

III

MONETARY POLICY AND MARKETS

III.1. MONETARY POLICY

The exchange rate based stabilization program had to be halted due to the developments in the financial markets that occurred in February 2001. Following the 22nd of February, when the new exchange rate system was put into effect, the Central Bank set its short-term priorities so as to remove defects in the payments system, to make the financial system function again and to provide stability in financial markets. The new program put into effect after the crises aimed mainly at arranging the role of the state banks and reducing their extensive short-term liabilities. The Central Bank played a key role in the operation of restructuring the state banks. Its balance sheet was affected heavily by that operation. To avoid the inflationary effects of the operation, the Central Bank controlled the base money by the implementation of monetary targeting, which imposed some restrictions on the classical aggregates of the Central Bank balance sheet. For this reason, the ceiling and floor values determined for the concerned items and the realizations became subject to performance and indicator values. The values for the NDA and for the periodical changes in the NIR was set, as ceiling values became the performance criteria. Moreover, considering the absence of a nominal anchor due to the abandoning of the exchange rate regime, money base targets were set to help the economic agents shape their expectations.

The Central Bank began to control the balance sheet aggregates after May.

By the implementation of the monetary policy, consistent with the floating exchange rate regime, targets related to the performance and indicator criteria determined for 2001 were achieved except for 30 June 2002. Base money exceeded its targeted level for that date slightly. This development stemmed from the emission sub item, which constitutes the major part of base money. This sub item cannot be controlled fully by the Central Bank due to the fact that it is mainly driven by the demand side. In addition, the control and forecast of the demand for money is negatively affected by the reduction in the transactions carried out via check and promissory notes during the year as well as the increasing demand for

cash. The relative low mid-month return level of emission in June caused the deviation of base money from its targeted level.

TABLE III.1.1
PERFORMANCE CRITERIA, INDICATIVE VALUES AND REALIZATIONS

	Money Base Upper Limit (TL trillion)			NDA Upper Limit (TL trillion)			NIR Change (US\$ million)		
	Target ⁽¹⁾	Target ⁽²⁾	Real. ⁽³⁾	Target ⁽¹⁾	Target ⁽²⁾	Real.	Target ⁽¹⁾	Target ⁽⁴⁾	Real.
30 April 2001	-	-	5,850	-	-	6,739	-	-	
31 May 2001	5,900	-	5,815	9,750	-	7,942	-1,500	-	-837
30 June 2001	6,050	-	6,247	13,250	-	12,943	-2,900	-	-3,059
31 Aug 2001	6,300	7,175	6,748	15,850	17,250	16,437	-2,000	-2,500	-1,370
31 Oct 2001	6,800	7,550	7,140	19,500	21,150	17,933	-2,600	-3,250	-304
31 Dec 2001	7,300	7,750	7,642	21,000	22,400	19,493	-600	-3,546 ⁽⁵⁾	-1,730

Source: Central Bank.

(1) May 2001 Letter of Intent.

(2) July 2001 Letter of Intent.

(3) Realization.

(4) Targeted amount increased by the amount which was not used in previous period or by 25 percent of the current period limit.

(5) The amount that was not used in the September-October period was transferred completely to the November-December period.

The Central Bank declared that in the new exchange rate regime, it would not intervene in the exchange rate markets except in cases where exchange rates display an instantaneous and highly volatile pattern.

In the beginning of the floating exchange rate regime, the Central Bank declared that the exchange rate would be determined by market dynamics and it would not intervene in the exchange rate markets except in cases where exchange rates display an instantaneous and highly volatile pattern. Program based FX auctions aimed at sterilizing the liquidity resulting from the use of the financial support provided by the IMF for the financing of Treasury TL payments within the framework of the monetary policy. These FX auctions also aimed at sterilizing the liquidity that stemmed from the Treasury's use of foreign borrowing, including credit extended by the World Bank for TL payments. The Central Bank sometimes intervened in the exchange rate markets in order to smooth the fluctuations which emerged in the case of negative external developments and domestic political problems. However, beginning in August, non-programmed interventions were reduced to negligible levels, and as of September, program based auctions were carried out on the daily basis.

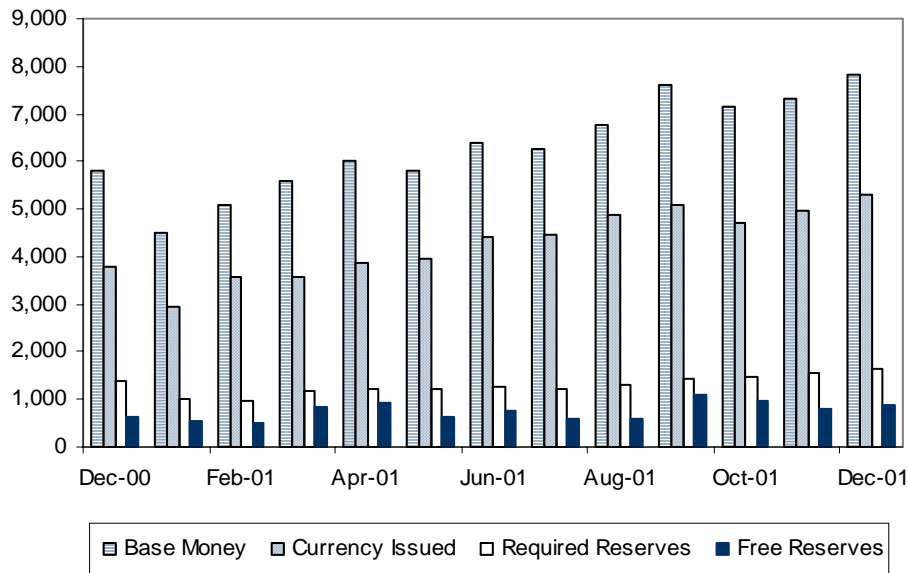
In 2001, short-term interest rates became the most important monetary policy tool in dealing with liquidity control and inflationary pressures. The Central Bank used the short-term interest rate tool by considering the domestic and foreign concerns and developments in inflation expectations.

III.1.1. The Central Bank Balance Sheet

The factors that affected the structure of the Central Bank’s balance sheet considerably in 2001 can be summarized as follows: the operation which was conducted in order to decrease the overnight borrowing requirements of the state and SDIF banks, the use of IMF funding by the Treasury through the Central Bank, changes in the definitions of the some of the balance sheet items as a result of the change made in the Central Bank law.

The factors that affected the structure of the balance sheet in 2001 can be summarized as follows: the operation aimed at decreasing the overnight borrowing requirements of the state and SDIF banks, the use of IMF funding by the Treasury through the Central Bank, changes in the definitions of the some of the balance sheet items as a result of the change made in the Central Bank law.

FIGURE III.1.1
BASE MONEY AND ITS SUB-ITEMS
(TL trillion)



Source: Central Bank.

The movements in the main items of the Central Bank’s balance sheet during 2001 may be illustrated as follows: Base Money, which constitutes the liability side of the Central Bank’s balance sheet, declined by 22 percent in January; as a result of the decline in the Currency Issued, which had increased due to the extended bayram holiday at the end of December 2000 and the long New Year’s holiday; and the decrease in the Required Reserved Ratio by 2 percent in early 2001. Base Money displayed an increasing trend in subsequent months and this tendency continued until the end of September. Base Money declined by 5 percent at the end October, compared to the figures at the end of September and then displayed relatively constant movements for the remaining part of the year apart from the

increase in mid- December due to the religious holiday. In the year 2001, Base Money increased by 34.8 percent when compared to the end-of-December figures, 51.2 percent when compared to the December averages (Figure III.1.1.).

The Currency Issued generally increases in the middle of each month due to salary payments and then it declines at the end of the month as a result of reverse movements in the Currency Issued.

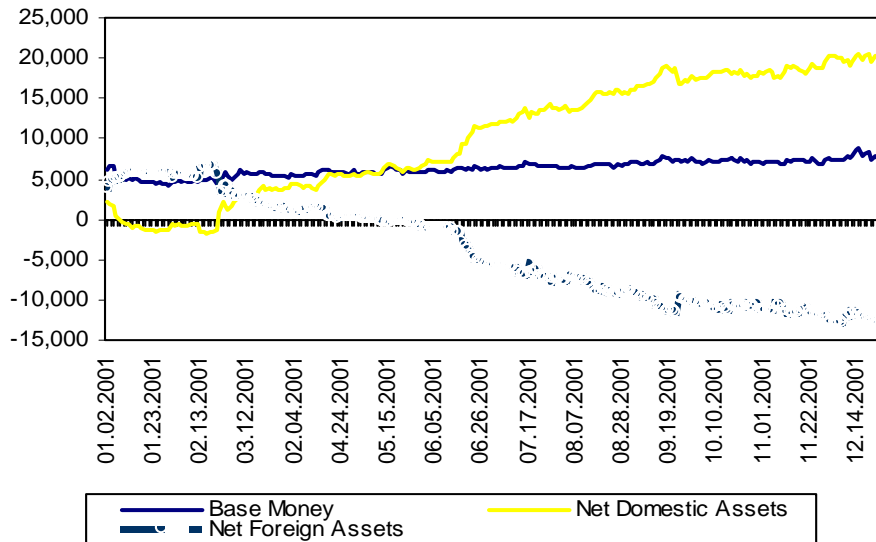
When the developments in the sub-items of the Base Money are examined, it is possible to notice that the Currency Issued increased in the middle of each month due to salary payments and then it declined at the end of the month as a result of reverse movements in the Currency Issued. Following the February Crisis, the problems in the payment system and the loss of confidence in the financial markets were the main reasons behind the increased currency demand. Particularly in March, the Currency Issued increased by 19.4 percent in terms of monthly averages due to the religious holiday. The increasing inflation as a result of the increase in public sector prices also contributed to the increase in the currency demand, which slowed down in October and November, but then increased once more in December because of the religious holiday and the New Year's holiday. When the end-of-2000 figures are compared with the end-of-2001 figures, a 40 percent nominal increase in the Currency Issued can be seen. However, when the comparison is made in terms of the December averages, it shows to a 65.8 percent rise.

Required Reserves displayed a sharp decline in January as a result of the amendment in the Required Reserve Ratio that was made at the end of 2000 and put into effect on the 12th of January.

Another sub-item of Base Money, Required Reserves, displayed a sharp decline in January as a result of the amendment in the Required Reserve Ratio that was made at the end of 2000 and put into effect on the 12th of January. In the following days, the Required Reserves had an increasing trend. In particular, putting the deposits of the SDIF banks up for sale increased the efficient Required Reserve ratio and then the Required Reserves increased. When the year-end figures are compared, Required Reserves increased by 15.8 percent in nominal terms. The last sub-item of Base Money, Free Reserves, displayed fluctuations throughout the year because of the weekly average obligations and increased by 46.2 percent in nominal terms by the end of 2001.

The Net Domestic Assets (NDA) and the Net Foreign Assets (NFA) constitute the asset side of the Central Bank's Balance Sheet. NFA, which is computed with the current parity, decreased sharply following the 64.6 percent increase shown by the 19th of February. The NFA, which was US\$ 9,972 million on the 19th of February 2001, declined to US\$ -8,859 million by the end of the year. One of the sub-items of NFA, Net International Reserves, (NUR), displayed a similar movement and declined to US\$ -2,980 million by the end of 2001. The Central Bank started to carry out FX sale auctions with the twofold aim of enabling banks to repay their FX debts and also controlling liquidity.

FIGURE III.1.2
BASE MONEY, NET DOMESTIC ASSETS,
NET FOREIGN ASSETS
(TL trillion)



Source: Central Bank.

