MONETARY POLICY REPORT

OCTOBER 2002

CENTRAL BANK OF THE REPUBLIC OF TURKEY

CONTENTS

GENERAL ASSESSMENT [*]

In July-September 2002 period, the Base Money component of the CBRT balance sheet continued to be the main nominal anchor of the monetary policy and short-term interest rates were determined taking into account the impact of various macroeconomic variables on the future inflation.

Developments since May have generated fluctuations both in Turkish lira and foreign exchange markets and decelerated the downward trend in inflation. Sustaining the resolute implementation of the economic program after the announcement of the election date has contributed to the recovery of confidence in the program. Adoption of harmonization with the EU Laws in July and August and announcement of early election decision had positive reverberations in the market, and interest rates at ISE Outright Purchases and Sales Market and CBRT's Turkish Lira Deposit Buying Auctions decreased. The Central Bank cut down the short-term interest rates on August 5, 2002, taking into account the positive expectations for the forthcoming period and the relative stability in the markets.

In October, there seems to be no deviation risk from the end-year inflation target determined within the framework of the economic program. Restoration of stability since August has, to a great extent, prevented the impact of fluctuations in the market on inflation rate from being permanent. Indeed, the inflation figures of August and September seem to confirm this conjecture.

The results of the CBRT Survey of Expectations show that there has been a slow-down in the downward trend of inflation expectations in June and July, although there has been no significant rise in long-term expectations. According to the results of the Survey of Expectation of the first half of October, CPI inflation expectations have remained below the target. Consequently, Survey of Expectations results also confirm that the year-end inflation target will be attained.

The factors that decelerated the downward trend in inflation in summer have been the substantial increases in the prices of administered goods and non-food prices. Increase in WPI prices and private manufacturing industry prices have been more apparent in July, and price increases in the private manufacturing sectors that use imported inputs have been more remarkable. Notwithstanding these developments, the rise in inflation has not been persistent and August inflation has stayed parallel to expectations. In September, the price increases recorded a historically low level despite that the positive effects of the summer were over.

Sizeable increases in the prices of durable goods due to exchange rate developments in July together with a rise in the prices of services in August slowed down the downward trend in consumer prices in the third quarter. Consequently, when the price increases in September and developments regarding the factors that might affect future inflation are taken into account, it is anticipated that the year-end consumer prices inflation would stay below the target level. The annual inflation that dropped down to 37 percent in September and the results of CBRT Survey of Expectations support this anticipation. Meanwhile, the possibility of a military operation in Iraq and the uncertainties caused by the election process are accepted as factors that may affect inflation, however it is believed that these factors would have an effect on 2003 inflation, not the target of 2002.

The main points of the monetary policy implementation in July-September 2002 period were as follows: The indicative Base Money and Net International Reserves targets specified for September 30 and December 31, 2002, were converted to performance criteria with the Letter of Intent dated July 30, 2002 and the indicative targets pertaining to Net Domestic Assets were revised. The targets specified for September 30, 2002 have been attained.

Taking into account the inflation developments, expectations and other factors that might affect the future trend of inflation in July-August 2002 period, the Central Bank cut down the short-term interest rates on August 5, 2002. Thus, the overnight borrowing rate was

[*] . This Report has been prepared with the data available in October.

reduced to 46 percent from 48 percent while overnight lending rate was cut down to 53 percent from 55 percent.

The measures taken regarding the financial markets were intended for activating the monetary and exchange rate policy implementations and can be grouped into three. Within this framework, the Banks Association of Turkey put the TRLIBOR into practice on August 1, 2002 and CBRT has kept on with its efforts to gradually abandoning its intermediation role in Interbank Money Market and Foreign Exchange and Banknotes Markets. Thirdly, taking into account the prospective contribution to the deepening of the markets, as of September 2, 2002, the CBRT started to support the Primary Dealership system introduced by the Treasury and to provide the primary dealers with limited and conditional Turkish lira liquidity within the framework of the open market operations.

In September, compared with end-June figures, M1 and M2 monetary aggregates shrunk by 0.7 and 2.3 percent, respectively, in real terms. While currency in circulation as a sub-item of M1 increased by 1.6 percent; sight deposits as a sub-item of M1 decreased by 2.7 percent in September. Meanwhile, time deposits as a sub-item of M2 shrunk by 2.8 percent. Compared with June figures, M2X decreased by 0.3 percent in September.

The interest rates in the bonds and bills secondary market, which had followed an upward trend from mid-May until mid-July, decreased after mid-July and partially recovered by mid-September. Fluctuations in interest rates in July-September period induced fluctuations in transaction volume and days to maturity of bills and bonds. The interest rates of the CBRT Turkish Lira Deposit Buying Auctions with 4 weeks maturity followed a similar trend to other market interest rates in July-September period.

It is observed that there have been sizeable increases in monthly average interest rates at Treasury auctions since June. This rising trend sustained in July as well. With the recovery of confidence in the markets in August, the average compound interest rate at the Treasury auctions dropped down to 63 percent. Despite the decline in average interest rate in September, it is observed that the investors have demanded higher interest rates for the same maturities compared to August.

Preceded by depreciation in July, Turkish lira appreciated in August and ease in the volatility of exchange rates was observed notwithstanding the prevailing effect of political unrest on the exchange rates. In August, some banks bought sizeable amounts of foreign exchange in the market in order to cover their open positions in their balance sheets and this contained further appreciation of Turkish lira. When uncertainties eased in October, a sharp exchange rate depreciation occurred. Expectations for the exchange rate followed a parallel course as well.

The banks have squeezed their credit volume due to some problems in credit repayments and uncertainty about interest and exchange rates. Meanwhile, credit demand decreased because of high credit interest rates and decrease in income level. While real credit volume shrunk by 18 percent in the first nine months of 2002, this ratio became 7 percent in the third quarter of the year.

Owing to tight fiscal policies, in January-August period, primary budget surplus privatization receipts increased by 45.9 percent compared with the same period in 2001 and reached TL 12.9 quadrillion. The transfer of CBRT profit amounting to TL 3 quadrillion to Treasury played an important role in this alleviation in primary surplus in the first eight months of the year. In the same period, budget revenues increased by 51.2 percent while expenditures rose by 49.3 percent and reached TL 70.4 quadrillion.

The domestic debt stock, which was TL 122.2 quadrillion at the end of 2001, increased by 12.2 percent by August and reached TL 137.1 quadrillion. The possibility of a military operation in Iraq and worries concerning Brazilian economy have been the basic factors making up the domestic borrowing conditions in August. These developments resulted in shortening of borrowing maturity and increase in borrowing cost, which in return *caused a serious change in the instrument composition of domestic debt stock.*

GNP growth turned to positive in the first quarter of the year and continued its upward trend in the second quarter. Thus, compared with the previous year, GNP increased by 4.7 percent in the first half of the year. Economic growth that exceeded the expected level in the first half of the year indicates that the growth target of 3 percent will be exceeded.

When demand components in the first half of 2002 are analyzed, it is observed that the inventory building made the greatest contribution to growth and that of net exports was also significant. Domestic demand, which had shrunk in the first half compared with the same period of the previous year, recovered in the second half.

In the January-July 2002 period, exports increased by 6 percent and imports by 8.1 percent compared with the same period of the previous year and trade deficit reached US dollars 7.1 billion. Therefore, proportion of exports covered by imports became 72.6 percent, lower than the figures of 2001. In January-July period, current account deficit reached US dollars 718 million due to substantial increase in imports. When reserves and credits received from the International Monetary Fund are excluded, net capital inflow was very limited in the said period.

A look into the world economy shows that recovery in the second quarter was slower than that in the first quarter and the current risks became more apparent. While US economy lost its pace of growth in the first half, the growth rates announced for the Euro area show that the recovery is rather sluggish. In Japan, where increase in export revenues is the only source of growth, structural problems are yet to be solved. The state of Latin American economies is another important variable for the global growth. It is estimated that in case the risks in these countries materialize, the already vulnerable and slow global growth will be adversely affected. In the second quarter of the year, the Asian economies have been successful in sustaining the growth rates that they had attained in the first quarter. The tension between USA and Iraq and its upward pressure on oil prices are expected to have a negative impact on global recovery.

Resolute and harmonious implementation of tight fiscal and monetary policies underlies a more apparent economic recovery and sustained disinflation. The fact that there were no fundamental risk factors blocking the way to attaining the end-year inflation target and that it became apparent that a growth rate higher than expected would be achieved, certify the success of the program and economic policies.

I.PRICE DEVELOPMENTS

Triggered by the political developments in May and in the following months, Turkish lira has appreciated and prices of administered goods have increased, which in return decelerated the downward trend in inflation in July and August. Similarly, improvement in economic expectations was halted in the same period. However, restoration of stability in financial markets in August restrained the impact of these developments on economy from becoming persistent and resolved implementation of the economic program after the announcement of the early election decision has helped to restore confidence in the markets.

Mainly due to these developments, price increases accelerated in all sectors except for the food group in July. Rise in WPI and private manufacturing sector prices has been more apparent and increase in the prices of goods manufactured by private manufacturing sectors that use imported materials have accelerated. Nevertheless, the rise in inflation has not been persistent and inflation has remained parallel to August expectations. In September, inflation recorded a historically low level although the seasonal effects of summer were over.

After February, annual increases in CPI and WPI have converged. However, since June, WPI, which is more directly affected by depreciation of Turkish lira and increases in public prices, has increased faster than CPI and annual WPI inflation has exceeded that of CPI by the end of the third quarter (Figure I.1). Annual WPI and CPI inflation reached 40.9 and 37.0 percent, respectively, in September 2002.

Restoration of stability in financial markets in August restrained the impact of political developments on economy from becoming persistent and resolved implementation of the economic program after the announcement of the early election decision has helped to restore confidence in the markets.

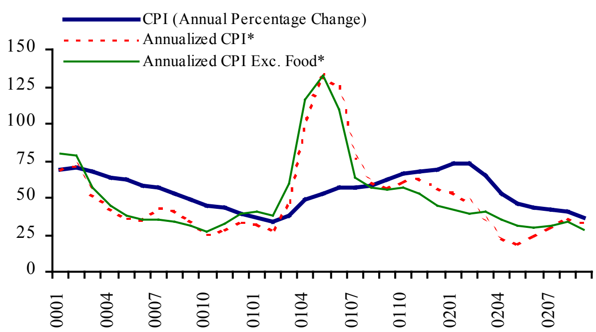
Figure I.1. Annual and Periodical Inflation Rates

	ANNUAL				JAN-SEP		
	Weight (%)	2000 Dec	2001 Dec	2002 Sep	2000	2001	2002
WPI	100,00	32,7	88,6	40,9	23,7	62,9	21,7
WPI (Public)	23,17	24,7	99,7	38,6	18,7	83,9	27,7
WPI (Private)	76,83	35,7	84,6	41,8	25,6	55,4	19,3
TEFE (Exc. Agriculture)	77,78	30,4	96,3	38,8	23,4	74,7	23,5
CPI	100,00	39,0	68,5	37,0	26,9	47,4	20,1
CPI (Tradable)	58,16	34,6	78,1	38,6	22,5	51,3	17,7
CPI (Non-tradable)	41,84	43,4	59,4	35,5	31,2	44,2	22,6
CPI (Goods)	70,69	34,6	80,9	38,4	22,0	54,5	18,2
CPI (Services)	29,31	47,0	48,2	34,5	35,6	36,5	23,9
CPI (Administered)	20,72	32,9	92,0	35,2	24,5	75,7	23,7
CPI (Non-administered)	79,28	40,7	62,1	37,7	27,4	39,8	18,7
CPI (Food)	28,50	52,0	28,1	42,4	21,5	36,3	8,7
CPI (Durable Goods)	7,33	38,5	65,6	42,4	30,3	65,1	42,0
CPI (Exc. Food)	68,91	41,3	64,3	35,6	28,5	51,0	23,7
CPI (Exc. Housing)	74,2	35,7	72,9	39,5	24,6	48,2	19,6
ER Basket (average)	-	22,2	113,6	15,6	18,5	118,3	18,1
Export Prices	-	-1,0	-5,0	0,0(1)	-	-	-
Import Prices	-	0,2	-5,8	0,2(1)	-	-	-

Source: SIS, CBRT
(1) 2002 June

In the third quarter, rise in oil prices continued due to appreciation of exchange rate and developments in international markets. Besides this, public prices excluding oil prices increased substantially compared with the first half of the year, which in return has adversely affected the consumer and wholesale prices.

Figure I.1. WPI and CPI; 1994=100
(Annual Percentage Change)

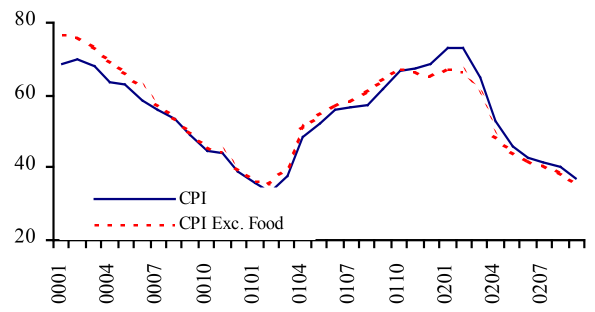


*Three months moving average (annualized, seasonally adjusted)

20.1 percent increase in CPI in January-September period shows that the year-end inflation target of 35 percent will be attained.

Food and agriculture prices have started to increase in August again. The agriculture and food prices which were feared to pose risk to inflation, increased by 4.0 and 4.5 percent in September, respectively. These increases have not surpassed the seasonal effects and have remained even below the average rates of increase in the previous years and have not shown a tendency to block the way to attaining the year-end inflation target of 35 percent. (Figure I.2).

Figure I.2. CPI and CPI Excluding Food; 1994=100 (Annual Percentage Change)



Source: SIS

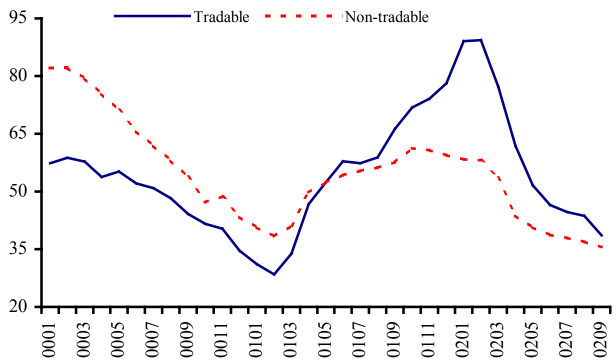
I.1. Developments in Consumer Prices

Affected by the developments in exchange rates, prices of durable goods increased in July and prices of services recorded high rates of increase in August, which in return resulted in a slow-down in the downward trend in CPI inflation in the third quarter. However, the risk of not achieving the year-end inflation target was eliminated when it was revealed by the September inflation rate that there had been no increase beyond seasonal factors in food prices. As a result, CPI inflation, which was 20.1 percent at the end of the first three quarters, remained below the program projections for the first nine months of the year.

Developments in the Prices of Tradables and Non-Tradables:

The course of food and clothing sector prices in July and August had a positive impact on the prices of tradables, however, exchange rate appreciation, which boosted prices of durable goods, had an adverse effect on inflation. In the same period, increase in the prices of non-tradables became more apparent due to seasonal factors. Seasonal increases in food and clothing in September exerted an upward pressure on tradable goods. In January-September period, prices of tradables and non-tradables increased by 17.7 percent and 22.6 percent, respectively (Figure I.1.1).

