16 of July 2002 LOI	
49. Withdraw Tarişbank's license, if by end-August 2002 no qualified investor has offered to purchase it. Its nonperforming loans will then be transferred to the SDIF's Collection Department, and remaining liabilities and performing assets absorbed by Bayindirbank, the bridge bank established earlier this year, by end-2002.		17 of July 2002 LOI	
50. By end-September 2002 the SDIF to announced a detailed strategy for the disposal of assets held by the Collection Department	BM	18 of July 2002 LOI	
51 By end-October the SDIF to announce the sale of a loan portfolio with a total face value of at least US$250 million	BM	18 of July 2002 LOI	
52. The BRSA to complete a reorganization study to enhance its supervisory capacity by end-December 2002	BM	23 of July 2002 LOI	

Action	Type	LOI Para[1/]	Status July 30, 2002
Corporate debt restructuring			
53. Introduce in January 2002 a voluntary market-based framework (the "Istanbul Approach") for dealing case-by-case with multicreditor exposures to large and medium-size borrowers		36	***Done.***
54. Create in early 2002 a multiagency Coordination Committee with private sector participation under the Treasury, responsible for facilitating and monitoring the corporate debt restructuring process, as well as identifying and proposing the removal of impediments that may exist		36; 13 of April 2002 LOI	***Not done.*** Work to be carried out by the Production and Finance Committee chaired by the Treasury.
55. Establish secretariat to the Production and Finance Committee in April		13 of April 2002 LOI	Although the Committee has not been established yet, the BRSA is coordinating the process.
56. Production and Finance Committee to develop further measures consistent with preserving the transparency and integrity of the bank recapitalization exercise, to catalyze banks' and corporates' participation in the "Istanbul Approach"		13 of April 2002 LOI	Although the Committee has not been established yet, the BRSA and Turkish Industrial Development Bank are coordinating the process.
57. Production and Finance Committee to work with the relevant government agencies to establish by June 2002 a database to monitor corporate debt		13 of April 2002 LOI	***Not done.*** The CMB has issued reporting requirements for trading firms who in turn submit information to the ISE. A database on corporate debt has not been developed.
58. A private asset management company will be set up by end-August 2002, with the SDIF owning a minority share		13 of April 2002 LOI	The authorities have been using technical assistance to rethink strategy towards asset sales. Sales strategy for SDIF assets to be developed by end September 2002 requested technical assistance for the drafting of a proposal for potential investors. Implementation contingent on private sector interest.
59. a. The Ministry of Justice to prepare an action plan based on the findings of a World Bank Report on Standards and Codes (ROSC) on Turkey's insolvency regime and form a Commission to prepare necessary amendments to the Bankruptcy Law		37	A commission to prepare necessary amendments to the Bankruptcy Law, in line with the findings of the World Bank ROSC, has been established.
b. The Ministry of Justice to produce a package of comprehensive reforms of the Execution and Bankruptcy Act by September 31, 2002	BM	16 of June LOI	***Underway.***
c. Enactment of the reforms of the Execution and Bankruptcy Act by end-January 2003	BM	16 of June LOI	

