REPORT ON 2001 MONETARY POLICY

SÜREYYA SERDENGEÇTİ

GOVERNOR
THE CENTRAL BANK OF THE REPUBLIC OF TURKEY

ANKARA
15 MAY 2001

I. INTRODUCTION

Distinguished Press Members,

1. This press conference will give me the opportunity to inform you about monetary policy goals, targets, instruments and the assumptions related to the new program that will be implemented in the rest of 2001. Before going over the monetary program and its goals, I would like to first explain the macroeconomic developments for 2000 and the first four months of 2001 as well as the framework of the monetary program revised in parallel to the change in exchange rate policy and the post-crisis developments in financial markets.

II. THE GENERAL ECONOMIC SITUATION AND EXPECTATIONS

2. The first part of my speech involves the effects of the 2000 program as well as the crisis on the Turkey's macro-economic indicators and the developments foreseen for the new period.

Growth

3. In 2000, after the announcement of "Disinflation Program", a recovery was observed in the economic activities in Turkey as seen in other countries that have implemented stabilization program based on exchange rate (Figure 1). The recession experienced in the Turkish economy during 1999 also played an important role in this development. Removal of uncertainties in the exchange rate with the adaptation of the program, the implementation of fiscal measures and the improvement in Treasury's external borrowings resulted in a sharp drop in the real interest rates. Falling interest rates, which created a wealth effect and caused a sharp rise in consumer credits, led to an increase in consumption expenditures (Figure 2). In addition to the decline in interest rates, the delayed consumption expenditures of 1999 were realized in 2000, thus contributing to GNP growth and an increase in imports. Similar to the experiences in other countries that have implemented an exchange rate-based stabilization program, main contribution to the private consumption expenditures stemmed from the expenditures on consumer durable goods.

FIGURE 1
REAL GNP GROWTH (Annual Percentage Change)

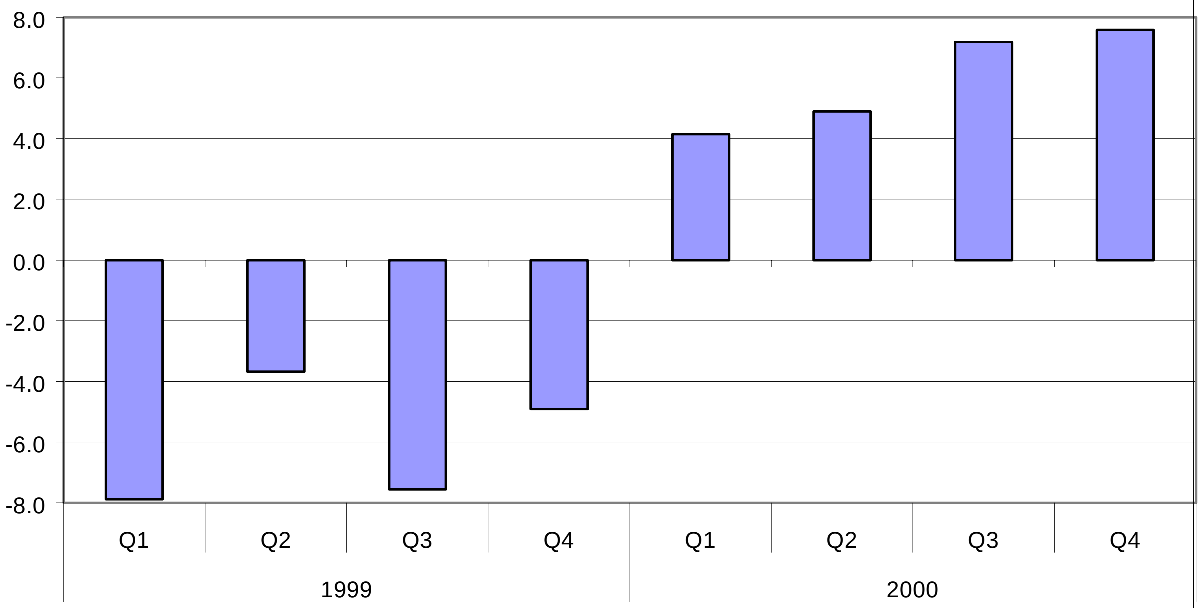
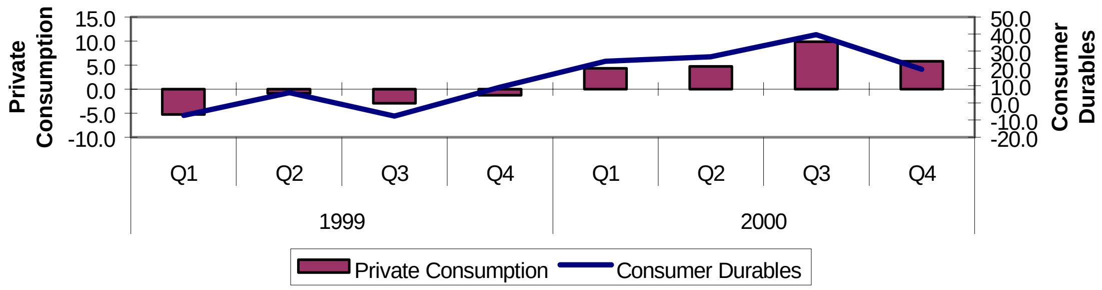
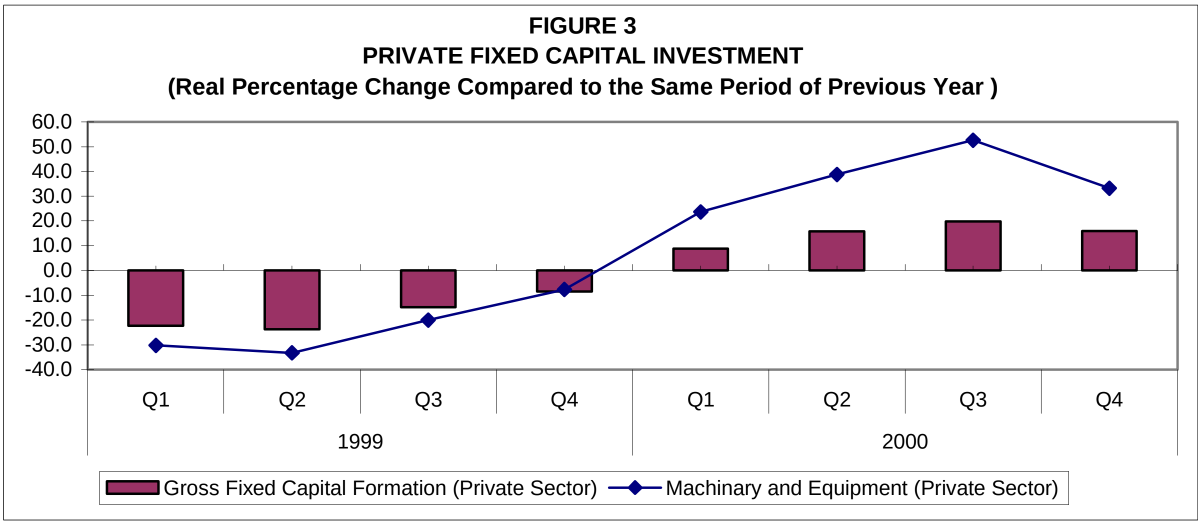


FIGURE 2
PRIVATE CONSUMPTION EXPENDITURE
(Real Percentage Change Compared to the Same Period of Previous Year)

