



MONETARY POLICY IN 2002

(Updated and revised as of July 2002)

August 2002

CENTRAL BANK OF TURKEY

Outline of Presentation

- Monetary Policy Framework – Exchange Rate Regime
- Monetary Policy Strategies
 - Assumptions, Communication – Accountability, Transparency, Interest Rates Policies, Monetary Targets, Inflation Targeting
- Current Situation and Expectations in Economy
 - Stability Indicators, Price Stability and Growth, Balance of Payments, Monetary Targets
- Price Developments
 - January – June developments, price movements in the future
- Outlook for Exchange Rate Policy
- Outlook for TL Policy

Monetary Policy Framework

Exchange Rate Regime

Characteristics of the 2000 Monetary Policy and Exchange Rate Regime

- ✓ It was **based on a fixed currency peg exchange regime**, daily values of which being predetermined,
- ✓ The Central Bank's **influence over short-term interest rates were limited.**

While the Central Bank assumed the exchange rate risk, the interest rate risk was borne by market.

- ✓ **A gradual transition to floating exchange rate regime was envisaged.**

Monetary Policy Framework

Exchange Rate Regime

- **Under the free floating exchange rate regime;**
 - ✓ The Central Bank's **control over short-term interest rates** has been increased.
 - ✓ **Level of exchange rate has started to be determined** according to the supply-demand conditions of markets.
 - ✓ In other words, while **the Central Bank has begun giving strong signals regarding short-term interest rates**, the level of exchange rate has been left **at the discretion of markets.**

Monetary Policy Framework

Exchange Rate Regime

- There are some **advantages and disadvantages** in both exchange rate regimes.
- Under **fixed exchange rate regime**;
 - ✓ **Exchange rate**, a variable that the public opinion can follow daily, **is an effective anchor in steering expectations.** Moreover, **there is strong correlation between inflation and exchange rate.**
 - ✓ Central Bank has **no control over short-term interest rates.**
 - ✓ Central Bank must enjoy **strong international reserves and additional reserve facilities.**
 - ✓ Predictability of exchange rate **can accelerate short-term capital movements.**
 - ✓ **There is no flexibility against external shocks.**

Monetary Policy Framework

Exchange Rate Regime

- Under **free floating exchange rate regime**;
 - ✓ There is no anchor that the public opinion can follow closely. Therefore, **inflation itself must be used as the most effective anchor in the inflation targeting system.**
 - ✓ Central Bank **does not need to hold high international reserves for maintaining exchange rate stability.** However, a certain amount of reserve might be needed for servicing external debts. The fact that exchange rate risk remain in market will limit short-term speculative capital movements.
 - ✓ **Its flexibility against external shocks is rather high.**
 - ✓ **Expectations of current account deficit or surplus** play an important role in setting exchange rate. Another factor affecting the level of exchange rate is the change in **Turkish lira and Foreign exchange portfolios of domestic residents** due to domestic and foreign political developments.

Monetary Policy Strategy - Assumptions

- Monetary policy strategy has been set up in line with the following hypotheses.
 - ✓ **Maintaining a well-functioning floating exchange rate regime** under which price stability is the overriding objective of the monetary policy;
 - ✓ **Continued sizeable public sector primary surplus in order to lessen public sector debt stock;**
 - ✓ **Completion of the banking sector restructuring;** activation of fund transfer channel between financial sector and real sector.
 - ✓ **Enhancing the role of private sector** in the economy.

Monetary Policy Strategy – Communication Accountability

- The CBRT aims to improve the **mechanisms of communication** so that economic agents are in a better position to evaluate monetary policy implementation.
- So, the cost of achieving our final objective will be kept at minimum.
- In this context, the CBRT informs the public of all its implementations in detail.
- To ensure **accountability**, the CBT provides information to **the public, to the Parliament and to the Government** periodically regarding monetary policy implementation.

Monetary Policy Strategy - Transparency

- **Increasing transparency** makes monetary policy more predictable, more effective and more credible in order to attain the final objective. Expectations become more sensitive to the Central Bank's decisions.
 - ✓ **Political transparency:** Clear-cut goals; inflation targets,
 - ✓ **Transparency in monetary policy:** Written announcements such as change in short-term interest rates,
 - ✓ **Operational transparency:** Openness in interventions in markets and policies,
 - ✓ **Economic transparency:** Quarterly Monetary Policy Reports, Annual Report, Auditing Reports, which evaluates past performances and future expectations.

Monetary Policy Strategy – Interest Rates

- The CBRT takes its decisions by looking into **the future inflation** within the framework of its fundamental objective of achieving price stability.
- **To bring down risk premium** and therefore **real interest rates**, it is important to ensure that
 1. **Priority is given to inflation targets and forecasts only,**
 2. **A sustainable economic growth and a rise in employment are secured.**

As in the past, **targeting other subjects** such as balance of payments, exchange rates, growth, public finance, banks **will provide mixed signals to economic agents**. In this case, risk premium and real interest rates will increase. This should be avoided.

Monetary Policy Strategy – Interest Rates

- **High real interest rates in Turkey is the result of the previous crises and high inflation environment, not the nominal interest rates.**
- To get rid of this situation;
 - ✓ First of all, strict determination must be shown **in fight against inflation.**
 - ✓ **Tight fiscal and monetary policies must be implemented coherently and decisively.**
 - ✓ To increase economic productivity, **structural reforms must be realized as soon as possible.** In this context, **reform in banking sector is vital.**

Monetary Policy Strategy – Interest Rates

- ✓ **Under structural reforms significant steps have been taken to solve the problems of the banking sector. The following issues have been realized within the last one year period;**
 1. State-owned banks reduced their short-term borrowing requirements. They were restructured according to good governance principles. Their operational profits increased by reducing disguised employment and by closing down non-profit-making branches.
 2. Private banks that have lost equity capital and that might create systemic risk were put out of the system. Moreover, private banks were separately audited by two independent agencies and the BRSA. Capital adequacy ratio of the system is being brought to international standards.
 3. In order to overcome problems between the banking sector and real sector, the so-called Istanbul Approach has been put into operation.
 4. Therefore, in the period ahead, a sound foundation has been laid for a healthy relationship between banking and real sectors, and for enhancing productivity in the economy by utilizing resources more rational.
- ✓ Moreover, efficiency of the banking system will greatly contribute to monetary policy implementations.

Monetary Policy Strategy – Short-Term Interest Rates

- Under the floating exchange rate regime, **short-term interest rates** are the most effective instrument of the Central Bank in achieving its primary objective of price stability.
 - **Interest rate decisions are based on which factors?**
 - ✓ Surveys on **inflationary expectations** and the CBRT's **internal inflation forecasts**.
 - ✓ **Price-setting behaviours** of the public and private sectors,
 - ✓ **Exchange rates and balance of payments position,**
 - ✓ **Wages, employment and unit labor costs,**
 - ✓ **Aggregate supply and demand,**
 - ✓ **Fiscal policy** indicators,
 - ✓ **Monetary and credit** aggregates,
 - ✓ **International economic and political environment**

Determinants of Interest Rate Policy

- In light of these figures, it is apparent that the Central Bank reduced short-term interest rates in a controlled manner in the January-May period.

Maturity	Quotations	Previous Rates	20 February 2002	14 March 2002	8 April 2002	30 April 2002
Overnight (O/N)	Borrowing	59	57	54	51	48
	Lending	62	62	61	58	55
One Week	Borrowing	62	59	55	52	49

Determinants of Interest Rate Policy

- Starting from the second half of May, the volatility in the foreign exchange and TL markets, and the reversal of downward trend in inflation expectations have been decisive factors to prevent a further reduction in interest rates.

Monetary Policy Strategy – Monetary Targets

Monetary Base is the nominal anchor of the monetary policy.

- **Despite widely-recognized limitations**, monetary base is a very visible aggregate that can serve as a monetary program guide.
- In the monetary program, monetary base has been targeted in line with the real growth and the target inflation.
 - ✓ It has been targeted to increase by 40 percent nominally in 2002. In the first six months of 2002, monetary base increased by 15.7 percent nominally, and by 3.3 percent in real terms.
 - ✓ **This target**, however, **will be adjusted in accordance with changes in demand for base money.**
- This procedure, together with the prudent fiscal policy and structural reform measures, will efficiently encourage economic agents' inflation expectations to converge towards price projections contained in the economic program adopted by the Government.
- The continuation of tight fiscal policy and realization of structural reforms will decrease the cost of bringing the inflation down on one hand, and increase the efficiency of the monetary policy by reducing the gaps between the inflation expectations and targets on the other hand.

Monetary Policy Strategy – Inflation Targeting

What is Inflation Targeting?

- Under the floating exchange rate regime, the CBRT will switch to Inflation Targeting system in order to increase the efficiency of monetary policy and to shape expectations. “Inflation Targeting” means not only announcing an inflation forecast, but also **conducting a monetary policy** by which a Central Bank commits itself to use **monetary policy instruments towards the target inflation** only.
- Under the floating exchange rate regime, inflation targets serve as **nominal anchor** for monetary policy and inflation expectations.
- The Central Bank has no target for exchange rate, and can **react flexibly** against shocks.
- The success in hitting the announced targets will **enhance the public confidence** in the government and monetary policy authorities.

Monetary Policy Strategy – Inflation Targeting

Main Subjects related to Definiton:

- **Institutions that will set the targets:** The Government and the CBRT, inflation is the common target.
- **Relationship between inflation targeting and other policy goals:** maintaining financial stability is a supportive goal.
- **Targeting period;** long-term, but achieving success in 2002 is vital for early credibility.
- **Choosing a target index;** CPI as an easily understandable index, but also observing core indices and using them in policy appraisals,
- **The CBRT's responsibilities;** making use of the necessary tools in reaching the target, flexibility in absorbing external shocks,
- ✓ **Importance of inflation forecasts;** delayed effect of monetary policy.
- ✓ **The role of long-term objectives;** exerting influence on expectations.

Monetary Policy Strategy – Inflation Targeting

- Broadly speaking, inflation targeting system is a component of institutional development in the economy.
- Under floating exchange rate regime, the success of inflation targeting system depends on the stability achieved by minimum intervention of the Central Bank on one hand, and the weakening of pass-through between exchange rate and inflation. As can be seen in the Graph, the pass-through has weakened significantly after switching to floating exchange rate.