TABLE III.1.2
SELECTED BALANCE SHEET ITEMS
(Current, TL trillion)

	End-of-Month Figures				Monthly Averages			
	Base Money	Currency Issued	NFA	NDA	Base Money	Currency Issued	NFA	NDA
2000 December	5,788	3,772	3,310	2,477	5,149	3,194	3,567	1,438
2001 January	4,506	2,926	5,205	-700	4,979	3,003	5,539	-560
February	5,071	3,586	2,915	2,156	4,898	3,130	5,172	-274
March	5,578	3,587	1,156	4,422	5,585	3,738	2,094	3,491
April	6,022	3,868	510	5,512	5,746	3,765	967	4,779
May	5,822	3,964	-1,038	6,860	5,935	3,835	-180	6,115
June	6,412	4,403	-5,528	11,940	6,203	4,151	-2,835	9,038
July	6,285	4,467	-7,342	13,627	6,569	4,493	-6,412	12,981
August	6,752	4,858	-8,924	15,676	6,624	4,610	-8,279	14,903
September	7,611	5,076	-10,221	17,831	7,182	4,982	-10,222	17,404
October	7,157	4,716	-11,167	18,324	7,232	4,902	-10,746	17,978
November	7,317	4,969	-12,107	19,423	7,162	4,780	-11,353	18,515

Source: Central Bank.

TABLE III.1.3
CENTRAL BANK BALANCE SHEET
(TL trillion)

	12/26 2000	03/03 2001	06/29 2001	09/28 2001	12/31 2001
	Current	Current	Current	Current	Current
I- BASE MONEY (a+b+c)	5,788	5,578	6,412	7,611	7,803
a.Currency Issued	3,772	3,587	4,403	5,076	5,283
b.Required Reserves	1,404	1.162	1,273	1,429	1,626
c. Free Reserves	611	829	736	1,106	894
II-NET FOREIGN ASSETS (A+B+C)	3,312	1,156	-5,528	-10,221	-12,754
A-Net International Reserves (1+2+3)	7,672	5,248	99	-1,307	-4,289
1-Gross International Reserves ⁽⁴⁾	13,601	20,130	21,659	29,940	27,874
2- Gross International Liabilities	-5,928	-14,616	-21,553	-31,248	-32,163
- FX Deposits of the Banking Sector	-4,295	-7,858	-8,882	-10,637	-10,353
- IMF	-898	-5,738	-11,528	-19,176	-20,293
- Other Liabilities ⁽¹⁾	735	-1,020	-1,144	-1,434	-1,517
3-Net Forward Position	0	-266	-6	0	0
B-Medium Term FX Credit (net)	930	1,477	1,775	2,164	2,030
C-Other (FX Lend. Exc.) ⁽²⁾	-5,290	-5,569	-7,403	-11,077	-10,495
III- NET DOMESTIC ASSETS	2,476	4,422	11,940	17,831	20,556
A- Treasury Debt	1,498	1,567	19,367	26,411	32,730
a-CBRT Portfolio ⁽⁴⁾	1,515	1,592	19,419	26,460	32,783
aa.Gov. Dom. Debt Inst. Prior Nov.5, 2001	1,400	1,568	19,325	26.363	32,703
ab.Gov. Dom. Debt Inst. Purc.from Sec. Mar.	114	25	94	98	80
b-Other	-17	-25	-52	-49	-53
B- Public Sector Deposits (TL)	-249	-1,155	-240	-848	-648
C- FX Deposits of Non-bank Sector	-1,208	-1,743	-2,344	-4,220	-3,137
D- Deposits of Public Funds	-116	-210	-140	-172	-104
E- Deposits of Non-bank Sector	-45	-35	-41	-45	-69
F- Cash Credits to the banking Sector	500	750	750	750	766
G- Open Market Operations (net)	5,219	8,973	-210	1,575	-1,244
H- Other	-2,445	-3,589	-4,309	-6,015	-8,008
I- Revaluation Account	-869	-1,380	-1,084	204	80
J- IMF Emergency Treasury	191	191	191	191	191
K- FX Lending ⁽³⁾	0	1,054	0	0	0
NET DOMESTIC ASSETS (1)		4,422	11,940	17,831	20,556
Revaluation Account (2)		-1,380	-1,084	204	80
2000 Allotment to Treasury from Revaluation Acc. (3)			-275	-275	-275
NET DOMESTIC ASSETS (Prog. Def.) (1-2-3)		5,802	13,299	17,902	20,752

Source: Central Bank.

(1) Other Liabilities = Overdrafts + Letters of Credit + Short Term Credit + Dresdner Account (1 year)

(2) Other = Dresdner Account (2 year) + Dresdner Account (3 year) + Assets and Liabilities in FX (net)

(3) Central Bank's FX lending, which was included in the Net Foreign Assets definition before, has been put under the heading of Net Domestic Assets.

(4) All securities denominated in foreign currencies and TL are calculated at the Dec. 31, 2001 values.

According to new monetary program, which was announced in May, foreign exchange sales would be directed towards the withdrawal from the system of the excess liquidity which resulted from the Treasury's use of IMF credit in domestic finance. These transactions were carried out on a pre-announced basis. As a result of foreign exchange sales in July, the NFA shrank by 144.5 percent compared to the 19th of February. The NIR sub-item also decreased by 99.5 percent. In the second half of the year, the rate of decrease was relatively limited. The Banks' FX Deposits, a sub-item of Gross International Liabilities, at first followed a stagnant path compared to the beginning of the year, then an increasing trend which continued until May. The primary reason behind this increase is the increase in mutual foreign exchange deposit accounts between banks. During the rest of the year, the Bank Foreign Exchange Deposit account was stable and increased by 12 percent per annum. In 2001, floor values for periodic changes in the NIR were set as a performance criterion. The NIR in the May-December period was 7.3 million US dollars, less than the targeted 9.6 million US dollar level.

On the asset side of the balance sheet, ceiling values for the NDA were set as a performance criterion. The performance criterion for the NDA, which is calculated by subtracting the revaluation account and the 2000 Allotment to the Treasury from the Revaluation Account, was attained as defined in the program.

The NDA account decreased sharply in January, but as a result of the February crisis, the direction of change was reversed. The upward trend in the NDA became steeper in May. In 2001, the NDA increased from TL 2,476 trillion, the level at the end of 2000, to TL 20,556 trillion at the end of 2001. In November, when the amendments made to the Central Banking Law on 04.22.2001 became effective, the NDA account was redefined and the Central Bank was no longer allowed to purchase T-bills issued for banking sector restructuring, from the primary market, a practice which had continued until the 5th of November 2001. As a result of this practice, the Central Bank's securities portfolio account was respecified in order to monitor changes in the account. The Treasury debt account, which was previously recorded under the Net Credit to Public Sector account, was recorded as a main item under the NDA account. The Treasury debt account consists of two sub-items: Central Bank Portfolio and Other. The results of the Central Bank operations in the secondary market can be followed in the "Government Domestic Debt Instruments Prior to November 5, 2001" along with the "Government Domestic Debt Instruments Purchased from Secondary Market" sub-items of the Central Bank portfolio account.

The NDA account decreased sharply in January, but as a result of the February crisis, the direction of change was reversed. The upward trend in the NDA became steeper in May.

The NDA account, followed a stable path during the first few months of the year then started to increase in May due to the following reasons: the outright purchase of the government bonds by Treasury and the use of IMF funds through the Central Bank.

The Treasury debt, which is recorded under the NDA account, followed a stable path during the first few months of the year and then started to increase due to the various reasons. In May, government bonds which had been previously offered by the Treasury for public bank restructuring were purchased. Secondly, IMF credit was utilized by the Treasury through the Central Bank. The Treasury debt account increased from TL 3,250 trillion, the level at the end of April, to TL 32,730 trillion at the end of the year.

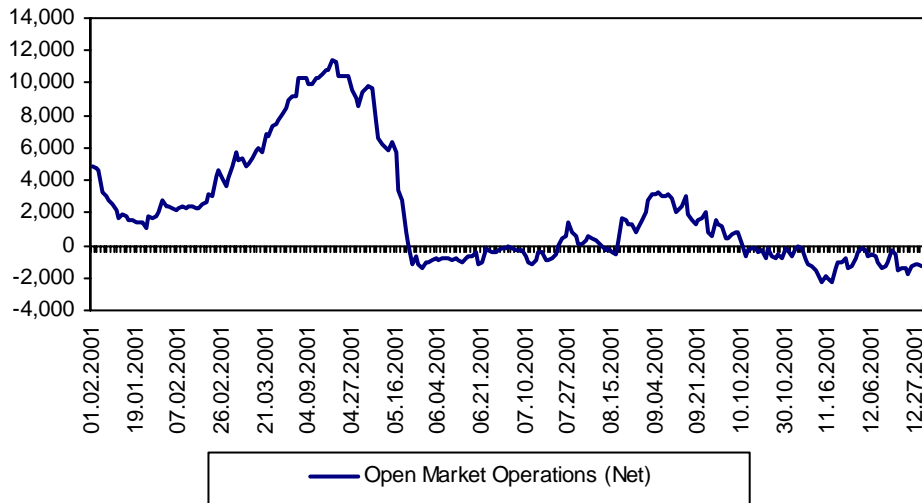
The transactions of the Public Sector Deposits (TL) were carried out according to the liquidity needs of the Treasury in line with changes in the public deposit account.

Another sub-item of the NDA, Public Sector Deposits (FX), followed the movements in the Treasury's foreign borrowing and the foreign debt repayments. This account shifted from TL 1,209 trillion at the end of 2000 to TL 3,137 trillion at the end of 2001.

The Credit to the Banking Sector, another sub-item of the NDA, increased from TL 500 trillion to TL 766 trillion. One of the reasons for this increase in the account was the newly issued credit, amounting to TL 250 trillion, to the SDIF. The export rediscount credit was also recorded under this account, which was another reason for the increase.

The Open Market Operations (OMO) account, which is an important sub-item in the NDA account, fell from TL 4,835 trillion to TL 2,516 trillion. This decrease, from the beginning of January to the 16th of February, was due to the withdrawal from the system of the liquidity which had been injected due to the religious holiday and the New Year. Starting from the 19th of February, the OMO account started to increase, reaching TL 11,319 trillion, which was the peak of 2001. Operations carried out to relieve the distress caused by the overnight liabilities of the state and SDIF banks were the main reason for this increase. In this way, government bonds issued by the Treasury were purchased. In addition, as a result of the drop in the overnight liability of the mentioned banks, the OMO account fell sharply to TL -1,134 trillion on the 23rd of May. While the OMO account remained negative till the last days of June, it started to increase and reached the TL 3,335 trillion level on the 5th of September owing to the Central Bank's net liquidity injection to the system. In the aftermath of the September 11 incidents, banks did not utilise the liquidity provided by the Central Bank, which was a factor in the OMO decrease. As of the 11th of September, the OMO came down to negative values.

FIGURE III.1.3
OPEN MARKET OPERATIONS (Net)
(TL trillion)



Source: Central Bank.

The “other” item, which is mainly composed of the Central Bank’s profit/loss, tended to increase in absolute value during 2001. Moreover, government bonds taken from public and SDIF banks in April and May, including the interest accrued, were swapped for longer-term bonds in June, August and October. This swap improved the profit/loss account and the “other” account gained in absolute value. Therefore, the increase in the Treasury debt account did not influence the NDA account.

The Revaluation account, which is affected by the change in the exchange rate, remained stagnant during the first few days of 2001. However, this account started to fluctuate when the TL was floated on the 22nd of February. The drastic decline in the value of the TL caused the revaluation account to drop sharply from TL -938 trillion, its level on the 22nd of February, to TL -2,297 trillion, the level observed on the 26th of February. In the following months, due to the change in the exchange rates, the Revaluation account entered an increasing trend and became positive after the 17th of September.

FX Lending to the banking sector, another sub-item of the NDA account, was put in the Central Bank balance sheet after the February crisis. FX deposits, which were used by the Central Bank to cover the foreign liabilities of the banks during

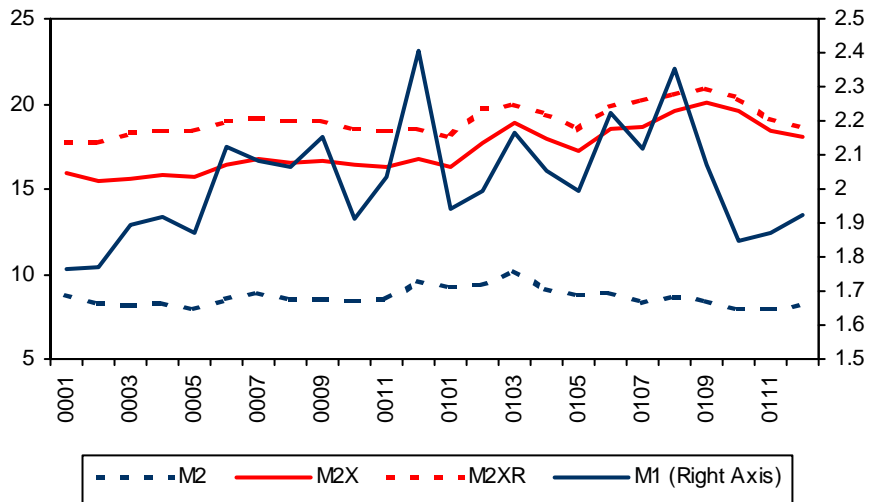
this period, is also recorded under the FX Lending account. This account, which remained positive after the 22nd of February, became zero from May onwards.