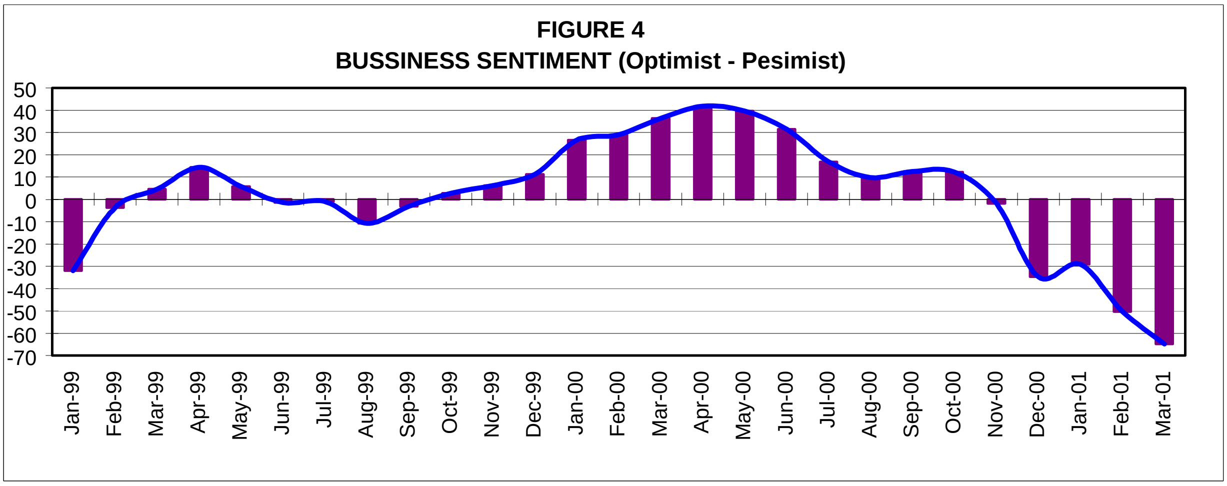


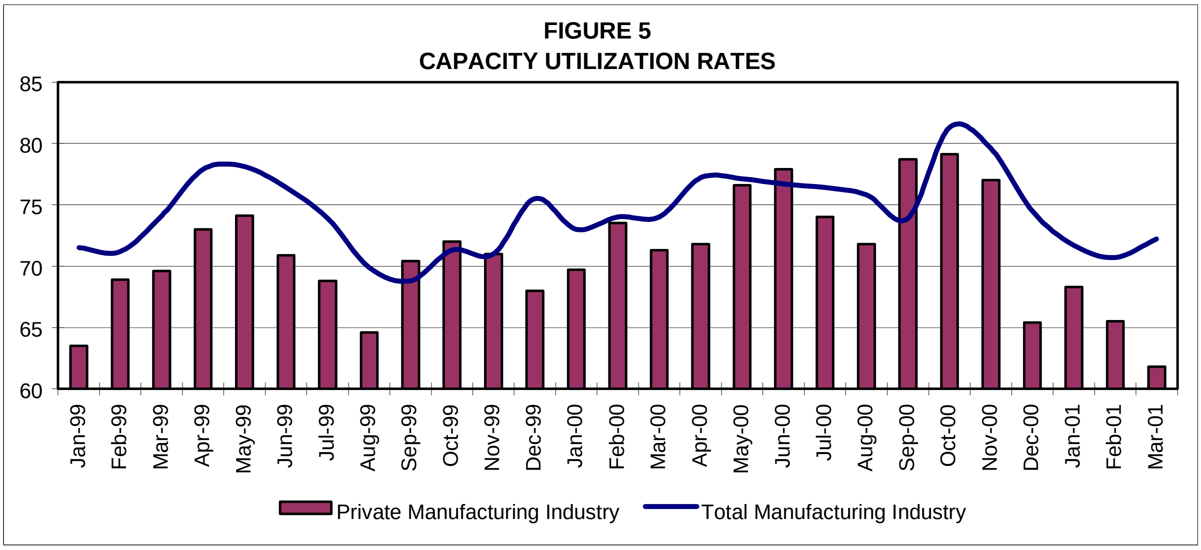
4. Achieving a stable economic environment led to a substantial increase in investment expenditures, particularly in machinery-equipment investments (Graphic 3). In this favorable atmosphere - the drop of real interest rates, the stable exchange rates, and positive expectations for future and capital inflows - firms displayed a tendency towards fixed investments and renewal of their inventories of intermediate goods, which they had depleted during 1999. Finally, recovery in the tourism sector had also a favorable effect on growth in 2000.

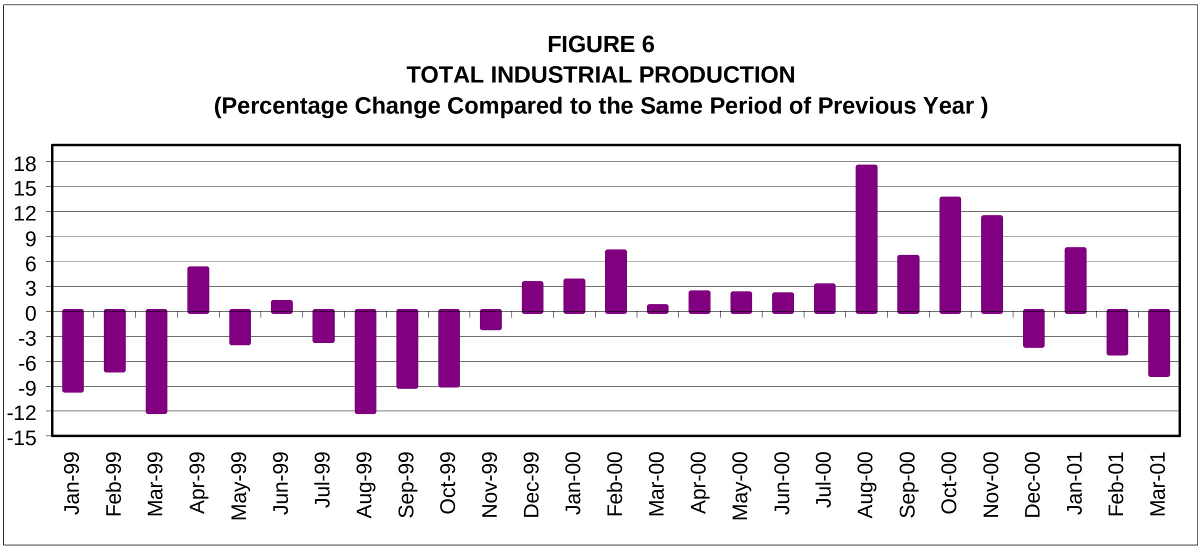


5. As a result of these developments, GNP and GDP increased by 6.1 percent and 7.2 percent, respectively in 2000. Moreover, the total domestic demand rose by 9.6 percent.

6. The crises of February and November had unfavorable effects on both the consumers' and producers' confidence. General expectations of firms for economy turned to be negative (Figure 4). The capacity utilization rates decreased (Figure 5), and the industrial production dropped by 2 percent in the first three month of 2001 (Figure 6). The sharp increase in the interest rates, the rapid depreciation of Turkish Lira and decline in employment had a negative impact on consumers' confidence, thus leading to contraction in consumption expenditures, particularly in the consumer durables.