Figure I.1.1. CPI Tradable and Nom-tradable; 1994=100 (Annual Percentage Change)

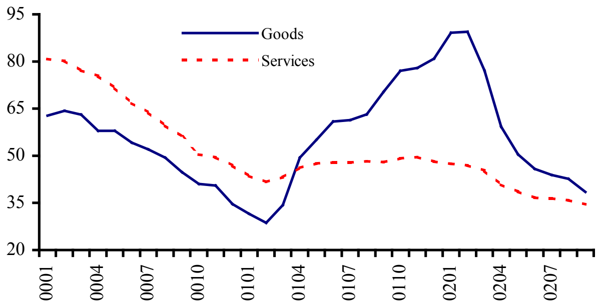


Source:SIS

Developments in the Prices of Goods and Services:

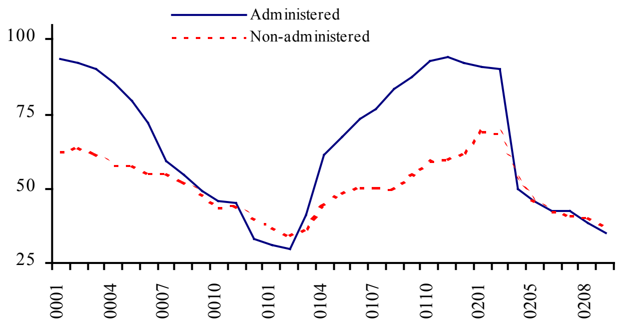
Prices of goods and services increased by 10.1 percent and 5.8 percent, respectively, in July-September 2002 period. The prices of goods were positively affected by price developments in food and clothing sectors in the third quarter of the year. However, seasonal price increases in educational and hospital services, increase in transportation prices due to rise in fuel prices and adjustments made in the prices of telecommunication services generated significant increases in the prices of services. To sum up, when cumulative increases in January-September period are compared, it is observed that prices of services increased by 23.9 percent while those of goods increased only by 18.2 percent

Figure I.1.2. CPI Goods and Services Prices; 1994=100 (Annual Percentage Change)



Source:SIS, CBRT

Figure I.1.3 CPI Administered and Non-Administered Prices; 1994=100 (Annual Percentage Change)



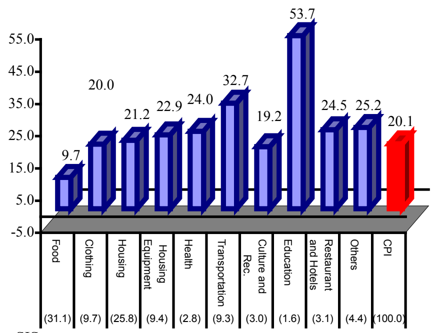
Source: SIS, CBRT

The rise in the prices of administrated goods in the third quarter has not reached a level to jeopardize the year-end inflation target.

Developments in the Prices of Administered and Non-administered Goods:

Increase in the prices of oil products and other administered goods became more significant in the third quarter of the year. Delay in certain price adjustments in the first quarter and the goal of attaining public revenue targets have been the casual factors of this development. The prices of administered goods, which increased by 13.3 percent in the first quarter, rose by 23.7 percent in January-September period. Compared with the first quarter, prices of oil sub-item of CPI increased by 1.3 percent and reached 9.9 percent in the third quarter. The delayed price adjustments in goods other than oil products, which were supposed to be made in the first quarter, were almost completed in June-August period and prices started to slow-down in September again. Meanwhile, prices of non-administered goods increased by 18.7 percent in January-September 2002 period. Despite the significant difference, the rise in administered prices has not reached a level to jeopardize the inflation target (Figure I.1.3).

Figure I.1.4 CPI and Sub-items :1994=100 (Jan-Sep 2002 Period Percentage Change)



Source: SIS

Food Prices

Compared with the April-June period, the positive impact of food prices on inflation decreased in the third quarter (Figure I.1.6). However, food prices, which contained further increase in CPI in July and August, did not exhibit an increase beyond seasonal factors in September and became a casual factor of low inflation in July-September period. In January-September period, food prices increased by 8.7 percent, which is 11.4 percentage points below CPI (Table I.1.1).

Table I.1.1.CPI and Sub-items; 1994=100

	SEPTEMBER		JAN-SEP.		SEP-SEP	
	2001	2002	2001	2002	2001	2002
CPI	5,9	3,5	47.7	20,1	61.8	37,0
Food, Beverages, Tobacco	6,4	4,5	39.4	9,7	55.2	41,8
Food	7,3	5,2	36.3	8,7	52.6	42,4
Clothing and Shoes	12,8	5,0	39.1	20,0	60.1	42,6
Housing	5,0	3,5	46.6	21,2	62.6	32,0
Rent	3,7	3,3	27.7	21,5	41.8	32,9
Housing Equipment	4,5	2,9	59.1	22,9	70.1	33,4
Health	3,4	0,9	48.9	24,0	53.5	31,9
Transportation	6,2	1,8	68.5	32,7	74.6	39,8
Culture and Recreation.	7,2	1,6	54.6	19,2	72.8	24,7
Education	9,7	9,5	51.8	53,7	53.8	54,3
Restaurant and Hotels	1,2	2,2	33.4	24,5	41.7	36,5
Others.	2,3	1,5	61.9	25,2	74.8	40,2
Goods	7,2	4,0	54,5	18,2	70,4	47,9
Goods Exc. Food.	7,1	3,4	65,0	23,5	80,5	36,6
Services	3,6	2,6	36,5	23,9	38,4	34,5

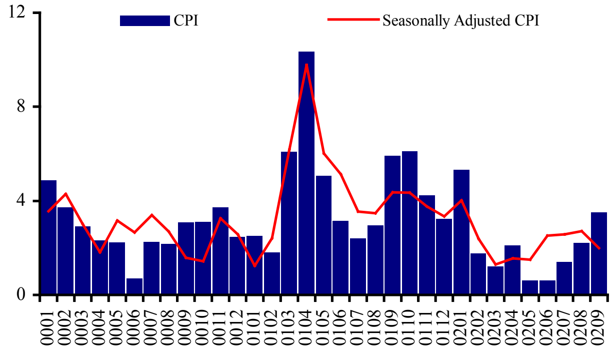
Source: SIS, CBRT

When prices in July-September period are analyzed, it is observed that, decrease in the prices of fresh fruits and vegetables continued in July and August, notwithstanding the slow-down. The prices of the mentioned products had dropped by 48.4 percent in March-August period. Following this slump, prices of fresh fruits and vegetables increased by 7.6 percent in September. As a result, food prices increased by 5.2 percent in September and annual inflation in food prices declined to 42.2 percent.

Prices of Durable Goods

The upward pressure on exchange rates in May-July period became a casual factor in the significant increase in the prices of durable goods in July. Increase in automobile prices was mainly due to increase in exports, and introduction of new models became another factor that affected prices of this group. As a result, prices of durable goods incremented only by 3.8 percent in the second quarter and by 9.8 percent in July-September period.

Figure I.1.5. CPI and Seasonally Adjusted CPI; 1994=100 (Monthly Percentage Change)

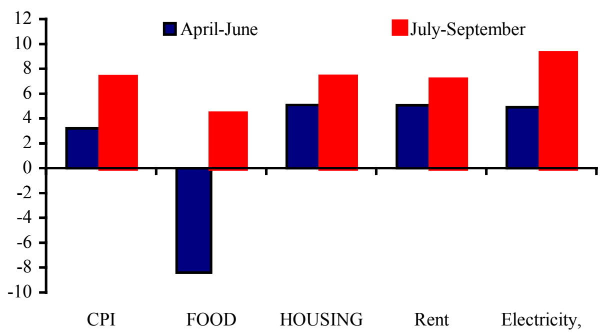


Source: SIS, CBRT

Housing Prices

House rents started to increase in August and September and an increase of 3.3 percent was recorded in September as the highest monthly increase of year 2002. Prices of heating, electricity and other expenses under housing group also increased. Parallel to the price increases in other public prices, State Economic Enterprises in energy sector made price adjustments in June-September period, which in return affected housing prices adversely. In January-September period, the price increase in housing sector became 21 percent, just 1.1 percentage points over the general CPI increase (Figure I.1.6).

Figure I.1.6. CPI, Food and Housing Groups, Cumulative Percentage Change; 1994=100



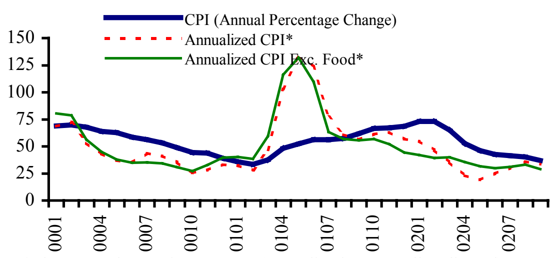
Source: SIS

When price increases in September as well as developments that may affect inflation in the forthcoming period are taken into account, it is predicted that the year-end consumer price inflation will remain down the targeted level. This prediction is supported by the 37 percent level reached for annual inflation in September and CBRT's expectations survey. Meanwhile, the uncertainty caused by the probability of a military operation in Iraq and the results of the polls are expected to affect inflation figures, however, it is stated that such factors are important for 2003 inflation not 2002.

When price increases in September as well as developments that may affect inflation in the forthcoming period are taken into account, it is predicted that the year-end consumer price inflation will remain down the targeted level.

The annual inflation trend, which is annualized from 3-month moving averages of seasonally adjusted CPI, returned to a downward trend in September after a rise in July and August. While annual CPI increased by 37.0 percent in September, seasonally adjusted annualized inflation in CPI became 33.0 percent and CPI excluding food became 28.9 percent (Figure I.1.7).

Figure I.1.7. Annual Inflation Trend CPI (Annual Percentage Change)

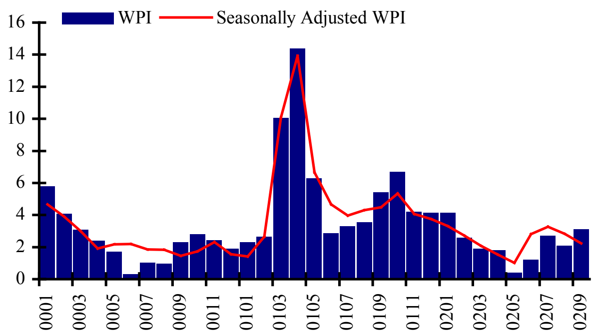


*Three months moving average (annualized, seasonally adjusted)

I.2 Developments in Wholesale Prices

In the third quarter of the year, annual WPI inflation slowed down due to the same reasons with those of CPI inflation. However, accelerated price adjustments in public sector in June-July and September and increase in interest rates and exchange rates at the beginning of the third quarter became more effective on WPI than CPI and thus, decrease in WPI slowed down more apparently than CPI (Figure I.2.4).

Figure I.2.1. WPI and Seasonally Adjusted WPI; 1994=100 (Monthly PercentageChange)

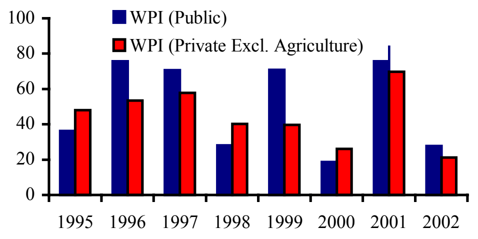


Source: SIS, CBRT

Public price adjustments in June and July coupled with the increase in exchange rates and interest rates slowed down the downward trend of WPI inflation.

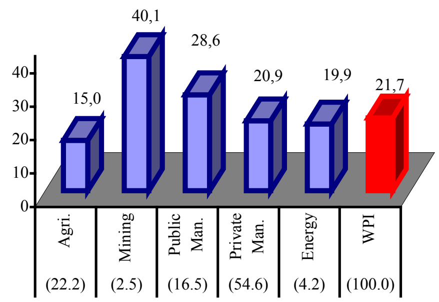
An analysis of the breakdown of WPI increase by public and private sectors shows that increase in public sector prices, which started an upward trend in March, has surpassed that of private sector prices in monthly terms in July-September period. Although decrease in agriculture prices contained further increase in private sector prices in the mentioned period, it is observed that the same trend held good for the private sector prices even when the agriculture prices covered entirely by the private sector were left out. While public prices increased by 27 percent in January-September period, increase in private sector prices excluding agriculture became 21.2 percent. A comparison of public sector prices in 1995-2002 period shows that public prices recorded the lowest increase in January-September 2002 period excluding only year 2000 (Figure 1.2.2).

Figure I.2.2.January-September Period WPI Public and Private Excluding Agriculture Prices (Percentage Change)



Source: SIS

Figure I.2.3.WPI and Sub- items; 1994=100 (January-September 2002 Period Percentage Change)



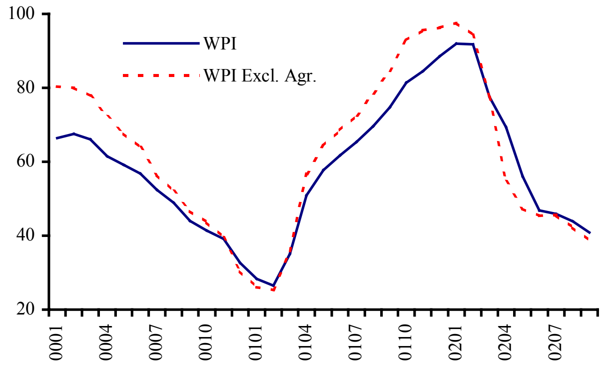
Source: SIS

Agriculture Sector Prices

Following a downward trend in May, June and July, agricultural prices started to increase in August and September, however, this increase remained below the seasonal averages. Although the rate of increase in agricultural prices was 4.0 percent in September, the seasonally adjusted increase stayed only at 2.1 percent. Agricultural prices, which increased by 15 percent in January-September 2002 period, is the sub-item of WPI that increased the least (Figure I.2.3). The agricultural prices are not expected to disturb the downward trend of WPI inflation in the rest of the year.

The downward trend in WPI inflation excluding agriculture, which started in last November, continued in July-September period though slowed down relatively (Figure I.2.4). In January-September period, rate of increase in WPI excluding agriculture became 23.5 percent, well above the 15 percent increase in agricultural prices.

Figure I.2.4. WPI and WPI Excluding Agriculture: 1994=100 (Annual Percentage Change)



Source: SIS, CBRT

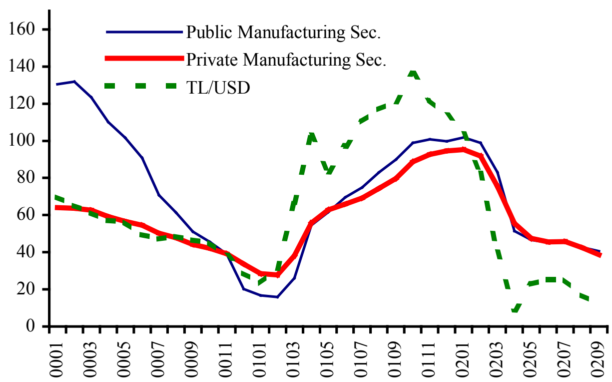
Agricultural prices, which increased by 15 percent in January-September 2002 period, is the sub-item of WPI that increased the least.

Manufacturing Sector Prices

The manufacturing sector prices, which make up 71.1 percent of WPI, is the group that is most severely affected by the exchange rates and developments in expectations. Due to increase in exchange rates and interest rates as well public sector price adjustments at the beginning of the third quarter, the downward trend observed in manufacturing sector prices since the turn of the year was interrupted in July. However, with the relative restoration of stability in Turkish lira as well as in foreign exchange markets, the rate of increase in manufacturing sector prices continued its downward trend in August and September though decelerated compared with the period before July (Figure I.2.5). The 23.2 percent increase in total manufacturing sector prices in January-September period surpassed the WPI increase of 21.7 percent.

With the relative restoration of stability in Turkish lira as well as in foreign exchange markets, the rate of increase in manufacturing sector prices continued its downward trend in August and September though decelerated compared with the period before July.

