



FINANCIAL STABILITY AND CENTRAL BANKS

In the framework of modern central banking, the primary objective of central banks is to achieve and maintain price stability. In line with this objective, monetary policy is implemented through operations performed in financial markets and its success heavily depends on the efficiency of financial intermediation. Financial stability has a crucial role on sustainability of economic growth, and furthermore absence of stability in financial system affects economies negatively. Hence financial stability, which is an important part of macroeconomic stability, is accepted as an auxiliary objective by an increasing number of central banks.



Central Bank of Turkey and Financial Stability

With the amendment of the Law on the Central Bank of Turkey (CBT) in 2001, financial stability has been specified as an auxiliary objective. According to Article 4 of the Law, the CBT is empowered to monitor financial markets; to regulate the volume and circulation of Turkish currency; to establish payment, securities transfer and settlement systems and to set forth any regulations regarding these systems; and to set up the procedures and conditions regarding the liabilities of financial institutions for reserve requirements. The CBT takes measures to maintain stability in the financial system and makes regulations for money and foreign exchange markets. In line with the principle of transparency, the CBT also shares its views and evaluations of the system with the public and gives warnings concerning fragilities and risks in the financial system. In case of extraordinary circumstances, the CBT ensures the stability of the financial system by taking additional measures.

To illustrate this point, necessary measures were put into effect by the CBT in order to minimize the adverse effects of the Iraq War and terrorist attacks on September 11, 2001 on domestic markets and preserve the accomplishments already gained on the way to achieving price stability and maintaining banking and financial stability. In the context of these measures, the necessary arrangements were made to provide foreign exchange and Turkish currency liquidity in the market.

Parallel to the turmoil in international financial markets, Turkish financial markets experienced excessive fluctuations in the period between May-June 2006, like other emerging markets. In order to prevent excessive volatility and maintain financial stability, especially in the foreign exchange market, the CBT has taken the necessary measures. Within the context of extracting excess New Turkish Lira liquidity and removing the liquidity shortage in the foreign exchange market, the CBT;

- Suspended foreign exchange buying auctions effective from May 16, 2006.
- Directly intervened in the foreign exchange market by selling foreign currency on June 13, 23 and 26, 2006.
- Decided to hold New Turkish Lira deposit purchase auctions beginning on June 26, 2006.
- Hold foreign exchange sale auctions on June 26 and 27, 2006.
- Made technical changes in borrowing-lending interest rate margins on June 28, 2006.

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NEW APPOINTMENTS TO THE CBT

Mr. Burhan Göklemmez and Mr. Mehmet Yörükoğlu, Phd, were appointed Vice Governors of the CBT on May 31, 2006 and June 3, 2006 respectively.



B.Göklemmez



M.Yörükoğlu

OPEN LETTER WRITTEN TO THE GOVERNMENT AND SENT TO THE IMF AS A PART OF PROGRAM CONDITIONALITY

On July 14, 2006, the CBT announced to the Government and the public the reasons why annual inflation in June 2006 was above the path consistent with the year-end target and the evolution of possible developments through an "open letter". The letter has also been sent to the IMF in line with the program conditionality.

THE PATH CONSISTENT WITH THE TARGET*	UPPER LIMIT	REALIZATION*
6.5 %	8.5 %	10.12 %

*June 2006

The letter stated that the main reason for the inflation exceeding the upper limit of the uncertainty band had been attributed to the existence of a combination of different supply shocks. It was underlined that the rising prices of crude oil, tobacco products, unprocessed food and gold have been influential in inflationary developments in the first four months of 2006, as well. It was asserted that the coexistence of different kinds of supply shocks and the depreciation of the domestic currency had caused deterioration in the inflation expectations, and as a consequence, the Monetary Policy Committee (MPC) had decided to increase the policy interest rates by 1.75 points in the unscheduled meeting held on June 7, 2006. The letter emphasized that since the markets turned unstable in the following days and inflation expectations continued deteriorating afterwards, the MPC held another unscheduled meeting on the 25th of June 2006 to assess the developments and reacted immediately and thus the policy interest rates were increased by 2.25 points. It was also underlined in the letter that the CBT not only tightened monetary policy by increasing the policy rate, but also withdrew excess New Turkish Lira liquidity gradually in the financial markets through the combination of New Turkish Lira deposit purchase auctions and foreign exchange sales. Additionally, the projections regarding the medium term outlook of inflation have been presented in the letter. In this context, it was stated that the net effect of the recent developments on aggregate demand in the coming period would anticipated to be disinflationary and the exchange rate movements would be expected to cause an impact approximate to 3.5 points on the year-end inflation rate in 2006.



To find out more: <http://www.tcmb.gov.tr/> (Press Releases)



"REGIONAL FINANCIAL STABILITY AROUND THE EUROZONE" CONFERENCE

The CBT hosted "The Regional Financial Stability Around the Eurozone" round-table conference held by Euro 50 Group between 1-3 June, 2006. The conference began with the opening speech delivered by Governor Yılmaz. In his speech, Governor Yılmaz mentioned the importance of financial stability for economies and the influence of the developments in the Eurozone on financial stability around the Zone.

"CHAIR IN CONTEMPORARY TURKISH STUDIES"

The publicity of the "Chair in Contemporary Turkish Studies" established at the London School of Economics, was held in England on October 27, 2005. As for Turkey, the publicity of the Chair for Turkish media and academicians was held by the Minister of State Prof. Dr. Beşir Atalay, LSE Director Sir Howard Davies and the LSE European Institute Director Prof. Kevin Featherstone with a press conference at Istanbul Modern Art Museum on June 16, 2006. The representatives of the CBT and other lead donors took part at the opening ceremony of the Chair.