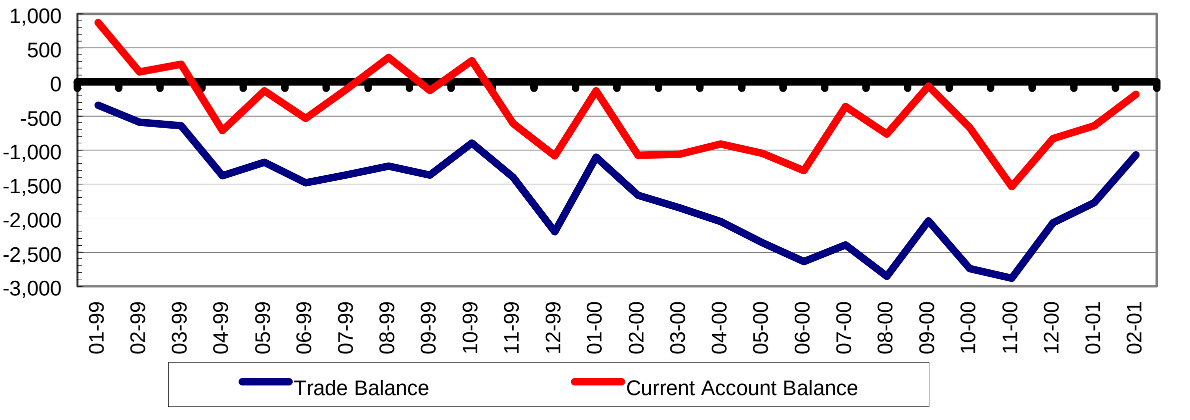


7. The measures taken after the February crisis and the announcement of the new economic program contributed to the partially stabilization of financial markets to the easing of the social tensions. In the following days, the disbursement of external financing, which is envisaged in the new economic program, is expected to stabilize the interest rates and the exchange rates restoring both producers' and consumers' confidence. Therefore, we expect that the sharp contraction in the first half of 2001 would diminish, as the confidence will be restored. Turkey's competitive edge will be improved leading an increase in export and tourism revenues. As a result, the real GNP is expected to decrease by 3 percent in 2001.

Balance of Payments:

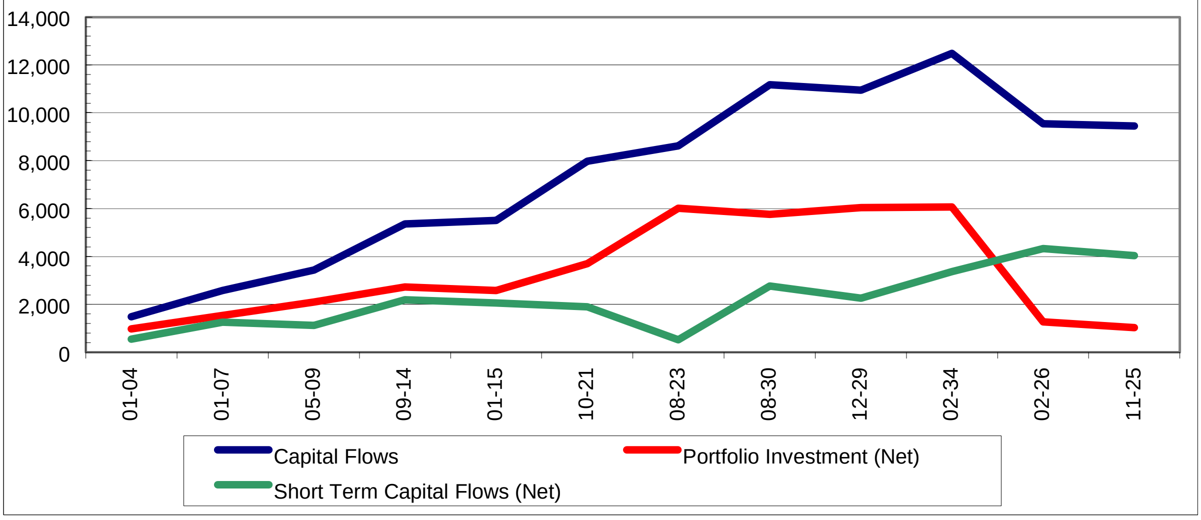
8. Within the framework of the exchange rate policy in 2000, the value of Turkish lira moved in line with the pre-announced exchange rate basket, gradually slowing down the depreciation rate against this basket. However, Turkish lira appreciated in real terms in 2000 because the inflation rate materialized above the nominal depreciation rate due to inflationary inertia. Real appreciation of Turkish lira against Euro was relatively higher due to the depreciation of Euro against the US dollar during the course of year, which had a two-sided negative impact on our trade with the Europe. While the dollar value of Turkish exports to the EU countries decreased, both the volume and value of our imports from the EU countries expanded considerably. However, two main factors of Turkey's import expansion in 2000 were the substantial price increases of crude oil as well as other energy prices in international markets and the rapid recovery of the domestic demand. As the rapid rise in imports could not be matched with limited increase in exports, foreign trade balance worsened. Although revenues from tourism and shuttle trade increased, they could hardly recover the foreign trade deficit and hence, the ratio of current account balance to the GNP was realized as 4.8 percent (Figure 7).

FIGURE 7
TRADE BALANCE and CURRENT ACCOUNT BALANCE
(Million US Dollars)