Figure I.2.5. Exchange Rate, Public and Private Manufacturing Industry Prices; 1994=100 (Annual Percentage Change)



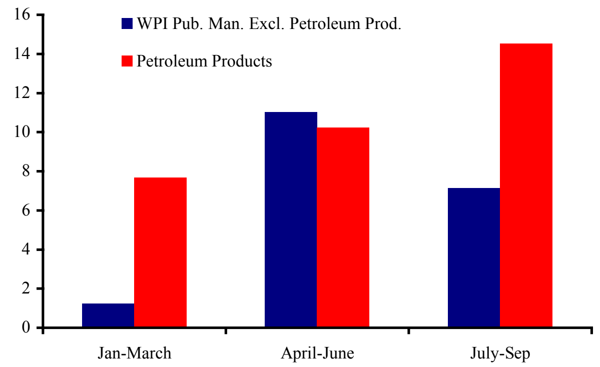
Source: SIS, CBRT

When price increases in private manufacturing sector sub-items in January-September period are analyzed, it is observed that the highest rates of increase belong to clothing, basic metal and leather products sectors. In January-September period, rates of increase in machinery and equipment manufacturing, refined petroleum products and metal goods sector, which are sensitive to changes in exchange rates, exceeded the total rate of increase in private manufacturing sector with a partial effect of the rise in oil prices. With the positive developments in agricultural sector prices, increase in the prices of food and beverages sector, which have the largest share in private manufacturing sector, remained limited in January-September period with an increase of 14.8 percent.

As was the case in April-June period, public manufacturing sector prices, which constitute 17.2 percent of the total manufacturing sector, again displayed an increase exceeding the private manufacturing sector price increases in July-September period. While the rate of increase in public manufacturing sector prices was 10.6 percent in April-June period, it became 11.1 percent in July-September period. In the mentioned periods, increases in private manufacturing sector were 6.2 percent and 9.3 percent, respectively.

Instigated by the rise in crude oil prices, the prices in petroleum products sector, which has the largest share in public manufacturing sector, increased making a negative impact on public manufacturing prices (Figure I.2.6). When petroleum products are left aside, it is observed that price increase in public manufacturing sector in July-September period has been less than that of April-June period. The rate of increase in public manufacturing sector, which was 1.3 percent in January-March period, climbed up to 11 percent in April-June period and dropped back to 7.2 percent in July-September period.

Figure I.2.6. 2002 Prices of Petroleum Products and WPI Public Manufacturing Excluding Petroleum Products; (Percentage Change)



Source: SIS, CBRT.

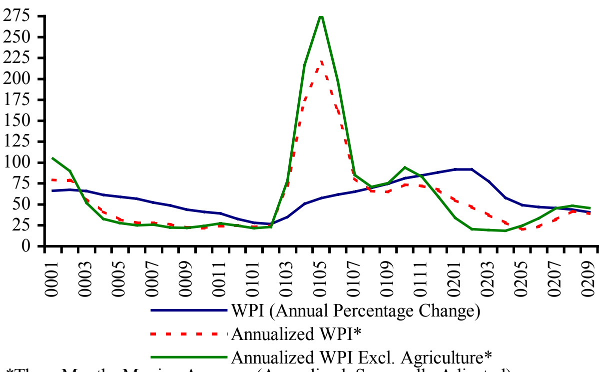
Energy Prices

In January-September period, increase in energy prices realized as 19.9 percent, remaining below the 21.7 percent increase in WPI. As was the case in April-June period, rate of increase in energy prices was below the averages of the past years. In January-September period, electricity and gas prices increased by 15.7 percent while that of water increased by 44.1 percent.

To sum up, despite a certain slow-down, the downward trend in TEFE continued in the third quarter of 2002. With the effect of positive developments in agricultural production, agricultural prices contributed to the downward trend in WPI inflation in July-September period. Relative stability in financial markets in August and September helped to contain further increase in manufacturing sector prices, which in return supported the downward trend in WPI as well.

Similar to the case in CPI, the upward trend in annual WPI inflation (seasonally adjusted, annualized three-month moving averages) that started in June reversed in September. The seasonally adjusted and annualized WPI inflation dropped down to 38.9 percent in September. Meanwhile, WPI inflation excluding agriculture came down to 45.8 percent in September (Figure I.2.7).

Figure I.2.7. Annual Inflation Trend, WPI (Annual Percentage Change)



*Three Months Moving Average (Annualized, Seasonally Adjusted)
Source: SIS, CBRT

I.3.Inflation Expectations

Analyzing the expectations for fundamental macroeconomic variables is of crucial importance to monetary policy decisions. CBRT makes use of three surveys in order to analyze inflation expectations. These surveys contain expectations for rates of increase in several price indices of representatives from financial and real sectors. Not only the expectations for inflation, but also expectations for some financial and real indicators are monitored through these surveys.

In June and July, expected inflation rate increased due to persistent uncertainties since May 2000. After relative stability was maintained in financial markets, inflation expectations started to decrease in August again.

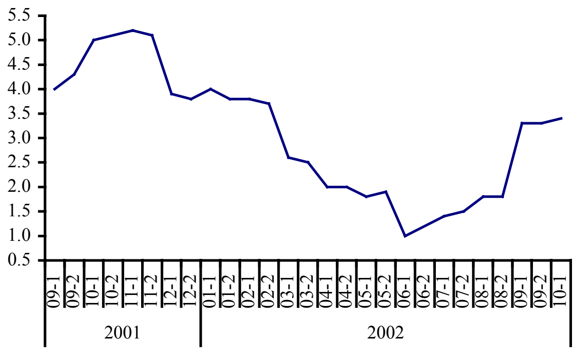
Expectations for Consumer Prices

The CBRT Expectations Survey is used to analyze the expectations for CPI inflation. The survey, which was first conducted on August 3, 2001, contains the expectations and forecasts of real and financial sector representatives for inflation and other macroeconomic variables. The expectations data are compiled by the State Institute for Statistics (SIS) twice a month, once in the first and once in the third week of each month, following the announcement of inflation figures. The participants are requested to state their one-month, two-month, twelve-month and year-end CPI inflation expectations. The survey is very important for inflation expectations analysis as it is conducted twice a month and the results are quantitative. The number of participants in the CBRT Expectations Survey in the first period of October was 75; 70 percent of which were from finance sector and 30 percent were from the real sector.

As uncertainties increased in the middle of the second quarter of 2002, expectations for CPI inflation for the next 12 months followed a flat course. Following the announcement of the election date and adoption of harmonization laws with European acquis, a relative stability was attained and expected inflation rate started to decrease again (Figure I.3.3). A similar tendency was observed for expectations for year-end inflation too. Inflation realizations until September had indicated a strong possibility that the year-end inflation target would be attained and owing to this development, expected year-end inflation came down even under 35 percent level (Figure I.3.2).

When the inflation expectations for the current month are analyzed, some deviations are observed depending on the seasonal factors of the related month. The survey averages are generally lower than those of the previous years' averages. According to the results of the survey conducted in the first period of October, CPI is expected to increase by 3.4 percent (Figure I.3.1).

Figure I.3.1. CPI Inflation Expectation for the Current Month (Monthly, Percent)

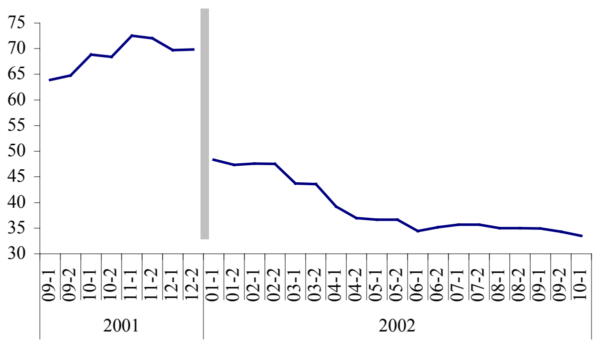


Source: CBRT Expectations Survey

In the third quarter of 2002, expectations for the year-end CPI inflation leveled off at the targeted inflation rate. According to the survey conducted in the first period of October, the average expectation for inflation was below 35 percent, which is the year-end CPI inflation target (Figure I.3.2).

The CBRT Expectations Survey in September and October show that the expectations for year-end inflation have stayed below the targeted level.

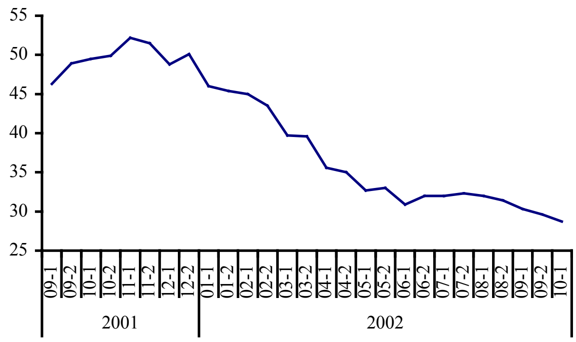
Figure I.3.2. Expectations for the Year-end CPI Inflation (Percent)



Source: CBRT Expectation

The average expected rate of increase for CPI inflation in the next 12 months continued its downward trend following a flat course in June and July (Figure I.3.3). The fact that the average of the expected rate of increase in CPI for the next 12 months is lower than the average of expected rate of year-end inflation indicates survey participants' firm belief that the downward trend will persist.

Figure I.3.3. CPI Inflation Rate Expectations For The Next 12 Months (Percent)



Source: CBRT Expectations Survey

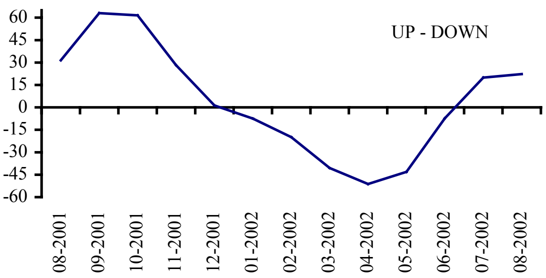
The expected rates of inflation for the next 12 months revealed by expectations survey conducted in the second half of September and first half of October were 29.6 percent and 28.7 percent, respectively.

Expectations for Wholesale Prices

The CBRT Business Tendency Survey is used to analyze the expectations for WPI inflation. The survey, in which public sector and private sector companies participate, was first conducted in 1987. In 1997, a question related with the expectations for WPI inflation for the next three months was annexed to the questionnaire. The answers of the participants from the private sector are taken into account in the analysis. In August 2002, 476 private sector companies participated in the survey.

When the quantitative inflation expectations for the next three months from the Business Tendency Survey are analyzed, it is observed that the up-down difference increased in periods when uncertainties increased, and followed a flat course when exchange rate assumed a more stable position (Figure I.3.4). Expectations for WPI inflation are forecasted to decrease in the forthcoming period.

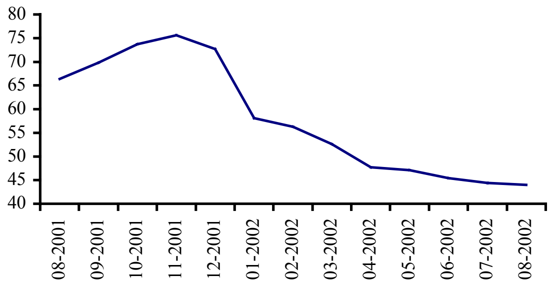
Figure I.3.4. Next 3-Month WPI Inflation Expectations (Percent)



Source: CBRT Business Tendency Survey

According to the survey results, the downward trend, which started in the last few months of 2001 continue in expectations for year-end WPI inflation and WPI in the next 12 months (Figure I.3.5. Figure I.3.6). However, the result of the survey conducted in August show that the downward trend in expectations for the end-year WPI inflation and for WPI inflation in the next 12 months has weakened. Expectations for year-end wholesale prices, revealed by the August survey, is 44.0 percent, which is well above the expected year-end WPI inflation of 31 percent.

Figure I.3.5. Year-end Expected WPI Inflation (Percent)

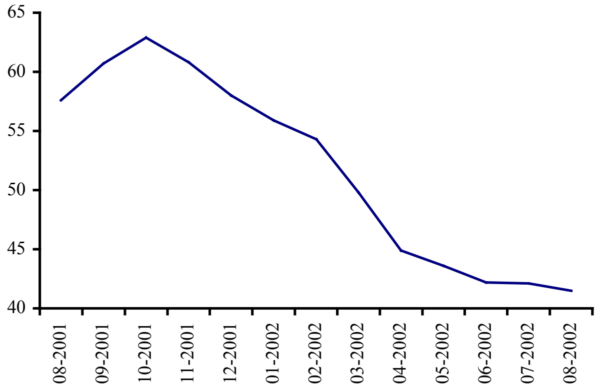


Source: CBRT Business Tendency Survey

Retaining the downward trend, year-end average WPI inflation still exceeds the expected year-end WPI inflation.

The expected year-end WPI inflation for the next 12 months, which was 42.1 in the July survey, decreased to reach 41.5 percent in August.

Figure I.3.6. Next 12-Month WPI Inflation Expectations (Percent)



Source: CBRT Business Tendency Survey

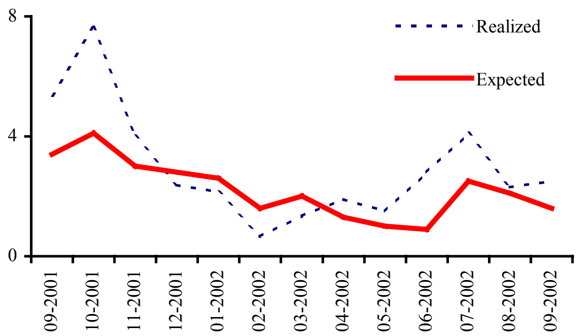
Expectations for Manufacturing Sector Prices

The expectations for manufacturing sector prices inflation are assessed through the Monthly Manufacturing Sector Tendency Survey of SIS. The survey, which is prepared in order to provide the public with most up-to-date information within the shortest time possible, reflects the expectations of firms representing 70 percent of the total manufacturing sector for production, sales and sales prices.

According to the results of the said survey, expectations for manufacturing sector sale prices have continued the downward trend in the third quarter of 2002 except for July. Following acceleration of public price adjustments and depreciation of Turkish lira in May-June period, expectations for manufacturing sector prices increased in July. In the following term, the expected level of manufacturing prices decreased due to relative recovery in the exchange rate and deceleration in public price adjustments.

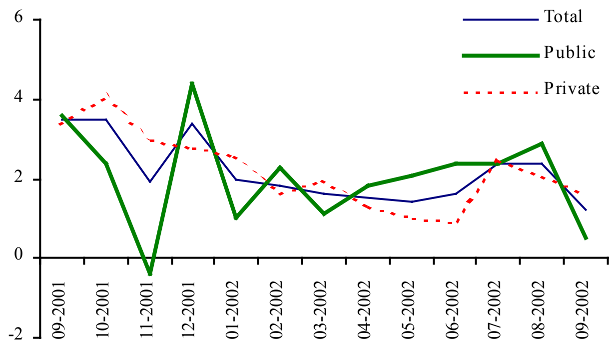
The October results of the survey revealed that expected increase in manufacturing sector prices, public sector prices and private sector prices were 1.2 percent, 0.5 and 1.6 percent, respectively. In the same month, overall inflation became 2.8 while prices in public sector and private sector were 3.4 percent and 2.5 percent and these figures are obviously well above the expected levels. (Figure I.3.7).

Figure I.3.7. Realizations and Expectations for the Private Sector Manufacturing Industry Prices (Monthly, Percentage Change)



Source: SIS Monthly Manufacturing Sector Tendency Survey

Figure I.3.8. Expectations for Industrial Sector Prices (Monthly, Percentage Change)



Source : SIS Monthly Manufacturing Sector Tendency Survey

Consequently, an analysis of the three surveys regarding inflation expectations reveal that:

i) Parallel to the downward trend in inflation, the expectations for inflation in the third quarter decreased. In periods when uncertainties increased, deviations from the short-term expectations have not gained a permanent state thanks to the relative restoration of stability.