III.1.2. Monetary Aggregates

Money supplies, defined as narrow (M1) and broad (M2), decreased and M2X increased in real terms in 2001.

Money supplies, defined as narrow (M1) and broad (M2), increased by 34.9 and 17.2 percent respectively on a nominal basis but decreased by 20 and 15 percent in real terms in 2001. There was a decrease in time deposits, a sub-item of M2 money supply, by 13.4 percent in real terms. The reason for the decline in M1 and M2 money supplies is that due to the crisis, investments in banking system either tended towards foreign currency (FX) deposits or were removed from the system.

FIGURE III.1.4
REAL MONETARY AGGREGATES
(TL billion)

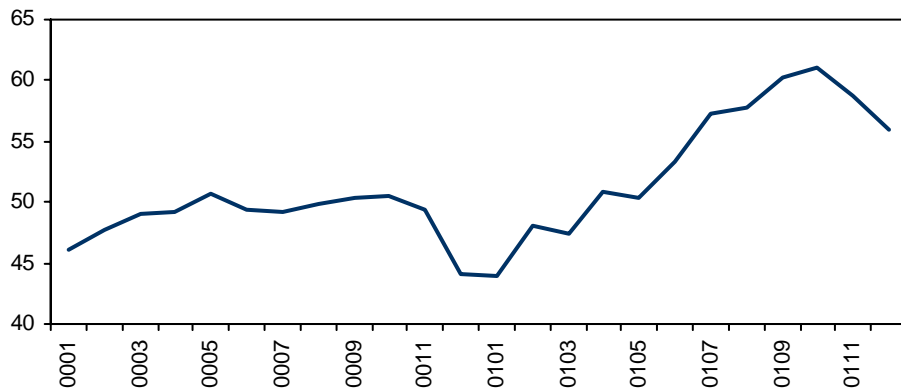


Source: Central Bank "Weekly Press Bulletin", the last Friday of each month in Money Supplies CPI (1994=100) was used.

Following the crisis, the lack of trust and negative expectations resulted in volatility in exchange rates. Turkish lira deposits were converted to FX Deposits, especially in the second half of the year. While FX deposits based on TL and US dollars rose, deposits in Turkish lira decreased in real terms in 2001. As of late December 2001, compared to the end of 2000, deposits in Turkish lira decreased by 13.6, Because of depreciation in the Turkish lira, FX Deposits increased by

39.2. There was an increase in FX Deposits, by US\$ 13.4. As a result of this development, the share of FX Deposits in total deposits increased to 56.0 percent by the end of 2001 from 44.1 percent at the end of 2000.

FIGURE III.1.5
FX DEPOSITS/TOTAL DEPOSITS
(Percent)



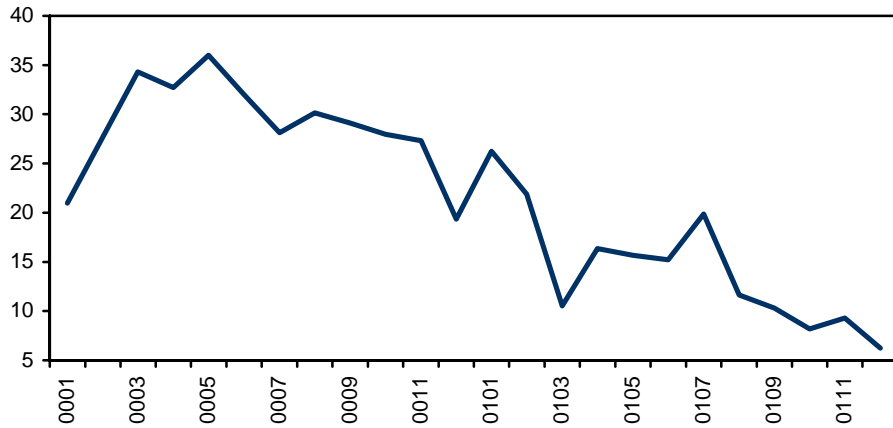
Source: Central Bank "Weekly Press Bulletin".

In order to encourage Turkish Lira deposits, stoppage on income taxes was lowered on Turkish Lira deposits while income taxes on FX Deposits were higher and started to pay interest on required reserves established for TL deposits. This regulation, which was put into effect in August, did not affect FX Deposits, which had increased to US\$ 38.9 billion by the end of August and to US\$ 40.8 billion by the end of December from US\$ 36.3 billion at the end of 2000. This increase in FX Deposits in US dollars and the depreciation of the Turkish lira caused an increase in FX Deposits in Turkish lira at the rate of 134.6 percent. As a result of this fact, M2Y money supply increased 8.1 percent in real terms, compared to the end of 2000.

In the year 2001, M2XR money supply, which is the sum of M2X and the repo transactions that banks carry out with their clients, increased by 0.5 percent in real terms. This caused a decrease of 65.1 percent in repo transactions compared to the end of 2000. The decline in the balance sheets of banks after the February 2001 crisis, the reduction in O/N borrowing requirement of public banks and increased stoppage cuts for repo incomes within the framework of the re-construction of banking system all played a role in the decrease in repo transactions.

In the year 2001 M2XR money supply increased by 0.5 in real terms. This caused a decrease in repo transactions.

FIGURE III.I.6
REPO/TOTAL TL DEPOSITS
(Percent)



Source: Central Bank "Weekly Press Bulletin".

TABLE III.I.4
DEVELOPMENTS IN MAIN MONETARY AGGREGATES, EXCHANGE
RATES AND PRICES
(Cumulative Change, Percent)

	2001											
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
M1	-17.1	-13.3	-0.2	4.3	6.3	22.5	19.3	36.6	27.3	20.4	27.0	34.9
Cur. in Circulation	-19.5	-13.2	-4.5	5.2	8.0	19.5	25.0	28.9	38.8	33.7	33.5	49.4
Sight Deposits	-15.6	-13.4	2.5	3.7	5.2	24.4	15.6	41.6	19.9	11.9	22.8	25.6
M2	-1.6	1.9	16.7	15.4	16.6	23.0	16.4	24.7	28.9	29.7	34.4	43.2
Time Deposits	3.6	7.0	22.3	19.1	20.0	23.2	15.4	20.7	29.4	32.8	36.9	46.0
M2X	-0.5	10.3	25.0	31.1	31.7	46.9	50.8	62.9	77.4	83.8	80.1	82.2
FX Dep. (TL)	1.0	21.7	36.3	52.4	52.2	79.0	97.2	114.3	142.8	156.8	141.7	134.6
FX Dep. (US dollar)	-0.1	-2.6	-4.9	-6.5	-3.6	-1.6	3.3	7.2	9.0	9.4	11.8	12.0
REPO	37.5	16.9	-35.3	-2.1	-4.3	-3.0	19.0	-25.8	-32.5	-45.3	-35.9	-53.2
US Dollars	1.4	35.3	57.7	73.2	72.6	89.2	97.0	104.3	128.8	137.3	120.0	115.9
German Marks	0.9	34.2	50.7	69.3	60.3	74.3	86.7	101.6	127.9	133.1	112.2	107.0
CPI (1994=100)	2.5	4.4	10.7	22.1	28.3	32.3	35.5	39.5	47.7	56.6	63.3	68.5

Source: Central Bank "Weekly Press Bulletin", the last Friday of each month.

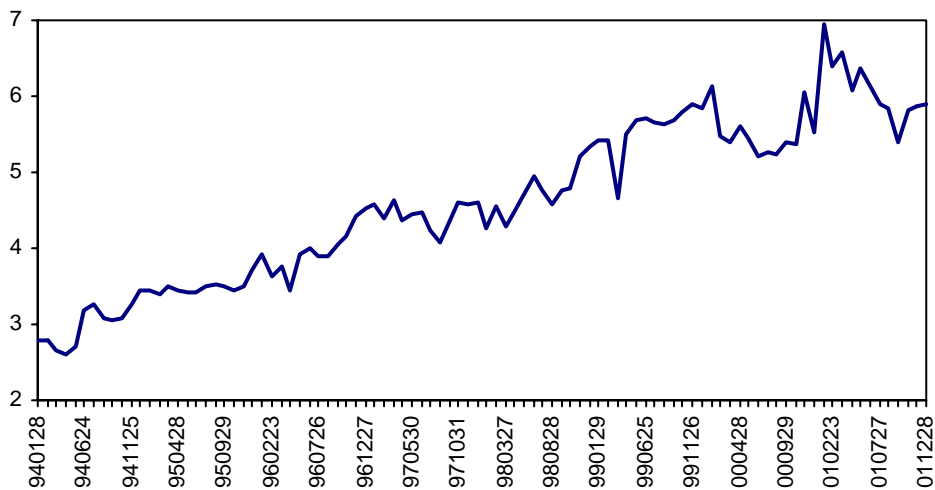
TABLE III.1.5
MONETARY AGGREGATES
(TL billion)

	December 1998	December 1999	December 2000	March 2001	June 2001	September 2001	December 2001
Cur. in Circulation	1,106	2,003	3,215	3,071	3,842	4,462	4,801
Sight Deposits	1,178	2,928	4,995	5,118	6,212	5,991	6,272
M1	2,284	4,931	8,210	8,190	10,054	10,452	11,073
Time Deposits	8,573	17,665	24,603	30,100	30,312	31,839	35,913
M2	10,857	22,596	32,813	38,289	40,366	42,291	46,986
FX Deposits	8,569	17,523	24,355	33,188	43,601	59,123	57,147
M2X	19,426	40,119	57,167	71,477	83,967	101,415	104,133
REPO	2,255	4,080	5,977	3,868	5,796	4,037	2,798
M2XR	21,680	44,199	63,145	75,345	89,762	105,451	106,931

Source: Central Bank "Weekly Press Bulletin", the last Friday of each month.

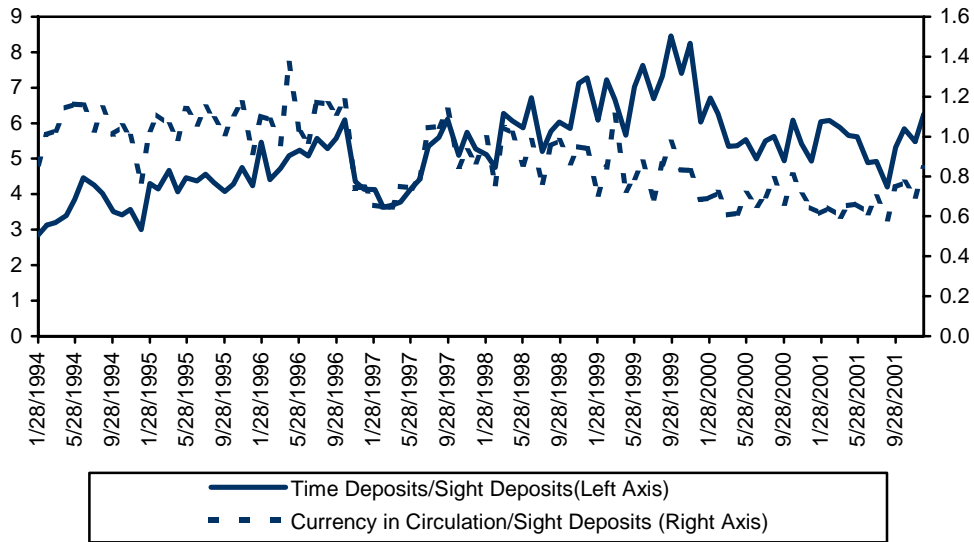
The reserve money multiplier, which is defined as the ratio of M2 money supply to reserve money, showed a downward trend in the first nine months of 2001. The increase in the currency issued, which has an important share in reserve money, is the main reason for the increase in reserve money and the decrease in the multiplier. The deceleration in currency issued and the increase in time deposits led the multiplier to increase to 5.9 in the last quarter of 2001 (Figure II.1.7).