Action	Type	LOI Para[1/]	Status July 30, 2002
60. Support the upgrading of administrative procedures in the judiciary to improve the capacity of the courts		37	***Underway.*** A draft legislation has been submitted to the Council of Ministers for creation of intermediate courts of appeals in bankruptcy cases and for accelerated creditor enforcement procedures.
61. The CMB to introduce international accounting standards, including inflation accounting provisions, by January 1, 2003.		38	The CMB has issued the regulation. Firms are taking steps to adopt the new accounting framework.
62. Starting end-March 2002, the CMB to require corporate groups to provide consolidated financial statements and to set up a dedicated group to monitor their finances		38	***Done.*** The CMB has issued the regulation.
63. Starting end-March 2002, the CMB to require corporate groups with financial affiliates to provide consolidated group statements and share those statements with the BRSA		38	***Done.*** The CMB has issued the regulation. The Accounting Standards and Corporate Finance departments of the CMB are monitoring the accounts.
64. Send a draft law to parliament by end-March 2003 which transfers supervisory responsibility of non-bank financial institutions (excluding insurance companies) from Treasury to the BRSA effective July 1, 2003		23 of July 2002 LOI	
65. The Treasury to launch a study, with independent consultant advice, to be completed by end-2002 that will consider how best to strengthen the regulatory and supervisory framework of insurance companies. In addition, by the end of the year the Treasury also to send to the Council of Ministers a new draft law to regulate insurance companies in line with applicable EU Insurance Directives and IAIS Core Principles.		23 of July 2002 LOI	
Public sector reform			
66. Parliament to approve Public Procurement Law in line with UN (UNCITRAL) standards in January 2002	PA for SBA	40	***Done.***
67. Establish an independent procurement agency by end-March 2002	BM	40	***Done.***
68. Change laws and regulations to make them consistent with the new public procurement framework		40	See below.
69. Parliament to amend the Public Procurement Law by end-May 2002, to (i) bring the real value of the thresholds toward those in line with international best practice and (ii) extend the minimum time period for procurement applicable for cases below the thresholds	PA for second review	40	***Done.*** Parliament passed the required amendments on June 12.

Action	Type	LOI Para[1/]	Status July 30, 2002
70. a. Compile a comprehensive list of public investment projects to be phased out in time to make decisions for the 2003 budget		40	The High Planning Council Decision was communicated to spending agencies in mid-July 2002. It instructs line agencies to rationalize their investment programs by 3 percent. Further discussions with line agencies, aimed at greater reductions, will take place during budget preparation and finalized by end-2002
b. The government to adopt by September 2002 an action plan leading to further reductions in the average project completion time in the public investment program by more than 3 percent annually in both 2003 and 2004. The action plan will include details on the 2003 public investment program and further steps for the 2004 program for which the details will be ratified by the High Planning Council in 2003.		7 of July 2002 LOI	
71. Approval by Council of Ministers in January 2002 of plan to reform the tax system	PA for SBA	40	***Done.***
72. a. Enact the first phase of the tax reform plan by end-April 2002	BM	40; 15 of April 2002 LOI	***Done.*** Special Consumption Tax Law (implementing indirect tax changes) was approved by parliament on June 6.
b. Issue a decree by end-August 2002 setting the earmarking of SCT proceeds at zero, starting with the 2003 budget	BM	17 of June LOI	
73. Submit to parliament legislation for the second phase of the tax reform plan by end-October 2002	BM	40	The GDR has been seeking inputs from civil society, and a World Bank technical assistance mission is expected in early-September. Passage by parliament is expected by end-March 2003.
74. Reorganize tax administration in line with the study carried out with the World Bank:		40 and 15 of April 2002 LOI	***Underway.*** The Ministry of Finance put in place an audit coordination unit in mid-May. However the details of its operations remain to be spelled out. The GDR has designed a new functional structure that includes the standard functional units. However, implementation has been delayed by several months; 250 tax auditors have been hired to-date.
a. By end-July, institute an audit coordination unit in the Ministry of Finance, and require that it produce a coordinated audit plan by end-November each year	BM (first such plan by Nov 2002)		
b. By September 15, the Minister of Finance to adopt a strategy to strengthen the collection of outstanding public sector tax arrears	BM		A comprehensive plan to address tax arrears is being prepared