The downward trend in inflation expectations continued in January-September 2002 period.

ii) According to the most up-to-date results of the CBRT Expectations Survey, the expected year-end inflation rate is below the year-end inflation target of 35 percent. This supports the possibility that year-end inflation will remain below the targeted level.

Despite the promising course of inflation and decrease in expected inflation rate in July-September period, there still exist certain risks to the future inflation. These risks can be grouped in two main points:

i) The uncertainty generated by the possibility of a military operation in Iraq is likely to push up the oil and natural gas prices in international markets. As the energy prices are adjusted according to crude oil prices, such a development is likely to pose a risk to inflation.

ii) The private sector expenditures and certain public adjustments that were delayed during the election process will probably be made in the aftermath of the elections, which is another factor that poses risk to inflation.

II. MONETARY AND EXCHANGE RATE POLICY

II.1. General Framework of the Monetary and Exchange Rate Policy

The monetary policy, which was launched at the beginning of year 2002, with Base Money as the nominal anchor and the interests as monetary policy instruments under floating exchange regime, has been pursued in this period too. In the said period, the CBRT has carried on with its implementations intended for attaining its final goal of price stability and enhancing financial stability in accordance with this goal.

Within this framework, the Late Liquidity Window facility and the repo transaction intended for providing the banks under Re-capitalization Program with liquidity through repo transactions have been maintained. Meanwhile, activities launched in order to establish forward exchange rate markets have been sustained and the Turkish Banks Association introduced the TRLIBOR on August 1, 2002.

Progress has been made in CBRT's efforts to abandon the intermediary function in Interbank Money Market and Foreign Exchange and Banknotes market. With this withdrawal, CBRT intends to enhance the dept of the exchange market, to establish pricing mechanisms that will reflect the risk perceptions in a proper way and to avoid misleading signals regarding monetary and exchange rate policies through preventing the transactions in these markets from being perceived as CBRT-oriented transactions.

Within this framework, borrowing by the banks from other banks through CBRT's intermediation in the Foreign Exchnage Depo Markets started to be phased out as of July 1, 2002 and the practice will have been entirely abandoned by December 2, 2002. On September 2, 2002, transactions made by institutions that are entitled to make transactions in the Foreign Exchange Buying-Selling Market against Turkish lira with other institutions through CBRT's intermediation were terminated.

Taking into account the possible contribution to the deepening of financial markets, the CBRT started to support the Primary Dealership system initiated by the Treasury on September 2, 2002 and started to provide the primary dealer banks with Turkish lira liquidity within the framework of open market operations (Box II.1.1).

In compliance with its final objective of attaining price stability and departing from its future inflation predictions, the CBRT cut down the short-term interest rates in the July-September 2002 period. Thus, overnight borrowing interest rate, which was 48 percent, came down to 46 percent and overnight lending interest rate, which was 55 percent, declined to 53 percent by August 5, 2002. Meanwhile, the weekly borrowing rate dropped down to 46 percent from 49 percent. Within the framework of the Late Liquidity Window facility, lending interest rate at the Interbank Money Market declined from 65 percent to 53 percent while borrowing interest rate, which was 5 percent, was left intact.

The Turkish Lira Depo Purchase Auctions with a standard maturity of 4 weeks, which was launched on April 1, 2002 in order to enhance CBRT's effectiveness in sterilizing the excess Turkish lira liquidity, have been maintained. However, the foreign exchange purchase auctions, which were interrupted on July- 1, 2002, have not been held in this period too.

In the Letter of Intent dated January 18, 2002, indicative targets were set for the second half of the year for Base Money, Net Domestic Assets and Net International Reserves components of CBRT balance sheet. In the Letter of Intent dated July 30, 2002 the indicative targets for Base Money and Net International Reserves were converted to performance criterion and targets for Net Domestic Assets were revised. The targets specified for September 30, 2002 have been met (Table II.1.1 and Table II.1.2).

BOX: II.1.1. PRINCIPLES ON PRIMARY DEALERSHIP SYSTEM

The primary aim of public debt management is to meet the need for borrowing via the most feasible borrowing instrument with the most favorable maturity at minimum cost; in other words to ensure effectiveness in the public debt management. A deep and liquid primary and secondary government securities market is the prerequisite for attaining this goal. It is quite hard to attain this goal for those countries that have shallow and illiquid financial markets. However, there are various methods to deepen and develop these markets. One of the most effective ones among these methods is the Primary Dealership (PD) system.

In PD system, the Treasury borrows from the domestic financial markets through banks that are selected according to pre-set criteria In this system, the Treasury, which is in charge of borrowing management, holds borrowing auctions in which only these primary dealer banks can participate. The aim of the PD system is to ensure effectiveness and stability of public borrowing in the primary market as well as to provide sustainability in liquidity by enhancing the depht of the market. Moreover, the borrowing instruments required or demanded by the markets are mostly specified by the banks in PD system, which means they assume the task of a mediator who establishes communication between the Treasury and the government securities through ensuring diversity in borrowing instruments

The Primary Dealership system was introduced by the Treasury in May 2000, however the system became actually defunct in November due to outbreak of crisis and was legally terminated in May 2001 as the terms of the primary dealership contracts signed with the banks expired. The Treasury started efforts to reactivate the primary dealership program at the turn of year 2001 and the program was launched on September 2002 again.

The banks within the system are given certain privileges and responsibilities with the aim of enhancing the effectiveness of public debt management, ensuring stability in public borrowing, deepening the primary market for government securities and developing the financial system. These privileges and responsibilities have been announced for the information of the public. Within the framework of these responsibilities, the primary dealer banks are obliged to participate and bid in the primary market auctions in order to attain stability in borrowing policy. Accordingly, the primary dealer banks are to buy at least 5 percent of the total government securities issued by the Treasury for every three months with minimum 3 percent for every month. The mentioned minimum amount does not include the noncompetitive bids, sales after the auctions and three-month reference bill auctions. When it is taken account that the amount of 3-month reference bill auctions constitute 15 percent of the total issue and the number of primary dealer banks is 10, it is observed that the primary dealer banks will undertake most of the borrowing.

The banks are also obliged to provide buying-selling quotations with a minimum value of 3 quadrillion Turkish liras for benchmark securities in ISE Bills and Bonds Market. Another borrowing policy method used for deepening and enhancing the effectiveness of the secondary market is the repurchasing auctions. Within this framework, the banks in the system can participate in the repurchase auctions with government securities in their portfolio with shorter maturities than those in the auction. 5 percent of the securities sold at the auction can be repurchased at a given auction. Thus, the Treasury does not only extend the maturity of issue volume but it also contributes to the deepening and liquidity of the market.

Along with responsibilities, the banks have also privileges. The banks can participate in the auctions at primary government security market without collateral, can submit non-competitive post-auction bids and can assume intermediary role in offer for sale through TAP sales. In secondary market, these banks can be counterparts to lending-borrowing transactions in the Government securities Borrowing Transactions Market established by the CBRT. Other banks, however, can only act as lenders. Moreover, the commission levied from the transactions carried out by the PD banks in the ISE Bills and Bonds Market will be discounted. The mentioned privileges will all help to decrease the borrowing costs.

The primary dealers are endowed with certain rights in the money markets as well. Within this framework, with the aim of attaining its primary objective of price stability and establishing financial stability required for an effective implementation of policies intended for attaining this aim, the CBRT has started to support the primary dealership program and introduced the Turkish lira liquidity facility for the PD banks within the framework of the open market operations.

Within the framework of the arrangements regarding auctions which are to be held by the Treasury and in which the CBRT will in no way be a party, on July 22, 2002 the CBRT started to provide the PD banks with liquidity not to exceed 10 percent of the total value of securities they have purchased/will purchase or securities not redeemed. The PD banks will either use this liquidity for repo transactions to be carried out by quotation method, or use at most half of this liquidity to sell their Turkish lira denominated government securities - that are deemed benchmark securitie-, to the CBRT.

Quotation method will be used in repo transactions to be carried out with the PD banks and the interest rates will be determined by the CBRT. The interest rates will be calculated by adding some extra points to CBRT's borrowing interest rates, however the rate will not exceed the average of CBRT's Turkish lira borrowing/lending allocations. The repo transactions to be carried out with the PD banks will either be overnight or will have one-week maturity. Interest rates on both repo transactions will be 49 percent as of September 3. The PD banks will carry out repo transactions between 10:00 am-16:00 pm.

Auction method will be used in the benchmark government securities buying transactions that the CBRT will carry out with the PD banks in order to ensure that the interest rates reflect the market conditions. In line with the implementation in question, the banks, which need liquidity, will inform the CBRT of their intention. The CBRT, then, will negotiate with other PD banks and decide on the state security/securities for which direct purchasing auctions will be held; however, taking into account the market conditions, CBRT can carry out the purchases through quotation method as well. Thedaily amount of government securities to be purchased shall not exceed 20 percent of the securities selling facility, which equals the half of 10 percent liquidity facility provided for the PD banks.

Consequently, the PD system, which was initiated on September 2, 2002, aims at enhancing the effectiveness of public debt management, establishing stability in public borrowing, deepening of secondary market of government securities and developing the financial system. Meanwhile, at the Treasury's request, the PD banks will prepare reports detailing transactions and their portfolio and reports pertaining to the general economy and financial markets. Thus, the Treasury will be able to monitor the PD banks' portfolio, and communication between the Treasury and the security market will be facilitated which will help to enhance the effectiveness of the borrowing policy.

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2 Eylül 2002 Basın Duyurusu, Press Release dated September 2, 2002 at www.tcmb.gov.tr

Table II.1.1. Performance Criteria and Indicative Targets for Base Money and Net Domestic Assets (TL, Trillion)

	Base Money		Net Domestic Assets	
	Ceiling (1)	**Realization**	**Ceiling (1)**	**Realization**
February 28, 2002(2)	8.250(P)	7.823	26.100(G)	24.318
March 31, 2002	-	8.207	-	25.259
April 30, 2002	8.900(P)	8.680	27.700(G)	25.197
June 30, 2002	9.089(P)(3)	9,009	28.739(G)(3)	26.374
September 30, 2002	10.600(P)	10.104	31.139(G)	28.551
December 31, 2002	10.850(P)		33.139(G)	

((1) The ceilings are calculated based on the averages of the values at the aforementioned dates and the values at the following 5-working day period.
(2) Taking into account of the holiday effect on the cash demand, the performance criterion on February 28, 2002 was calculated based on the averages of the values on February, 11-12 and March, 11-12.
(3) Due to the transfer of Pamukbank to SDIF, the abovementioned bank was held exempt from holding TL 161 trillion worth of Turkish lira required reserves. Therefore, the ceilings for end-of June that were determined on the Letter of Intent dated January 18, 2002 as TL 9,250 trillion and TL 28,900 trillion for Base Money and Net Domestic Assets were updated to TL 9,089 trillion and TL 28,739 trillion, respectively.
(P): Performance criterion, (I): Indicative target

Table II.1.2. Performance Criteria and Indicative Targets for International Reserves (Us dollars, Million)

	Floor	**Realization**
February 28, 2002	-6.500	-4.907
March 31, 2002	-	-5.292
April 30, 2002	-7.200	-4.926
June 30, 2002	-7.800	-5.755
September 30, 2002	-8.500	-5.889
December 31, 2002	-9.700	

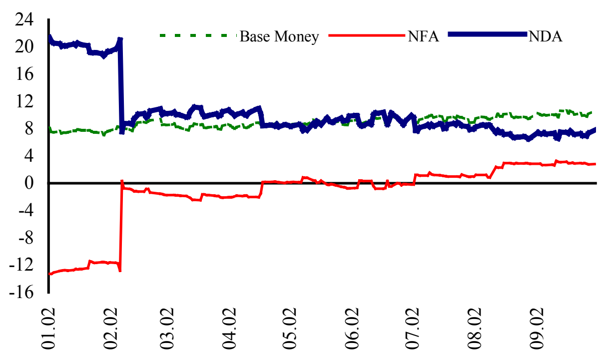
II.2. Developments in Central Bank Balance Sheet

In July-September period, the daily movements in the Base Money item, which constitutes the liabilities side of the CBRT balance sheet, were mainly determined by the seasonal features of the Currency Issued sub-item. However, the new regulations regarding required reserves and liquidity ratios that became effective with the tables dated May 10, 2002 have markedly increased the impact of free deposit movements on Base Money in the mentioned period. As of June, when the outcomes of the new implementation started to show up, volatility of Base Money component diverged significantly from the previous months. The average level of Base Money have increased upon the revival in economic activity in the mentioned period.

Table II.2.1. CBRT Balance Sheet Items

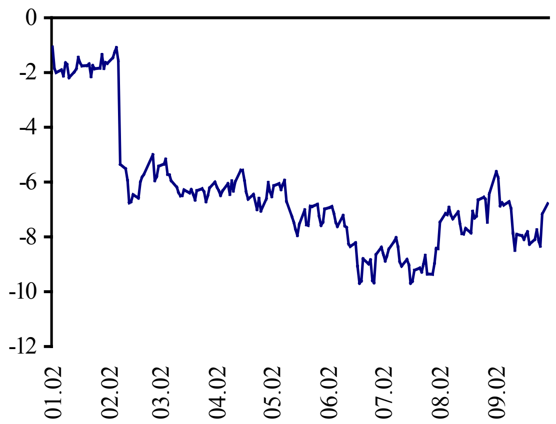
	28/06 2002 CONSTANT	**30/09 2002 CONSTAN**	**30/09 2002 CURRENT**
I- BASE MONEY (a+b+c)	**9029**	**10632**	**10632**
a-Currency Issued	**6592**	**6938**	**6938**
b. TL Required Reserves	**1389**	**1585**	**1585**
c. Free Deposits	**1048**	**2109**	**2109**
II-NET FOREIGN ASSETS(A+B+C)	**-151**	**2834**	**2310**
A-Net International Reserves (1+2+3)	**9041**	**12838**	**15489**
1-Gross Foreign Reserves	**31346**	**35350**	**42367**
2-Gross International Reserve Liabilities	**-22305**	**-22513**	**-26878**
- FX Deposits of Banking Sector	**-9278**	**-9051**	**-10601**
- IMF	**-10962**	**-10962**	**-13185**
3-Net Forward Position	**0**	**0**	**0**
B- Medium Term FX Credits (net)	**2030**	**2013**	**2304**
C-Other	**-11222**	**-12017**	**-15483**
III-NET DOMESTIC ASSETS	**9180**	**7799**	**8323**
Treasury Debt	**27904**	**28151**	**29762**
a-CBRT's Portfolio	**28165**	**28325**	**29938**
aa.Gov. Dom. Debt Inst. prior to Nov. 5,2001	**28142**	**28325**	**29938**
ab.Gov. Dom. Debt Inst. purchased from the seconday market	**23**	**0**	**0**
b-Other	**-261**	**-175**	**-175**
Public Sector Deposits (TL)	**-1043**	**-1286**	**-1286**
FX Deposits of Non-bank Sector	**-2905**	**-6016**	**-7050**
Open Market Operations (net)	**-8655**	**-6779**	**-6779**
NDA (1)	**9180**	**7799**	
Treasury Liabilities to the IMF (2)	**15456**	**18591**	
Treasury FX denominated borrowing with an original maturity of less than 1 year (3)	**1871**	**2725**	
NET DOMESTIC ASSETS (Prog.def) (1+2+3)	**26507**	**29115**	

Figure II.2.1. Base Money, NDA and NFA (TL, quadrillion)



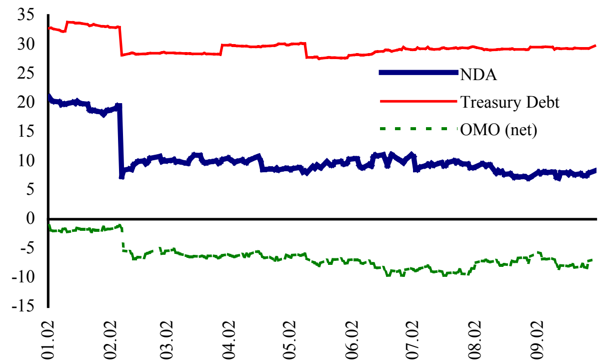
The developments in the Net Domestic Assets item, which is one of the two main items on the assets side corresponding to the Base Money item under liabilities side of the CBRT balance sheet as per Stand-by definitions, were determined by the developments in the Deposits of the Public Sector, FX Deposits and Open Market Operations (net) items.

