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**19 MARCH 2001**  
**THE CENTRAL BANK OF THE REPUBLIC OF TURKEY**

As a consequence of the financial turmoil in the financial markets in the second half of November 2000, substantial increases in interest rates were observed and the high foreign exchange demand resulted in the 6 billion USD fx reserve erosion of the CBRT in the period between 22 November and 5 December. The support of the international financial institutions together with the enhancement of the policies described in the context of the program contributed to the partial establishment of financial tranquility and the fx reserves of the CBRT increased by the amount of 5 billion USD in the following period.

However, the financial turmoil that was experienced in late November increased the fragility of the banking sector building on the before-crisis existing structural deficiencies. The sharp increases in interest rates had a negative impact on the financial structure of the state-owned banks and some private banks, which in turn increased the structural deficiencies in the banking sector significantly.

The unfavorable developments preceding the Treasury auction in February resulted in the complete depletion of the credibility of the program and brought about a serious attack against the Turkish lira. Consequently, faced with an FX demand of 7.6 billion USD at one-day value, the CBRT responded by squeezing the TL liquidity. The result of the general liquidity deficiency in the system together with the excessive daily liquidity needs of the state owned banks resulted in the complete non-intermediation of the payments system.

Under these circumstances, considering the potential negative impact of defending the existing exchange rate policy on the economy, the previous exchange rate policy framework was abandoned in favor of a floating exchange rate regime.

The program implemented in the year 2000 included an exchange rate policy framework foreseeing a widening band around the central exchange rate path starting from mid-2001 and finally ending up with a floating exchange rate regime at the end of the third year after the attainment of single digit inflation rates. However, as a consequence of the loss of confidence in the financial markets, the abandonment of the former exchange rate policy framework and the introduction of a floating exchange rate regime appeared as a compulsory action.

The Central Bank has carried out a number of operations under the new floating exchange rate regime in order to reestablish the smooth functioning of the financial markets. In this respect, the demand for Turkish lira has been met after February 26 to reestablish a healthy payments system. Following the Central Bank funding that met the financial market's demand for liquidity, the interest rates that reached 2000 percent per annum in simple terms during the crisis fell down to 80 percent level.

In this operational framework, CBRT favored providing the banking system with the necessary sources to meet their foreign liabilities without any delay through the use of fx depos. Recently, the foreign exchange market has calmed down. Nevertheless, the equilibrium in the foreign exchange market has not been attained due to shallow transaction volume.

The CBRT will continue to provide the necessary fx liquidity that will allow banking system to meet their foreign liabilities. However, it does not make any commitment about the level of the foreign exchange rate.

In the following period, CBRT will give priority to reestablishing the financial stability. Accordingly, CBRT will carry its operations in line with this objective.

At this stage, it will be useful to give some information about the operations concerning the state-owned banks. Currently, state-owned banks are facing a need for making a substantial volume of overnight borrowing due to their structural problems. The overnight borrowing requirement of the state-owned banks that reaches approximately 17 quadrillion Turkish lira prevents the attainment of the equilibrium level in interest rates and limits the extent that the monetary policy can be implemented. This problem, which continuously feeds up the fragility in the financial market, has a priority. In order to solve this problem, the Treasury will give bills and bonds to the state-owned banks in order to cover their duty losses. Within the framework of a predetermined program, state-owned banks will reduce their overnight liabilities to the banking and non-banking sectors with the help of the liquidity provided by CBRT through repurchase agreements or direct purchases via these bonds and bills. In addition, CBRT and Treasury will withdraw the increasing liquidity via reverse repurchase agreements and direct sales of bonds and bills.

In the forthcoming period, CBRT will give priority to the control of monetary aggregates to reduce the inflationary pressures in the economy. However, in practice, the efficiency in the functioning of the payments system and the foreign exchange markets will also be considered.

In the implementation of monetary policy, Net Domestic Assets and Net International Reserves figures will be followed and the inflationary expectations will be influenced through the monetary aggregates.

CBRT's interventions in the foreign exchange market will only be directed towards dampening the excessive volatility in the foreign exchange rates and increasing the smooth functioning of the market. However, CBRT's intervention will not restrict market forces in determining foreign exchange rates.

On the other hand, the new "Central Bank Law" draft will be submitted to the parliament in the near future. In this draft, the primary objective of the Central Bank is foreseen as to establish the price stability. The draft will also include the establishment of a Monetary Policy Committee that would be responsible for designing and implementing the monetary policy, the revisions about the procedures of designation and resignation for the positions in the governing bodies of CBRT and many other changes. In addition, accountability and transparency in the monetary policy implementation will also be enhanced. As part of this practice, periodic reporting system will be introduced.

With the establishment of stability in the markets, the monetary policy will be directed towards the price stability. In the medium term, CBRT will

introduce the inflation-targeting regime after providing the necessary initial conditions. As emphasized by the Minister, Turkey is obliged to overcome the inflation. The primary source of many problems observed in the society has been the high inflation experienced in the last 20 years that directed the society towards speculative behavior. We will overcome this problem in complete harmony with the government and with the support of a strong fiscal policy.