Action	Type	LOI Para[1/]	Status July 30, 2002
c. In the budget for 2003, include resources to increase the number of auditors by 400 (for October 17) to move toward OECD standards	BM		
d. To help overhaul the revenue administration in the medium term, implement a functional reorganization, beginning at end–June			A new functional structure is expected to be approved in September 2002
75. Council of Ministers to adopt a civil service reform strategy by end–2002		40	
76. As part of the preparatory work for #75, by end-March 2002 establish a ministerial committee to carry out a functional review of government, which will be completed by end–September 2002		40	***Done.*** CoM decision dated February 4, 2002 has been issued. However, the functional review is several months behind schedule.
77. By end–September, have in place an integrated system to monitor total general government and SEE employment levels on a quarterly basis	BM	40	A circular (dated December 14, 2001, No. 94997) has been sent to SEEs; monitoring of SEE employment levels has started on a quarterly basis as of March.
78. 15,000 individuals (public sector workers) to have been retired or notified of their retirement by mid-January 2002	PA for SBA	41	***Done.***
79. By end-January 2002,	PAs for first review (i) and (iii)		
(i) identify all redundant workers and positions in SEEs		41	(i-ii) ***Done.*** A total of 45,800 positions have been determined as redundant in SEEs.
(ii) sharpen tentative estimate based on aggregate analysis, by using company-specific information and by end-May produce final estimates		15 of April 2002 LOI	
(iii) eliminate all open, unfilled redundant positions		41	***Done.***
80. Extend voluntary retirement offers to the recently identified redundant workers in Türk Telekom and in the Privatization Agency portfolio of companies; for those who accept, provide payments, and allow them to retire, no later than end–March 2002		41	***Underway.*** The retirement offer remains open.
81. Through voluntary retirement offers, and layoffs only when necessary, reduce the number of redundant workers by one-third by end–June, and cumulatively by two-thirds by end–October 2002	PC (the Oct action)	41	***Underway.*** Between end-January and end-June, 11,342 redundant positions had been eliminated (including some individuals notified of their impending retirement as part of the prior action for the program—see item #78). In July so far, 2,580 additional public workers have retired from state enterprises.

Action	Type	LOI Para[1/]	Status July 30, 2002
82. By end-June 2003, phase out the remaining redundancies		41	
83. The Ministry of Finance and the Treasury to formulate by end-September 2002 an action plan to address redundancies in the central government		15 of April 2002 LOI	***Underway.*** The modalities of extending the staff reduction program to the civil service are under consideration.
84. Audit SEE compliance with this program on a quarterly basis		41	***Underway.*** Treasury Controllers audited all SEEs (except Türk Telekom) in April–May. Second-quarter audits have begun.
85. To strengthen the legal framework for fiscal policy pass the Law on Public Debt Management and issue two supporting communiqués	PAs for the first review	42	***Done.***
86. a. Submit to parliament by end-June 2002 a Law on Financial Management and Internal Control consistent with best international practices	BM	42	***Not met.*** See below.
b. Submit to parliament a Law on Financial Management and Internal Control	PA for third review	10 of July 2002 LOI	
c. Parliament to pass Law on Financial Management and Internal Control by end-March 2003	BM	10 of July 2002 LOI	
87. Close, by end-March 2002, 548 additional revolving funds	BM	42	***Done.***
88. Incorporate in the draft budget for 2003 the revenue and expenditures under Law 3418	BM for Oct 17, 2002)	42	
89. Eliminate the earmarking under Law 3418 and Law 4306		42	
90. Amend by July 2002 the governing legislation for the remaining EBFs to require passage of their budgets by parliament, external audit of their accounts (reported to parliament), and monthly reporting of their accounts, on a consolidated basis, with the central government's accounts	BM	42	A provision in the draft Law on Financial Management and Internal Control addresses this. However, this law will be passed by end-year at the earliest.
91. Eliminate the remaining budgetary fund (the Support Price and Stabilization Fund) in three years, when the World Bank's Agricultural Reform Implementation Project ends		42	
92. In the draft 2003 budget to be submitted to parliament (i) include net lending as an appropriation, and (ii) extend accounting and coding reforms to all consolidated budget agencies, and to general government units on a pilot basis	BMs for Oct 17, 2002)	42	To extend coding reforms to general government units on a pilot basis, the MoF has prepared a budget implementation circular. Studies regarding accounting reform are progressing as planned.