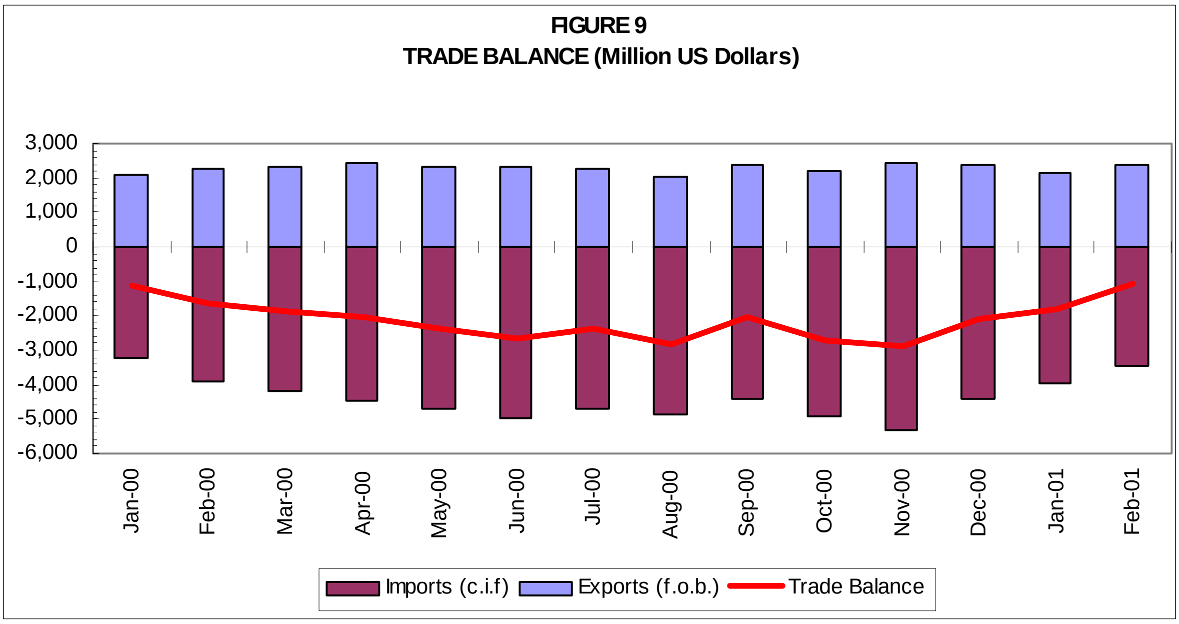


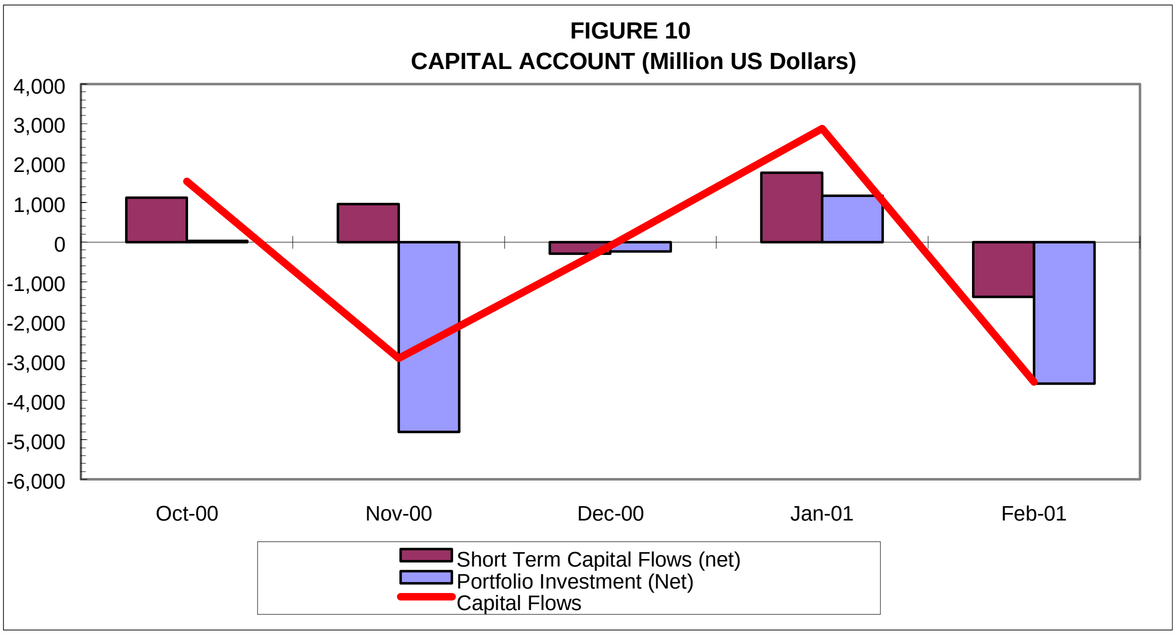
9. While portfolio investments, resulting mainly from the successful bond issues of the Treasury in international markets, was the major financing source of current account deficit in the first half of 2000, short-term capital inflows gained importance after August. Although there was a considerable capital outflow as a consequence of the financial crisis in November, Turkey managed to keep its net external borrower position throughout 2000. Other sources of capital inflows in 2000 were the long term borrowing of the private sector and short term borrowing of the banks (Figure 8).

FIGURE 8
CAPITAL ACCOUNT (Cumulative, Million US Dollar)



10. Rising interest rates and declining domestic demand after the November crisis, started to show their effects on imports at the beginning of 2001. Although imports in January-February 2001 grew more than the same period in the previous year, the increasing trend of 2000 seems to have come to a halt. Indeed, imports decreased by 12.3 percent in February 2001 compared to the same month of 2000 and increasing exports positively influenced the foreign trade balance (Figure 9). Due to the partial stability of financial markets in January 2001, both portfolio investments and short-term capital inflows increased. However, February crisis caused capital outflows and reduced international reserves (Figure 10).





11. During the rest of 2001, the rapid depreciation of Turkish lira is expected to restore our competitiveness in international markets, increasing our exports and tourism revenues. Moreover, we are anticipating that imports will contract due to the decline in GNP growth and domestic demand, which will reduce the current account deficit.

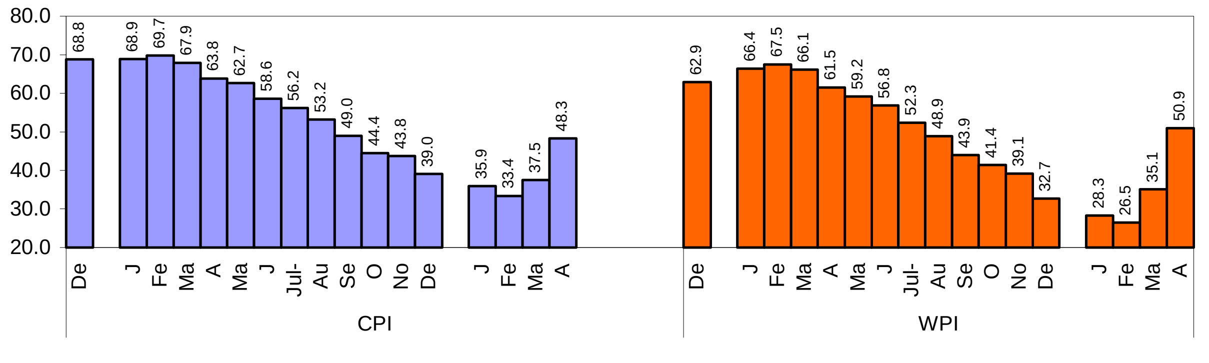
Developments in Prices

12. At the end of 2000, CPI and WPI inflation were realized as 39,0 percent and 32,7 percent respectively, and were brought down to the lowest levels of last 14 years (Figure 11). However, the annual inflation figures were realized above the targeted levels of the anti-inflation program of 2000, which were 20 percent for WPI and 25 percent for CPI.

13. As you know, exchange rate is a major determinant of inflation in Turkey. Although the value of the exchange rate basket increased by 20 percent during 2000, the inflation rate was realized above this increase. One of the main reasons for this was the rigidity created on prices due to the backward indexation behavior arising from chronic inflation history in Turkey. The inflationary expectations, which fell drastically after the announcement of the disinflation program, became stable since May, because of the high inflation figures in first three months of the year and slow progress in structural reforms.

14. Another reason for realization of inflation above the target was the boost in domestic demand based on consumer durables, which is one of the major characteristics of exchange rate-based stabilization programs. Increased demand for consumer durables, positive effects of crawling peg regime and the decline in interest rates on the prices of consumer durables, resulted in a non-homogenous increase in domestic demand. In addition to this, as the exchange rate of US dollar is the major determinant of core inflation in Turkey rather than Euro, appreciation of US dollar against Euro in the first three quarters of 2000 negatively affected the cost-reducing effect of the exchange rate policy.

FIGURE 11
CPI-WPI (Annual Percentage Change)



15. High interest rates arising from the crisis in November accelerated the contraction in domestic demand towards the end of 2000. Consequently, WPI and CPI inflation figures turned out to be lower in the first two months of 2001. However, the shift to the floating exchange rates at the end of the February of 2001 led to an increase in production costs and in public sector prices March that had been increased in line with the exchange rate in the course of 2000. Therefore, March inflation was realized at 6.1 percent in CPI and 10.1 percent in WPI. The price adjustments in public sector continued in April and CPI and WPI inflation were realized at 10.3 and 14.4, respectively.

16. Shrinking domestic demand and accumulating inventories prevented effects of depreciation and rising costs from being reflected especially on the consumer prices in March. However, we observe that the effects of rising exchange rates made much impact on the prices in April. In the last two months, WPI inflation was higher than CPI inflation, pointing out to a contraction in domestic demand.

17. Owing to cost pressure, high inflation rates in the coming months are expected to continue, even though relatively lower than the rates of March and April. However, the positive impact of the new policies on exchange rates and interest rates and the seasonal factors will contribute to slow down the monthly inflation rates in the third quarter of 2001. Moreover, the monthly CPI inflation on a seasonally adjusted basis is expected to be around 2 percent in the last quarter of 2001. As a result of these developments, the annual CPI inflation is expected to be 52,5 percent at the end of the year.

18. At this point, I would like to stress that during 2001 the major factor that will affect the year-end inflation projection, as the main macroeconomic parameter of the program is the necessity for the implementation of the targets and policies determined in the context of the economic program. In this context, pursuing a monetary policy; achieving the targeted primary surplus with tight fiscal policy; adopting an incomes-policy in line with the projected inflation, and securing stability in interest and exchange rates by the effective use of external financial support, are the main factors that will contribute to the realization of the inflation projection of 2001.

I. Monetary Policy Implementations after February 22

19. As I had mentioned in my past speeches, especially in the Shareholders' General Meeting, the February crisis appeared as a panic attack against domestic currency mainly due to the increasing financial fragility after the November crisis.