Figure II.2.2 Open market Operations (Net-Quadrillion TL)



(-) values indicate liquidity withdrawal from the market.

Figure II.2.3. NDA and its Important Sub-items (Quadrillion TL)



It is observed that Open Market Operations (net) account, through which the CBRT's at Open Market Operations and forward transactions at the Interbank Money Market are followed, have traced a parallel course with Public Sector Deposits (TL). CBRT is still carrying out reverse repo transactions within the framework of the Open Market Operations and buying transactions at the Interbank Money Market in order to mop up the excess liquidity generated by the Banking Operation of 2001. Another important variable used in mopping up the excess liquidity in the market is the domestic borrowing of the Treasury.

From July, when an increase was observed in the Treasury's Turkish lira deposits with the CBRT, until the beginning of September, the amount of liquidity absorbed by the CBRT decreased significantly. The amount of sterilized liquidity, which was approximately 9 quadrillion Turkish liras in July dropped down to 6 quadrillion Turkish liras at the beginning of September. In the rest of September, Open Market Operations (net) decelerated parallel to the increase in Public Sector Deposits (TL) and the amount of liquidity sterilized by the CBRT became 7 quadrillion Turkish liras.

As was the case in the previous months, in July-September period, the FX Deposits was, to a great extent, determined by the Treasury's borrowing strategy in terms of foreign currency, the loans received from the IMF and foreign debt payments. Within this framework, the IMF credit tranche amounting to 1.15 billion US dollars remitted to the Treasury accounts after the third review of the Stand-by agreement became the main source of increase in the FX deposits of the Treasury at the beginning of August. Consequently, the FX deposits which totaled 3.5 quadrillion Turkish liras in July increased in August and September and reached 6 quadrillion level.

The Net Foreign Assets under the assets side of the stand-by balance sheet which is traced through fixed cross rates, had turned to positive with the release of the credit tranche at the second review of the Stand-by agreement in April. In the consequent periods, the Net Foreign Assets which had occasionally assumed negative values due to the Treasury's payments in terms of foreign exchange, have remained positive since the beginning of July. In the same period, parallel to the increase in the Treasury's FX deposits monitored under Net Domestic Assets, Net Foreign Assets have increased as well. The foreign exchange purchase auctions held by the CBRT in concord with the floating exchange rate regime in the mentioned period have had no effect on the Net Foreign Assets since auctions were interrupted in July.

Table II.2.2. Contribution of Main Balance Sheet Items to Increase in Base Money

	Monthly Average (TL, trillion)			Contribution to Base Money Growth (Percentage)	
	2001 Dec.	2002 June	2002 Sept.	Dec. 2001-June 2002	June 2002-Sept. 2002
Base Money	**7.786**	**9.184**	**10.185**	**100**	**100**
Currency Issued	5.296	6.266	7.036	69	77
TL Required Reserves	1.554	1.468	1.528	-6	6
Free Deposits	936	1.450	1.621	37	17
NFA	**-12.274**	**-882**	**2.350**	**815**	**323**
NDA	**20.060**	**10.067**	**7.835**	**-715**	**-223**
· Treasury Debt	32.871	28.740	29.408	-295	67
· Public Sector Deposits (TL)	-532	-559	-1.061	-2	-51
· FX Deposits of Non-bank Sector	-4.031	-4.032	-7.191	-0.1	-316
· OMO (net)	-1.005	-8.311	-7.437	-522	87

II.3. Developments in Monetary Aggregates

Compared with the figures of June, the M1 and M2 monetary aggregates decreased by 0.7 and 2.3 percent in real terms in September. The currency in circulation as a sub-item of M1 money supply increased by 1.6 percent in real terms compared with figures of June and sight deposits, which is another sub-item, decreased by 2.7 percent (Table II.3.2). Time deposits as a sub-item of M2 money supply, meanwhile, decreased by 2.8 percent in real terms. Meanwhile, in September, M2X money supply increased by 0.3 percent in real terms compared with the figures of June.

Compared with the figures of June, the M1 and M2 money supplies decreased by 0.7 and 2.3 percent, in real terms, in September.

While TL deposits decreased by 2.8 percent in September compared with the figures of end-June, the TL value of FX deposits increased by 1.4 percent. The US dollar value of the FX deposits in the same period increased from 41.1 billion to 42.4 billion.

The share of FX deposits in M2X, which was 54.5 percent in end-June 2002, reached 55.4 percent in September. The fluctuations in financial markets that started at the beginning of May caused an increase not only in FX deposits in terms of US dollars but also in interest rates and exchange rates.

Table II.3.1. Monetary Aggregates)

	2001 SEP.	2001 DEC.	2002 JUN..	2002 JUL.	2002 AGU.	2002 SEP.
M1	10,452	11,073	12,871	12,549	13,384	13,707
Currency in Circulation	4,462	4,801	5,922	6,165	6,227	6,452
Sight Deposits	5,991	6,272	6,950	6,384	7,157	7,256
M2	42,291	46,986	53,345	54,211	54,098	56,883
Time Deposits	31,839	35,913	40,473	41,662	40,713	42,176
M2X	101,415	104,133	117,240	123,428	121,909	125,456
FX Deposits	59,123	57,147	63,896	69,217	67,811	69,526
M2XR	105,451	106,930	120,947	127,192	125,920	128,800
Repo	4,037	2,798	3,707	3,764	4,011	3,391
CPI (1994=100)	5,044	5,756	6,445	6,538	6,680	6,913
US Dollar	1,532,969	1,439,567	1,602,733	1,681,867	1,625,818	1,648,260

*CBRT "Weekly Press Bulletin", the provisional data were used for the last Friday of each month.

Table II.3.2. Monetary Aggregates Real Percentage Change

	ANNUAL			CUMULATIVE			COMPARED WITH JUNE		
	2002			2002			2002		
	JUL.	AGU.	SEP.	JUL.	AGU.	SEP.	JUL.	AGU.	SEP.
M1	-9.3	-14.9	-4.3	-0.2	4.1	3.1	-3.9	0.3	-0.7
Currency in Circulation	8.6	7.1	5.5	13.1	11.8	11.9	2.6	1.5	1.6
Sight Deposits	-21.7	-27.8	-11.6	-10.4	-1.7	-3.7	-9.4	-0.7	-2.7
M2	0.5	-5.7	-3.6	1.6	-0.8	-1.0	0.2	-2.2	-2.3
Time Deposits	3.9	-2.3	-3.3	2.1	-2.3	-2.2	1.5	-3.0	-2.8
M2X	1.3	-6.6	-9.8	4.4	0.9	0.3	3.8	0.3	-0.3
FX Deposits	2.0	-7.4	-14.2	6.6	2.2	1.3	6.8	2.4	1.4
M2XR	-3.5	-8.0	-10.9	4.7	1.5	0.3	3.7	0.4	-0.7
Repo	-62.6	-35.5	-38.7	18.5	23.5	0.9	0.1	4.4	-14.7

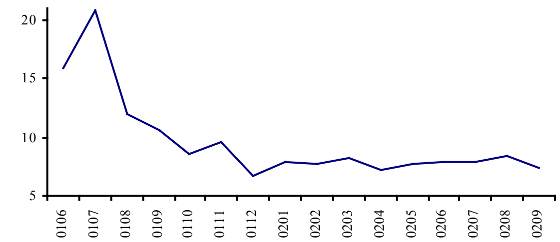
CBRT "Weekly Press Bulletin", the provisional data were used for the last Friday of each month.

As to developments in term structures of TL deposits, the share of sight TL deposits in total TL deposits has not changed compared with June 2002 and remained at 14.7 percent in September. Meanwhile, the repo transactions in proportion to TL deposits, which was 7.8 percent in end-June dropped down to 6.9 percent in September.

The share of FX deposits in M2X, which was 54.5 percent in end-June 2002, reached 55.4 percent in September.

M2XR monetary aggregate, which includes M2X money supply and the repo transactions between banks and clients, decreased by 0.7 percent in real terms compared with the end-June figures. The repo transactions which had started to decrease due to the reduction in the short-term finance requirements of the public and the intervened banks and increase in the withholding tax levied on repo transactions in August, started to increase as of May due to political uncertainties (Figure II.3.1).

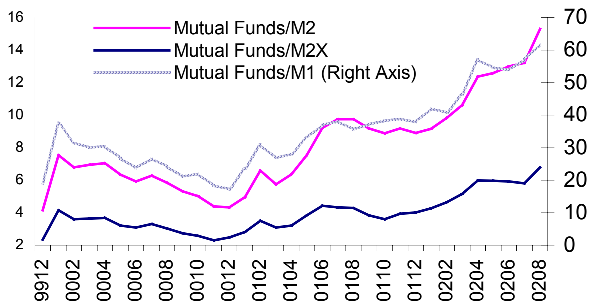
Figure II.3.1. Share of Repo Transactions in TL Deposits



* CBRT "Weekly Press Bulletin", the provisional data were used for the last Friday of each month.

It is observed that the economic agents have directed their savings overwhelmingly to mutual funds in recent years. Government securities constitute 97 percent of the mentioned funds. These investment instruments, which are quite similar to time deposits in terms of yield function, can be a substitute for M1 as they have high liquidity. Therefore, mutual fund developments affect the money supply developments. When the share of mutual funds in M2 money supply are analyzed, it is observed that this share is growing (Figure II.3.2). The share of mutual funds in M2, which was 13.0 percent in June 2002, reached 15.3 percent in August. The share of mutual funds in M2X monetary aggregate, which was 5.9 percent at the end of June reached 6.8 percent in August (Figure II.3.2)

Figure II.3.2. Share of Mutual Funds in M1, M2 and M2X Money Supplies (Percent)



II.4. Developments in Interest Rates

On April 30, 2002, the CBRT cut down the short-term interest rates taking into account the developments in inflation and inflation expectations and revised these rates again on August 5, 2002. With the last revision, overnight borrowing and lending interest rates were cut down by 2 percent and one-week borrowing interest rate by 3 percent (Table II.4.1).

Table II.4.1. CBRT Interest Rate Quotations (Simple, percentage)

	Feb. 20, 2002	March 14, 2002	April 8 2002	April 30 2002	August 5 2002
O/N-Borrowing	57	54	51	48	46
O/N-Lending	62	61	58	55	53
1-Week Borrowing	59	55	52	49	46
Late Liquidity Window Borrowing*	-	-	-	-	5
Late Liquidity Window Borrowing*	-	-	-	-	63

*As of June 1, 2002 the CBRT initiated the implementation of "late liquidity window" in the Interbank Money Market between 16:00-16:30 as a new TL liquidity facility from 1st July 2002. The interest rates within this facility were determined as 5 percent for borrowing and 65 percent for lending on June 1, 2002..

Despite the slow-down in annual inflation in May-June period, interest rates and exchange rates fluctuated and increased. Meanwhile, short-term inflation expectations have deteriorated slightly while the long-term expectations have not changed remarkably. In the period between the end of July and beginning of August, the laws intended for harmonization with EU acquis were adopted and the early election decision was announced, which together favored the market stance. In the mentioned period, decrease in interest rates on ISE Bonds and Bills Outright Purchases and Sales Market and in the Turkish lira Depo Purchase Auctions held by the CBRT was coupled with a slow-down in exchange rates. CBRT cut down short-term interest rates on August 5, 2002. The rationale behind this action were the temporary nature of increase in inflation, unchanged long-term expectations and relative ease of fluctuations in the markets.

On August 5, 2002, the CBRT cut down short-term interest rates parallel to its inflation forecasts considering the temporary nature of increases in inflation, stable long-term inflation expectations and relative ease in fluctuations in the markets.

Figure II.4.1 Interest Rates at 4-Week Turkish Lira Depo Purchase Auctions (Simple, Percentage)

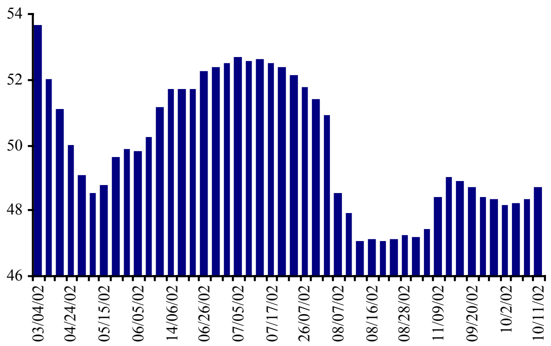


Figure II.4.2 Interest Rates at ISE Bonds and Bills Outright Purchases and Sales Markets (Weighted average, compound, percentage)

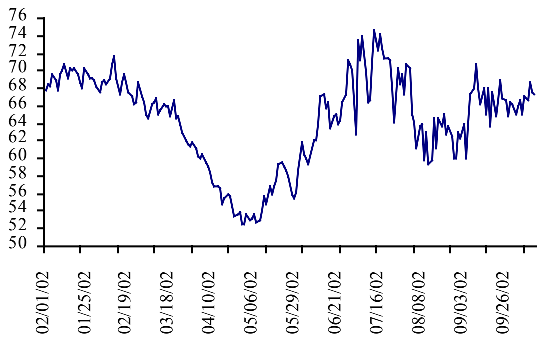
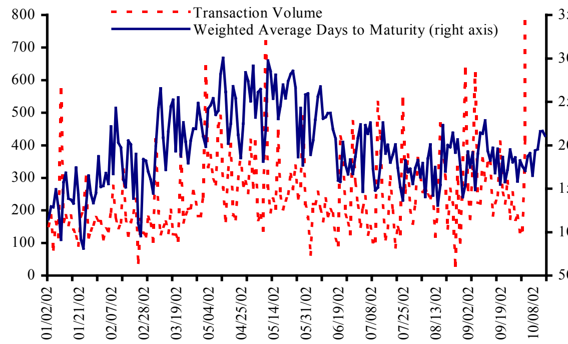


Figure II.4.1 and II.4.2 show the above mentioned developments. Especially, the volatility in the interest rates at the ISE Bonds and Bills Outright Purchases and Sales Market is noteworthy. The average compound interest rate, which floated around 55 percent in the first few days of May, climbed up to 75 percent in mid-July and then came down to 60 percent in mid-August again. Volatility in interest rates in July-September period was coupled with volatility in the transaction volume and the days to maturity of bonds and bills (Figure II.4.3). Generally, the days to maturity has decreased in periods when the interest rates increased.

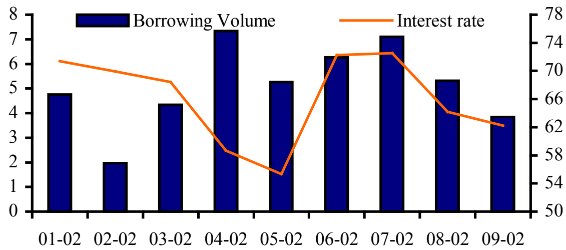
Figure II.4.3. ISE Bonds and Bills Outright Purchases and Sales Trading Volume (Tl, trillion) and Weighted Average Days to Maturity



Interest rates at the ISE Bonds and Bills Outright Purchases and Sales Market declined to 60 percent in mid-August.