Action	Type	LOI Para[1/]	Status July 30, 2002
93. Complete, by end-March 2002, a survey of end-2001 commitments in excess of appropriations	BM	42	***Done.***
94. To monitor and address expenditure commitments on a regular and timely basis, conduct surveys of commitments in excess of appropriations twice a year (as of end-June and end-December), with the aim of having the results available within six weeks after the end of each period		15 of April 2002 LOI	The survey for end-June is being compiled.
95. Address the impact of public sector retrenchment through the labor redeployment and reinsertion program and through unemployment insurance		42	As per the circular (No.1087, 2002/3) issued on January 21, 2002, services for counseling and training have started to be tendered. Unemployment insurance payments started in March 2002.
96. Continue to implement the pension reform agenda for SSK and BK as set out in 1999. To this end, pass legislation underpinning the necessary institutional and administrative reforms by end-2002. Also prepare by end-2002, with technical assistance as needed, a study of the solvency of our civil service pension fund.		7 of July 2002 LOI	
97. a. Change the legal framework for SEEs, with effect from 2003, to help strengthen their governance structure, including by increasing the power of their Boards, clarifying their financial relationship with the government, and publishing details about their accounts		5 of June 2002 LOI	A draft law has been prepared and will shortly be circulated within government for comments. It will be submitted to parliament by end-2002. See item #97b.
b. By end-December 2002 submit to parliament legislation to improve governance state enterprises	BM	11 of July 2002 LOI	A draft has been completed and will shortly be circulated within government for comments.
Enhancing the role of the private sector			
98. The Privatization Administration (PA) to proceed with the public offerings of POAŞ by end-March 2002 and the public offering of TÜPRAŞ by end-June 2002 and launch the initial public offering for THY as soon as market conditions allow		45	The sale of the remaining public share in POAŞ to the strategic investor was announced on July 16 and is expected to be completed in mid-August. New privatization strategy has been announced for TÜPRAŞ on July 2002. The privatization of THY depends on market conditions.
99. a. CoM to adopt a privatization plan for Türk Telekom in April 2002	PA for the second review	45	***Not met because of change in strategy.*** The corporatization plan approved on June 4, 2002 requires a more complex privatization strategy than originally envisaged. Deadline changed to end–November.

Action	Type	LOI Para[1/]	Status July 30, 2002
b. CoM to adopt a privatization plan for Türk Telekom by end–November 2002	BM	21 of June LOI	*Underway*. Preparations are proceeding according to the road map approved last May. The tender for an advisor on TT's revaluation was announced on July 8, and the selection completed by August.
100. Parliamentary approval of Tobacco Law	PA for SBA	45	*Done*.
101. Prepare and adopt a privatization plan for TEKEL by end-September	PA for fourth review	45	*Underway*. A restructuring study is being undertaken to provide a basis for the privatization plan. Salomon Smith Barney was selected on July 23, 2002 to prepare the privatization plan, which will be submitted to the CoM in September.
102. Proceed with the privatization of ŞEKER, with the first step being the adoption of a privatization plan by May 2002		45	*Underway*. The Privatization High Council will approve shortly a road map for the privatization of ŞEKER.
103. a. In the electricity sector, in January 2002, subject to legal clarification, the Council of Ministers to adopt a government decree annulling with immediate effect all the projects for which transfer of operating rights (TOOR) contracts are pending		45	*Changed*. See item b.
b. Following the Constitutional Court decision regarding the pending transfer of operating rights (TOOR) contracts, determine which, if any, investors are eligible for Treasury guarantees and inform by end-June 2002 those eligible of the amendments needed to bring the contracts in compliance with the license regulations of the Energy Market Regulation Agency and the Electricity Markets Law. With the exception of these eligible projects, transfer all state-owned thermal generation and electricity distribution assets under the scope of privatization by end-July 2002. Moreover, the eligible contracts for which the financial arrangements have not been finalized by end-January 2003 will be cancelled, and the related assets transferred under the scope of privatization by end–February 2003		16 of April 2002 LOI	*Underway*. With the exception of the projects potentially eligible for Treasury guarantee, all state-owned thermal generation and electricity distribution assets are expected to be transferred under the scope of privatization by end-July. Pre-qualification tenders for these distribution assets would be launched by February 2003.
104. By March 2002, the Ministry of Energy to inform the PA which electricity assets will be privatized, and by April 2002 the prequalification tenders for the distribution companies will be launched		45	*Changed*. See item #103 above.
105. Complete the transfer of gas distribution companies to the PA by March 2002		45	*Underway*. A Privatization High Council Decision has been taken to transfer two distribution subsidiaries of BOTAŞ to the PA by end-August 2002, with a view to privatizing it in 2003.