FIGURE III.1.7
MONEY MULTIPLIER
(M2/RESERVE MONEY)



Source: Central Bank "Weekly Press Bulletin", the last Friday of each month.

FIGURE III.1.8
COMPONENTS OF THE RESERVE MONEY MULTIPLIER



Source: Central Bank "Weekly Press Bulletin", the last Friday of each month.

IMPORTANT DEVELOPMENTS AFFECTING THE MARKETS IN 2001

3 January: Debenture bonds amounting to TL 4 quadrillion and US\$ 750 million in foreign currency were given by the Undersecretariat of the Treasury to the Ziraat Bankası and Halk Bankası in order to balance the functional damages.

19 February: During the period prior to the payment of the cumulative internal debts, political tension and subsequent statements caused panic in the markets and this resulted in a crisis. Due to the dense domestic trading in foreign exchange, 7.6 billion at the exchange value of the succeeding day was realized.

20 February: In order to maintain its foreign exchange rate policy, the Central Bank lessened the liquidity. Owing to the hard up of the liquidity in the Turkish Liras, the portion amounting to US\$ 7.6 billion in total has been annulled and the quota proportion has simply heightened to 2.300 percent in the Interbank Monetary Market.

- The Turkish Grand National Assembly adopted "The Electricity Market Act" envisaging the functioning of the regulations directed towards the markets on the electric energy.

21 February: As a result of the continuation the demands for the foreign exchange, the Central Bank made a foreign exchange sale amounting to US\$ 3.5 billion. Some Banks having the higher short termed financing needs have confronted with the difficulty to meet their obligations.

22 February: The crisis has reached up to the dimensions threatening the functioning of the Banking system. Aiming to prevent the additional burdens to be brought in consequence of these developments on the economic structure, the value of the Turkish Lira before the foreign monetary units is decided to transform into a "floating" order.

23 February: Standard & Poor's decreased Turkey's credit rating from "B(+)" to "B" for long term loans and from "B" to "C" for short-term loans.

28 February: Ulusalbank was transferred to the Savings Deposit Insurance Fund.

2 March: Changes were made in economy management; a new Minister for Economy and a new Central Bank Governor were appointed.

15 March: İktisatbank was transferred to the Savings Deposit Insurance Fund.

14 April: The program concerning with the “Transition into the Powerful Economy” has been made clear along with the composing measures and regulations. The realization of 15 legislative regulations within the coverage of the program is also envisaged.

3 May: A new Letter of Intent was signed with the International Monetary Fund and declared to the public.

5 May: The new Central Bank Act, determining the principal objective of the Central Bank as the establishment of price stability, instrumental independence and the Monetary Policy Board was printed in the Official Gazette.

15 May: The Central Bank of Turkey announced “Monetary and Exchange Rate Policy in 2001” in the framework of new economic program. The Banking Supervision and Regulation Authority declared Banking Sector Restructuring Program. The International Monetary Fund board approved financial aid package related with the new economic program.

18 May: The International Monetary Fund has liberated the first credit slice amounting to US\$ 3.9 billion.

15 June: A swap operation was hold for domestic debt. Interbank and Esbank were merged with Etibank.

20 June: The “Tobacco Act” envisaging to reshape the General Directorate of Tobacco, Tobacco Products and Alcohol Enterprises and to increase the productive in the subject matters entering into the field of action of this organization along with the establishment the “free competition” was adopted by the Turkish Grand National Assembly.

21 June: “The Arbitration Act” was adopted by the Turkish Grand National Assembly.

9 July: Emlakbank was transferred to Halk Bankası and Ziraat Bankası.

10 July: Bayındırbank, Sitebank, Kentbank, EGS Bank and Tarisbank were transferred to the Savings Deposit Insurance Fund.

12 July: The International Monetary Fund and World Bank approved US\$ 3.9 billion worth of credit.

3 August: The International Monetary Fund liberated credit amounting to US\$ 1.5 billion.

15 August: The Futures FX Market was opened on the Istanbul Stock Exchange.

11 September: Terrorists attacked the World Trade Center in New York.

5 November: Internal debt debenture bonds amounting to TL 15.8 quadrillion from the portfolio of the Central Bank were exchanged for long term debenture bonds amounting to TL 18.8 quadrillion.

- In accordance with the provisions of the new Act, the Central Bank put an end to formalities such giving credit or advances to the Treasury.

16 November: The International Monetary Fund made it clear that an additional US\$ 10 million will be given in 2002 as an instrument of additional resources.

28 November: The International Monetary Fund liberated a credit slice amounting to US\$ 3.1 billion according to the Stand-By agreement.

30 November: Toprakbank was transferred to the Savings Deposit Insurance Fund.

7 December: The banking licence of İktisat Bank, which had been transferred to the Savings Deposit Insurance Fund, was cancelled.

23 December: Argentina declared a moratorium.

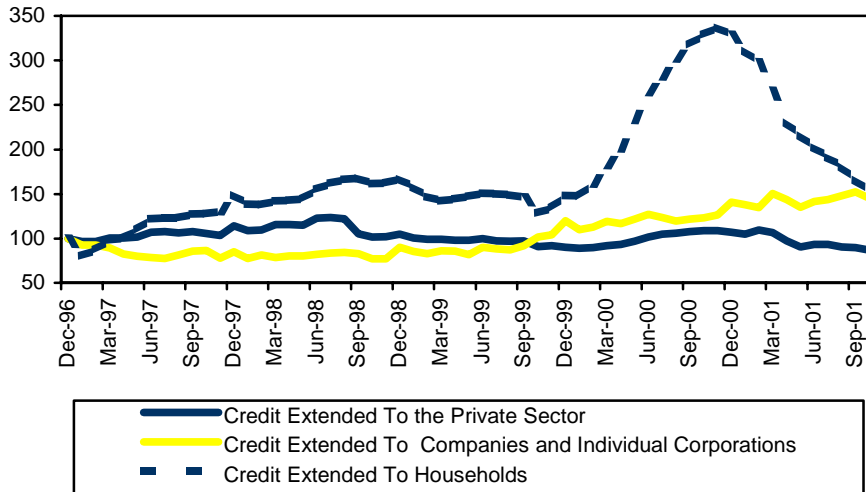
III.1.3. Developments in Credit

The volume of real credit contracted considerably in 2001 in contrast to the steep increasing trend observed in 2000. November of 2000 became the turning point of the credit volume trend, which had showed an upward movement since the beginning of 2000. The banking system did not extend new credit to the non-financial sector until May of 2001; moreover, some of the outstanding credit was called in. Afterwards, a steady trend began to be observed in credit volume. (Figure III.1.9).

Supply side developments became the main determiner of the developments in credit volume. In the November 2000-May 2001 period, the banking system experienced a severe liquidity shortage problem and in order to carry out their liabilities, banks stopped the extension of new credit. They either called in part of their credit or reflected high O/N interest rates in their outstanding credit. During the period after May, banks were reluctant to extend credit after taking into consideration the contracting economy and its probable reflection in balance sheets of companies.

Supply side developments became the main determiner of the developments in credit volume.

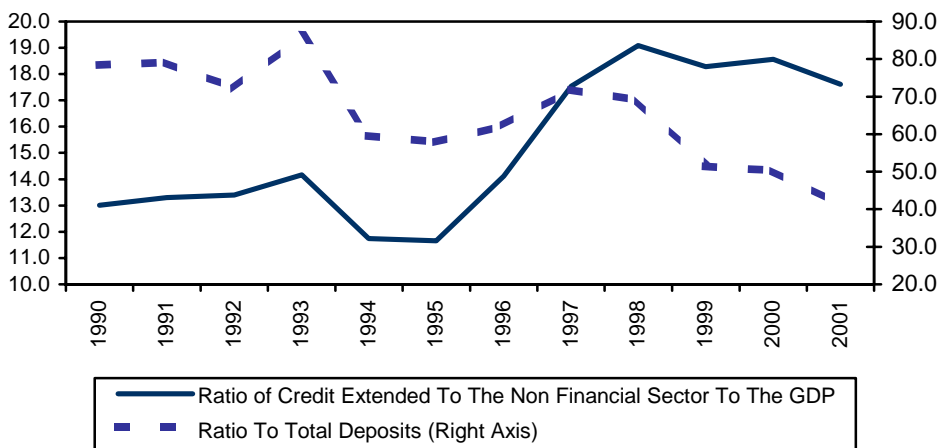
FIGURE III.1.9
INDEX OF REAL CREDIT VOLUME⁽¹⁾ 1996=100



Source: Central Bank.
(1) Realized with CPI.

The credit to deposit ratio, which can be considered an indicator of the stance of the banking system regarding credit extension, was observed to display a persistent decrease after February of 2001 (Figure III.1.10).

FIGURE III.1.10
RATIO OF CREDIT EXTENDED BY DEPOSIT BANKS TO TOTAL DEPOSITS AND THE GDP
(Percentage)



Source: Central Bank.

Credit volume had increased until the last quarter of 2000 due to low interest rates and improved economic activity. However, after the November 2000 crisis credit volume began to decrease sharply owing to increasing interest rates, contracting production and domestic demand.

TABLE III.1.6
DEVELOPMENTS IN CREDIT
(TL trillion)

	1999	2000	2001			
	December	December	March	June	September	December
TL Credit ⁽¹⁾	9,071	17,035	16,819	15,939	16,265	17,194
FX Credit ⁽¹⁾	6,643	8,402	10,868	12,746	15,540	13,959
Total Credit ⁽¹⁾	15,714	25,438	27,687	28,685	31,805	31,153
Deposit Banks⁽²⁾						
Commercial Credit	13,020	21,018	22,849	24,733	27,941	27,304
Special Credit	2,694	4,420	4,838	3,951	3,864	3,849
Share of Banks in Total Credit Volume						
State Deposit Banks	28.6	31.9	31.6	26.9	24.7	23.9
Private Deposit Banks ¹	67.9	64.6	64.3	68.7	70.5	71.9
Foreign Deposit Banks	3.4	3.4	4.1	4.4	4.9	4.1

Source: Central Bank.

(1) Credit extended to the non- financial sector by deposit banks.

(2) Credit extended to the domestic economic agents.

III.2. CENTRAL BANK TRANSACTIONS

The Central Bank implemented a rule-based monetary policy imposing restrictions on the balance sheet items consistent with the exchange rate policy determined within the framework of the “Disinflation Program” in 2000. This policy had been implemented consistently until late 2000, however the financial crisis which emerged in November of 2000, resulting from the deterioration in the current account balance, increasing risks in the banking sector and the emerging liquidity shortage necessitated an increase in Central Bank funding. This led to deviations from the targets of Net Domestic Assets and Net International Reserves determined by the program and necessitated the revision of the targets. The additional measures and the Supplementary Reserve Facility provided by the International Monetary Fund caused the markets to be more tranquil in January, however could not prevent the fragile structure in the banking sector in which the liquidity was distributed heterogeneously to the public and private banks. The high level of interest rates considering the announced increase in the exchange rate basket, the heterogeneous distribution of liquidity among the market agents restrained the effective liquidity management of the Central Bank significantly and gave way to the continuation of fragility in the markets.

In such an environment, the political atmosphere on the day before the huge volume of redemption by the Treasury brought about a high borrowing requirement contributed to the emergence of an unfavorable situation in the markets. As a result, the Central Bank faced an excessive demand for FX mainly by domestic residents on February 19, 2001. Faced with such a demand, as the existing exchange rate policy necessitated, the Central Bank sold US\$ 7.6 billion at 1-day value due to the holiday in US financial markets. As a consequence of the crisis emerging from the serious attack on its reserves, the Central Bank chose the policy of squeezing TL liquidity in order to defend the existing exchange rate regime. This implementation caused interest rates to rise to very high levels. As a result, a US\$ 6.1 billion portion of the US\$ 7.6 billion FX sales was cancelled due to the failure of the market participants to meet the TL correspondence of these transactions on February 20, a day of extreme TL shortage. However, an FX sale amounting to US\$ 3.5 billion was made on February 21, 2001. The extremely high levels of interest rates, which are not sustainable even for very short periods, led to the failure of the banks with high levels of short-term financing requirements to meet their liabilities. The Turkish lira was left to float against foreign currencies on February 22 in order to prevent the latter deficiencies from further threatening the effective functioning of the banking sector and to compel the economy to face additional costs.