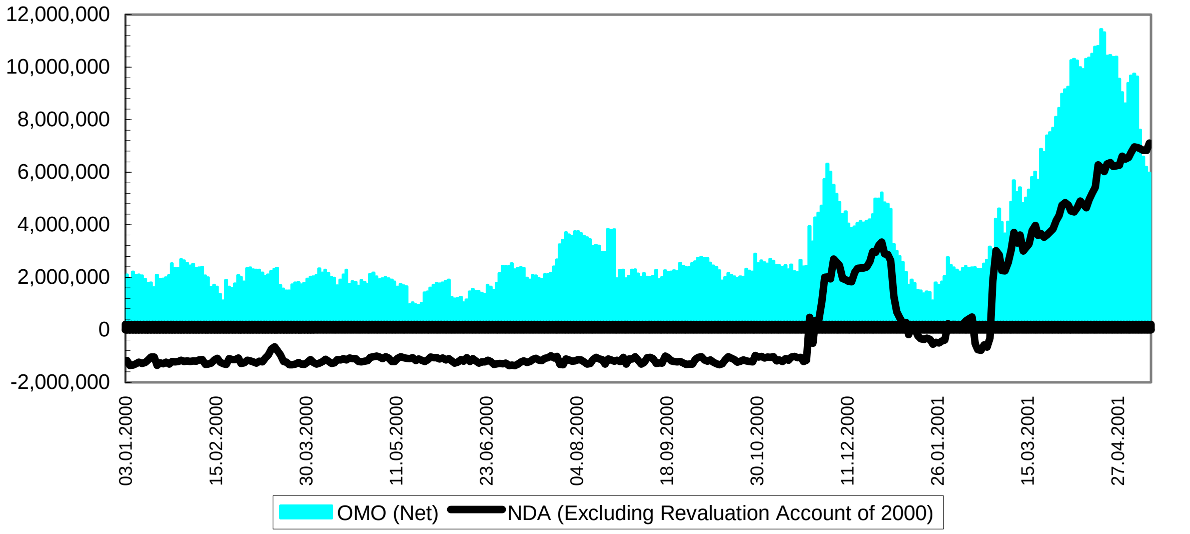
20. Considering that the currency peg system could have deteriorated the problems of banking system, bringing additional burdens on the economy, the Turkish lira was allowed to float against the other currencies.

21. With the loss of nearly US $5 billion in reserves on 22 February and the floating of the Turkish Lira, monetary and exchange rate policy had a new aspect. After switching to the floating regime, the Turkish Lira started to rapidly depreciate and fluctuate as expected and as observed in other countries.

22. During the following two days after the floating of the currency, the open market operations by auction were not conducted. Instead, liquidity was provided by open market operations with quotation and direct purchasing and selling TL in interbank money market. During these two days CBRT realized its funding with high interest rates. As of 22 February, CBRT started to announce the average value of daily selling and buying rates realized in the foreign exchange markets as the reference value of exchange rate in daily basis as in the previous years.

23. As of 26 February, CBRT has started to intervene in the markets in order to make the banking system function and to overcome the disturbances in the payments system. In that framework, CBRT has brought effective ceiling values to the short-term interest rates; relatively increasing the mobility of liquidity in the market. In that period, the main function of funding from open market operations was to roll over the maturing repurchase agreements of state banks and banks taken over by the Saving Deposits Insurance Fund (SDIF). In addition, on February 26, the quotation rate in interbank was reduced to 150 percent from its extremely high levels prior to that date, in the following dates this rate was decreased to 110 percent. Besides, CBRT allowed banks to conduct more mutual foreign exchange deposit transactions. CBRT also supported them to fulfill their foreign liabilities by selling them foreign currency deposits.

FIGURE 12
OPEN MARKET OPERATIONS-NET DOMESTIC ASSETS (TL Billion)



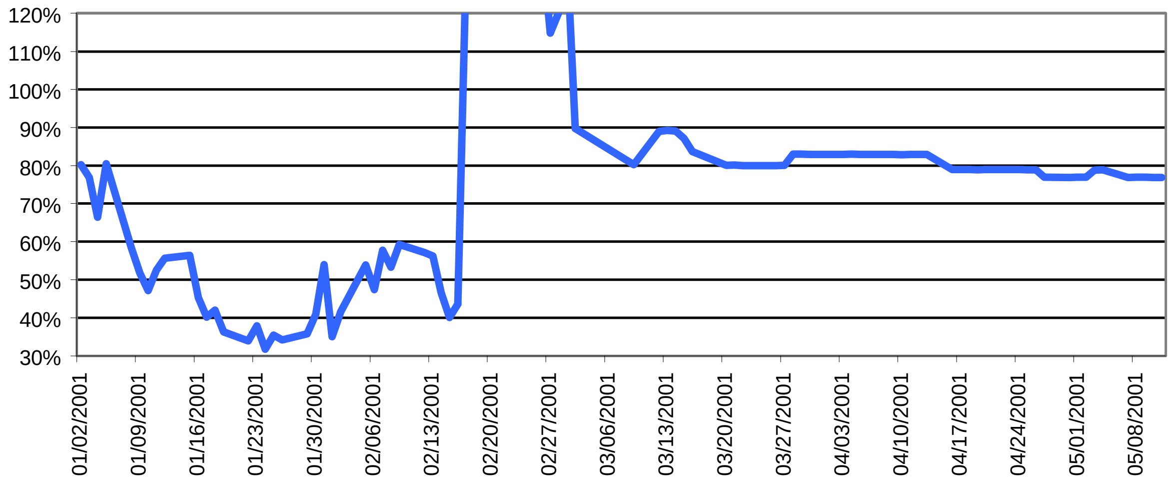
24. As of 12 March, in addition to the overnight funding, CBRT started funding via open market operations with 7 days maturity. During March 12-21 period, the share of overnight operation in the overall CBRT funding was gradually declined and, as of March 26, funding with 7 and 14-day maturity was started. The Central Bank has been providing liquidity mainly via open market operations and repurchase transactions by quotation from March 12 up to now. During the said period, funding in different maturities was realized in 80-90 percent interval and the quotation rates were reduced gradually.

Besides, CBRT has supported banks in fulfilling their short- term external liabilities by starting the foreign currency sale auctions as of 29 March. The main purpose of the foreign currency auctions was to restrict the excessive and volatile reactions of the market to the relatively small changes in foreign currency demand in a more transparent manner.

25. On the other hand, in the aftermath of February crisis, excessive liquidity was withdrawn from the system with Repo-Reverse Repo Market of Istanbul Stock

Exchange and interbank money market. These transactions have been realized in maturities ranging from overnight to 1 month and interest rates realized at 77-92 percent interval. With these practices, CBRT was the main determinant of the short-term interest rates.

FIGURE 13
WEIGHTED AVERAGE SIMPLE O/N INTEREST RATES ON ISE REPO-REVERSE REPO (01.01.2001 - 11.05.01)



26. In this respect, in the aftermath of the crisis, CBRT satisfied the demand for TL in the economy, by giving priority to the functioning of the payments system. In addition, exchange deposit transactions, direct interventions and foreign currency sale auctions that have been implemented as of 29 March have helped the banking sector to meet their foreign liabilities.

IV. GOALS OF MONETARY POLICY AND THE FACTORS THAT INFLUENCE ITS FRAMEWORK

27. At this point, I would like to give information about the aims of the short-term and medium-term monetary policy and the factors that influence its framework.

28. As I have just mentioned above, the policy implemented right after the February crisis until today aimed at ensuring the financial stability. In the forthcoming short-term period, implementing a consistent policy for minimizing the inflationary impact of the depreciation of the Turkish Lira after the float is among the priorities of the Central Bank. In the medium-term, the ultimate goal of the monetary policy will be price stability. The policies for maintaining stability in financial markets and ensuring the efficient functioning of payments system will appear as factors that support the short and medium-term policies.