Inflation Targeting; Interaction Between Exchange Rate and Inflation

Pass-through between Exchange Rate Movements and CPI

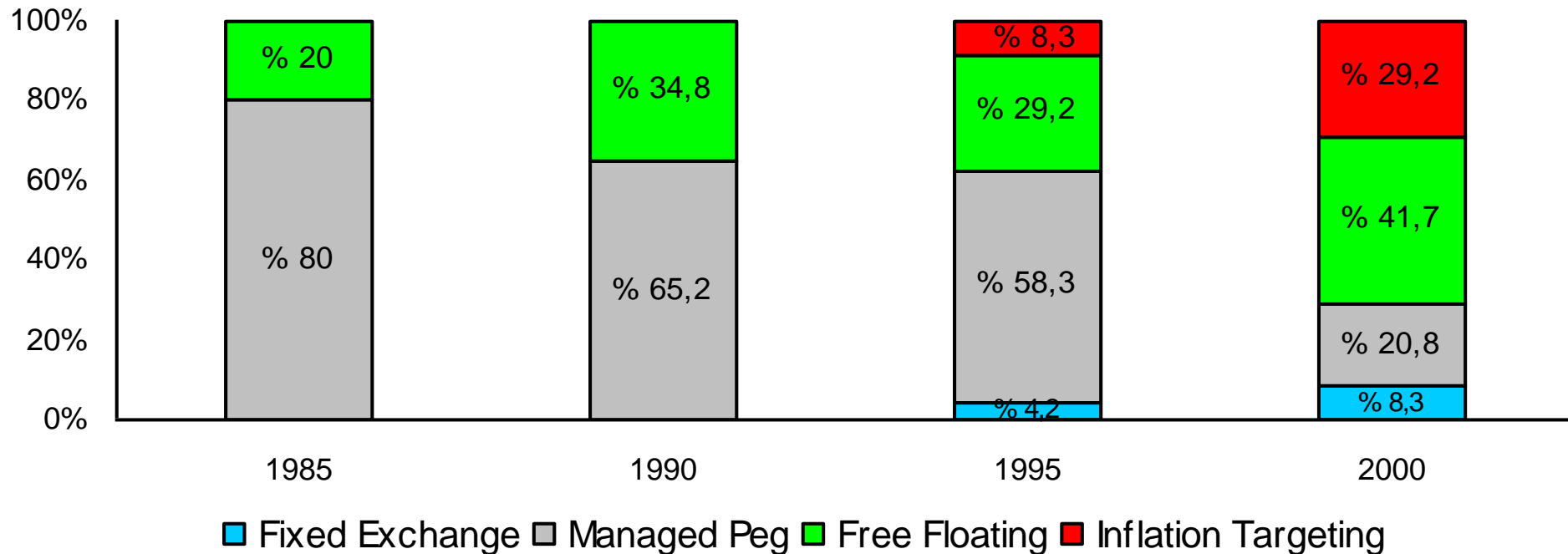


Monetary Policy Strategy – Inflation Targeting

- **Other factors** for the success of inflation targeting:
 - ✓ Fiscal responsibility,
 - ✓ Financial deepening,
 - ✓ **Eliminating backward-looking indexation mechanisms in the economy,**
 - ✓ Flexibility in goods and factor markets to allow smooth adjustment to relative price changes.

Monetary Policy Regimes in Developing Countries

In recent years, implementation of inflation targeting system has increased in developing countries.



Monetary Policy Strategy – Inflation Targeting

Experience of IT in Developing Countries;

- **Inflation has declined** in all developing countries.
- IT has helped authorities to shape inflation expectations and to fight against inflation shocks.
- Rigidity in inflation has been gradually reduced.
- Pass-through between the past inflation and current inflation has diminished, and **forward-looking expectations** have begun exerting influence **on the current inflation**.
- **It has been tested against adverse shocks**; for example: the 1997 Asian Crisis, Australia, Chile, Israel and New Zealand in the 2000 Oil Shock.
- There still exist some risks limiting discretionary power (supply-side shocks), an inflation-growth dilemma could arise. However, the **Sacrifice Ratios** in developing countries implementing IT have declined. In other words, the sacrificed economic growth in return for a decline in inflation and fluctuations in output growth have diminished.
- Under the floating exchange rate regime, **exchange rate movements** have **gradually lost their importance** for the central banks.

Monetary Policy Strategy – Inflation Targeting

Significant Progress has been made to satisfy the preconditions for the IT:

- **The Central Bank Law** has been amended to ensure instrument independence, accountability and transparency; the CBRT enjoys full control over its credits.
- **Borrowing Law** will bring about discipline and transparency in the public sector, will facilitate the adaptation of fiscal policy to inflation targeting.
- The technical capabilities at the CBRT bank have been improved in line with the requirements of the inflation targeting framework:
- ✓ **Forecasting and policy analysis models;**
 - We are obtaining technical support from international institutions and central banks.
 - Short- and long-term forecasting models; We are conducting works on statistical modelling based on leading indicators, time-series modelling, narrowly-defined structural dynamic modelling, judgement modelling and general equilibrium modelling.
- ✓ **Improving statistical database;**
 - Inflation Expectation Survey for industrial and financial sectors
 - Daily retail prices analysis by using sampling method

Monetary Policy Strategy – Inflation Targeting

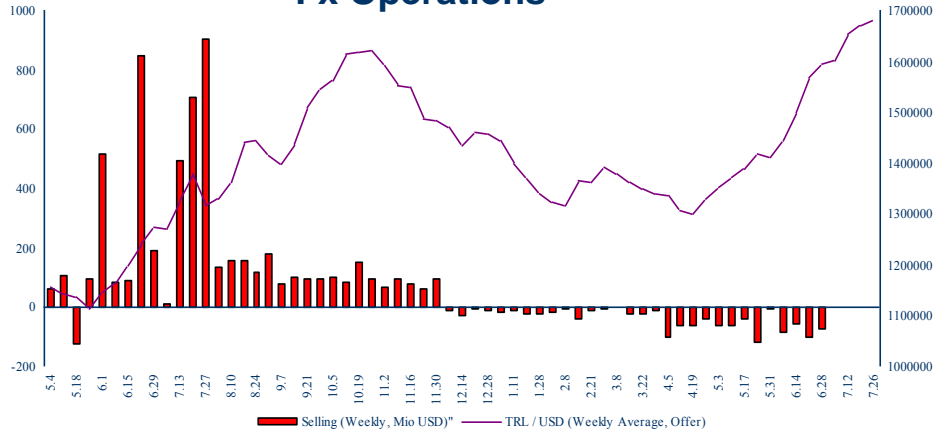
● Risks in Developing Countries:

- ✓ Expectations might deteriorate, and the cost of bringing inflation down might not be reduced, **if structural reforms are not realized as planned.**
- ✓ **Inflationary rigidity** in housing (rent), education and health sectors;
- ✓ **The habit of backward-looking indexation,**
- ✓ The need for **achieving banking rehabilitation**, enhancing competitiveness, and developing resistance to external shocks in order that monetary policy transmission mechanism may function effectively and timely.
- ✓ **Harmony between fiscal policy and monetary policy.**

MACROECONOMIC CONDITION AND EXPECTATIONS

Stability Indicators in the Economy

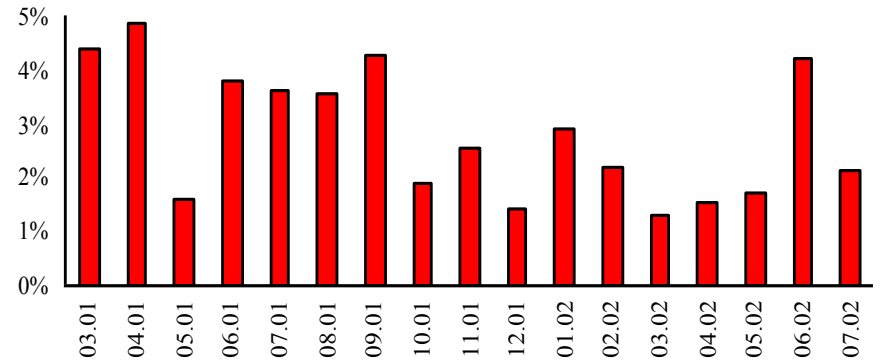
Fx Operations



* (+) Indicate FX selling to the market.

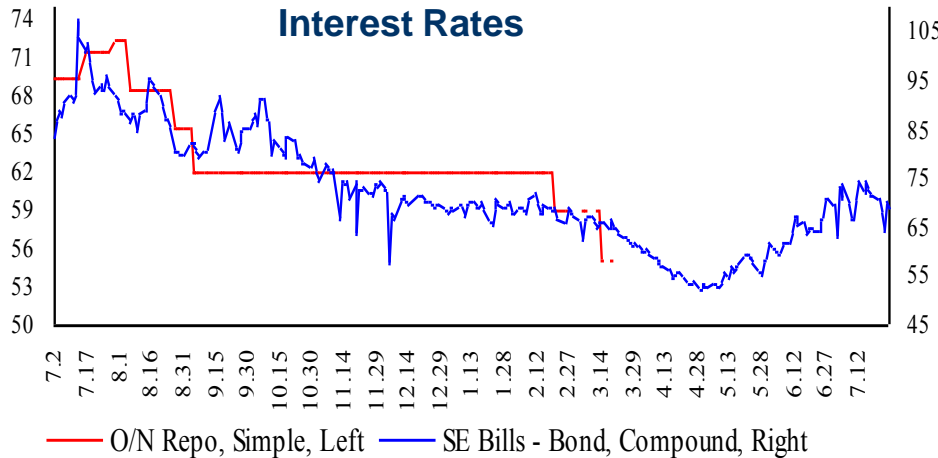
The CBRT's Fx interventions have declined.

Volatility of Exchange Rate (TL/USD, Coefficient of Variation)



Volatility of exchange rates is increased in June due to uncertainties.

Interest Rates



Declining interest rates started to rise in May.