The Turkish lira was left to float against foreign currencies on February 22.

In the period following February 22, prevention of imbalances in the payments system and stability in the financial markets continued to be the main objectives of the Central Bank. The abandonment of the rule based monetary program after the switch to the new exchange rate regime enabled the Central Bank to take flexible measures directed towards maintaining stability in the financial markets. In line with this, the Central Bank significantly cut its quotations in the Interbank Money Market as of February 26, 2001. By its effective liquidity management, the Central Bank started to determine interest rates to a great extent by setting effective lower and upper limits on market interest rates.

The Central Bank determined market interest rates to a great extent after February 26.

After the switch to the floating exchange rate regime, the Central Bank helped the banking sector to meet foreign liabilities through FX deposit transactions at daily announced rates.

The FX interventions of the Central Bank after the switch to the floating exchange rate regime was directed towards damping the excessive volatility in the FX level without affecting its long-run value. Moreover, a programmed auction system for FX sales started to be implemented as of March 29.

The banking sector's existing open position during the crisis constituted additional pressure on the exchange rate. This fragile structure was eliminated through FX sales by the Central Bank, the issuance of FX denominated and FX-indexed government securities for public and SDIF banks to strengthen their financial structure and the swap operations performed in June. Thus, the pressure on the exchange rate was reduced relatively.

Before February 22, the dual structure resulting from the extreme financing needs of public and SDIF banks in the O/N market and the heterogeneous distribution of liquidity among the banks restrained monetary policy implementation and especially the liquidity management of the Central Bank. After the switch to the floating exchange rate regime, one of the priorities of the Central Bank in order to achieve stability in the markets had been to remove the excessive pressure on market interest rates and the volatility caused by the high level of the O/N borrowing requirements of these banks. In line with this, the Central Bank started to meet the O/N borrowing requirements of the public and SDIF banks. This operation was implemented in coordination with the Treasury. Through this operation, the Treasury issued government securities for the public and SDIF banks in the period after March 16 and TL 14 quadrillion of these government securities was purchased by the Central Bank, resulting in the reduction of the short-term borrowing requirements of these banks. The remaining short-term borrowing requirements of these banks were met by the 7- and 14-day maturity repo transactions within the OMO. The liabilities of these banks to depositors and other banks, amounting to TL 13.6 quadrillion on March 16, were reduced gradually to the zero level by the end of May. As a consequence of the completion of this operation by the end of May, the liabilities of these banks arising from the repo transactions with the Central Bank declined to TL 5.9 quadrillion. The excess liquidity arising from this operation started to be withdrawn due to the Central Bank's reverse repo transactions in the ISE Repo-Reverse Repo Market within the OMO, borrowing transactions in the Interbank Money Market and FX sales by the Central Bank. The banking sector, excluding the public and SDIF banks, had excess liquidity in the period after the operation. As a consequence, the interest rates set by the Central Bank to withdraw the excess liquidity became the market interest rates and almost all of the transactions in the market were at these rates. As a result, the monetization effect of the operation was controlled by the Central Bank and Base Money was constrained at the targeted levels, which was an important element of the monetary program.

Through banking sector operations, the additional pressure on market interest rates arising from the public and SDIF banks was eliminated.

According to the monetary program announced on May 15, 2001, Base Money was the nominal anchor until the preconditions of the Inflation Targeting regime

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The Central Bank changed the interest rates four times in the July-September period.

could be satisfied. In addition, it was stated in the new Central Bank Law that the main objective of the Central Bank is to achieve price stability. In the following periods of 2001, which could be considered as a transition period to the Inflation Targeting regime, the Central Bank changed its short-term interest rates in consideration of the current and near-term trends in inflation, in addition to the policy of controlling balance sheet items. Within this framework, the Central Bank changed the interest rates four times in the July-September period, depending on inflation expectations as well as economic and political developments in domestic and external markets.

During this period, the interest rates in the Interbank Money Market and the ISE Repo-Reverse Repo Market reverse repo interest rates were set equal by the Central Bank. The Central Bank announced 1-week, 2-week and 1-month interest rates in addition to O/N interest rates to encourage longer maturity of the transactions in the market, most of which were O/N transactions due to uncertainty and risk perceptions. In September, the interest rates on 2-week and 1-month maturities were set lower than the O/N borrowing interest rate, parallel to the improvement of the expectations and increasing maturities in the market; although the latter interest rate was set higher than the interest rate for 1-week maturity.

TABLE III.2.1
INTEREST RATES
(Weighted Average Compound Interest Rates)

2001	ISE Bonds and Bills Market	ISE Repo-Reverse Repo Market	Treasury Auctions	OMO (repo)	Interbank Money Market (O/N)
January	59.41	65.6	64.9	90.14	53.2
February	85.86	*	124.1	*	*
March	137.08	141.5	193.7	162.10	125.1
April	119.91	124.4	130.4	134.10	124.6
May	85.82	103.1	82.0	113.65	104.2
June	83.44	87.4	88.4	98.98	87.7
July	93.87	91.8	95.0	101.29	92.1
August	87.76	86.8	92.6	95.80	86.8
September	83.39	80.4	87.6	85.74	80.4
October	81.98	80.3	86.4	85.20	80.2
November	73.41	80.2	79.3	85.21	80.3
December	69.82	80.1	74.1	85.12	80.3

Source: Central Bank, ISE.

*Figures are not shown due to their higher value.

III.2.1. Open Market Operations

Open market operations in 2001 can be analyzed in two separate periods before and after the February Crisis, in accordance with the different targets and priorities of the Central Bank in these periods.

The crisis atmosphere which emerged in November of 2000 brought about a liquidity injection of TL 3.5 quadrillion via outright purchases and repo transactions in the remaining part of the year, increasing OMO funding and NDA band targets determined by the program were breached. By the beginning of 2001, the volume of currency issued, which had increased by a sizeable amount during the religious holiday period at the end of 2000, returned to normal levels and the liquidity need of the market started to be provided via FX sales to the Central Bank. As a consequence, the net effect of the OMO on the market was TL -2.8 quadrillion in the period up to February 19, the day on which the February crisis emerged. After that, the OMO was conducted in line with the NDA targets, which had been revised after the November crisis. Liquidity management was conducted via repo auctions similar to the period before the November 2000 crisis and there were no outright purchase transactions during this period. The deteriorating effects of the November crisis has been removed to some extent before February Crisis and a sizeable reduction was observed in the level of interest rates which had skyrocketed in the crisis period. However, the interest rates were still higher than their level before the November crisis, which was inconsistent with the announced increase in exchange rates as determined by the program.

In 2001, the net effect of the OMO on the market was TL -2.8 quadrillion in the period up to February 19.

Faced with an excessive FX demand on February 19, the Central Bank squeezed TL liquidity in order to defend the existing exchange rate regime and the funding volume through repo transactions was kept lower than the volume of maturing repos during the February 19-21 period. The Central Bank performed an outright purchase of government securities, amounting to TL 700 trillion, from the Treasury on February 21. In the days following the switch to the floating exchange rate regime, the Central Bank performed outright purchases, amounting to TL 452.6 trillion, from the market.

Faced with an excessive FX demand on February 19, the Central Bank squeezed TL liquidity.

The switch to the floating exchange rate regime on February 22 necessitated a new liquidity management strategy and the Central Bank started to cut its OMO quotations in a rapid manner starting on February 26. Within this framework, the O/N quotations were between 112 percent and 140 percent in the February 26-March 2 period. In a similar manner, repo and reverse repo quotations in the ISE Repo-Reverse Repo Market had intervals of 120-150 percent and 80-100 percent

respectively for the same period. The Central Bank was not involved in repo transactions in the ISE Repo-Reverse Repo Market after March 12. The main objective of the OMO had been to remove the pressure of short-term interest rates on the public and SDIF banks by meeting their liquidity needs via repo transactions. In line with this, reverse repo transactions in the ISE Repo-Reverse Repo Market were used to withdraw liquidity from the market. The Central Bank became a determinant of market interest rates by removing the pressure caused by the public and SDIF banks' excessive financing requirements. During this period, the policy followed included re-determining OMO and Interbank Money Market quotations in a coordinated manner and increasing the maturity of transactions.

Within the framework of the measures taken in response to the possible negative effects that the terrorist attacks in the USA on September 11 might have on the financial markets, several measures were taken in case of additional liquidity needs. In this respect, it was planned that the required liquidity would be met via repo transactions in the ISE Repo-Reverse Repo Market within OMO at 62 percent, parallel to the measures related to the Interbank Money Market. However, no additional liquidity need emerged in this period and this additional liquidity facility within OMO was not used by market participants.

TABLE III.2.2
QUOTATION RATES IN OPEN MARKET OPERATIONS
(Simple Interest rate, Percentage)

DATE	O/N	7-day	14-day
03.28.2001	83	85	87
04.05.2001	83	87	89
04.16.2001	79	83	87
04.27.2001	77	81	85
05.02.2001	77	79	82
05.03.2001	79	79	82
05.07.2001	77	77	79
05.15.2001	75	76	77
05.16.2001	70	73	74
05.17.2001	67	71	72
05.24.2001	65	69	70
05.29.2001	63	69	70
07.16.2001	67	71	72
08.06.2001	62	68	69
08.27.2001	60	65	66
09.04.2001	59	62	58
09.12.2001	59	62	58

Source: Central Bank.

The most important factor determining OMO implementation in 2001 was the banking sector operation through which the Central Bank purchased TL 14 quadrillion worth of the government securities issued by the Treasury for the public and SDIF banks in April and May. The Central Bank had started to roll-over the remaining part of the liquidity needs of these banks at 7- and 14-day maturity repo transactions. In the remaining months of 2001, another important function of the OMO was to withdraw the excessive liquidity arising from the banking sector operation via reverse repo transactions in the ISE Repo-Reverse Repo Market together with the borrowing transactions in the Interbank Money Market. By the end of May, the date by which the banking sector operation was completed, the volume of repo transactions amounted to TL 5.9 quadrillion, indicating a decline from its level of TL 14.4 quadrillion in April. The volume of the withdrawn liquidity by the Central via OMO and Interbank Money Market amounted to TL 6.9 quadrillion in the same period.

The most important factor determining OMO implementation in 2001 was the banking sector operation.

TABLE III.2.3
AVERAGE INTEREST RATES IN REPO-REVERSE REPO TRANSACTIONS
WITHIN OMO
(Percentage)

2001	Repo		Reverse Repo	
	Simple	Compound	Simple	Compound
January	63.63	90.14	-	-
February	303.84	*	100.00	171.46
March	95.69	162.10	81.45	125.48
April	86.10	134.10	80.71	123.74
May	76.62	113.65	70.69	102.86
June	69.48	98.98	63.39	88.30
July	70.65	101.29	65.45	92.28
August	67.83	95.80	63.71	88.90
September	62.31	85.74	59.34	80.84
October	62.00	85.20	59.35	80.86
November	62.00	85.21	59.89	81.74
December	62.00	85.12	59.47	81.03

Source: Central Bank.

*Figures are not shown due to their higher value.

The effective liquidity management of the Central Bank in the remaining period of 2001 was consistent with the Treasury domestic borrowing strategy. Developments in the Treasury accounts of the Central Bank balance sheet and FX interventions kept the figures for Base Money and NDA at the levels determined

The net effect of OMO on the market was TL 9.9 quadrillion in 2001.

by the Stand-by agreement. At the end of the year, the funding to the public and SDIF banks was TL 5.4 quadrillion. By the end of the year, the liquidity withdrawn via OMO and Interbank Money Market had been TL 1.1 quadrillion and TL 5.7 quadrillion levels respectively. The net effect of OMO to the market for the period after the February crisis and for the whole year were TL 12.7 quadrillion and TL 9.9 quadrillion respectively.