29. The basic issues that will determine the framework of the monetary policy in the rest of 2001 are as follows,

a. Restrictions of the operations done in the banking sector on "Net Domestic Assets", which is the operational target variable of the Central Bank,

b. The amount and timing of supplemental external financing and its distribution among the Central Bank's reserves and the consolidated budget,

c. The rise in domestic debt stock due to the high borrowing requirement of the Treasury and the additional burdens stemming from the restructuring of banking sector on the debt stock.

Now, let me give some detailed information about these issues.

The Overnight Borrowing of State-owned Banks and Fund Banks

30. As it is already known, the extensive overnight borrowing requirements of the public banks and Saving Deposit Insurance Fund (SDIF) banks led to a sharp rise in interest rates and to a distortion of the markets especially during the February crisis. This situation led to the deterioration in the financial sector, mainly in the state banks and became a factor that had prevented the Central Bank from conducting an efficient monetary policy.

31. In this framework, in order to reduce the overnight borrowing of the public banks and SDIF banks from private banks and non-bank sector with high interest rates, the Central Bank started to provide funds to meet their overnight borrowing needs. On 16 March 2001, the date on which this operation was started, 41 percent of the overnight borrowing requirements of public and SDIF banks amounting to TL. 21.7 quadrillion were met by the Central Bank. As of 11 May 2001, the share of the Central Bank funding increased to 91,5 percent. Thus, the Central Bank saved the public banks and SDIF banks from overnight borrowing with high interest rates and extended the maturity of their borrowing, ensuring the decline of the interest rates at the same time.

32. The borrowing requirements of state banks and SDIF banks that amount to 21,7 quadrillion as of 16 March 2001 will be decreased to one third of that amount, TL 7 quadrillion. The Central Bank funding amounts to TL 19 quadrillion as of 14 May 2001 of which TL. 7.4 quadrillion consists of direct purchase of domestic debt bonds, whereas TL 11,6 quadrillion, of repo. In the forthcoming days, it is intended to increase the amount of direct purchase of securities from the related banks to TL 14 quadrillion and to decrease the value of the term-repo stock to TL 7 quadrillion within this framework.

33. We are contemplating to conclude this operation in May, which was started in March: With the close of the operation, overnight borrowings of state and SDIF banks will be entirely diminished and their balance sheets will get smaller. Thus, the vulnerability of the system caused by these banks will be prevented, while the constraints on the efficiency of the monetary policy will be lessened. The securities given by the Treasury to the public banks and SDIF banks will be directly purchased by the Central Bank or, will be accepted in repurchase agreements. Accordingly, the overnight borrowings of the state banks and SDIF banks between the private banks will be reduced to a negligible level today, while their overnight borrowing with the non-banking sector until May.

34. Part of the liquidity so increased will be withdrawn again by the Central Bank via reverse-repurchase and interbank TL operations. Hence, the Central Bank increased the withdrawn amount of the liquidity from TL 2,5 quadrillion to 6 quadrillion Turkish Liras to eliminate the inflationary pressures caused by excessive liquidity. The rest of the liquidity was withdrawn via foreign currency sales and Treasury auctions. During this period, Net Domestic Assets increased by nearly TL 3 quadrillion. The Treasury's borrowing program will be drawn up in such a way to support the liquidity control. The weekly auctions announced by the Treasury are a significant sign of this support. The most important issue that I would like to stress once more at this point is that any pressure on exchange rates resulting from the liquidity created by these operations should be avoided.

35. In order to obtain enduring results from these operations, it is inevitable to reduce the size of the state banks and fund banks and to solve the structural problems. Moreover, these banks should not assume duties that may lead to losses. In this context, state banks and fund banks are being restructured, efficiency of their fund management is being improved, their overnight borrowings are restricted, maturity of their borrowings are closely monitored and it is ensured that they apply the similar interest rates on deposits. The basic principle will be that, state and fund banks must be in close cooperation with the Central Bank

36. Simultaneously, in order to make supervising and regulating of the banks more efficient, it is compulsory that immediate precautions be taken to prevent the banks from creating problems within the system.

External Financing

37. In addition to the improvement in current account deficit, one of the most significant issues that may affect the framework of the monetary policy is the amount, distribution and periods of release of additional external financing (Table 1). At the end of the negotiations with the International Monetary Fund and the World Bank, an inflow of foreign resources amounting to nearly US dollars 15.7 billion is expected. This facility, which will offer a significant relief in meeting external liabilities by increasing our foreign currency reserves, will allow the Central Bank funding the Treasury in the next 5 months, ensuring the success of banking sector restructuring and sustainability of domestic debt stock. Of the external financing supplied by the International Monetary Fund, US dollars 3.7 billion (net US dollars 2.4 billion) will be used to support the reserves of the Central Bank.

38. About US dollars 6.5 billion of the external financing will be used in May and June. We believe that this resource will have a significant contribution to the stability of financial markets, decreasing the interest rates and maintaining equilibrium in the exchange rates.

39. Apart from the additional external financing support, prospective external borrowing of the Treasury will be one of the major factors that will ease the pressure on domestic financial markets caused by budget financing.

TABLE 1 EXTERNAL FINANCING (Million $)

	IMF	*WORLD BANK*	*GRAND TOTAL*
May	3 900	-	3 900
June	1 562	1 100	2 662
July	1 562	-	1 562
August	-	-	-
September	3 124	-	3 124
October	-	-	-
November	3 124	-	3 124
December	-	1 350	1 350
TOTAL	13 272	2 450	15 722
Redemption	-1 228	-	-1 228
TOTAL (NET)	12 044	2 450	14 494

Public Domestic Debt Stock and Borrowing Requirement of the Treasury

40. The ratio of the Treasury's domestic debt stock to GNP, including unsecuritized duty losses, which was 41 percent at the end of 2000, will rise to 61 percent by the end of 2001, with the Treasury papers issued to cover the state-owned banks' duty losses and capital requirements as well as to improve the financial structures of the SDIF banks. The increase in the domestic debt stock results from the Treasury papers of special issue, while the share of domestic debt stock in the GNP stemming from the borrowings via auctions will remain the same. By this operation, the Treasury takes over the liabilities of the state and SDIF banks of which economic effects were realized in advance.

41. Treasury papers of special issue bearing variable interest rates will be granted to state and SDIF banks in order to keep these banks from the overnight borrowing market. Moreover, the interest revenues from these securities will ease their borrowing requirements from the market. These two factors will increase the funds available for the government securities by allowing the Treasury to meet its domestic borrowing requirements at lower interest rates. Taking account of expected developments in Base Money, the supplemental external support will ensure the sustainability of the Treasury's domestic debt stock.

42. While the increase in the Central Bank's Treasury papers portfolio can be used in the liquidity management, these instruments bearing variable interest rates and payable on a quarterly basis will help the Central Bank keep Net Domestic Assets under control by raising its profits. As practiced today, the Treasury will support the liquidity control through the early redemption of the papers in the Central Bank portfolio in the view of borrowing facilities.

43. The Treasury intends to improve the primary dealer system within the framework of effective domestic debt management. Pursuant to changes made in the Central Bank Law towards a more efficient open market operations, and the Central Bank' increased ability to control short-term interest rates and Net Domestic Assets in the new period may boost the Central Bank's contribution to the primary dealer system compared to the previous year.