Turkish Eurobond Spreadleri (bps)

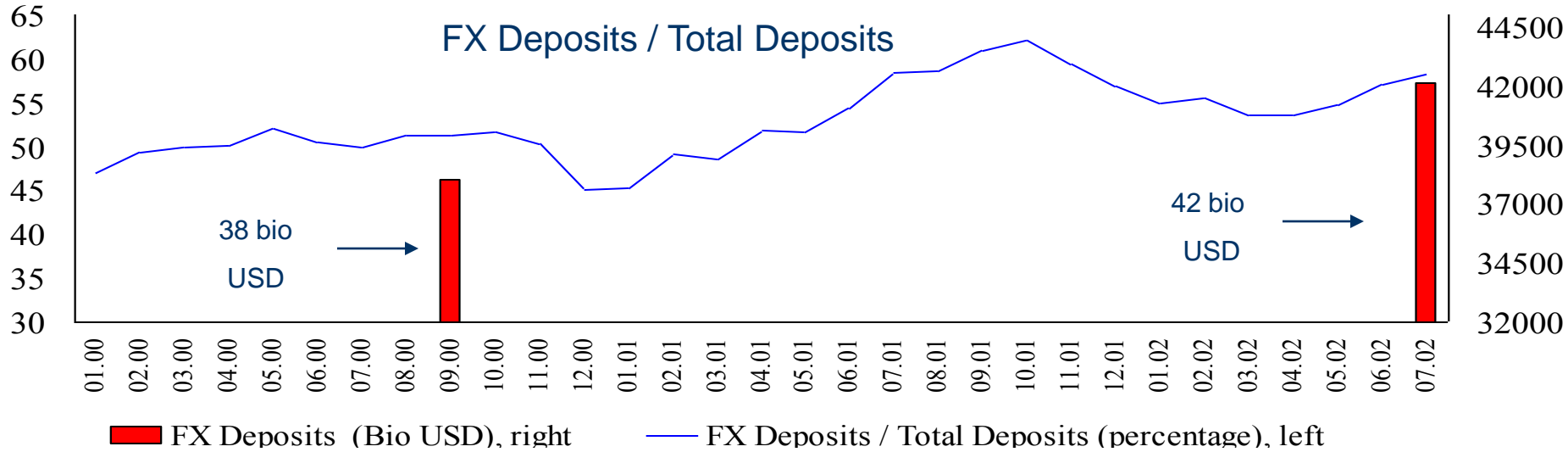


Spread = Difference between Turkish Eurobonds and US Treasury Bond

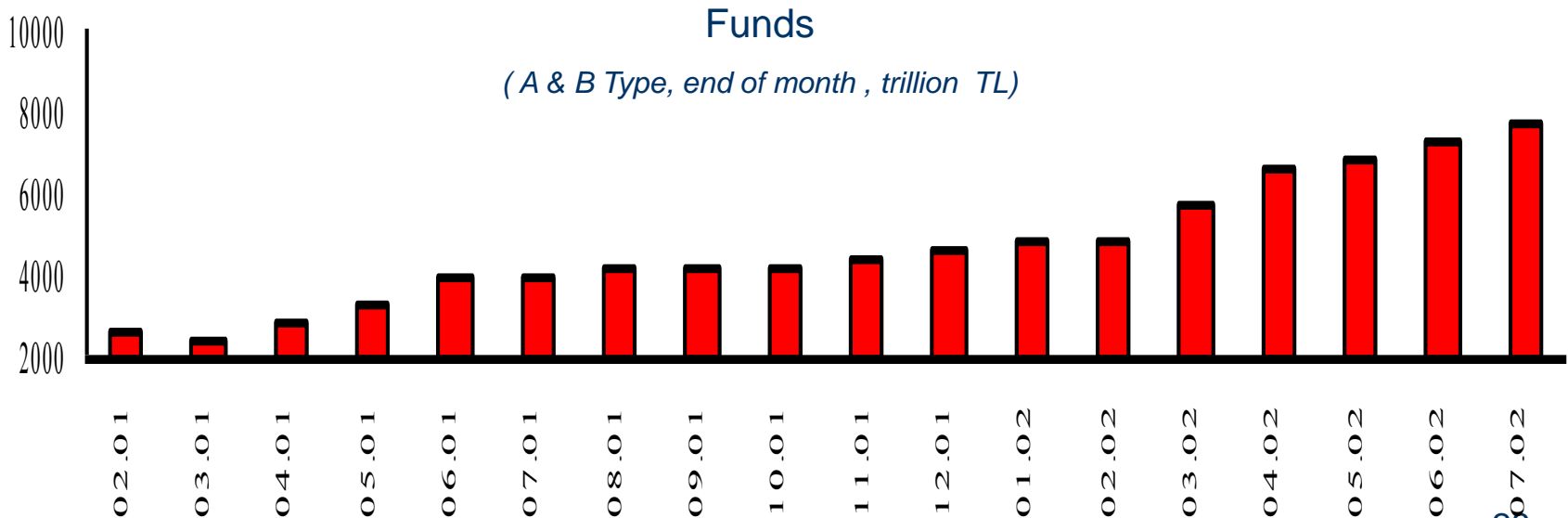
Source: JP Morgan

Same tendency has been observed in Turkish eurobond interest rates.

Stability Indicators in the Economy



Declining dollarization tendency has started to rise again.



Price Stability and Growth

In the last 30 years, the average growth rates in Turkey have decreased and become instable.

	1970-1979	1980-1989	1990-2001
GNP Growth			
- Average	4.8	4.0	3.2
-Std. Deviation	3.2	3.5	5.9
CPI			
- Average	24.1	49.6	74.8
-Std Deviaton	15.7	26.7	21.9

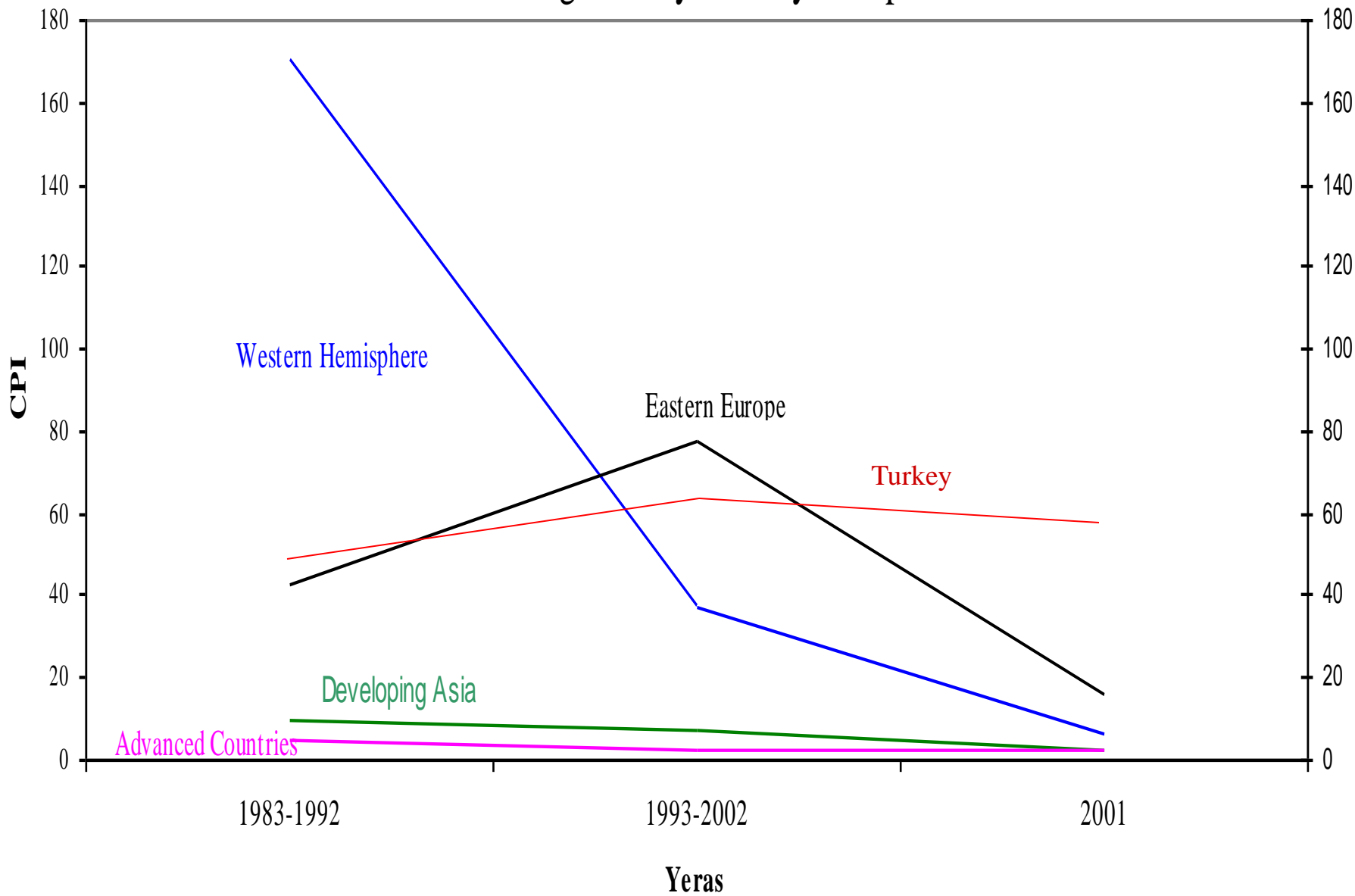
By decades, the average inflation in 1970-79 period was 24 percent, while the growth rate was 4.8 percent. In 1990-2001 period, inflation rose up to 75 percent, while the growth rate declined 3.2 percent. In addition, the standard devaiiton, which shows irregularity in growth rose from 3.2 percent to 5.9 percent.

The main reason is the high inflation environment.

Price Stability and Growth

- Under the uncertainty created by inflation;
 - ✓ The economic agents face difficulties in making medium-term investment and consumption decisions.
 - ✓ Risk and real interest rates in the economy will increase.
 - ✓ Maturities in all markets will shorten due to high risk perception.
 - ✓ Price mechanism cannot function correctly and cannot transfer information.
 - ✓ Confidence may be lost in economic policies, and governments cannot implement extensive and long range economic programs.
 - ✓ Economy's competitive edge weakens in international markets, making it difficult to access capital markets.
 - ✓ Income distribution worsens.
 - ✓ Backward-looking indexation mechanism gets rooted.

Average CPI by Country Groups



Price Stability and Growth

- Why did it happen so? We were not clear on our priorities, we lost time.
- Fighting inflation cannot be given up to another priority, such as growth, employment or exports. It should be kept in mind that a low and stable inflation is *sine qua non* for all these issues.
- There is no other choice but to beat inflation.
- We know from our last 25 years of experience that a sustainable growth, employment and export performance cannot be achieved unless this problem is solved.

Price Stability and Growth

Today

- In general, governments aim at **growth** and **employment** while central banks aim at **price stability**.
- In this context, today the targeted inflation in the program is the common goal of the **Government and the Central Bank**.
- The Central Bank will support the government policies provided that they do not **endanger price stability**.
- Price stability is the most important objective. To this end, tight fiscal and monetary policies have been implemented since the beginning.
- Why? Because sustainable growth can only be achieved if price stability is assured.
- If we deviate from our primary objective as before, we could not reach anything. No price stability, no sustainable growth. Real interest rates will soar in this case.
- On the other hand, the main source of growth is **the increase in productivity**.
- Therefore, **emphasis must be given to policies boosting productivity of the public and private sector** in order to achieve a sound growth in the medium-term.