TABLE III.2.4
OPEN MARKET OPERATIONS, 2001
(TL trillion)

2001	Direct Purchase From Treasury (1)	Sales Due To Early Redemption (2)	Direct Purchase From Market (3)	Reverse Repo (4)	Maturing Reverse Repo (5)	Repo (6)	Maturing Repo (7)	Net Effect (8) ⁽²⁾
January	70.0	70.0	-	-	-	15,816.0	18,623.0	-2,807.0
February	775.4	29.1	452.6	73.5	73.7	33,815.7	31,714.2	2,554.3
March	-	-	1.9	7,340.0	6,180.8	53,697.4	47,714.0	4,825.9
April	12.9	1,528.4	3,503.0	28,007.5	26,544.8	38,842.7	36,867.4	4,015.6
May	-	184.1	10,523.4	52,432.4	51,955.5	32,223.1	41,545.4	724.1
June	-	-	-	53,656.5	54,049.9	15,862.0	16,191.0	64.4
July	12,678.9	12,678.9	5.2	57,711.5	58,705.9	19,336.3	19,734.1	601.8
August	3,224.9	3,224.9	-	27,440.5	28,587.3	15,597.6	15,707.7	1,036.7
September	-	-	-	18,449.5	18,590.7	20,452.2	21,868.1	-1,274.8
October	17,329.5	17,329.5	-	17,586.0	17,739.9	20,485.2	21,714.3	-1,075.2
November	1,454.0	1,454.0	-	17,070.5	16,852.6	20,110.2	19,371.9	520.4
December	-	-	-	17,705.5	18,243.9	20,278.8	20,110.9	706.2
TOTAL	35,545.6	36,498.9	14,486.0	297,473.4	297,524.9	306,517.1	311,162.1	9,892.6

Source: Central Bank.

(1) (+) values indicate the injection of liquidity into the market.

(2) (8)=(3+5+6) - (4+7).

The OMO portfolio had increased to TL 19 quadrillion by the end of 2001.

The OMO government securities portfolio, which amounted to TL 1.5 quadrillion at the end of 2000 in terms of purchasing prices, had increased to TL 19 quadrillion level by the end of 2001. The source of the latter increase in the OMO portfolio was the outright purchases from the public and SDIF banks in April and May within the framework of the banking sector operations. In addition to these outright purchases, the Central Bank purchased government securities amounting to TL 452.6 trillion from the market in February. Besides these purchases, the Central Bank was not involved in any other outright purchase transactions at high

volumes. The government securities that were purchased within the framework the banking sector operations were replaced with longer term government securities in July and August. This part of the Central Bank portfolio was restructured once more in the late October - early November period based on the term structure of the domestic debt stock in an effort to increase the effectiveness of the monetary policy. The government securities purchased in July and August from the Treasury with accrued interests were replaced with those with coupons payable once a year, the payments being indexed to the CPI and maturing between 2006 and 2010. The principal and the coupon payments of these government securities will be deducted from the dividend of the Treasury from the Central Bank profit. In the event that the principal and coupon payments are higher than the dividend of the Treasury from the Central Bank profit, the remaining part will be paid by the Treasury in cash.

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MONETARY POLICY INSTRUMENTS (2001)						
MONETARY POLICY OPERATIONS	INJECTION OF LIQUIDITY	ABSORPTION OF LIQUIDITY	MATURITY	METHOD	COLLATERAL	PARTICIPANTS
OPEN MARKET OPERATIONS						
REPO	+		91 days at most ⁽¹⁾	Quotation ⁽²⁾ , auction	Government Securities(GS) ⁽³⁾	Banks, Financial Intermediaries
REVERSE REPO		+				
OUTRIGHT SALES		+	--			
OUTRIGHT PURCHASES ⁽⁴⁾	+				--	
INTERBANK MONEY MARKET						
BORROWING TRANSACTIONS IN THE INTERBANK MONEY MARKET		+	3 months at most ⁽⁵⁾	Quotations, Intervention, Deposits	GS, FX deposits, other ⁽⁶⁾	Banks
LENDING TRANSACTIONS IN THE INTERBANK MONEY MARKET	+					
FOREIGN EXCHANGE INTERVENTIONS⁽⁷⁾						
SALES OF FX IN RETURN FOR TL		+	same day, 1 day, spot (2 days), forward	_ Buying/selling FX at pre-announced exchange rate basket rates ⁽⁸⁾ _ Direct intervention _ Auction ⁽⁹⁾	--	Banks, Special Finance Institutions, Authorized Institutions and Intermediary Precious Metal Institutions
SALES OF TL IN RETURN FOR FX	+					
REQUIRED RESERVE RATIOS⁽¹⁰⁾						
Reserve requirement ratios were 4 percent for TL deposits ⁽¹¹⁾ , 11 percent for FX deposits in 2001. ⁽¹²⁾						Banks
LIQUIDITY RATIOS						
According to the Communique of the Central Bank dated November 25, 2000, the banks are obliged to maintain:						
_ Securities amounting to at least 4 percent, TL cash amounting to at most 2 percent, totaling to 6 percent; and TL free reserves amounting to 2 percent of TL deposits (a total of 8 percent)						Banks
_ Securities amounting to at least 1 percent, TL cash amounting to at most 2 percent of FX deposits (a total of 3 percent)						
_ Securities amounting to at least 4 percent, TL cash amounting to at most 2 percent, totaling to 6 percent and TL free reserves amounting to 6 percent ⁽¹³⁾ of TL liabilities excluding deposits (a total of 12 percent)						
_ Securities amounting to at least 1 percent, FX cash amounting to at most 2 percent, totaling to 3 percent and FX reserves amounting to 11 percent of FX liabilities excluding deposits (a total of 14 percent)						
_ TL free reserves amounting to 100 percent of the exceeding amount in the cases of FX general position (a total of 100 percent)						
OVERDRAFT FACILITY						
Banks can meet urgent fund needs amounting to their usable limits in the Interbank Money Market.						Banks
FORWARD TRANSACTIONS LIMIT						
Banks were allocated forward transactions limits at 1- and 3-month maturities in addition to their limits in the Interbank Money Market ⁽¹⁴⁾						Banks

Source: "Monetary Policy Issues and Experiences", Emir, Karasoy, Kunter (2000)

(1) The maturity of the repo and the reverse repo transactions within OMO was at most 1-month in 2001.

(2) Quotation method was used in repo and reverse repo transactions after February, 2001.

(3) According to the Central Bank Law, the instruments bearing high liquidity and low risk levels which are subject to open market operations will be determined by the Central Bank.

(4) According to new Central Bank Law, the Central Bank shall not grant advance or extend credit to the Treasury and to public establishments and institutions, and shall not purchase debt instruments issued by the Treasury and public establishments and institutions in the primary market. However, with a provisional article the Central Bank may purchase debt instruments issued by the Treasury in the primary market for a period of six months beginning from the effective date of this law, May 5, 2001. This period expired on November 5, 2001.

(5) The maturity of the transactions in the Interbank Money Market has been at most 1-month in 2001.

(6) This includes FX cash, foreign government securities, Treasury bonds and bills, gold deposits, revenue sharing certificates, contractor bonds issued by the Privatization Agency and eurobonds.

(7) After February 22, the Central Bank provided banks with FX deposit facility to meet their external liabilities in addition to FX interventions. This facility was not used after the beginning of May, 2001.

(8) This was effective until the exchange rate regime switch, February 22, 2001.

(9) FX sale auctions had been held since March 29, 2001; however, it was announced on November 30, 2001 that these auctions would not be held unless necessary. In addition to these, only one FX purchase auction was held in 2001.

(10) According to the Communique of the Central Bank dated August 8, 2001, the interest rate for the TL required reserves will be established and announced by the Central Bank. The interest payments will be accrued at the end of March, June, September and December. The interest rate for the TL required reserves, which was announced to be 40 percent by the press release dated September 10, 2001, will be subject to change depending on developments in the market interest rates.

(11) According to the Communique of the Central Bank dated December 10, 1999, the required reserve ratio for TL deposits was reduced from 8 percent to 6 percent and the remaining 2 percent was to be kept as free reserves in the context of weekly averages for the obligation of liquidity ratio. This policy implementation was also effective in 2001.

(12) By the Board decision taken within the framework of the authorization given by articles 22-c and 40-II of the Central bank on November 26, 2001, the FX deposits of SDF banks which are not subject to required reserves under the current application will be subject to a required reserve ratio of 11 percent when they are transferred to other banks. The transferred TL deposits will be subject to required reserves under general principles as of the transfer date.

(13) This implementation was in effect as of the week of January 13-19, 2001.

(14) The Central Bank initiated a new practice which went into effect on November 30, 2000 and increased the liquidity facilities of the banks on maturities, excluding 1 and 3-month, by the addition of a Forward Transactions Limit to the borrowing limits.

III.2.2. Interbank Money Market Operations

Until November 22, 2000 the Central Bank generally was not involved in transactions in the Interbank Money Market due to the existing rule based monetary policy and the constraints of the symmetric band on the Net Domestic Assets. However, this policy was abandoned in the liquidity shortage period after November 22. The Central Bank did not alter its bid quotation in this period but determined its offer quotation taking into consideration the interest rates in other markets. During this period, parallel to the liquidity shortage and on the basis of the upper limit of the Net Domestic Assets, revised due to the crisis, and transactions in OMO, liquidity was injected by Interbank Money Market transactions. However, the Central Bank was not involved only in borrowing transactions, but also in lending transactions.

By 19 February 2001, the Central Bank had withdrawn the majority of the liquidity injected during the liquidity shortage period at the end of 2000. The Central Bank was not involved only in borrowing transactions in the Interbank Money Market in this period, either. However, the net effect of these transactions was negative. The interest rates in the Interbank Money Market were lower than those in the last period of 2000; however, they were higher than those in the period before November 2000. The market was faced with a liquidity shortage on February 19, 2001 due to the emerging FX demand on this date. In such an environment, the Central Bank set its offer quotations at very high levels, 2300 percent and 4000 percent on February 20 and 21 respectively, in order to defend the exchange rate regime. The interest rates continued at high levels on February 22, the date of the exchange rate regime switch, and on the following day, but the Central Bank was involved in both borrowing and lending transactions in the Interbank Money Market. After February 26, the starting date for the implementation of a more effective liquidity management, the Central Bank was involved in lending transactions only on March 1, 2 and 16 and for small volumes.

After the switch to the floating exchange rate regime, in order to withdraw the excess liquidity arising from the injection of liquidity through OMO for the funding of public and SDIF banks, the Central Bank carried out borrowing transactions in the Interbank Money Market in addition to the reverse repo transactions of OMO in the ISE Repo and Reverse Repo Market. In the period between February 26 and March 16, the starting date of the banking sector operation, interest rates for these transactions declined to 80 percent from 100 percent. Until March 14, only O/N maturity borrowing transactions were made, but 1-week maturity borrowing transactions were also used after March 14. In the

Borrowing transactions in the Interbank Money Market were also used to withdraw the excess liquidity arising from the banking sector operation.

framework of the banking sector operation, the public and SDIF banks' repo transactions with depositors and private banks started to decline due to the funding of the Central Bank to these banks. To withdraw the excess liquidity arising from these operations, the Central Bank continued to carry out reverse repo transactions of OMO in ISE Repo and Reverse Repo Market and borrowing transactions in Interbank Money Market, so the liquidity withdrawn via these two channels was gradually increased. Within this framework, 2-week maturity transactions were used after March 23 in addition to O/N and 1-week maturity borrowing transactions.

TABLE III.2.5
CENTRAL BANK TRANSACTIONS
IN THE INTERBANK MONEY MARKET
(TL trillion)

2001	O/N Borrowing Amount	O/N Lending Amount	1 Week Borrowing Amount	2 Week Borrowing Amount	Other Maturities Borrowing Amount ⁽¹⁾	Total Net Borrowing ⁽²⁾
January	2,589	1,167	-	-	-	1,422
February	4,437	4,341	-	-	-	96
March	29,411	12	795	168	177.4	30,539
April	23,916	-	590	1,440	476.5	26,423
May	32,762	-	1,111	3,137	147.7	37,157
June	20,711	-	3,487	3,120	-	27,318
July	21,588	-	2,803	3,720	-	28,111
August	13,584	-	2,776	3,284	-	19,644
September	14,278	11	6,282	268	0.8	20,818
October	14,060	6	11,894	-	0.8	25,949
November	14,552	-	15,803	-	-	30,355
December	16,195	0.05	16,784	-	-	32,979
TOTAL	208,084	5,537	62,325	15,138	803	280,814

Source: Central Bank.