The monthly average interest rate of the Treasury auctions have started to climb since June. This upward trend continued in July as well (Figure II.4.4). The compound interest rates in August however, declined to 63 percent as the uncertainty perceptions reduced. Despite the decrease in average interest rate at the auctions in September, it is observed that the investors have demanded higher interest rates for the same terms compared with the auctions in August.

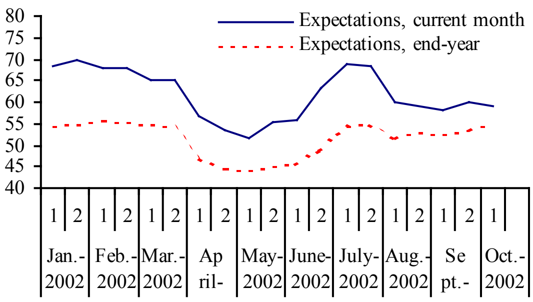
Figure II.4.4. Interest Rates at the Treasury Auctions (Percentage) and Borrowing Volume (Net, TL quadrillion)



*Auction interest rates are theaverage interest rates of the discouted bond auctions. The borrowing volume includes only the volume of the

The CBRT Survey of Expectations revealed that the downward trend in expectations for three-month Treasury auctions continued until the second half of May and than started to rise due to increased risk premium. In the first half of July, the expected rate of interest in the current month increased by 17.2 percent compared with the first half of May and reached 69 percent. With some relief in uncertainties and decrease in short-term interest rates in August, expected interest rates both for current month and for the end-year decreased substantially. However, this downward trend halted in September. The expected interest rate for the auctions, which had peaked in July, dropped by 10 percentage points compared with the peak figures of July and came down to 59 percent. The year-end expectations realized at 54.8 percent in the first half of October. This level is 10 percentage points above the figures of the first half of May when political uncertainty perceptions first surfaced (Figure II.4.5).

II.4.5. CBRT Survey of Expectations Three-Month Treasury Auction Interest Rate Expectations (Percentage, Compound)



When TL deposits, FX deposits and repo interest rates are analyzed, it is observed that the rates have followed a downward trend in the first 5 months of the year. The decrease in interest rates on deposits was disturbed in June and increased by 1.8 percent to reach 49.1 percent. No significant change in interest rates on TL deposits and repo was observed in July-September period while interest on FX deposits slightly increased in August and September. The downward trend in weighted interest rates suggested by the banks for commercial credits with a maturity shorter than 1 year continued until May 2002 and stopped in June (Figure II.4.6).

Figure II.4.6. Interest Rates on Commercial Credit, TL, FX Deposits and Repo (Percentage

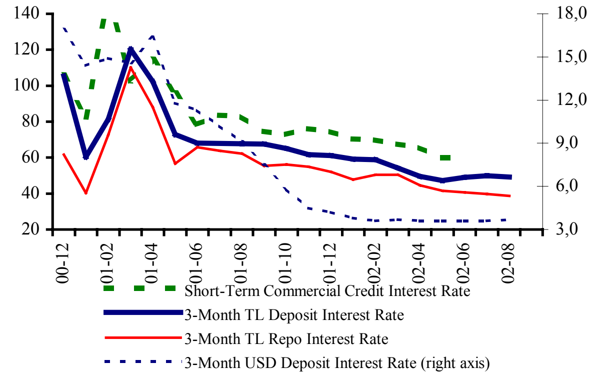
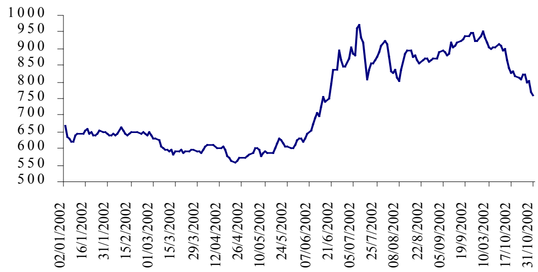


Figure II.4.7. Yield Difference (Base points, Turkey 15/1/2030-Generic Table for 30 years)

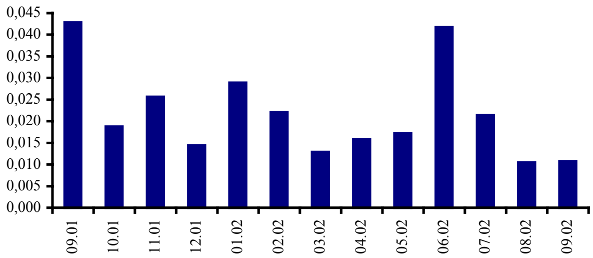


When the yield of the Eurobonds issued by the Treasury are compared with that of the benchmark securities having the same maturity, it is observed that the yield spread of Treasury securities has followed a downward trend until the end of April. The yield spread, which in fact signals country risk, has increased substantially as of May. This increase was remarkable especially in June and July. The spread, which decremented for a while with the ease of uncertainties in August, started to climb in September again. Despite the slump in October, the yield spread is still 100 basis points (1 percentage points) above its level at the turn of the year and 200 points above its mid-April level (its lowest level of 2 percent).

II.5. Developments in Foreign Exchange Markets

Turkish lira, which had started to appreciate as of the beginning of 2002 thanks to the favorable outcomes of the economic policies, started to depreciate as of the beginning of June due to political uncertainties. Adversely affected by the possibility of a military operation in Iraq and unfavorable developments in the

Figure II.5.1. Monthly Exchange Rate Volatility



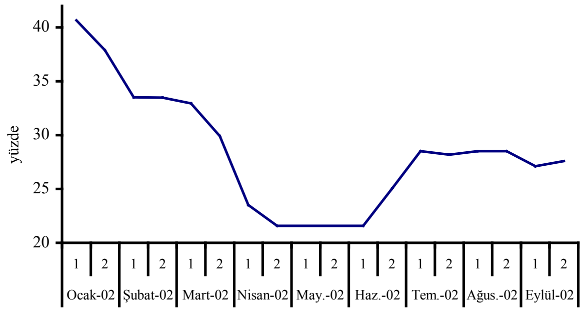
The ratio of the monthly standart deviation of the exchange rate to the monthly average of exchange rate is used to measure volatility.

Brazilian economy, the exchange rate became quite volatile (Figure II.5.1). In the CBRT Survey of Expectations, the end-year exchange rate expectations increased due to depreciation of Turkish lira. The expected year-end value of American dollar, which was 1.800.000 Turkish liras in June, climbed up to 1.850.000 Turkish liras in July and decreased in October and came down to 1.823.000.

Feeling the need to take measures against these developments that were hard to be associated with the current economic program as well as the economy policies to be implemented in the near future, the CBRT intervened in the markets on July 11

The announcement of the early election date and adoption of the laws intended for harmonization with EU acquis helped to decrease the exchange rates and alleviate the volatility. The ongoing impact of political developments on the exchange rates has persisted in August, however the degree of this impact has been rather limited compared with the previous months. The net volume of Treasury's borrowing in foreign currency did not spoil the demand-supply balance in August. However, heavy volumes of foreign currency purchased by some banks in order to reduce their open positions within the framework of restructuring program prevented further decrease in exchange rates.

Figure II.5.2. Expected Annual Appreciation of American Dollars in 2002



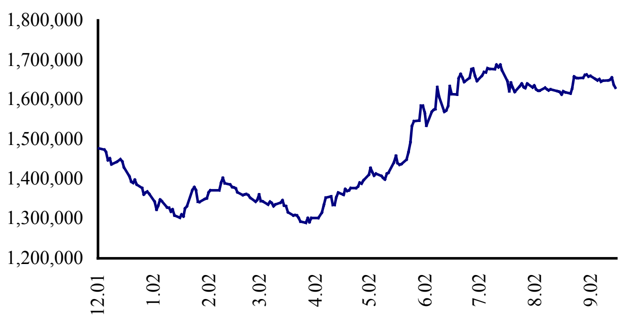
Her aya ait yıl sonu dolar kuru beklentileri 2001 yıl sonu değeri kullanılarak yıllık artış bekleyişi rakamına döndürülmüştür

The worries about a military operation in Iraq and postponement of the elections incited a rise in exchange rate again at the beginning of September and there has not been a remarkable slow-down until the beginning of October when worries about the election were relieved.

With the signals indicating the election would not be postponed, a slump was observed in the exchange rates. The expectations for the exchange rate followed a similar course too.

To sum up, the volatility in exchange rates in the third quarter was mostly determined by the shifts in risk perceptions of economic agents rather than changes in macroeconomic indicators.

Figure II.5.3. Exchange Rate (TL/US, Average of Buying/Selling Rates



III. DEVELOPMENTS IN FINANCIAL MARKETS

III.1. The Banking Sector

As of the end of September 2002, the number of banks that were taken over by Savings Deposit Insurance Fund (SDIF) reduced to three and studies for the resolution of these banks continued. T.Ticaret Bankası was liquidated in August 2002, while Toprakbank was transferred to Bayındırbank, a transmission bank within the body of SDIF. Deadline for survey to be conducted by investors for the sale of Pamukbank was extended to 13 December 2002 and final date for bid prolonged from 4 October 2002 to 20 December 2002. Moreover, it has been decided that other applicants to be approved by Banking Regulation and Supervision Agency (BRSA) would be included in this process. With decision of SDIF dated 10 October 2002, Denizbank's application for purchase of Milli Aydın Bankası (Tarişbank) was approved and a decision was made on commencement of negotiations for transfer of shares. Accordingly, total number of banks, which was 61 at the end of 2001, decreased to 55 in September 2002. The breakdown of banks in respect of groups reveals that during this period the number of deposit banks reduced to 41 from 46 and the number of development and investment banks to 14 from 15.

Within the framework of "Bank Capital Strengthening Program", BRSA extended subordinated loan of TL 213.3 trillion to Vakıflar Bankası in August.

In September, SDIF has mapped out a number of strategies for re-acquisition of bank assets to economy that consist of mostly commercial credits and started a new sale process.

Preliminary studies on asset management companies were completed in August 2002 in accordance with action plan that was announced by SDIF on 14 March 2002. Regulations on establishment and principles of operation of asset management companies, which will resolve the past-due loans and mobilize bank assets, was approved by BRSA on 18 September 2002. Hence, at the end of the studies initiated by SDIF, legal foundation necessary for establishment of asset management companies on the initiative of investors apart from SDIF was established. SDIF may participate in asset management companies at a rate of 20 percent if conditions are available.

Table III.1.1. Financial Markets-Main Indicators (TL, Trillion)

	28.09 2001	28.12 2001	28.06 2002	27.09 2002
Deposit (Residents)	98,282	102,069	113,444	121,529
TL	39,159	44,922	49,548	52,003
FX	59,123	57,147	63,896	69,526
Repos (Savings Holders)	4,037	2,798	3,707	3,391
Credit to Non-Financial Sector by Deposit Banks	32,314	31,249	30,796	30,640
TL	16,409	17,544	15,979	16,030
FX	15,905	13,705	14,818	14,610
Consumer Loans	2,671	2,323	2,376	2,566
Credit Cards	2,410	2,445	3,071	3,493
FX Position (USD, Million)	-774	159	-861	-526
Past Due Loans/Tot. Credit (%)	20.8	16.9	21.8	25.5
Past Due Loans/Tot. Credit (%)-Excluding SDIF	12.3	13.9	20.5	24.1
Securities Portfolio/Tot. Deposit (%)	41.5	44.8	21.7	22.3
Securities in Non-Trading Port. /Total Deposit (%)	17.1	13.4	43.7	42.1
Credit/Deposit (%)	33.9	31.0	27.6	25.6
Public Bank Dep./Tot.TL.Deposits (%)	53.1	54.5	54.5	56.9
Public Bank credit/Tot.TL Credit (%)	24.5	23.6	25.3	23.0

* 3.1 trillion TL loan of Pamukbank, which has been transferred to the SDIF as of June 19, 2002, is classified in transitory accounts, in June 2002.
Source: CBRT Weekly Press Bulletin, Last Friday data of each month.

III.1.a. Credit

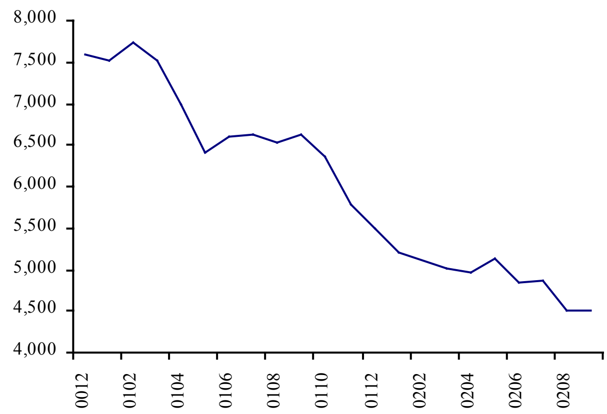
Transfer of non-performing loans of banks to past due loans item compliant with the program for restructuring the banks, which were accounted under performing loans, decline in number of banks and transfer of TL 3.1 quadrillion held in the portfolio of a bank that was taken over by SDIF to provisional accounts create problems in comparing of credit volume to the previous data. Therefore, studies of the Central Bank, BRSA and Banks' Union on data correction is continuing. These studies will allow making more reliable analyses of credit developments.

Banks contracted their credit volume due to negative impact of crisis on their financial structure, problems in credit returns and decline in credit demand. Rise in credit interest rates curbed credit demand as well in line with fall in real income of individuals. In the first 9 months of 2002, credit volume shrank by 18 percent in real terms and by 7 percent again in real terms in the third quarter (Figure III.1.1.). Real contraction in the third quarter stemmed from interest rate and exchange rate movements due to political uncertainties, Iraq crisis and loss of confidence in international markets as well. During this period, public bank loans reduced by 15 percent in real terms compared to June while private bank loans dropped by 6 percent again in real terms.

Credit volume contracted in the third quarter as well.

Developments in sub-items of loans extended by deposit banks reveal that in the third quarter of 2002, commercial loans in terms of Turkish Lira and loans in terms of foreign currencies increased by 7 percent and 8 percent in real terms, respectively, while specialization ,loans dropped by 4 percent in real terms.

Figure III.1.1. Loans to Non-Financial Sector (Discounted with CPI 94=100 Index. TL, Billion)



In September, foreign loans in terms of US dollar dropped to USD 8.9 billion, decreasing by USD 142 million compared to June. The share of Turkish lira equivalent of loans in terms of foreign currency in total loans, which was 41.6 percent in April, rose to 49.4 percent in July and dropped to 46.9 percent in September (Figure III.1.2).