Stability Indicators in the Economy

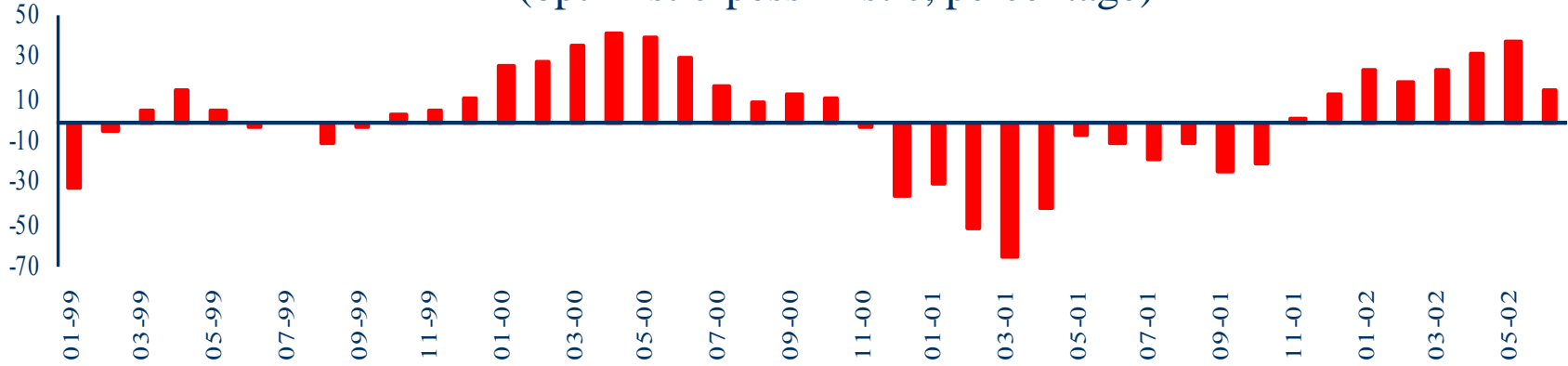
Growth

- In 2002, GNP is projected to increase by 3 percent. Developments in the first six months indicate that **this target could be met** despite political uncertainties. “Growth” will no longer be sacrificed.
- **In agricultural sector**, the growth rate of value added is expected to be around 5 percent in 2002 thanks to favorable weather conditions.
- **Production in manufacturing industry** has increased by 8.3 percent in January-May period. Capacity utilization ratio in June heralds a high increase in output. Also imports figures denote a spur in output. Production increase **in sectors sensitive to foreign demand** has been determinant in this regard.
- Political uncertainty that occurred in the second half of May caused **interest rates** and **exchange rate** to rise. Output and demand may somewhat be affected negatively.
- Growth expectations for 2002 have reached 2.5 percent since the New Year. However, it is probable that growth expectations may be influenced adversely due to uncertainties.

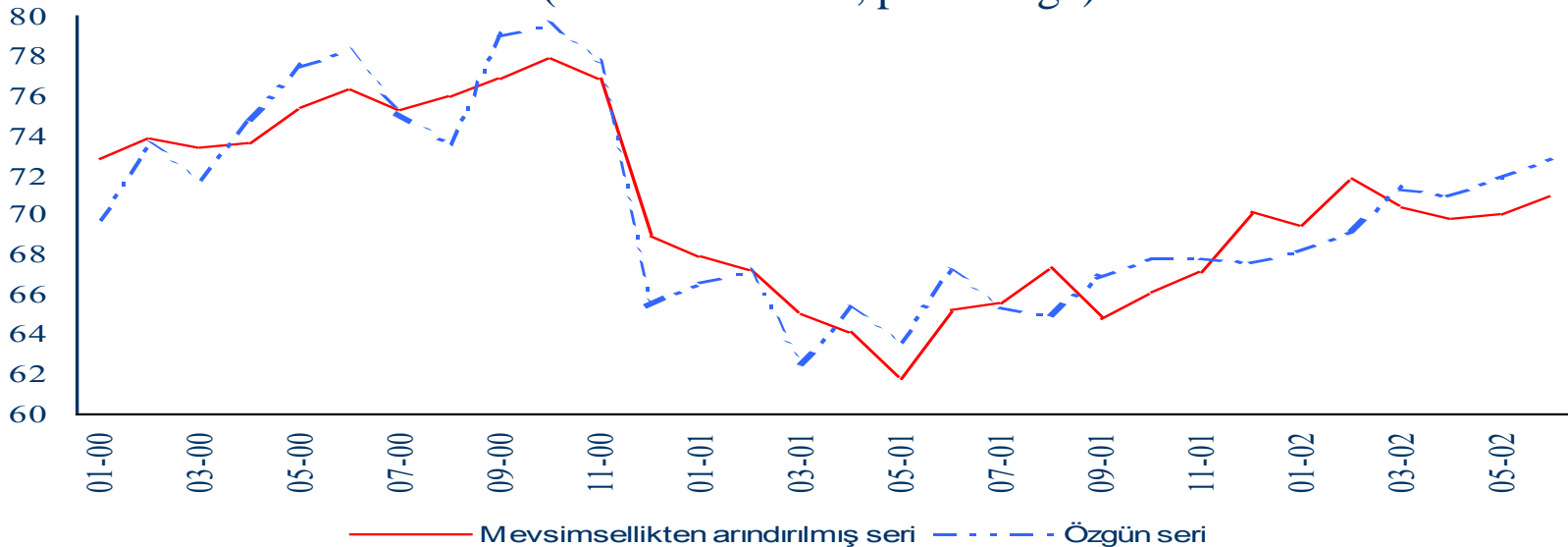
Stability Indicators in the Economy

Business sentiment compared to the previous month

(optimistic-pessimistic, percentage)



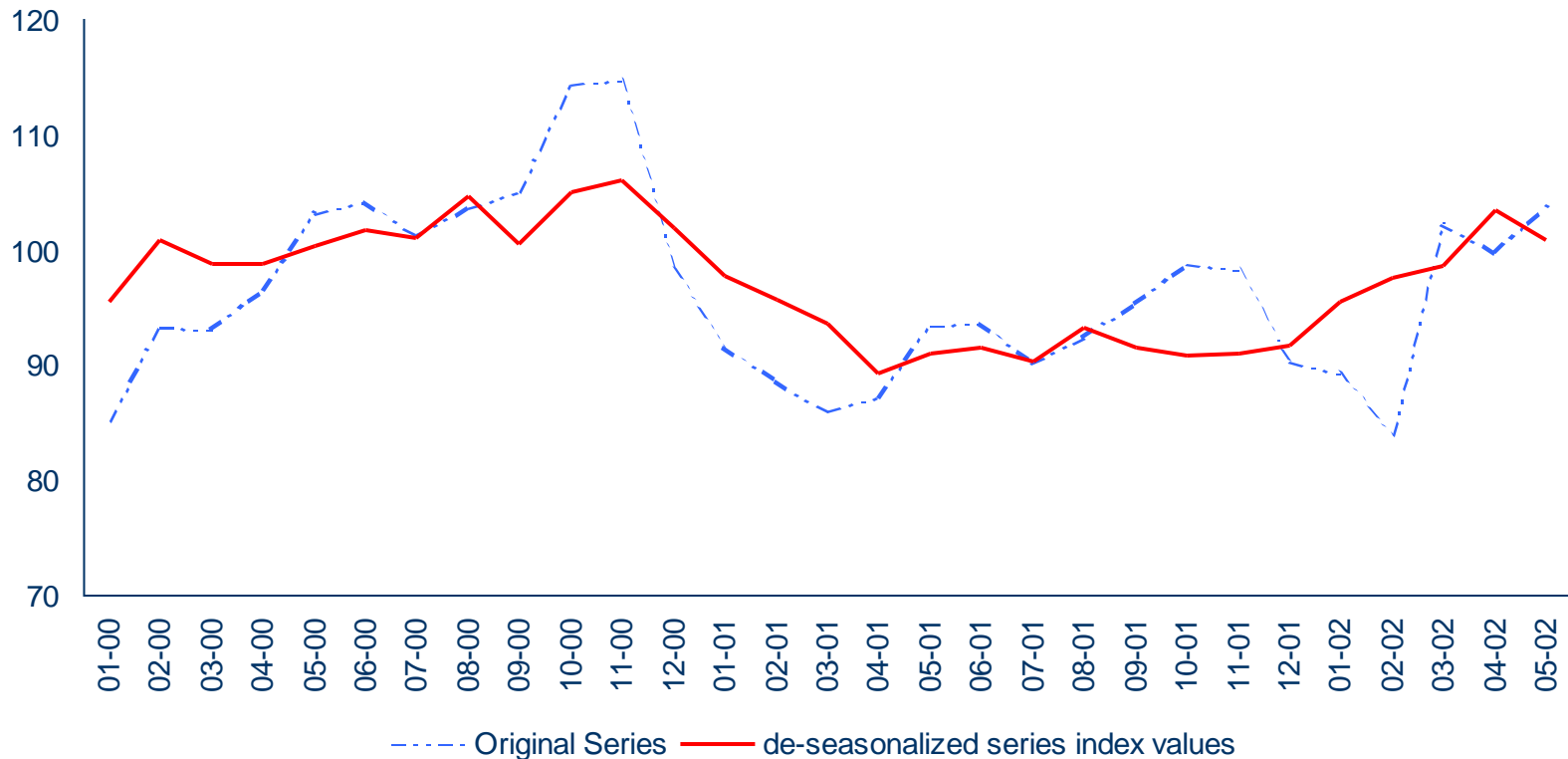
Private Manufacturing Industry Capacity Utilization Ratio,
(de-seasonalized, percentage)



Stability Indicators in the Economy

Total Industrial Output

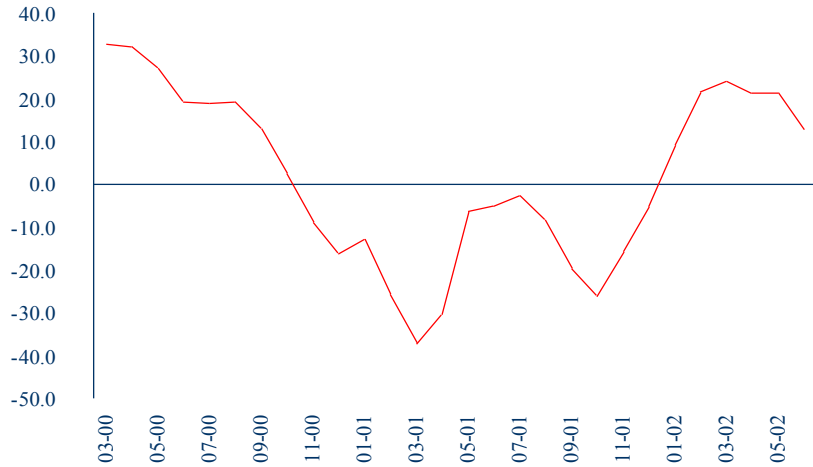
(original series & de-seasonalized series index values)