(1) Transactions referred to here include broken date and 1-month maturity transactions

(2) Net purchases are calculated as total purchases minus total sales. Negative values indicate that sales are greater than purchases.

In the period between March 16 and September 14, the Central Bank was involved only in borrowing transactions in the Interbank Money Market and there were no lending transactions at its announced offer quotations. However, to limit the negative effects on the markets of the September 11 terrorist attacks in the USA, on September 12, the Central Bank announced that it would meet the additional liquidity demand of banks within their borrowing limits in Interbank until the closure of the market at 4.30 p.m., parallel to the measures taken in other markets. Within this framework, the Central Bank was involved in lending transactions amounting to TL 17.1 trillion at the offer quotation that was reduced to

62 percent on September 12. However, there was no volatility in the short-term markets after September 11, and the Central Bank continued to withdraw liquidity via transactions in the Interbank Money Market.

Contrary to the practice in the period before November 2000, the Central Bank made transactions in the Interbank Money Market at interest rates parallel to those in other markets. While the Central Bank performed transactions with banks at the announced bid quotations in the interval between the closure of the session in which banks could perform transactions with each other and the closure of the market, the volumes of these transactions were very limited. The bid rate of the Central Bank did not change during 2001 and remained at the 5 percent level. The offer rate was changed four times after March 16, going down 110 percent from 120 percent in March, 100 percent and 90 percent in May, and 62 percent in September.

TABLE III.2.6
AVERAGE SIMPLE INTEREST RATE
THE INTERBANK MONEY MARKET
(Percentage)

2001	Transactions in the Market			Transactions of Central Bank		
	O/N ⁽¹⁾	1 Week	2 Week	O/N ⁽¹⁾	1 Week	2 Week
January	42.70	37.39	48.38	35.74	-	-
February	400.27	45.59	44.60	111.51	-	-
March	81.19	84.77	86.00	80.89	84.78	86.00
April	80.99	84.47	87.46	80.85	84.12	87.37
May	71.46	71.19	74.78	71.30	71.28	74.34
June	63.00	69.03	70.00	63.00	69.00	70.00
July	65.34	70.02	71.12	65.40	69.92	71.09
August	62.54	67.83	69.16	62.64	67.86	69.24
September	59.03	62.04	66.00	59.02	62.02	66.00
October	58.93	62.00	-	58.92	62.00	-
November	59.00	62.00	-	59.00	62.00	-
December	59.00	62.00	-	59.00	62.00	-

Source: Central Bank.

(1) For the average O/N interest rates of the Central Bank transactions, the O/N interest rate of borrowing transactions were shown.

The Central Bank performed its borrowing transactions in the Interbank Money Market at the interest rates set in line with those in other markets. In this respect, the interest rates at O/N maturity declined to 67 percent from 80 percent during the period between March 16 and May 17. These interest rate cuts were followed by interest rate cuts of 65 percent on May 24 and 63 percent on May 29. O/N interest rate was raised to 67 percent on July 16 taking into consideration the effects of the Argentinean crisis on the markets and exchange rate. However, this

The Central Bank used interest rates set parallel to those in other markets in its borrowing transactions in the Interbank Money Market.

The Central Bank of the Republic of Turkey

rate was reduced to 62 percent on August 6, 60 percent on August 27 and 59 percent on September 4. O/N interest rates stayed at 59 percent in the period between September 4 and the end of 2001. The interest rates for other maturities on which the Central Bank carried out transactions were reduced parallel to the interest rate cuts on O/N maturity.

Transactions of O/N, 1-week and 2-week maturities constituted respectively 72.7 percent, 21.8 and 5.3 of the total borrowing transactions that the Central Bank carried out.

The borrowing transactions of the Central Bank in the Interbank Money Market were performed mostly on O/N maturity, but 1-week, 2-week and broken date maturities were also used in March. In the following periods, the share of 1-week and 2-week maturity transactions in the total volume was increased and 1-month maturity transactions started to be used due to the gradual increase in the stability of the markets. However, O/N maturity transactions constituted the highest share of the total volume of transactions of the Central Bank until November. The volume of 2-week maturity transactions increased rapidly starting in May; however, there were no 2-week maturity transactions after September 3. Transactions of O/N, 1-week and 2-week maturities constituted respectively 72.7 percent, 21.8 percent and 5.3 percent of the total borrowing transactions that the Central Bank carried out.

In the period after March 2001, the borrowing transactions by which the Central Bank withdrew the excess liquidity from the market constituted the highest portion of the total volume. Hence, market interest rates were determined to a great extent by the Central Bank in the Interbank Money Market. In the periods when market interest rates deviated from those the Central Bank used, the deviation was limited.

TABLE III.2.7
TRANSACTION VOLUME IN THE INTERBANK MONEY MARKET
(TL trillion)

2001	Total	O/N	1-Week	2-Week	1-Month	Other Maturities
January	17,024	16,939	70	4	9	1
February	18,561	18,519	21	10	11	-
March	44,055	42,023	898	173	-	961
April	37,431	34,465	867	1,624	477	-
May	40,153	34,752	1,791	3,444	163	4
June	30,704	22,311	5,069	3,324	-	-
July	31,069	22,926	4,089	4,054	-	-
August	22,638	15,623	3,515	3,500	-	-
September	23,198	15,481	7,413	303	0.8	-
October	28,331	15,078	13,253	-	0.8	-
November	32,347	15,394	16,953	-	-	-
December	35,430	17,411	18,019	-	-	-
TOTAL	360,939	270,919	71,957	16,436	661	966

Source: Central Bank.

During 2001, one-sided transactions amounted to TL 361 quadrillion and these transactions were performed at O/N, 1-week, 2-week, 1-month, T/N, T/W and broken date maturities. O/N maturity transactions constituted 75 percent of the total volume whereas 1-week and 2-week constituted 20 percent and 4.5 percent of the total volume respectively.

While 80 banks had been authorized to perform transactions in the Interbank Money Market at the beginning of 2001, this number declined to 62 at the end of 2001 due to transfers, mergers and liquidations. A total of 30 banks used the forward transaction limits that were put into practice in 1999 and the total volume of this facility amounted to TL 661 trillion in 2001 at 1-month maturity. In 2001, there were no 3-month maturity transactions within the framework of this facility. In addition, a total of 51 banks used TL 4.8 quadrillion of the overdraft facility, which was also effective from 1999 in order to satisfy the daily urgent funding requirements in the banking system and minimize tightness in the payment systems.

III.2.3. Foreign Exchange and Foreign Currency Markets

The total volume of transactions in foreign exchange and foreign currency markets was US\$ 267.2 billion in two-sided terms, 64 percent of which was realized in the FX deposits market, 28 percent in the TL-foreign exchange market, 4 percent in the TL-foreign currency market and 4 percent in other markets (Table III.2.8).

TABLE III.2.8
TRANSACTIONS VOLUME IN FOREIGN EXCHANGE-FOREIGN
CURRENCY MARKET⁽¹⁾
(US\$ million)

2001	TL-FX		FX					SWAP	Total
	TL-FX	Forward	TL-FC	FX-FC	FX-FX	FC-FC	Deposits		
January	13,464.6		265.0	229.7		13.9	8,981.0		22,954.3
February	36,096.2		434.6	1,329.7	45.0	42.1	12,683.6	320.0	50,951.2
March	4,745.3		664.5	1,715.2	55.7	97.4	24,036.2	466.0	31,780.3
April	3,686.0		850.5	1,388.6	8.8	110.7	21,818.0	530.0	28,392.6
May	3,849.8		319.2	631.5	50.9	198.3	19,473.6	86.0	24,609.4
June	2,921.2		388.8	722.6	19.8	168.6	11,925.3	10.0	16,156.2
July	4,660.0	96.0	1,006.4	669.6	38.3	291.2	15,591.2	14.0	22,366.6
August	2,837.0	26.0	143.9	736.4	156.8	487.6	16,630.1		21,017.8
September	1,045.5	2.0	156.6	428.1	85.8	237.8	11,686.7		13,642.6
October	1,241.4		137.5	757.8		414.1	11,472.3		14,023.1
November	1,020.8		99.5	463.4		193.3	8,771.4		10,548.6
December	385.0		60.2	1,805.1	185.9	531.0	7,826.7		10,793.8
Total	75,952.9	124.0	4,526.8	10,877.7	646.9	2,786.0	170,896.2	1,426.0	267,236.5

Source: Central Bank.

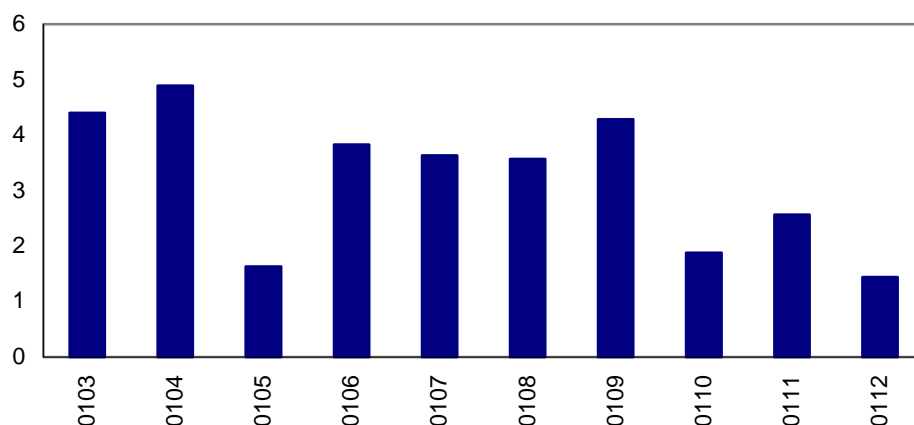
(1) Transaction volume figures are two-sided.

At the end of 2000, the pre-determined path of the daily exchange rate basket was announced for the January-June 2001 period. Moreover, the Central Bank indicated that a progressively widening band system would be introduced after July 2001. However, the Turkish lira was left to float against foreign exchange on February 22 as a result of the crisis.

The exchange rate depreciated substantially and displayed a highly volatile pattern in the first months after the switch to the floating rate regime.

The exchange rate depreciated substantially and displayed a highly volatile pattern in the first months after the switch to the floating rate regime (Figure III.2.1).

FIGURE III.2.1
EXCHANGE RATE VOLATILITY
(TL / US\$, Coefficient of Variation, Percent)



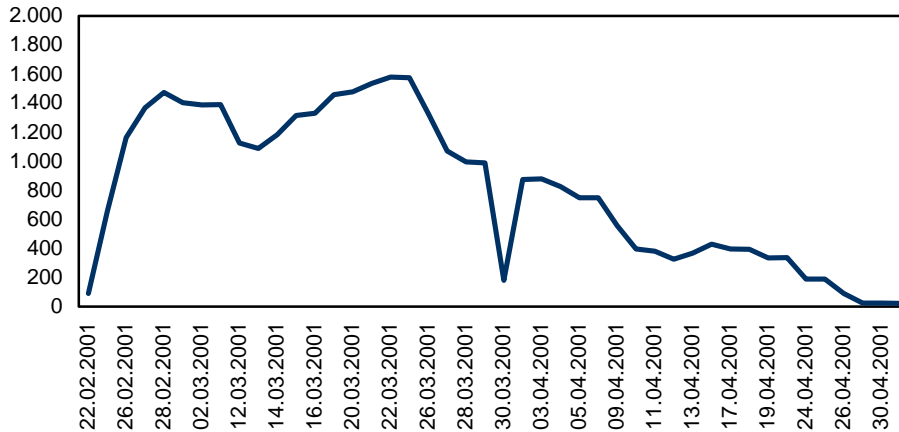
Source: Central Bank.

After switching to the floating regime, every workday at 15:30, the Central Bank announced the average of the bank's buying-selling quotation averages in the FX market as the indicative exchange rate. In order to provide the banking system with the necessary sources to meet their foreign liabilities, the Central Bank granted the banks an FX deposit facility within the daily-announced rates (Figure III.2.2).