Figure III.1.2 FX loans

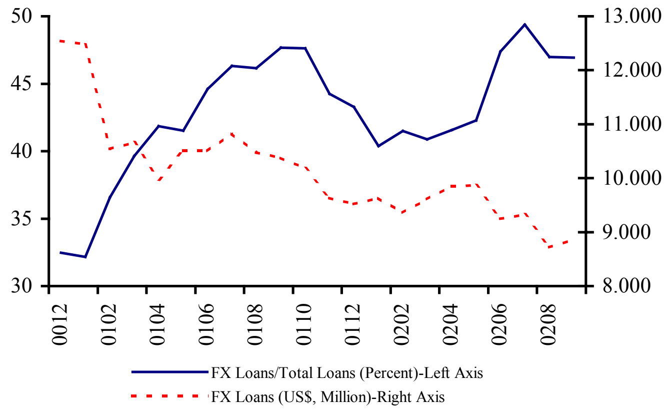


Table III.1.2. Deposit Banks Credit (TL, Trillion)

	Public	Private*	Foreign	Total
28.09.2001	7,916	22,822	1,576	32,314
TL	5,469	10,492	448	16,409
FX	2,447	12,330	1,128	15,905
28.12.2001	7,389	22,575	1,287	31,249
TL	5,449	11,539	557	17,544
FX	1,940	11,036	730	13,705
28.06.2002**	7,796	21,537	1,463	30,796
TL	5,585	9,786	608	15,979
FX	2,211	11,751	855	14,817
27.09.2002	7,040	21,724	1,876	30,640
TL	5,531	9,738	761	16,030
FX	1,509	11,986	1,115	14,610

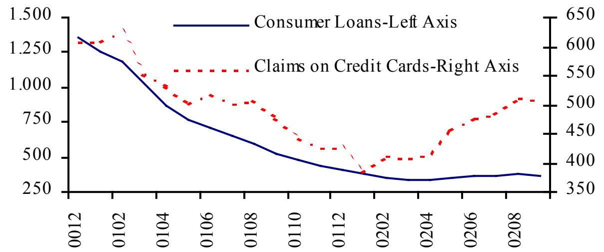
* Including SDIF.
** 3.1 trillion TL loan of Pamukbank, which has been transferred to the SDIF as of June 19, 2002, is classified in transitory accounts, in June 2002..

Source: CBRT Weekly Press Bulletin.

Consumer credits that declined by 8 percent in real terms in the first nine months of 2002 rose by 1 percent in real terms in the third quarter. The share of consumer credits in total credits, which was 7.3 percent at the end of 2001 and 7.6 percent in June 2002, rose to 8.2 percent in September. Moreover, in the first nine months and the third quarter of 2002, claims of banks on credit cards increased by 19 percent and 6 percent in real terms, respectively (Figure III.1.3).

Consumer loans and claims on credit cards increased by 1 percent and 6 percent in real terms, respectively in the third quarter of 2002.

Figure III.1.3. Developments in Consumer Loans and Claims on Credit Cards (Discounted by CPI 1994=100, TL, Billion)

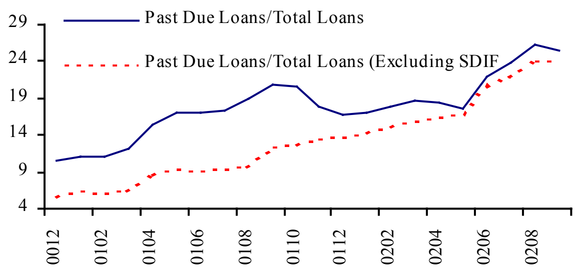


While the share of past due loans in total loans was 16.9 percent at the end of 2001, it rose to 21.8 percent in June 2002 due to the transfer of non-performing credits to the past due loans, which were accounted under performing credits in the balance sheet of private banks, in June 2002. In September 2002, the share of past due loans in total loans realized at 25.5 percent (Figure III.1.4). The share of past due loans of banks taken over by SDIF in total was 9.2 percent, while the shares of state-owned banks and private banks were 49 percent and 39.4 percent, respectively.

As of July 2002, textile sector has the largest share in the past due loans. The share of textile sector in past due loans realized at 24 percent in July.

The share of past due loans of banks taken over by SDIF in total was 9.2 percent, while the shares of state-owned banks and private banks were 49 percent and 39.4 percent, respectively.

Figure III.1.4. The Share of Past Due Loans in Total Loans (Percent)



III.1.b. Developments in the Securities Portfolio and the Securities in Non-Trading Portfolio of the Banks

Securities portfolio of the banks increased by 3 percent in real terms and securities in non-trading portfolio dropped by 3 percent in real terms in September 2002. In the same period, while a major portion of government securities of the state-owned banks are composed of securities to be held until due time, a major portion of government securities of private banks are comprised of ready-for-sale securities that are held for trading purposes. In September 2002, while the share of the state-owned banks in the ready-for-sale securities held for trading purposes was 19 percent, the share of private banks was 79 percent. Meanwhile, the share of state-owned banks in the securities to be held until due time was 64 percent and of private banks 34 percent.

In September 2002, while a major portion of government securities of the state-owned banks are composed of securities to be held until due time, a major portion of government securities of private banks are comprised of ready-for-sale securities that are held for trading purposes.

Figure III.1.5. The Sum of Securities Portfolio and Securities in Non-Trading Portfolio (Discounted by CPI 1994=100, TL Billion)

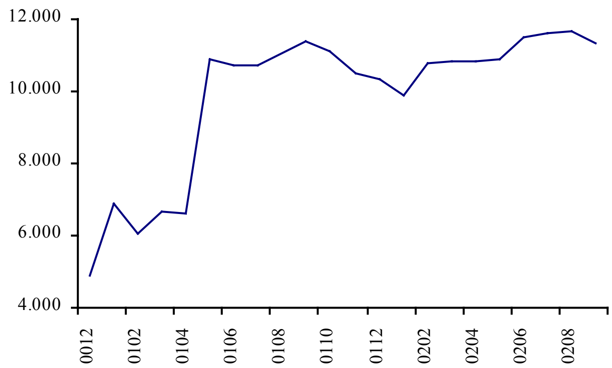


Table III.1.3. Developments in Securities Portfolio and the Securities in Non-Trading Portfolio (TL Trillion)

	Public	SDIF	Banking Sector
2002 June			
Securities Portfolio	**4,719**	**1,938**	**24,633**
TL	1,771	1,628	12,476
FX	2,948	310	12,157
Sec, in Non-Trad, Portfolio	**32,103**	**1,998**	**49,614**
TL	23,552	1,993	34,547
FX	8,551	5	15,067
2002 September			
Securities Portfolio	**5,031**	**3,926**	**27,136**
TL	1,193	3,884	13,051
FX	3,838	42	14,085
Sec, in Non-Trad, Portfolio	**32,512**	**1,848**	**51,146**
TL	24,057	1,595	36,104
FX	8,455	253	15,042

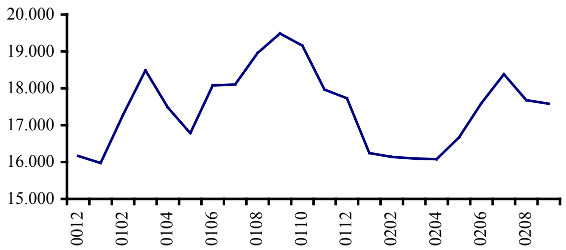
Source: CBRT.

III.1.c. Developments in the Source Structure of the Banking Sector

Between May-September 2002, the total deposits of the residents showed a tendency towards increase in real terms except for August (Figure III.1.6). The main reason of rise in total deposits in May, June, July and September 2002 was depreciation of Turkish lira and the rapid increase in FX deposits in real terms until the end of July. In September 2002, while total deposits dropped by 1 percent in real terms when compared to the end of 2001, it did not undergo a significant change in real terms in the third quarter of 2002. Total deposits were TL 122 quadrillion at the end of September.

Total deposits did show a minor change in real terms in September when compared to June.

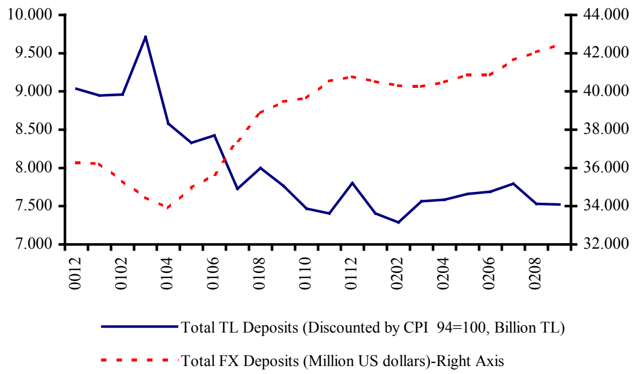
Figure III.1.6. Total Deposits (Discounted by CPI 94=100, Billion TL)



Turkish lira deposits dropped by 2 percent in real terms in June-September 2002 period, declining to TL 52 quadrillion. During the said period, the share of private banks in TL deposits decreased from 44.5 percent to 42.5 percent, while the share of state-owned banks in TL deposits rose to 56.9 percent from 54.5 percent. During the same period, the share of foreign banks in TL deposits came down to 0.7 percent from 1 percent.

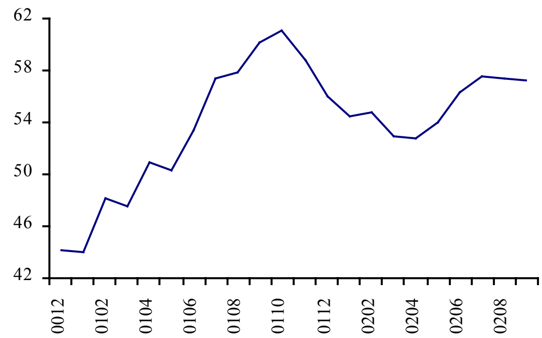
FX deposits increased in real terms in May-July 2002 period. However, in August and September, the exchange rates gained stability to some extent, and this led to a drop in FX deposits. Due to these developments, in the third quarter of 2002, FX deposits increased slightly by 1.3 percent in real terms and reached TL 69.5 quadtrillion. FX deposits in terms of USD increased from USD 40.9 billion to USD 42.4 billion in the June-September 2002 period (Figure III.1.7).

Figure III.1.7. Developments in TL Deposits and Foreign Exchange Deposits



When the shares of the bank groups in FX deposits are examined for June-September period, it is seen that share of state-owned banks rose from 22.5 percent to 22.6 percent, while the share of private banks dropped from 74.6 percent to 74.1 percent. Besides, the share of foreign banks increased from 2.8 percent to 3.2 percent.

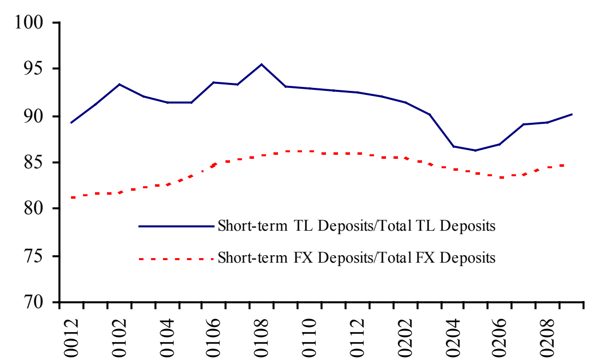
Figure III.1.8. The Share of FX Deposits in Total Deposits (Percentage)



The share of FX deposits in total deposits, which was 56 percent at the end of 2001, rose to 57.6 percent in July due to the depreciation in TL. It declined somewhat due to the recovery in exchange rate stability and realized at 57.2 percent in September (Figure III.1.8).

The volume of banks' repo transactions with their customers became TL 3.4 quadrillion in September 2002, reducing by 15 percent when compared to June. Drop in repo transactions noted in the third quarter is considered a favorable development in reducing the maturity inconsistency in the bank balance sheets. The share of repo transactions in Turkish lira deposits, which was 6.2 percent at the end of 2001, rose to 8 percent in August. However, it decreased to 6.3 percent in September.

Figure III.1.9. The share of short term TL and FX Deposits in the Total Deposits (Percentage)



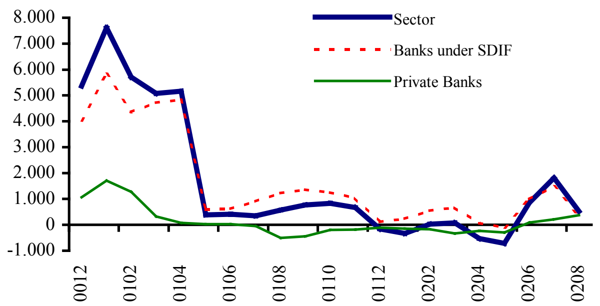
Short-term deposit is composed of sight, 1 month and 3 month deposits.

The maturity structure of deposits displayed a tendency towards longer maturity in early 2002 due to marked financial stability. However, maturity started to become shorter as of May owing to the uncertainties in international financial markets, Iraq crisis and increase in interest rate and exchange rate risks that stemmed from debates on early elections. The share of short-term TL deposits, which include three-month deposits and deposits having maturity up to three months, in total TL deposits rose from 86.9 percent to 90.1 percent during June-September period. Besides, the share of short-term FX deposits in total FX deposits increased from 83.4 percent to 84.8 percent in the same period (Figure III.1.9).

Maturity structure of deposits displayed a tendency towards longer maturity in the beginning of 2002, whereas the maturity of deposits started to become shorter as of September 2002.

The foreign exchange net general open position of the banking sector in terms of US dollars maintained its low level in the first half of 2002 (Figure III.1.10). Total net open position, which increased due to Pamukbank's high open position that appeared after its transfer to SDIF, dropped in August again.

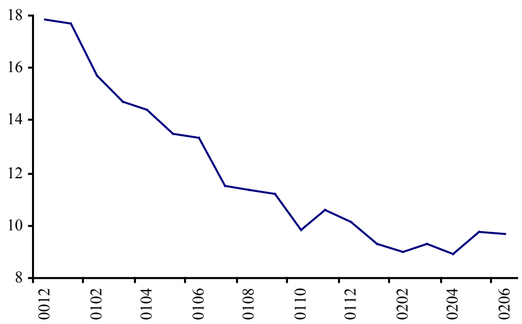
Figure III.1.10. The Foreign Exchange Net General Open Position of the Banking Sector (USD, Million)



Positive values exibit an open position, whereas negative values exibit an excess position.

While the banking sector had an excess position of USD 159 million at the end of 2001, this figure turned into an open position of USD 861 and USD 1,814 million in June and July, respectively, due to the transfer of Pamukbank to SDIF. In August, the amount of net open position reduced and realized at USD 526 million. While the state-owned banks had an excess position of USD 164 million as of August 2002, the banks under SDIF and private banks had open positions of USD 334 million and USD 375 million, respectively.

Figure III.1.11. Foreign Credit used by Banks (USD, Billion)



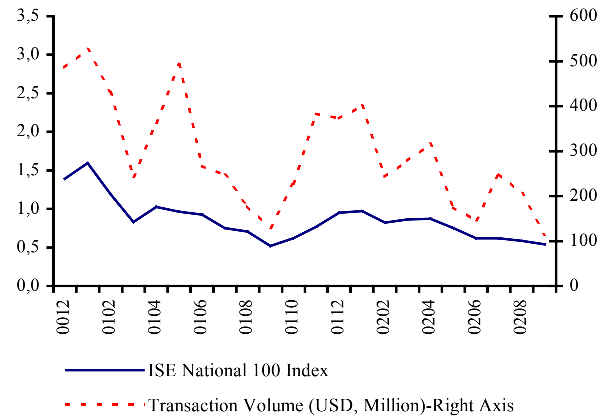
Foreign credit from abroad, one of the funding resources of the banking sector, which were USD 10.1 billion at the end of 2001, decreased to USD 8.9 billion in April 2002. Then foreign credit increased to 9.7 billion in June 2002.

III.2. The Securities Market

ISE National 100 Index and the transaction volume sustained its downward trend in September 2002 due to debates on the election date, ambiguities in the membership process of Turkey to European Union and the USA's likely operation to Iraq as well as chronic drops in foreign stock exchange markets.

The ISE National 100 index dropped by 46 percent in real terms in the first nine months of 2002. In the same period, services index, financial index and industrial index declined by 44 percent, 51 percent and 37 percent in real terms, respectively. As of September 2002, the downward trend in the trade volume persisted too.

Figure III.2.1. ISE National 100 Index and Trade Volume (USD)



ISE National 100 index continued to decline in terms of US dollar as well. (Figure III.2.1). While it was USD 1 in December 2001, it decreased to a level of USD 0.5 at the end of September 2002. In the first nine months, services index dropped to USD 0.4 from USD 0.6, financial index to USD 0.6 from USD 1.3 and industrial index to USD 0.5 from USD 0.8. Moreover, daily average transaction volume, which was USD 372 million at the end of 2001, decreased to USD 114 million in September 2002.