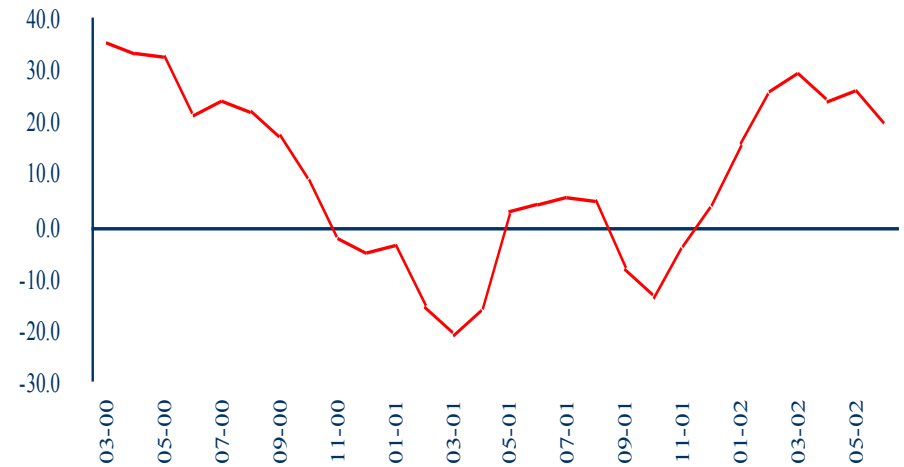
Stability Indicators in the Economy

Growth Indicators (*)

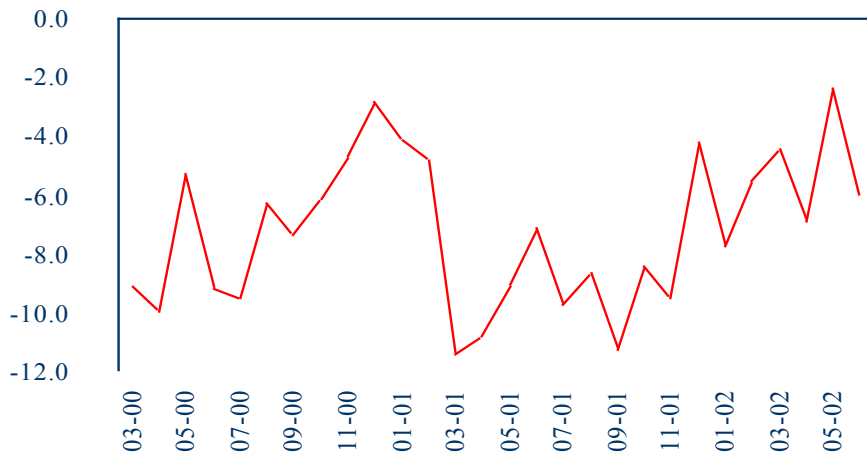
Volume of Goods Sold to Domestic Market



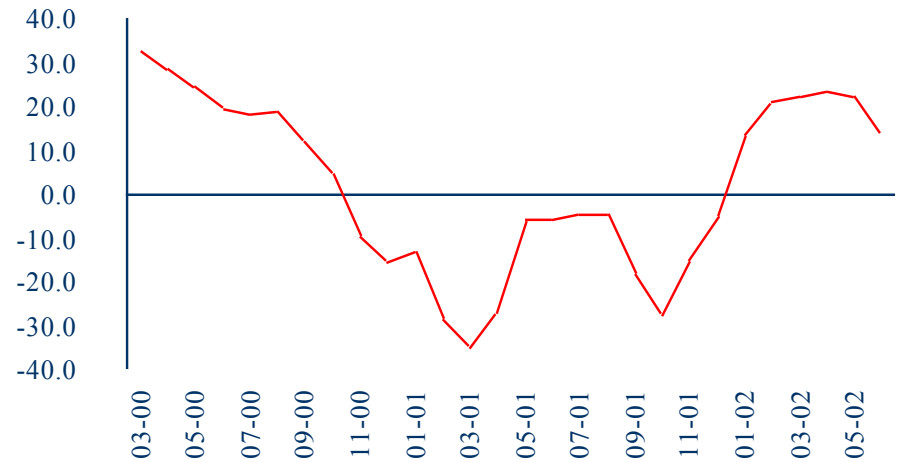
Output Volume



Finished Goods Inventory



Orders Taken from Domestic Market

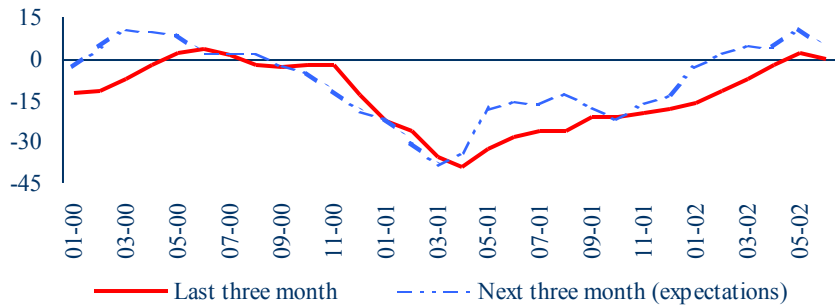


*Values reflect the difference between the optimist and pessimist views for the next 3 months.

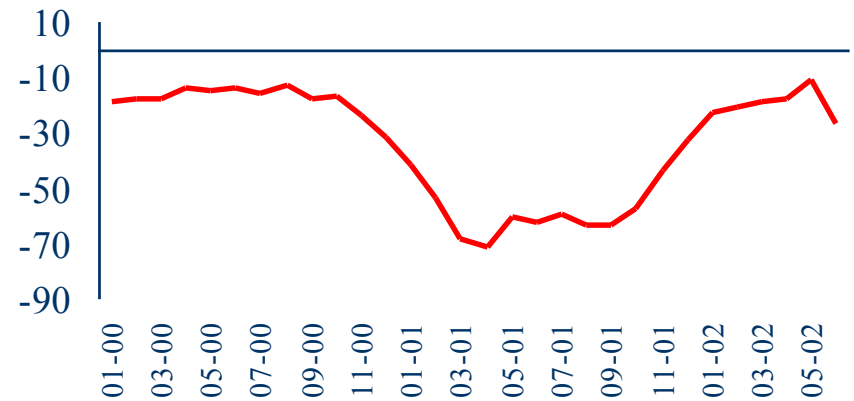
Stability Indicators in the Economy

Growth Indicators

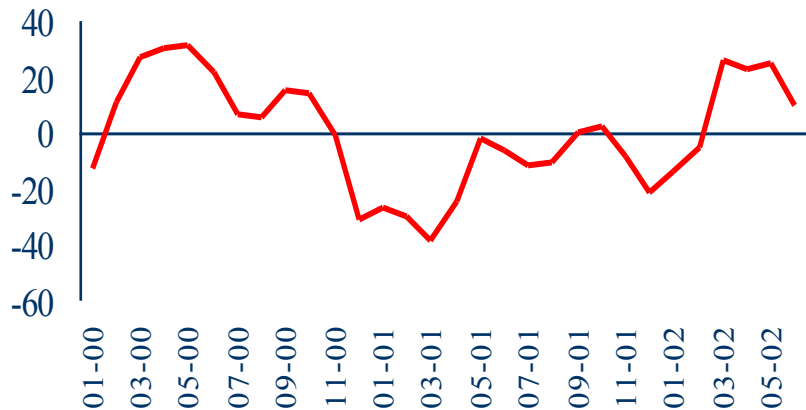
Total Employment



Investment Expenditure Tendency



Sales Revenues

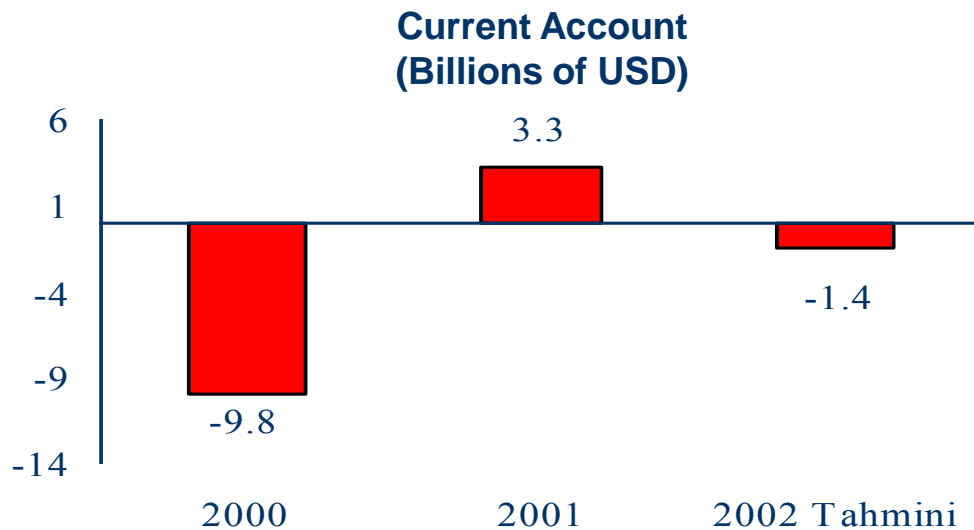


Exports Prospects



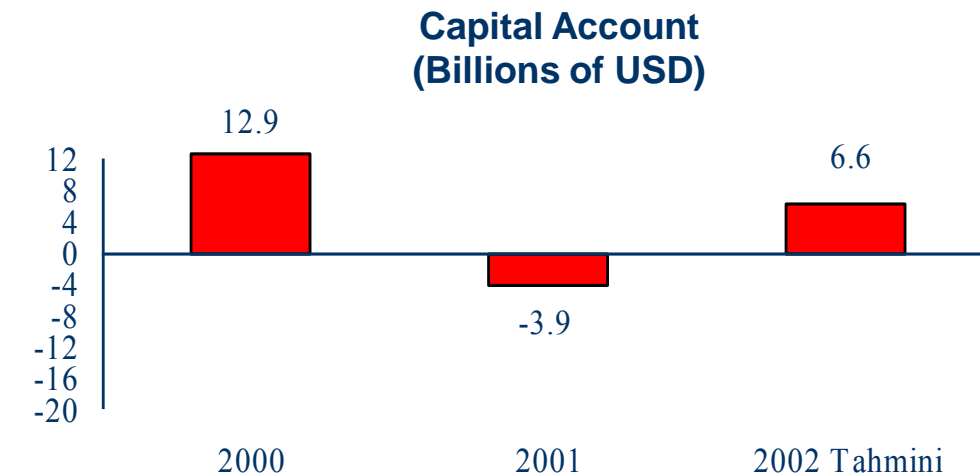
Stability Indicators in the Economy

Balance of Payments



● The economic slowdown and the depreciation of the Turkish lira have led to a noticeable turnaround in the external current account in 2001, with a surplus of US\$ 3.3 billion from a deficit of US\$ 9.8 billion in 2000.

● **A current account deficit of US\$ 1.4 billion is projected for 2002.**



● Net capital inflow, which was US\$ 12.9 billion in 2000, has turned to net capital outflow of US\$ -3.9 billion after the February Crisis.