Action	Type	LOI Para[1/]	Status July 30, 2002
106. The PA to go forward with the divesting of ETI Krom AŞ, ETI Elektrometalurji AŞ, ETI Gümüs AŞ, which are in the PA portfolio, as soon as licenses are transferred from ETI Holdings		45	A High Privatization Council decision (No: 2002/29) was issued on April 30, 2002 for the transfer of licenses of ETI Krom AŞ., ETI Elektrometalurji A.Ş., ETI Gümüs A.Ş., ETİ Bakır A.Ş. to these companies from ETİ Holding.
107. By October 2002, announce a block sale of at least 51 percent of the shares in PETKIM		24 of July 2002 LOI	
108. The PA to continue its divestment of ERDEMIR, and of tourism and fertilizer assets in its portfolio. The PA also to continue divesting its portfolio of small and medium-size companies		45	***Underway.*** On July 30, the public share in ERDEMIR was reduced to below 50 percent through a sale to an investment fund.
109. Build on efforts made in 2001 (including legal amendments and simplified procedures) to increase the sale of government land. Initiate a study to evaluate how the remaining obstacles to government land sales could best be removed		45	
110. The Council of Ministers to adopt in January 2002 follow-up actions to FIAS study to make Turkey more attractive for domestic and foreign investors	PA for SBA	46	***Done.***
111. Submit to the parliament by end-May 2002 a new draft Law on Foreign Direct Investment in line with the findings of the FIAS study	BM	46	***Done.*** Law submitted to parliament on June 14.
112. Submit to the parliament by end-March 2002 a draft law on work permits prepared by Ministry of Labor and Social Security, and issue a communiqué by end-April 2002 on the implementation procedures for employing foreign personnel employed by foreign capital companies as soon as the new law is approved by parliament		46	A draft law on work permits has been submitted to parliament and is currently at the General Assembly.
113. Complete by end-February 2002 legislation reducing the number of documents needed to obtain investment incentives		46	***Done.***
114. Establish and implement by end-February 2002 an employee code of ethical conduct for proceedings at customs		46	***Being implemented.*** A communiqué was issued on September 11, 2001.
115. Submit to the Council of Ministers by end-January 2002 legal amendments to strengthen the Turkish Patent Institute		46	Draft law has been submitted to parliament and passed the Industry Commission. Currently it is at the Budget and Planning Commission.
116. The Council of Ministers to adopt a strategy by end-January 2002 for increasing transparency and combating rent-seeking activities	BM	47	***Done.*** Decree signed on February 13.
117. Define and include as program conditionality concrete follow-up actions for the remainder of the 2002–04 program period based on the plan in #116:		47 and 18 of April 2002 LOI	***Done.***