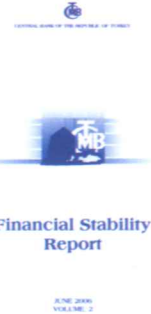
MEETINGS WITH FOREIGN INVESTORS

Governor Yılmaz held meetings with foreign investors in London on June 22-23, 2006 and in New York on June 26, 2006. Besides the developments in the Turkish economy that has been ongoing during the last five years, Governor Yılmaz also mentioned the recent fluctuations in the financial markets and the policies of the CBT.

FINANCIAL STABILITY REPORT II

The second issue of the Financial Stability Report was released in June 2006. The Report reveals scenario analysis regarding the whole financial system and states that the banking sector, having the largest share in the Turkish financial system, has recovered to a great extent recently in terms of the risks regarding the banks' balance sheets. Additionally, it is underlined that the strength of the financial system as a whole has also improved.

To find out more: <http://www.tcmb.gov.tr/> (Publications/Periodic Publications)



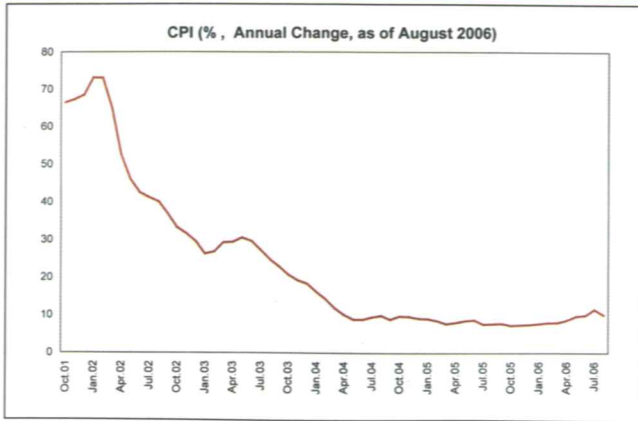
INFLATION REPORT 2006-III

Inflation Report-III was published and announced with a press meeting on July 28, 2006. In the first chapter of the Report, recent macroeconomic developments are assessed; assumptions and risk factors are summarized. In the following chapters, the international developments, inflationary dynamics, aggregate supply and demand conditions, financial markets and public finance developments are analyzed in detail. In the last chapter, inflation forecasts that have been produced on certain assumptions on foreign and domestic conditions covering the period until the end of 2007 are presented. The last chapter also explains the possible risks in the disinflation period.

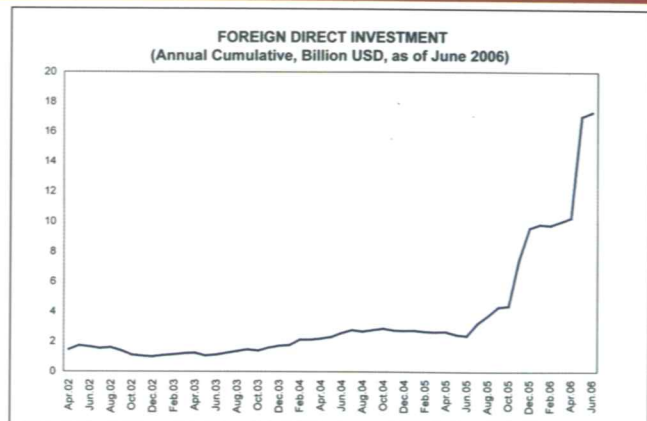
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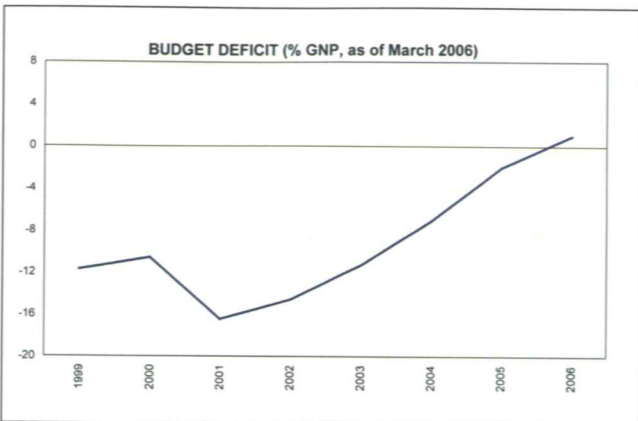
AT A GLANCE



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Source: TREASURY



Source: CBT

Published quarterly by the
Central Bank of
the Republic of Turkey
Issue: 3
September 2006

Owner on behalf of the
Central Bank of the
Republic of Turkey and
Responsible Editor:
Nesrin Doğaneli

Publication Board:
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Publication:
Central Bank of
the Republic of Turkey,
Banknote Printing Works
Department

For Subscription:
iletisimbilgi@tcmb.gov.tr

Distributed free of charge



CBT WEBSITE RENEWED

The CBT website was renewed so as to emphasize the basic functions of the Bank. To this end, the website was made more user friendly and the visual design was improved. By using the "Quick Links" menu in the home page, the Inflation Report and the Financial Stability Report, monthly CPI data, international reserves, rediscount and advance rate statistics can be reached.

Under the title of "Films and CDs", classical music CDs sponsored by the Bank and the album book "The History of Inflation in Turkey" is presented.

CBT Interest Rates*	Borrowing	Lending
Overnight (%)	17.50	22.50
CBT Exchange Rates* ¹	FX Buying	FX Selling
Dollar	1.4780	1.4851
Euro	1.8930	1.9021

Central Bank Foreign Exchange Reserves (as of 18 August 2006, Billion USD)	57.01
CPI (% Annual Change, August 2006)	10.26

* As of August 28, 2006, ¹ Indicative