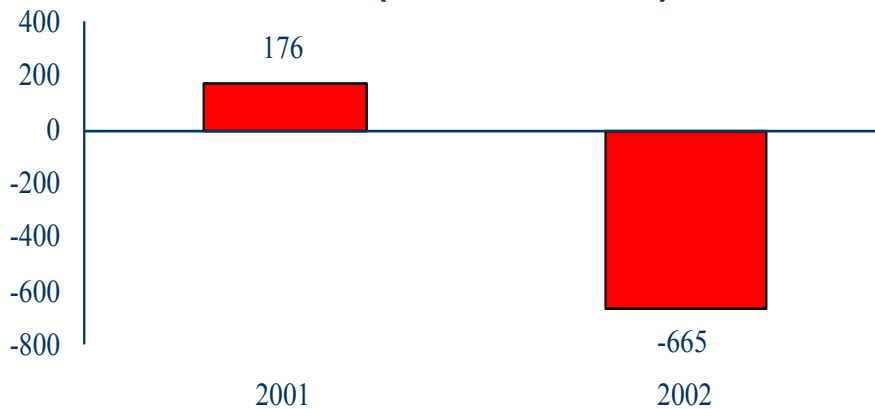
● Capital inflows are projected to be US\$ 6.6 billion in 2002.

*Included IMF Credit

Stability Indicators in the Economy

Balance of Payments

Current Account (January-April)
(Millions of USD)

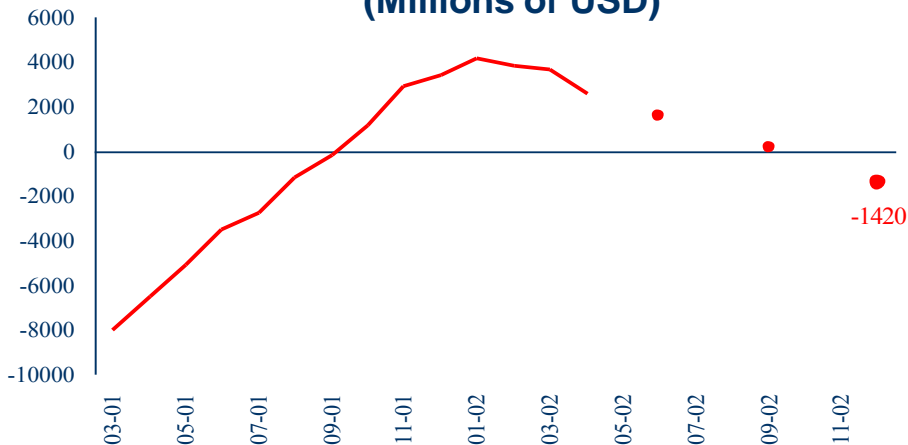


● Running a surplus of USD 176 Millions in the period January-April 2001, Current Account has run a deficit of USD 665 Millions in the same period this year.

Year-end deficit figure;

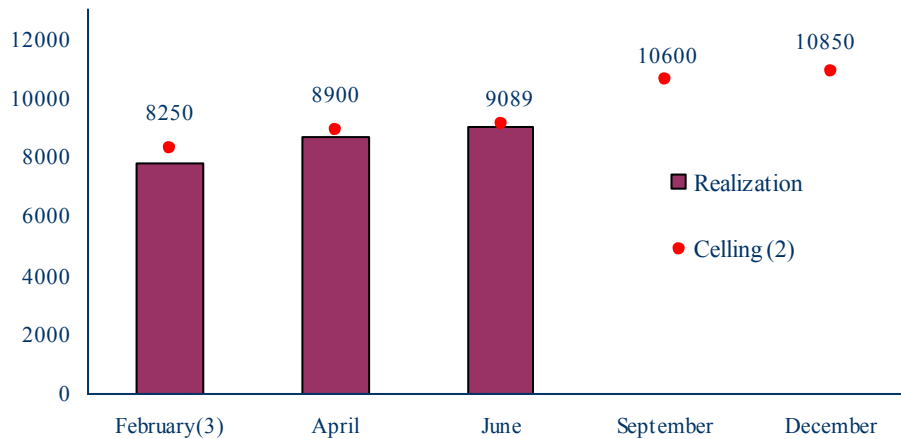
- Besides improvements in the economies of EU countries, and increasing tourism revenues, it will materialized depending on the rise in imports.

Current Account – Cumulative 12 Months
(Millions of USD)

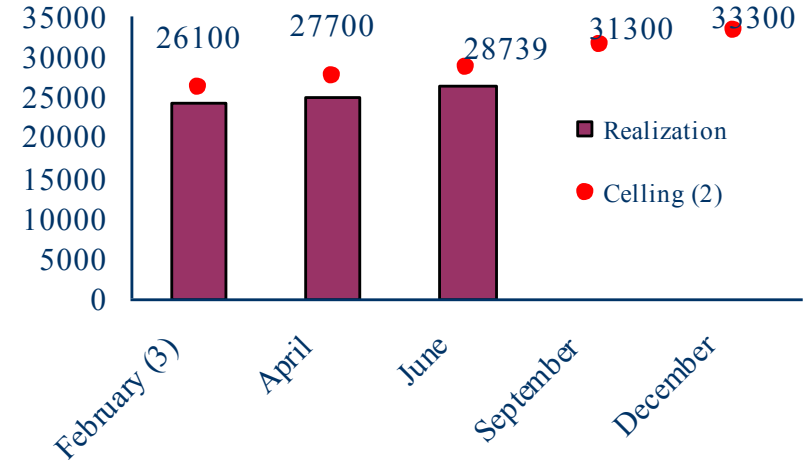


The CBRT's quantitative targets are on track

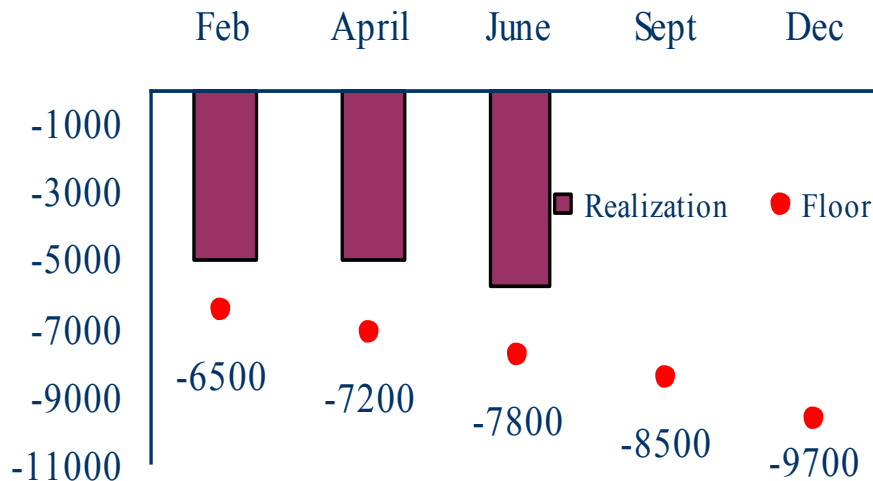
Monetary Base (TL Trillion)



Net Domestic Assets (TL Trillion)



Net International Reserves (USD Million)⁽¹⁾



- (1) Defined as Net International Reserves of CBRT minus (i) Treasury liabilities to the IMF (ii) Treasury fx denominated borrowing with an original maturity of less than one year.
- (2) Based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.
- (3) Calculated by using the four working day average of Feb. 11-12 and March 11-12, to take account of the transitory impact of the Bayram religious holiday on currency demand.

Price Developments in January-June 2002

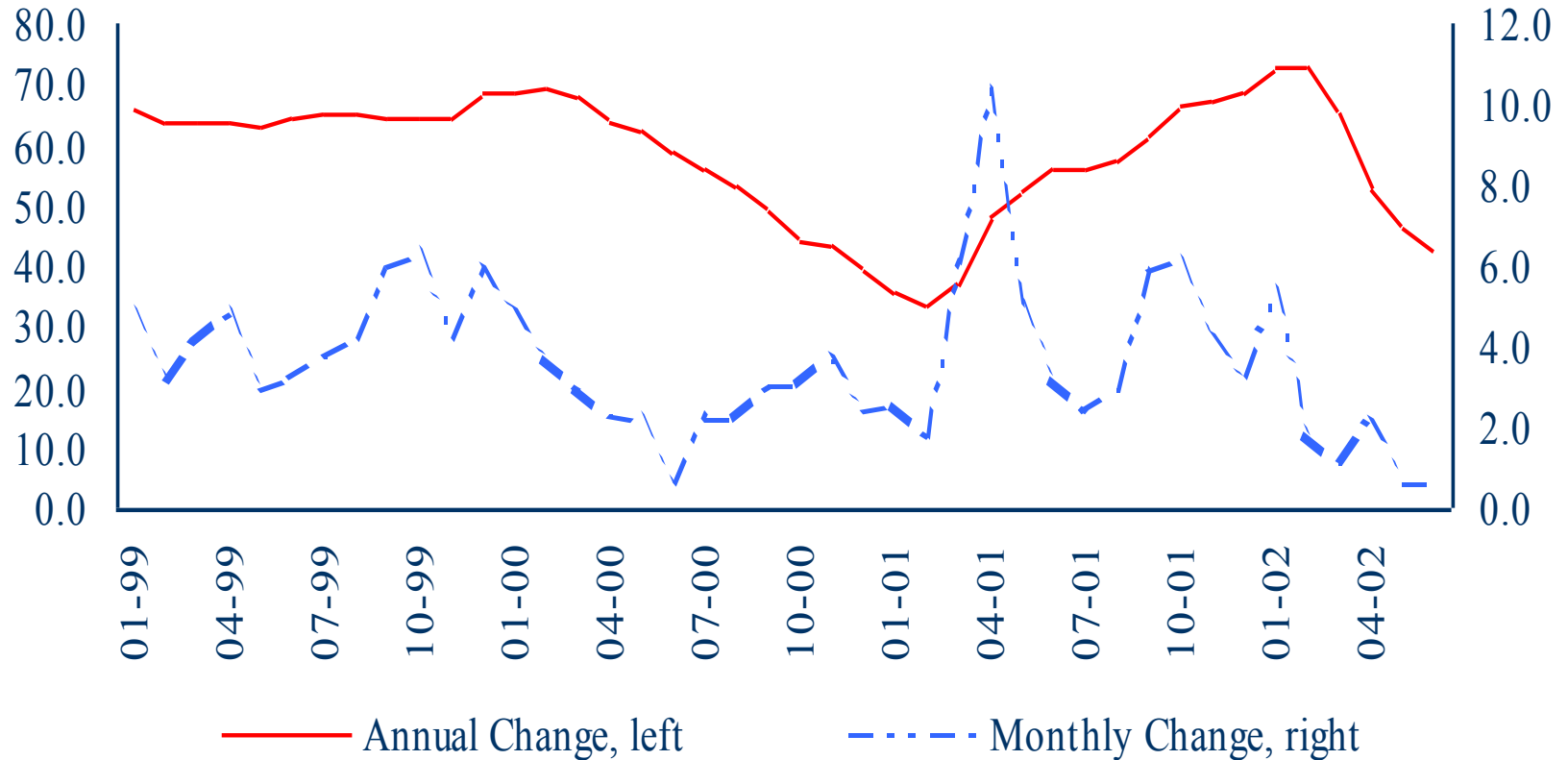
- In this period, **WPI** increased by **12.5** percent, while **CPI** increased by **12.0**. These developments indicate that **the end-year target for CPI, which is 35 percent**, could be reached.
- Inflation, which realized higher than expected in January, started to decline rapidly in February-March period. Inflation expectations also turned to positive after February. In other words, February was a turning point for both inflation and expectations.
- In the February-May period, **some monthly price increases were the lowest in the last 15 years**.