Action	Type	LOI Para[1/]	Status July 30, 2002
a. Establish by end-April 2002 a Steering Group for public sector reform, as well as a subcommittee to provide support to the Steering Group in implementing the plan to enhance transparency and good governance	BM		***Done***
b. Publish (i) the above-mentioned action plan to enhance transparency and good governance, and (ii) the Report on the Observance of Standards and Codes (ROSC) on the quality of economic data, carried out in consultation with the IMF			***Done.***
c. Improve the public sector personnel system, including passage of legislation to establish a code of ethical conduct for civil servants and public administrators by end-2002	BM		
d. Increase access to information, through the preparation of an Information Act, defining the rights of citizens to request information and the obligation of public organizations to provide information by end-2002			
118. Establish an Investor Relations Office by February		48	***Done.***
119. Establish an Investor Council consisting of prominent business representatives from Turkey and abroad		48	Inaugural meeting scheduled for July 18 was postponed.
120. Further strengthen the efforts of the Treasury, the CBT, and the BRSA to explain policies under the economic program in their respective areas, including through the arrangement of regular (bimonthly) press conferences by the Treasury		48	***Ongoing.***
Safeguards Assessment			
121. Follow-up measures in the context of Safeguards Assessment:		19 of April 2002 LOI	
a. With effect from 2001 financial statements the CBT to publish audited financial statements consistent with IAS			***Done.***
b. Starting with the 2002 financial statements, the CBT to clarify disclosures of the Fund position and the relationship with the Treasury, and limit the amount of profits available for distribution to realized profit, less unrealized losses			***Ongoing.***
c. CBT to expand the role of its existing audit committee			The Audit Committee will meet twice a year with the external audit firm and, once established, with the internal audit department. It will also review the CBT's overall risk management practices and systems of internal control.
d. Include among the duties of the external auditor to issue a report reviewing the consistency between program data reported to the IMF (specifically covering base money, net international reserves, and net domestic assets) and the audited financial statements			***Done.***

Action	Type	LOI Para[1/]	Status July 30, 2002
e. By May 15, 2002 the CBT to ask the existing audit firm to prepare such a report, to be issued by July 15, 2002	PC (issuance of report)		*Done*.
f. By May 15, 2002, the CBT to issue a Memorandum of Understanding to clarify the Treasury/CBT relationship with the Fund.			*Done.* Memorandum of Understanding was signed between Treasury and CBT on May 6.
g. The CBT to reorganize by end-2002 the internal audit function. To this end, it will (i) adopt a new charter, which will detail the mission, scope, accountability, independence, responsibility, and authority of the audit function in line with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors, and (ii) formulate an implementation plan identifying staffing levels, reporting lines, scope of audits, risk assessment methodologies, and developing an internal audit manual and training programs	PC (measure (i) and (ii))		*Underway*.
i. Internal audit department to conduct an audit of foreign exchange management and program data as of end-2002 by May 15, 2003	BM		

1/ Unless otherwise noted, paragraph numbers refer to January 18, 2002 Letter of Intent.

Statement by the IMF Staff Representative
August 7, 2002

1. **This statement updates on developments since the staff report was issued.** The new information does not alter the thrust of the staff appraisal.

2. **In an extraordinary session convened last week, parliament set a date for early elections and passed EU-related legislation.** As anticipated in the staff report, on July 31 parliament voted to hold early elections on November 3. On August 3, parliament passed key legislation aimed at meeting the EU's Copenhagen criteria. The changes include the abolition of the death penalty (except in times of war) and the granting of education and broadcasting rights in minority languages.

3. **Market indicators have improved following these decisions.** Between July 31 and August 6, the benchmark bond rate dropped by 9 percentage points to 67 percent, the Turkish lira appreciated by 3 percent against the U.S. dollar, and stock prices rose by 4 percent.

4. **Inflation continues to be on track to stay within the 35 percent target for end-year.** In July, the CPI rose by 1.4 percent, bringing the cumulative increase this year to 13.6 percent and 12-month inflation to 41.3 percent. Although a larger-than-expected wholesale price increase of 2.7 percent points to some pressures on consumer prices in the period ahead, the end-year inflation target remains fully attainable.

5. **Against this background, the CBT lowered its interest rates on August 5.** After the two percentage point cut (simple), the overnight rate stands at 58 percent (compounded).