V. TARGETS AND INSTRUMENTS OF THE MONETARY POLICY

44. The Central Bank has revised its monetary policy strategy upon the change in the exchange rate regime. As announced earlier, exchange rates will be determined mainly by demand and supply conditions in the market within the framework of floating exchange rate regime. The Central Bank will intervene in the foreign exchange market only to compensate for the short-term excess volatility in exchange rates, and the content and scale of these interventions will not have an impact on the long-run equilibrium level of the exchange rate. The intervention of the Central Bank in the foreign exchange market will be conducted mostly by means of foreign exchange auctions. On the other hand, it should be noted that at times when capital inflows are rapidly declining, the importance of international reserves would increase significantly. In the current policy, the Central Bank will take this factor into account.

45. In a floating exchange rate regime, it is of great importance that the forward markets become operational for the effective management of the exchange rate risk ensuing from the foreign exchange demand and supply due to international trade, capital flows, invisible accounts and for the removal of the excess volatility in exchange rates within market-based rules. As has been observed from the experiences of other countries that have adopted floating exchange rate regime, the formation of forward markets diminishes the uncertainty in price formation and so reduces excess volatility. At present, there is a forward market (forward and swap) operating under the CBRT Foreign Exchange Market where participant banks can do transactions with each other. In addition to this, with the regulation for the Establishment and Operating Principles of the Forward and Option Markets, drawn by the Board of Capital Markets and published in Official Gazette, the infrastructure of the legislation concerning the markets where forward contracts in various financial instruments is prepared. In this context, in the forthcoming period, the Central Bank will also make every effort to devise foreign exchange-based risk management instruments to be traded in an organized market, and to make this market function properly.

46. Since one of the most important leading indicators of the inflation is the exchange rate, Central Bank will react according to the source and direction of the sudden exchange rate shocks and their prospective effects. In the current situation where the exchange rates are floating and the pressure created by the public banks on the system is being eliminated gradually, Central Bank will use the short-term interest rates effectively in order to provide stability in the markets.

47. In this period, which can be called as a transition period, the Central Bank will concentrate on controlling the monetary aggregates in the short run until the prerequisites of the direct inflation targeting are provided.

48. Within the base scenario framework, the ceiling levels determined as indicative for the “base money” will form the basic operational target of the Central Bank. The ceiling values of the base money determined as indicative are shown periodically in Table 3. With the floating exchange rate regime, the low levels of Central Bank interventions require the “stabilizing variable” function of the Net Foreign Assets to decrease. Therefore, as long as Net Foreign Assets are determined according to the base scenario and the levels of the banks’ exchange deposits are realized within the expected frame, the Net Domestic Assets, excluding the resources provided for the Treasury Debt Management, are, in a sense, consistent with the projected rate of increase in the base money.

49. In this respect, the rate of increase in base money determined in consistent with the projected inflation and growth, is also in consistent with the Net Domestic Assets, excluding the resources provided for the Treasury Debt Management. In this context, the base money is expected to increase by 25.8 percent in 2001. This rate is equivalent to an increase of 47 percent, after deducting the effect of the Religious Holiday on the currency in circulation at the end of 2000, and the reduction of reserve requirements in 12 January 2001. In other words, the level of base money, which was TL 5.8 quadrillion at the end of 2000, is projected to be TL 7.3 quadrillion at the end of 2001. The annual increase of 52.5 percent in the consumer price index and the real decline of 3 percent in GNP were taken into account on determining this rate.

50. In accordance with the program, ceiling levels for *“Net Domestic Assets” and floor on changes in Net International Reserves”* have been fixed. The values of the performance criteria, the technical details of which I will give in the following section, are given as periods in Table 2 and 4.

51. The uncertainties on expectations in the current situation and the other reasons that make estimation of the money demand more difficult are also increasing the uncertainties for the indicative level of the Net Domestic Assets. In particular, permanent deviations of the exchange rate and realized inflation from their expected levels can indicate that the base money might result somewhat different from its expected value. Therefore, base money targets will be revised, if necessary.

52. With the effective policy implementation and the recovery of confidence in the system as well as new foreign financing facilities, we anticipate a gradual decrease in nominal and real interest rates. The indicative levels of the base money are also determined in consistent with the expected decline in the interest rates. The level of Net Domestic Assets and Net International Reserves reflect the assumption that the external financing could be used in line with the mentioned goals. If the decreasing trend in interest rates turns out to be faster than expected, the change in the Net International Reserves may be above the floor level and Net Domestic Assets may be below the ceiling level. However, in case of an inflationary pressure, the Central Bank will use the short-term interest rates effectively.

53. With the increased pass through of the short-term interest rates to the other interest rates in the economy, the efficiency of the monetary policy will increase. Restored confidence and determination in addressing the structural problems of the banking sector are important factors that will support it.

VI. PERFORMANCE CRITERIA

54. Within the framework of the 2000 program, minor changes were made in the definition of the Central Bank’s balance sheet drawn up in line with the goals of the program and performance criteria. The equilibrium, the basic logic of the balance sheet, remains the same. Accordingly:

i. Base Money = Net Foreign Assets + Net Domestic Assets

ii. Base Money = Currency Issued + Banks' Required Reserves (TL) + TL Free Deposits

55. It is possible to define the balance-sheet aggregates in detail in terms of sub-items as well as in terms of general definitions mentioned above:

56. **Net Domestic Assets** consist of; Cash Credits to Public Sector (net) *(Treasury Debt Management Support Account included*) (+, -), Fund Accounts (-), Deposits of the Non-Banking Sector (-), Cash Credits to Banking Sector (+), Open Market Operations (+, -), FX Revaluation Account (+, -), IMF Emergency Assistance Account (+), Other Items (+, -) and Foreign Currency Deposits Supplied by CBRT (+),

57. **Net International Reserves** consist of; Gross International Reserves (+), Gross International Liabilities (-) and Forward Transactions (Net) (+, -)

58. **Net Foreign Assets** consist of; Net International Reserves (+, -), Medium-Term FX Credits (net +, -) and Other Items *(Excluding Foreign Currency Deposits)* (+, -).

59. According to definitions given above, Net Domestic Assets variable will be increased in the amount of Foreign Currency Deposits item and the supplemental financing to be used to support the Treasury's debt management. The definition of Net International Reserves will not change. On the other hand, we have changed the definition of Net Foreign Assets because of excluding foreign currency deposits supplied by CBRT from the "Other" item.

60. Here, the main logic is that, in the previous program, foreign exchange deposits extended by CBRT to banking sector had a decreasing effect on the Net International Reserves and an increasing effect on the "Other" item, netted out under the item of Net Foreign Assets. Hence, it used to have zero effect on the Net Foreign Assets. It also would not affect Net Domestic Assets at all. In order to achieve symmetry in the balance sheet items and to monitor their effect on the total of basic items of the balance sheet, the foreign exchange deposits were included in Net Foreign Assets. Previously, the item of Net Foreign Assets was put in the item of "Other" under Net Foreign Assets. In CBRT statement, the foreign currency deposits records made up in the form of a compositional change on Assets[1] column are defined as a transaction that increases Net Domestic Assets and decreases Net Foreign Assets as well as Net International Reserves. On the other hand, the

[1] Foreign exchange deposits extended is registered under II.Foreign Exchange-Convertibele-Correspondent Accounts (foreign currency) and IV. Domestic Correspondents (foreign currency) in Assets column.

additional external financing that will be used for supporting the Treasury debt management - these will not be used in the accumulation of the CBRT's foreign currency reserves - will be observed at Credits to Public Sector (net) under the Net Domestic Assets (Annexed Balance-Sheet).

61. In parallel to the framework described above, the definition of the performance criteria has also been changed. According to the new definition, Net Domestic Assets excluding the Revaluation Account will be ***"Net Domestic Assets Including External Financing to Support Treasury Debt Management and Excluding Revaluation Account"***[2] (Program Definition). The content of the other performance criterion Net International Reserves will not change in the new program. However, instead of monitoring the changes in stock values, floor values are fixed for the changes in Net International Reserves based on periods.