Price Developments in January-June 2002

- **Main factors determining price developments in the first 5 months were;**
 1. Positive expectations created by confidence in the program, and stability achieved in the money and foreign exchange markets,
 2. Nominal appreciation of TL,
 3. Bringing domestic demand under control by pursuing tight fiscal and monetary policies,
 4. Increase in agricultural output with favorable weather conditions after March and decrease in food prices beyond seasonal effects.

Price Developments

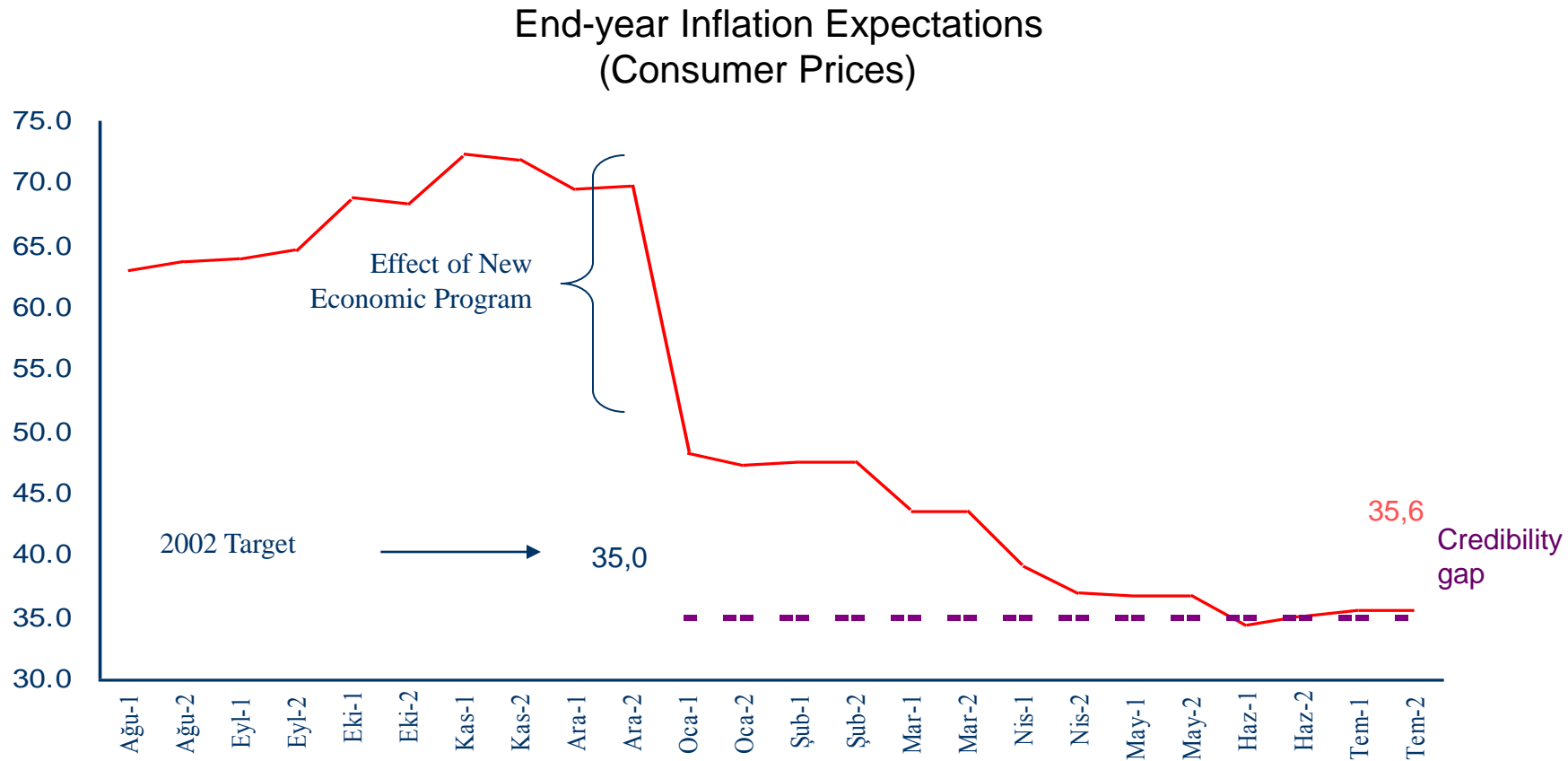
CPI (percentage)



Price Developments in January-June 2002

- **Uncertainties** that occurred in the second half of May put **interest rates** and **exchange rate** in an upward trend, exerting a cost-oriented pressure over prices.
- Thus, **manufacturing industry prices that have increased between 0.6 and 2 percent in the first 5 months period rose by 3.5 percent in June.** Determining factors were price increases in petroleum and chemical products as well as in the metal sector. Moreover, price adjustments in the public sector manufacturing industry have been observed.
- Similar development has been observed in consumer prices. De-seasonalized consumer prices in June **realized 1 point above the May figure.**
- This situation has **negatively affected the short-term inflation expectations** of economic agents. However, there has been no significant change in the inflation expectations for the next 12 months period.
- Increments in public sector prices have already been made. The downward trend in inflation will resume if the program is strictly implemented and stability is achieved in exchange rate.

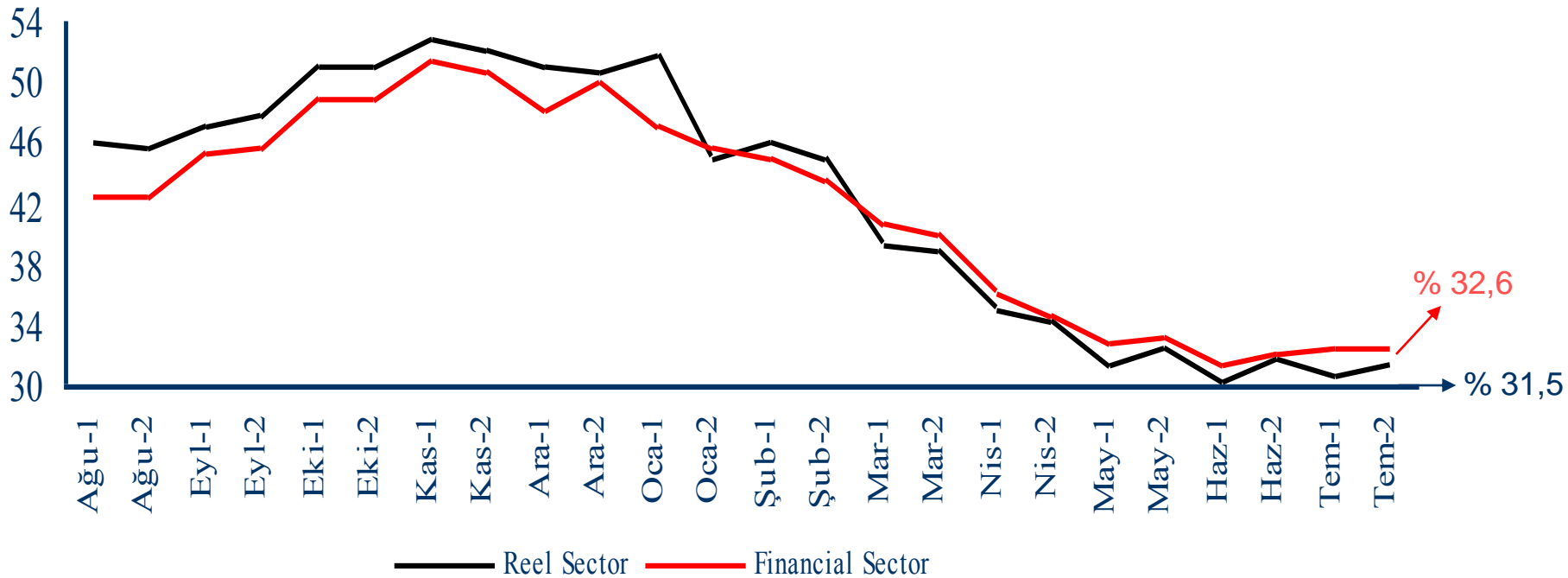
Inflation expectations are rapidly converging to the target.



For the first time in 25 years, the inflation expectations of public opinion are the same as the Government and the Central Bank.

The medium-term program is steering the inflation expectations for 2003 towards the target.

Inflation Expectations for the Next 12 Months
(Consumer Prices)



Price Movements in the Future

● Price stability:

- ✓ A pre-condition for a rapid, equitable and sustainable growth,
- ✓ The primary objective of the monetary policy

● Medium-term inflation targets:

- ✓ 2002 → % 35
- ✓ 2003 → % 20
- ✓ 2004 → % 12
- ✓ 2005-.... → Single digits

Price Movements in the Future

Risks:

- ✓ **Relaxation:** Price stability will not be achieved by meeting the target of 35 percent for 2002. There still much to be done.
More confidence must be built up for reducing inflation even further.
- ✓ **Transformation of short-term political uncertainty into a long-term one** and instability in FX and TL markets,
- ✓ **Continuation of backward-looking indexation and price setting habits** (especially in education, health, housing sectors).
- ✓ Pricing and taxing policies in line with public sector borrowing requirements,
- ✓ **Non-productive considerations** in incomes policy,
- ✓ International **oil prices** and external shocks such as rapid increases in **energy prices**.