6. **The authorities have taken further measures to keep fiscal policy and supporting reforms on course.** To help support the public sector primary surplus target, the authorities raised natural gas prices by 6.1 percent in early August. They have also indicated that several state enterprise prices will be increased this week: sugar by 8 percent, tea by 5–10 percent, and telecommunications services by 1–2 percent. Moreover, the Treasury and the Privatization Administration are working with the management of TEKEL (the alcohol and tobacco company) to implement cost-cutting measures to achieve the company's budget target. Finally, the remaining prior action for this review was completed on August 2, when the Public Financial Management and Internal Control Law was submitted to parliament.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

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

IMF Completes Third Review of Turkey's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Turkey's economic performance under the three-year Stand-By Arrangement. The decision will enable Turkey to draw up to SDR 867.6 million (about US$1.1 billion) immediately.

The stand-by arrangement was approved on February 4, 2002 (see Press Release No. 02/7) in a total amount of SDR 12.8 billion (about US$17 billion). So far, Turkey has drawn SDR 9 billion (about US$12 billion).

After the Executive Board discussion on Turkey, Horst Köhler, Managing Director and Chairman, said:

"The Turkish authorities are to be commended on their continued strong implementation of the economic program. This has yielded quite promising outturns in the first part of the year, including a solid recovery in economic activity, a sharp drop in inflation, and a strong balance of payments performance. This was helped by the rapid decline, through April, in interest rates on domestic and foreign borrowing, which eased the government's debt situation.

"However, recent political uncertainty unsettled domestic financial markets and prompted a substantial rise in interest rates. While Parliament's decision to hold elections on November 3 points to a resolution of the uncertainty and has already resulted in some easing of financial market conditions, it will be essential that the authorities implement the program to the fullest extent possible. Against this background, the coalition partners' renewed commitment to fully implement the program is most welcome, as is the evident support of the thrust of the program among political parties and in the private sector. These developments testify to the strong ownership of the program, and give further scope for its fundamentals to reassert themselves and for interest rates to decline rapidly once the political uncertainty is resolved.

"The authorities' impressive record of fiscal restraint has strengthened long-term debt sustainability and the credibility of economic policy, and unwavering continuation of this effort will be instrumental in keeping the government debt position manageable and improving its resilience against adverse shocks. Strong fiscal discipline and strict adherence to the fiscal targets, both during the present election period and over the medium term, will remain key for securing strong and sustained economic growth.

"Looking ahead, it will be important that the planned fiscal reforms further enhance the durability of the adjustment. In this regard, it will be important that as much of the direct tax reform as possible is implemented in 2003. At the same time, the authorities should continue their efforts to cut unproductive spending, restructure state enterprises, and strengthen tax administration, and press ahead with the reforms of public financial management.

"The central bank has made commendable progress in reducing inflation and inflation expectations, while managing a successful transition to a floating exchange rate regime. It should remain focused on achieving its inflation target and continuing its preparations for the introduction of formal inflation targeting.

"Financial sector reform has also been impressive, with the private bank recapitalization exercise nearing completion, and the operational restructuring of state banks well advanced. The remaining priorities are for the Savings Deposit and Insurance Fund (SDIF) to quickly resolve the intervened banks under its control, and to develop a sales strategy for its remaining assets. With operational restructuring now bearing fruit, it will be important to prepare the state banks for sale. Reforms to the bankruptcy law will improve the effectiveness of the Istanbul Approach for corporate debt restructuring.

"The authorities are encouraged to intensify their efforts to privatize state enterprises, by bringing key assets to the point of sale, while ensuring transparency in the sales process. They should also use the time available from the postponement of the Investor Council meeting to finalize the reforms needed to improve the investment climate.

"Overall, the program has been implemented as agreed and has shown its potential to deliver strong economic performance. At the same time, the remaining vulnerabilities highlighted by the recent market developments have underscored that strict adherence to the program will remain key to ensuring its lasting success," Mr. Köhler said.