62. In the following three tables, performance criteria and indicative Base Money values can be seen for May-December period (Tables 2, 3 and 4). The values that show Net Domestic Assets in the first table are the ceiling values of the Net Domestic Assets that are going to be monitored including external financing that were given to support the Treasury Debt Management. The values for May, June, August and October are performance criteria, whereas, the end of year 2001 value is an indicative ceiling. These values will be monitored from the balance sheet prepared based on current exchange rates. In this framework, the maximum of the year-end Net Domestic Assets may only be TL 21 quadrillion. The increase in the Net Domestic Assets value is due to external financing that will be used to support Treasury Debt Management. Excluding this supplemental financing, the year-end ceiling value of Net Domestic Assets is around TL 9.5 quadrillion.

[2] In the balance-sheet of the 2000 program, "IMF Emergency assistance account (Treasury)" was placed in the net domestic assets monitored as the performance criteria as well.

TABLE 2: NET DOMESTIC ASSETS (Trillion TL)*

Year 2001	**Ceiling Values**
May 31 (Performance Criterion)	9 750
June 30 (Performance Criterion)	13 250
August 31 (Performance Criterion)	15 850
October 30 (Performance Criterion)	19 500
December 31 (Indicative Ceiling)	21 000

(*) Calculated as the average of 5 end- of- period working days

63. In Table 3, the indicative values for Base Money are given. As I mentioned before, the indicative values of Base Money are determined in consistent with the inflation and growth targets estimated in the program. Base money aggregates will be reviewed by the continuous evaluations in the development in the interest and inflation rates.

TABLE 3: BASE MONEY*

Year 2001	**Ceiling Values (Trillion TL)**
May 31 (Indicative Ceiling)	5 900
June 30 (Indicative Ceiling)	6 050
August 31 (Indicative Ceiling)	6 300
October 30 (Indicative Ceiling)	6 800
December 31 (Indicative Ceiling)	7 300

(*) Calculated as the average of 5 end- of- period working days

64. In Table 4, floor values for the changes in Net International Reserves are given. Of the floor values given above, the 2001 year-end value has been set as indicative. The negative values in the table show the maximum decline in the Net International Reserves in each period. This change will be evenly distributed over the periods. Moreover, Net International Reserves will be calculated on basis of fixed cross exchange rate of the program that were fixed in accordance with the cross exchange rates of November 30, 2000.

65. The limits on the changes in net international reserves for June and subsequent periods will be increased by either the unused portion of the limit on the change in net international reserves from the previous period or by 25 percent of the limit during the current period, whichever is less.

TABLE 4: NET INTERNATIONAL RESERVES

YEAR 2001	**Floor Values of the Changes in Net International Reserves (Million US Dollar)**
May (Performance Criterion)	-1 500
June (Performance Criterion)	-2 900
July-Aug. (Performance Criterion)	-2 000
Sept.-Oct. (Performance Criterion)	-2 600
Nov.-Dec. (Indicative Floor)	-600

VII. OVERALL EVALUATION AND CONCLUSION

Distinguished Press Members,

66. The Law No. 4651 amending the Central Bank Act No.1211 has explicitly stated price stability as the primary objective of the Central Bank. This law will strengthen the Central Bank's institutional infrastructure by achieving the operational independence, transparency in policy implementations and accountability. The Monetary Policy Committee will enable the Central Bank to use its policy tools in cooperation with the Government in order to achieve inflation targets adding a new dimension to institutional structure. In addition, the Central Bank will support the growth and employment policies of the Government as long as they are compatible with its price stability goal. The law is available on the website.

67. I would like, once more, to stress that it is very crucial for the Central Bank to maintain the sustainability of the new exchange rate policy in a consistent manner. Although resorting to exploit some daily opportunities, risks and trends may be understandable; all extraordinary or excessive reactions given by the market participants will only serve to damage the balances that we are striving to restore step by step. In such cases, the Central Bank will use monetary policy instruments more effectively and consistently.

68. Even though the management of the program is under the responsibility of the government and economic institutions, the reactions of the business world, consumers and market participants to the decisions taken and to the policy implementations will determine the overall performance, the viability of the goals and sustainability. What we expect from a National Program is that all sections in the society should believe and support the implementations and decisions.

69. Having explained the numerical aspects, details and basic assumptions of the new program, let me conclude my words by saying that even though we are aware of the fact that 2001 is a loss year in the anti-inflation process, it is nevertheless a gain in terms of resolving structural problems of the Turkish economy, rapidly and permanently.

70. Each time, the costs of crises become heavier. Structural problems of banking system were one of the most significant and unsolvable problems of Turkey. But now, we are determined to resolve these problems. Resolving the problems and minimizing the sector will allow the private sector to find permanent and long-term resources. Considering the fact that crises have negative impact on all sectors, it is obvious that we must work more and save more in order to establish a strong system that can resist to external and internal shocks and to achieve a sustainable macroeconomic structural target.

71. The basic parameters of our target function should be to consider the overall picture of each and every periodical process, to minimize the adverse effects of short term shocks on overall economic conjuncture and to restore foreign investors' confidence rapidly by concentrating on our medium and long term goals gradually.

72. While inflation is vanishing in world economies, the perseverance of inflation in Turkey is a hindrance on our way to attaining a position we deserve. Globalized markets increase the cost of mistakes. One should not forget that that these costs might be too heavy to bear after some time.

Thank you all for listening.

Appendix: CBRT BALANCE SHEET (Current-Billion TL)

	Dec 31, 2000	March 30, 2001	April 30, 2001
I-BASE MONEY (a+b+c)	5 787 892	5 577 563	6 022 150
a. Currency Issued	3 772 411	3 586 507	3 868 413
b. TL Required Reserves	1 404 157	1 161 982	1 217 020
c. Free Deposits	611 324	829 074	936 717
II-NET FOREIGN ASSETS (A+B+C)	3 302 660	1 155 994	510 020
A-Net International Reserves (1+2+3)	7 468 942	5 247 586	4 983 576
1-Gross FX Reserves	15 302 925	20 129 623	21 990 101
2-Gross International Reserve Liabilities	-7 833 983	-14 616 412	-16 777 083
- FX Deposits of Banking Sector	-4 295 403	-7 858 287	-9 307 469
- IMF	-2 804 769	-5 738 266	- 6 343 100
- Other	-733 811	-1 019 859	-1 126 514
3-Net Forward Position	0	-265 626	- 229 442
B- Medium Term FX Credits (net)	929 785	1 477 189	1 627 021
C-Other	-5 096 067	-5 568 780	- 6 100 577
III-NET DOMESTIC ASSETS (A+B+C+D+E+F+G+H+I)	2 485 232	4 421 569	5 512 130
IV. NET DOMESTIC ASSETS (program definition) (III-G)	3 360 439	5 801 980	6 631 799
A- Credits to Public Sector (net)	19 463	-1 330 838	773 092
a-Cash Credits To Public Sector	1 490 801	1 567 324	3 732 132
b-TL Deposits of Public Sector	-249 161	-1 155 372	-961 682
c-FX Deposits of Public Sector	-1 222 177	-1 742 790	-1 997 358
B-Funds	-115 720	-210 491	-160 465
C-Deposits of Non-Banking Sector	-45 736	-34 773	-33 890
D-Cash Credits to Banking Sector	500 000	750 000	750 000
E-Open Market Operations (net)	5 218 625	8 972 773	9 047 095
F-Other	-2 406 827	-3 589 109	-3 961 918
G-Revaluation Account	-875 207	-1 380 411	-1 119 669
H-IMF Emergency Assistance Account (Treasury)	190 634	190 634	190 634
I-Foreign Currency Deposits to the Banking Sector	0	1 053 784	27 251