An Overview of the FX Policy

General Evaluation:

- *Real exchange rates are determined in the short- and medium-term according to the following factors;*
 - The existence of different kinds of market players;** players who act with economic rationale, technical analysts, speculators (noise traders)
 - Structural reforms,**
 - Domestic and international political developments,**
 - Global shocks,**
 - Expectations on current account balance and capital movements**
 - Public sector debt stock; risk premium**
 - Public visibility of the economy**
- *In the long-term;*
 - economic fundamentals; terms of trade, productivity (BSE), fiscal policy,**

An Overview of the FX Policy

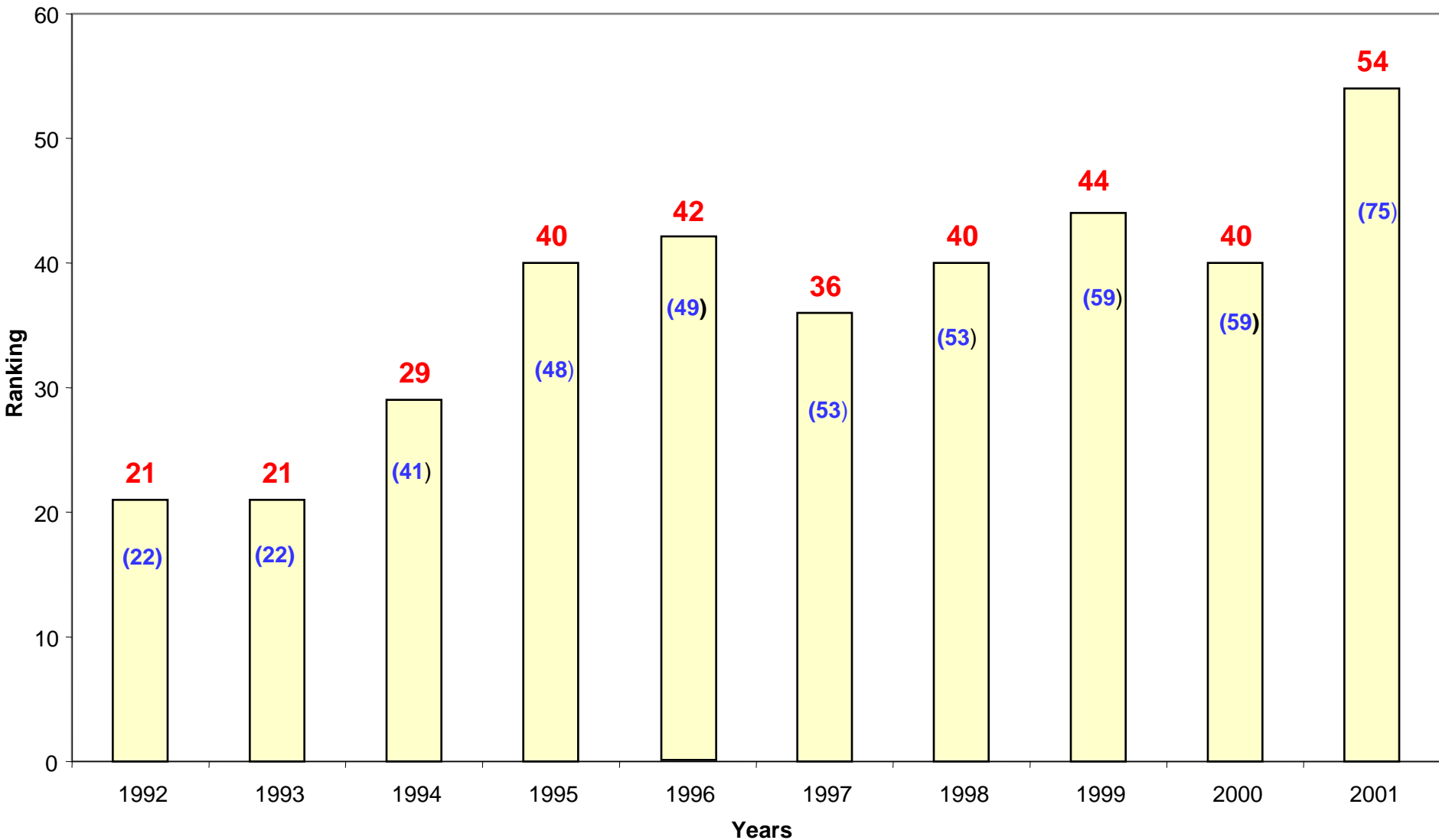
General Evaluation:

- The level of exchange rate is the result of all policies:
 - **Structural reforms, discipline in public finances and external support will boost TL, perception of political uncertainty and concerns over the continuation of the program will cause TL to depreciate.**
- Exchange rate policy actions are announced by press releases on every occasion. Exchange rate developments will be evaluated within the context of the target inflation.
- Exchange rate cannot be regulated according to the wishes of any sector:
Banks, companies, short position, domestic and foreign trade
- **A stability area** based on economic fundamentals will be created when **inflation, real and nominal interest rates** fall down and especially when a **yield curve** for TL emerges.

An Overview of the FX Policy

- Moreover, **competitive edge of a country cannot be determined by solely real exchange rate.** Factors that determine competitive edge;
 - ✓ **Price Competition:**
 - Real exchange rates, Relative Position, Unit Wages
 - ✓ **Qualitative Factors:**
 - Service after Sale, Standardization in product
 - ✓ **Structural Elements:**
 - Macroeconomic Performance, Economic and Social Development Level, Productivity, Qualified Manpower, Research – Development Studies

TURKEY'S POSITION IN GLOBAL COMPETITION



() indicate total number of countries, Above figures indicate the Turkey's ranking

Sources: World Economic Forum, Global Competitiveness Report, Overall Ranking

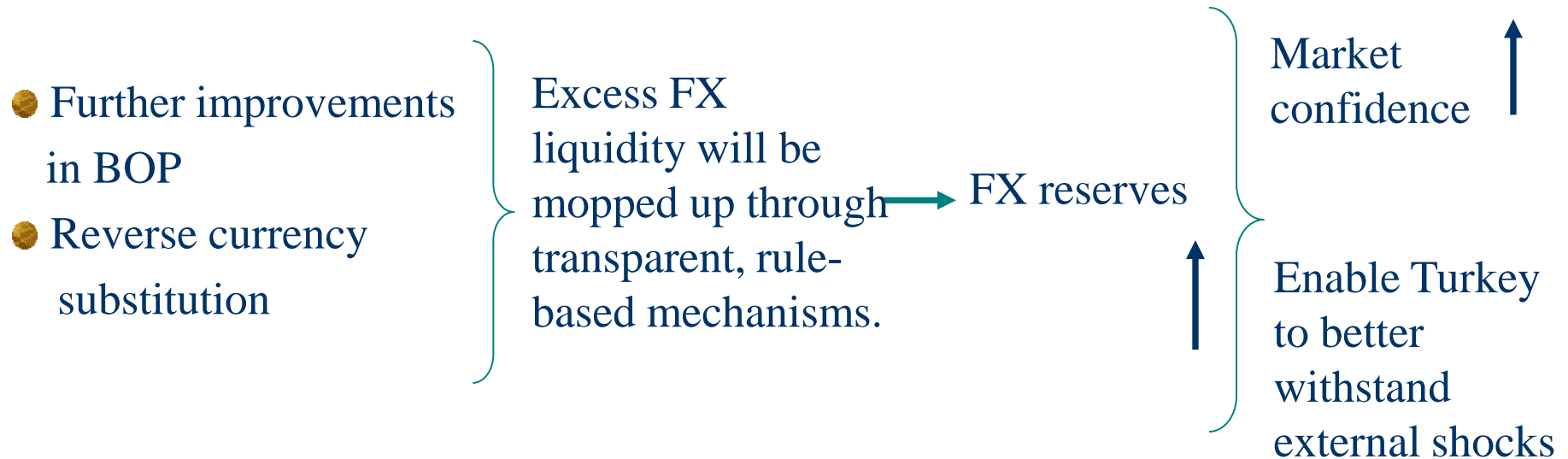
An Overview of the FX Policy

Operational Arrangements:

- In order to improve the functioning of the foreign exchange market, policy actions will focus on the following areas:
 - ✓ *Development of forward and futures exchange markets*, which will allow exporters and importers to hedge against exchange rate uncertainty;
 - ✓ *Clarification of the taxation and accounting procedures of the futures contracts*;
 - A multi-agency working group chaired by the CBT
 - Remote access problem is temporarily solved by the ISE
- In order to improve transparency in the FX market, the CBRT will gradually end its practice of acting as a *blind broker*:
 - ✓ Forex / interest rate risk;
 - ✓ Counterparty risk.

An Overview of the FX Policy

- With the decline in interest rates, the CBT is in a *stronger position* to sterilize the liquidity engendered by the use of Treasury's FX receipts for domestic payments via money market operations.



- Political uncertainty has compelled us to postpone fx buying auctions for some time.
- Exchange rate is to be intervened, only if there is excess volatility.
- Intervention might also be done through **warnings or announcements**.

An Overview of the FX Policy

Determining the Indicative Exchange rates

Effective from 1 April 2002, the CBRT;

- ✓ Between 10.30-15.30 at 1 hour intervals
- ✓ takes the average value of the averages of the buying and selling rates as quoted by banks in the interbank FX markets for 1 USD.
- ✓ the arithmetic average of the 6 averages is taken to determine the CBT's indicative FX selling rate of 1 USD to be announced at 15.30.

An Overview of the TL Policy

THE TL DEPOSIT BUYING AUCTIONS

- In order to enhance the effectiveness of its sterilization efforts, the CBRT launched a standard 4 week maturity TL deposit buying auction for a limited amount, and in a way not to affect the liquidity level of the system substantially starting from 1 April 2002.

THE INTRA-DAY REPO TENDERS

- In case a temporary liquidity shortage begins to develop;
 - ✓ the CBRT will inject liquidity into the system through the open market operations overnightly.

OTHER MARKET ARRANGEMENTS

- Starting from 19 June 2002, banks under the recapitalization program may utilize one-week repo facility in the open market operations in order to meet their short-term liquidity needs.

An Overview of the TL Policy

OTHER MARKET ARRANGEMENTS

- Starting gradually from 1 July 2002, the CBRT will have ended its “blind broker” function in the TL markets by 2 December 2002.
- The CBRT will carry out *late liquidity window* operations in the interbank money market consistent with its function as the lender of last resort.

OTHER ARRANGEMENTS

- Starting from 1 August 2002, Banks Association of Turkey has initiated the practice of Turkish Lira Reference Interest Rate (TRLIBOR).
- The practice of “**Primary Dealership**” will be reintroduced shortly by the Treasury to boost efficiency of debt management and to increase secondary market liquidities of government papers. The Central Bank is providing necessary support in this regard.

Policy actions concerning required reserves and liquidity requirement

- In order to provide more flexibility to the liquidity management, to bring to stability in financial markets, and to reduce the funding costs of financial institutions, the following measures have been taken without changing the required reserves ratio and liquidity requirement ratio;
- ✓ **Vault cash in TL and in FX** are excluded from liquid assets,
 - ✓ Calculation, maintenance and reporting periods are determined to be once in a two weeks,
 - ✓ 3 percentage points of reserve requirement rates for TL and FX are also permitted to be maintained as **two-week averages**.
 - ✓ All of the required reserves **shall be remunerated**.

Conclusion

- Despite volatilities caused by recent political turmoils, prudent fiscal and monetary policies along with deep-seated structural reform measures included in Turkey's Medium-term Economic Program will lay the foundations of an economy that is:
 - ✓ well-placed on the high road of sustained non-inflationary growth;
 - ✓ more resilient to adverse shocks;
 - ✓ less vulnerable to crises;
 - ✓ more equitable in income distribution;
 - ✓ more conducive to foreign and domestic investment;
 - ✓ as a consequence, better positioned to integrate into the European Union.