The Central Bank granted the banks an FX deposit facility following the switch to the floating rate regime.

Moreover, the Central Bank provided FX in return for Turkish lira in order to prevent excess liquidity in the exchange rate and to stabilize the market. The Central Bank provided the banks with approximately US\$ 1 billion worth of FX deposits and sold US\$ 2 billion worth of foreign exchange and foreign currency by March 29. After the beginning of May, the banks did not make use of the FX deposit facility provided by the Central Bank.

FIGURE III.2.2
FX DEPOSITS PROVIDED BY THE CENTRAL BANK
(Stock, US\$ million)

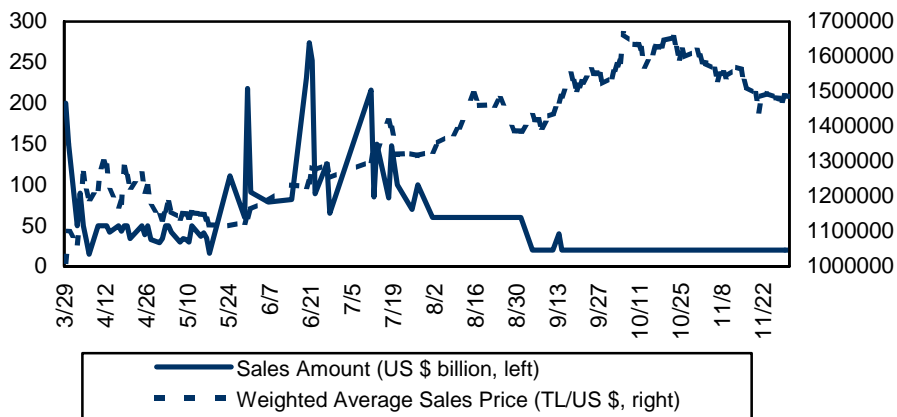


Source: Central Bank.

The Central Bank conducted regular FX sales auctions after March 29 in order to smooth excessive short-run exchange rate fluctuations without affecting the long-run equilibrium level of exchange rates and to perform the FX sales in a more transparent manner (Figure III.2.3).

The Central Bank conducted FX sales auctions after March 29.

FIGURE III.2.3
FX SALES AUCTIONS
(US\$ billion)



Source: Central Bank.

FX sales auctions were conducted daily until May 17. Between May 17 and July 11, FX sales auctions were conducted whenever required without pre-

announcing the amount. After July 11, the monthly program of FX sales auctions was pre-announced. These auctions were conducted in order to sterilize the excess liquidity in the market caused by the use of the external financing which was provided by the IMF to make the Treasury's domestic debt payments. In the same way, FX sales were conducted in order to sterilize the excess liquidity in the market caused by the use of the external financing provided by the World Bank and the Treasury's FX borrowings to make the Treasury's domestic debt payments. In this context, US\$ 2,835 billion worth of FX was sold by the FX sales auctions conducted between July 11 and November 30. Since the time of FX borrowings and FX payments were close to each other in the November-December period, the Treasury's payments were not expected to cause any excess liquidity in the market. Therefore, it was announced that FX sales auctions would not be conducted after November 30 unless they are required.

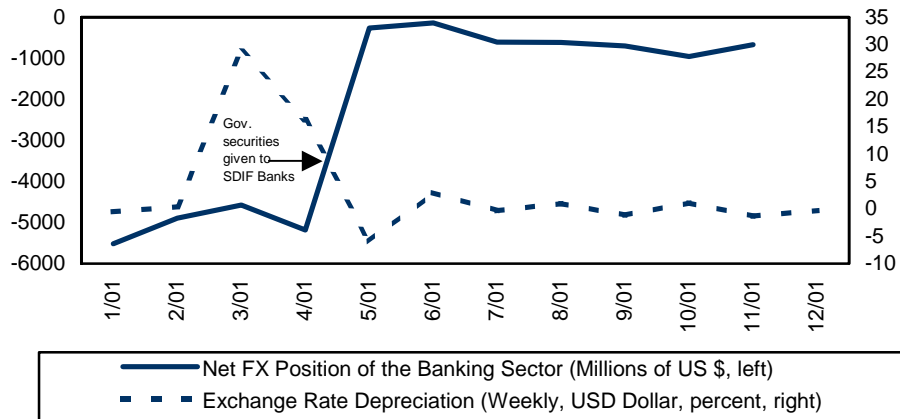
In 2001, US\$ 6.5 billion was sold in programmed and regular FX sales auctions conducted by the Central Bank. In 2001, only one FX buying auction was conducted and US\$ 47 million was purchased in this auction.

The high open positions of the banking sector put additional pressure on the exchange rate following the switch to the floating rate regime. These open positions were largely removed via the US\$ 7 billion worth of FX sales between March and July, the US\$ 8.1 billion of FX denominated government securities given to SDIF banks against their capital requirements and claims arising from duty losses and the US\$ 6.6 billion debt swap conducted with private banks in June. The volatility in the exchange rate diminished as a result of these measures (Figure III.2.4).

The volatility in the exchange rate diminished as a result of the substantial reduction in the open positions of the banking system.

The volatility in the exchange rate, which diminished after April, increased in July as a result of adverse developments in the Argentinean economy and the possibility of delay in the IMF credit. In August, the suspicions concerning the sustainability of the domestic debt declined as a result of the successful Treasury auctions. Interest rates declined and the interventions of the Central bank in the FX market were reduced to insignificant levels. In this period, the foreign exchange market reached equilibrium within the market dynamics and a relative stability was observed as a result of the banks' external credit agreements and the improvement in the current account.

FIGURE III.2.4
NET FX POSITION OF THE BANKING SECTOR AND EXCHANGE RATES⁽¹⁾



Source: Central Bank.

(1) November figure of Net FX Position of Banking Sector is provisional.

The volatility of the exchange rate increased in September as a result of the terrorist attack on the USA. After the second half of the October, there was relative stability in the FX market as a result of increasing confidence in structural reforms and additional external financing.

There was relative stability after the second half of the October as expectations turned positive.

The Turkish lira depreciated against FX after switching to the floating rate regime. The year-end depreciation of the TL compared to the previous year was 115.3 percent against the US dollar and 107.1 percent against the euro.

**NEW CENTRAL BANKING LAW AND CENTRAL BANK
INDEPENDENCE**

Economic conditions have changed dramatically since Central Bank Law no. 1211 was approved on January 26, 1970. Various amendments have been introduced to the law following developments in central banking and changes in international banking norms.

With the 1983 amendments, the Central Bank of Republic of Turkey was entrusted with the following duties; to carry out open market operations, to determine the terms, types and maturity period of deposits in banks, to determine the exchange rate regime jointly with the government, to manage international reserves in line with the economic interests of Turkey with reference to the related rules and procedures, to carry out transactions in foreign exchange and precious metals on the stock exchange in line with government decisions, to administer and to represent the Savings and deposits Insurance Fund. At the same time, the Central Bank's practice of making proposals to the Board of Ministers regarding interest rate levels bid and offered by the private banks and other similar regulations was abolished. In addition, the Bank's authority to regulate credit volume and the terms of credit in the banking sector was nullified.

With 1986 amendments, the Central Bank was for the first time allowed to conduct monetary and exchange rate policy with the aim of maintaining price stability. The 1990 amendment changed the term of office of the Governor of the Central Bank, to be appointed by the council of ministers, to five years.

With the 1994 amendment, Central Bank advances to the Treasury and public enterprises were to be limited. The Central Bank's short-term advances to the Treasury were limited to twelve percent of the difference between the current year total general budget allocation and the previous year's allocation. Starting in 1998, short-term advances to the Treasury were gradually reduced to three percent. The Central Banks' total discounts and advances to public enterprises were limited to fifty percent of the limit of short-term advances to the Treasury.

In line with the changes in EU norms and international Central Banking practices, a new Central Banking law was enacted on May 5, 2001. With this new law, no. 4651, fourteen articles of law no 1211 were amended, seven articles were repealed, and a new article was added. The main aim of these amendments was to strengthen the Central Bank's operational independence. Empirical research has proven that there is a direct relationship between Central Bank independence and

inflation. These research findings state that the more independence a central bank has, the better the country's performance in terms of inflation level and volatility.

The major changes in the Central Banking law can be summarized as follows:

Instrument Independence: As a measure of independence, it was decreed that one of the main objectives of the Bank is to achieve and maintain price stability. Furthermore, the Bank was delegated to be the only body responsible for conducting monetary policy, which enhances the Bank's independence. With this new law, while the Bank attained instrument independence, the task of determining the goal – i.e. the inflation target – is to be carried out jointly with the government.

Accountability and Disclosure to the Public: The new Central Banking Law states that an important objective of the Bank is to achieve and maintain price stability. The Bank will determine at its own discretion the monetary policy that will be implemented and the monetary policy instruments that will be used in order to achieve and maintain price stability. As a natural consequence of this discretion, the Bank is required to establish the highest possible level of accountability and transparency.

To this effect, the Governor of the Central Bank will submit a report to the Council of Ministers each year in April and October concerning the operations of the Bank and the monetary policy followed and to be followed. In addition, the Bank will furnish information twice a year regarding its operations to the Planning and Budget Commission of the Grand National Assembly of Turkey.

Furthermore, the Bank will prepare periodical reports concerning monetary policy targets and implementations and disclose this information to the public to enhance transparency and public monitoring. In the event that the target is not met, the Central Bank should submit this information to the Government in writing and inform the public disclosing the reasons why the set targets were not achieved in the allotted time or why there is a possibility of failure to meet the target and the measures to be taken to overcome it.

The Bank may have the balance sheet and the income statements audited by independent external auditing institutions.

The Monetary Policy Committee: Similar to the international developments, monetary policy committee was established to ensure effectiveness in maintaining price stability. The Monetary Policy Committee should, under the chairmanship of the Governor, be composed of Vice Governors, a member to be elected by and

from among the Board members and a member to be appointed by a joint decree on the recommendation of the Governor. This joint appointment ensures a link with the government policies. The Undersecretariat of the Treasury or the Undersecretariat of the Deputy to be designated by him/her may participate at the meetings without the right to vote.

No Extension of Credit to the Treasury: In order to sustain independence, the law established that the Bank should not grant advances or extend credit to the Treasury or public establishments and institutions. It was also legislated that the Bank should not purchase debt instruments issued by the Treasury or by public establishments and institutions in the primary market.

Last Resort Lender: The Bank may, as a last resort lender, provide daily or end-of-day credit facilities to the system against collateral so as to eliminate technical payment problems which may obstruct the efficient functioning of the financial markets and temporary liquidity shortages that may cause interruption in the payment system.

Supervision of Financial and Payment Systems: One of the duties of the Central Bank is to ensure and maintain financial stability. Within this context, the Central Bank improves the financial infrastructure and analyzes the systemic risks. Furthermore, the Bank is empowered to monitor the financial system and to take any measures necessary to protect it from financial crisis.

The Bank should, in order to monitor financial markets, be authorized to request necessary information and to gather statistical data from banks, other financial institutions and from establishments and institutions authorized to regulate and supervise the said institutions

The Bank was assigned to establish and sustain a secure and effective payment system, which adopts technological developments in the area. Furthermore, the Central Bank was assigned and empowered to supervise and to intervene in its own or other institutions' payment systems in order to ensure their smooth and effective functioning.

Terms of Office: The appointment of the Vice Governors has been increased from 3 years to 5 years, parallel to the term of office of the Governor of the Central Bank. Furthermore, similar to the Governor, Vice Governors cannot be removed from their posts before the termination of their term of office. In a similar vein, the term of office of the monetary policy council's jointly appointed member is five years.

Request for Information and Centralization of Risks: The Bank may, in collecting statistics, cooperate with public establishments and institutions, the Undersecretariat of the Treasury, State Institution of Statistics, the authorities of foreign countries entitled to collect statistical information and international institutions. The Bank is authorized to request and collect directly, all statistical information relating to the financial system and other statistical information that is deemed necessary for the surveillance of developments in the economy and the balance of payments from banks, other financial institutions and individuals.