The worth of balances of keeping stocks that are owned by foreign investors, which was USD 5,635 million at the end of 2001, decreased to USD 3,413 million in August 2002.

In the July-September period, other developing stock markets fell as well. In the same period, Brazilian stock market declined by 21 percent, Russian stock market by 8 percent, South Korean stock market by 13 percent and, Mexican and Polish stock markets by 10 percent.

IV. PUBLIC FINANCE AND DOMESTIC DEBT STOCK

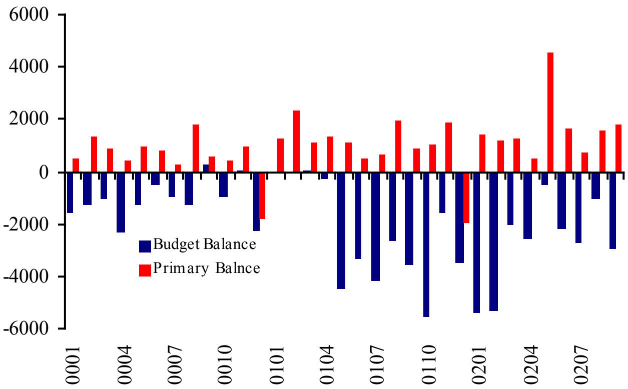
Due to persistence in implementing of tight fiscal policies, the primary budget surplus excluding privatization increased by 51.9 percent in the January-September 2002 period compared to the same period of the previous year and reached TL 14.7 quadrillion (Table IV.1.). The sum of TL 3 quadrillion, which was transferred from the 2001 net proceeds of the Central Bank to the budget in May, played a significant role in improvement in primary budget surplus that was noted in the first nine months of 2002. Primary budget surplus realized at TL 1.8 quadrillion in September 2002 (Figure IV.1).

Table.IV. 1. Consolidated Budget Balances (TL Trillion)

	2001 Jan-Sep	2002 Jan-Sep
Revenues	36373	55403
Expenditures	54807	79982
Budget Balance	-18434	-24579
Primary Budget Balance	11081	14743
Primary Budget Balance Exc. Privatization	9706	14743

Source: Ministry of Finance.

Figure.IV. 1. Consolidated Budget Balance and Primary Balance (Monthly, TL Trillion)



IV.1 Revenues

While the budget revenues reached TL 55.4 quadrillion in the January-September 2002 period increasing by 52.3 percent, tax revenues rose by 53 percent compared to the same period of the previous year and realized at TL 42 quadrillion (Table IV.1.1.).

Table.IV. 1.1. Consolidated Budget Revenues (TL Trillion)

	2001 Jan-Sep	2002 Jan-Sep	Increase Rate (percent)
REVENUES	36373	55403	52.3
Tax Revenues	27439	41979	53.0
Income Tax	8323	9630	15.7
Corporate Tax	2318	3787	63.4
Motor Vehicle Tax	367	651	77.5
Domestic VAT	4823	8177	69.5
Special Consumption Tax	-	1963	-
Petroleum Consumption Tax	3680	6353	72.7
Bank. & Insuran. Trans. Tax	1267	740	-41.7
VAT on imports	3498	6075	73.7
Non-Tax Revenues	5716	8942	56.4
Privatization	1375	0	-100.0
Other	4341	8942	106.0
Special Revenues and Funds	2765	3651	32.0
Annexed Budget Revenues	453	832	83.7

Source : Ministry of Finance.

Special consumption tax was put into effect as of 1 August 2002. In this scope, total of TL 2 quadrillion was collected in August and September. With the enforcement of special consumption tax, 16 items of taxes, fees, funds and shares including primary tax elements such as petroleum consumption tax, additional VAT and motor vehicle purchase tax were abolished.

The structure of tax revenues underwent significant transformations due to economic crisis in 2001 and this led to change in shares of direct and indirect taxes in tax revenues.

The increase in tax revenues in the January-September 2002 period mainly arose from domestic VAT, VAT on imports and petroleum consumption tax, which have the largest share in indirect taxes. Increase in imports owing to upsurge in output had a favorable effect on collection VAT on imports. In the January-September 2002 period, the share of indirect taxes in tax revenues, which was 58.6 percent in the corresponding period of 2001, rose to 66.3 percent.

In the January-September 2002 period, the share of indirect taxes in tax revenues realized at 66.3 percent.

Of direct taxes, income tax displayed a moderate increase in the January-September 2002 period and rose by 15.7 percent when compared to the same period of the previous year. This development mainly stemmed from the withholding tax. After the economic crisis in 2001, the rise in the interest rates increased the withholding tax revenues. However, the decrease in the interest rates caused a decline in the withholding tax revenues acquired from deposit and repo transaction in 2002.

Non-tax revenues increased by 56.4 percent in January-September 2002 period. The total amount transferred to the budget from the net proceeds of the Central Bank, which was TL 472 trillion last year, reached TL 3 quadrillion this year.

IV.2. Expenditures

In the January-September 2002 period, expenditures increased by 45.9 percent compared to the same period of the previous year (Table IV.2.1). During this period, non-interest expenditures rose by 60.8 percent when compared to the corresponding period of the previous year.

Table.IV. 2.1 Consolidated Budget Expenditures (TL Trillion)

	2001 Jan-Sep	2002 Jan-Sep	Increase Rate (percent)
EXPENDITURES	54807	79982	45.9
NON-INTEREST EXP.	25292	40660	60.8
Personnel	10461	16446	57.2
Wages	1673	2318	38.5
Other Personnel Expenditures	8788	14129	60.8
Other Current	2352	3849	63.6
Investment	2100	3556	69.4
Transfer Expenditures	39894	56131	40.7
Interest Payments	29515	39322	33.2
Domestic Debt Interest Pay.	27394	35939	31.2
Foreign Debt Interest Pay.	2121	3382	59.5
Transfers to the SEE's	878	1153	31.3
Tax Rebates	1752	3776	115.6
Social Security Institutions	4725	7915	67.5
Payments to Retirement Fund	2240	4000	78.6
Payments to SSK	730	1798	146.4
Payments to Bag-Kur	1537	1948	26.7
Unemployment Insurance Fund	218	169	-22.6
Agricultural Support	347	1114	220.9
Other Transfers	2677	2851	6.5

Source : Ministry of Finance.

In the January-September 2002 period, personnel expenditures increased by 57.2 percent, while other current and investment expenditures by 63.6 percent and 69.4 percent, respectively. Although public servants' salaries were increased by gross TL 100 million as of October 2002, TL 25 million of this increase for each month in the October-December 2002 period will be paid in January 2003. So, the cost of the increase in public servants' salaries will be limited effect on 2002 budget. Moreover, application of inflation difference related to salaries was abolished for the rest of the year.

High rates of increase were noted in tax rebates, transfers to social security institutions and agricultural support items that are included in non-interest transfers.

The increase in the transfers to social security institutions from budget in the first nine months of 2002 stemmed from high unemployment rate as well as the increase in informal employment. In the January-September period, TL 7.9 quadrillion was transferred to social security institutions. TL 4 quadrillion of this amount was transferred to Retirement Fund.

The increase in agricultural support payments in the January-September period resulted from the transfers from budget that were made within the framework of direct revenue support payments. The total amount transferred within this framework became TL 750 trillion in first 9-month period of 2002.

IV.3. Consolidated Budget Deficit and Financing

The consolidated budget cash deficit realized at TL 20 quadrillion in the January-August 2002 period. In this period, the Treasury was in net borrowing position in domestic borrowing. The Treasury remained at net payment position in government bonds and at net borrowing position in Treasury bills. In this period, the net borrowing in the Treasury bills was TL 16.2 quadrillion (Table IV.3.1).

Net foreign borrowing realized at 16.7 quadrillion in the January- August period. The credits provided from IMF played a significant role in this development.

Net foreign borrowing realized at TL 16.7 quadrillion in the January-August 2002 period.

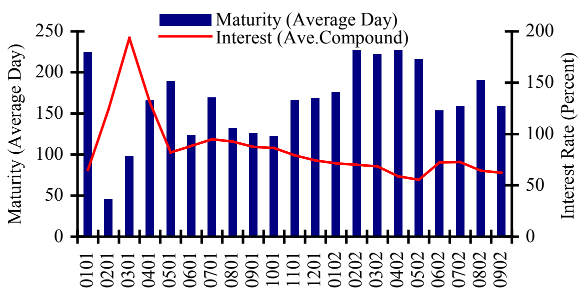
Table.IV. 3.1.Consolidated Budget Balance and Financing (TL Trillion)

	2001 Jan-Aug	2002 Jan-Aug
Primary Budget Balance	10228	12916
Budget Balance	-14912	-21643
Cash Balance	-15801	-20039
Financing	15801	20039
Net Domestic Borrowing	13782	6755
Government Bonds	946	-9412
Treasury Bills	12836	16167
Guarantied Debt Returns	0	0
Net Foreign Borrowing	-2656	16727
Other	4676	-3443

Source : Treasury.

In order to extend the borrowing maturity, the Treasury started to hold floating rate note auctions again since the beginning of 2002. With the increase in the credibility of the economic program, Treasury auction interest rates went into downward trend until May 2002, they increased in June and July because of political developments. The Treasury auction interest rates started to have downward trend since August (Figure IV.3.1.).

Figure.IV.3.1. The Treasury Auction Interest Rates and Maturity Structure



IV.4. Domestic Debt Stock

Domestic debt stock, which was TL 122.2 quadrillion at the end of 2001, reached TL 140.3 quadrillion, increasing by 14,8 percent as of September 2002. Transfer of IMF credits to the Treasury on February 7,2002, the early redemption of the FX linked securities in Central Bank's portfolio and in the Savings Deposit Insurance Fund (SDIF) banks' portfolio, and utilization of these sources by the SDIF banks to reduce their liabilities to the Central Bank were the main reasons that led to restriction in increase in the domestic debt stock. In this context, the effect of IMF credit on domestic debt stock manifested itself in two ways. The first one is the decline in domestic debt stock and its financing requirement and the second one is the change in the structure of domestic debt stock in terms of borrowing instruments.

In the May-September 2002 period, the structure of domestic debt stock was affected by domestic and foreign political developments as well as foreign economic developments. Political uncertainty that appeared as of the second half of May was followed by the debates on early general elections in the beginning of July. Consequently, decision was made on early elections in the beginning of August. The most outstanding development in foreign policy became the USA's possible Iraq operation. In the case of foreign economic developments, concerns about Brazil's sustainability of debt stock was one of the highlights of foreign economy. All these developments led to shorter maturity and increase in domestic borrowing cost, making a drastic change in the structure of domestic debt stock in terms of borrowing instruments (Table IV.4.1.- Table IV.4.2).

Non-cash domestic debt stock boosted in August due to the securities, which were issued for loaning to SDIF banks under Banking Act and Budget Law for the Financial Year 2002 within the re-structuring of banking sector and strengthening of bank capitals program. Moreover, the amount of government securities held by the Central Bank increased as a result of the reflected exchange rate difference owing to the coupon payments of FX-linked IMF credit securities that are included in cash domestic debt stock (Table IV.4.2).

Table.IV. 4.1. Domestic Debt Stock and Its Structure (Amounts are in TL Quadrillion and Shares are in Percent)

	2000		2001		2002*	
	Amount	Share In Total	Amount	Share In Total	Amount	Share In Total
CASH	29.6	81.2	58.3	47.8	79.9	56.9
Fixed Income	19.4	53.3	17.7	14.5	34.2	24.4
Flexible-rate	9.0	24.7	11.4	9.4	14.7	10.5
FX Denominated	1.2	3.2	7.1	5.8	13.2	9.4
FX Linked	0.0	0.0	22.1	18.0	17.8	12.7
IMF Credit	0.0	0.0	13.8	11.3	9.6	6.8
Swap/Tap	0.0	0.0	7.7	6.3	7.7	5.5
Public Sales	0.0	0.0	0.5	0.4	0.5	0.4
NON-CASH	6.8	18.8	63.8	52.2	60.4	43.1
Fixed Income	1.0	2.8	0.0	0.0	0.0	0.0
Flexible-rate	4.0	11.0	49.5	40.5	47.2	33.6
Interest linked	4.0	11.0	30.7	25.1	28.8	20.5
CPI -Indexed**	0.0	0.0	18.8	15.4	18.4	13.1
FX Denominated	1.8	5.0	12.4	10.1	11.4	8.1
FX Linked	0.0	0.0	1.9	1.6	1.9	1.4
TOTAL STOCK	36.4	100.0	122.2	100.0	140.3	100.0
Fixed Income	20.4	56.1	17.7	14.5	34.2	24.4
Flexible-rate	13.0	35.7	61.0	49.9	61.9	44.1
Interest linked	13.0	35.7	42.1	34.5	43.5	31.0
CPI -Indexed**	0.0	0.0	18.8	15.4	18.4	13.1
FX Denominated	3.0	8.2	19.5	16.0	24.6	17.5
FX Linked	0.0	0.0	24.0	19.6	19.7	14.0

* As of September 2002
** Indicates the CPI-Indexed part of the non-cash securities that take place in the Central Bank portfolio.
Source: Treasury.

Table IV.4.2.The Distribution of the Domestic Debt Stock According to Buyers (TL Quadrillion)

	2000 December	2001 December	2002 September
1. PUBLIC SECTOR	12.2	80.6	77.4
a. CBRT	1.5	32.5	28.0
IMF Credit	-	13.8	9.6
Other	1.5	18.7	18.4
b. State Banks (*)	2.9	22.7	24.1
c. SDIF Banks	3.9	15.1	11.1
d. Other Public	4.0	10.2	14.2
2. MARKET	24.2	41.6	62.9
TOTAL (1+2)	36.4	122.2	140.3

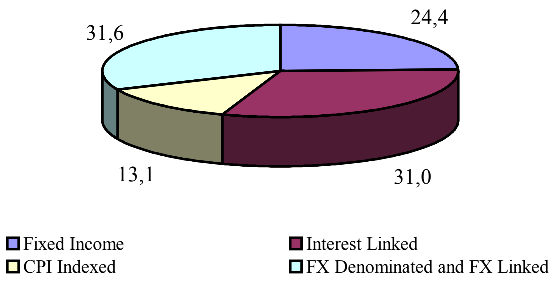
(*) The duty loss accruals, which are not linked to paper amounts TL 15.1 quadrillion as of end of 2000.
Source: Treasury.

In the January-September 2002 period, the structure of domestic debt stock changed in terms of borrowing instruments. While the share of fixed income instruments increased, the share of FX-denominated and FX-linked and flexible rate government securities decreased.

Because of additional foreign financing, the share of interest-linked government securities realized at 31 percent dropping by 3.4 points in September 2002 compared to the end of 2001. The share of CPI-indexed government securities reduced to 13.1 percent decreasing by 2.3 point, while the share of FX-denominated and FX-linked government securities came down to 31.6 percent by a drop of 4 points. On the other hand, the share of fixed- income securities in total domestic debt stock realized at 24.4 percent increasing by 9.9 points compared to the end of 2001 (Figure IV.4.1.). Concerns about the sustainability of the domestic debt stock in medium term reduced with the issuance of government domestic borrowing securities with longer maturities replacing government domestic borrowing securities of SDIF banks in exchange for their deposit transfers in November and December 2001 and the restructuring of government domestic borrowing securities with their incurred interest that take place in the portfolio of the state banks in December 2001 and January 2002. However, the developments in the second half of May led to debates on the sustainability of domestic debt stock again. Following the decision for early elections, uncertainties diminished and interest rates dropped. Primary dealer application started with ten primary dealer banks at the beginning of September.

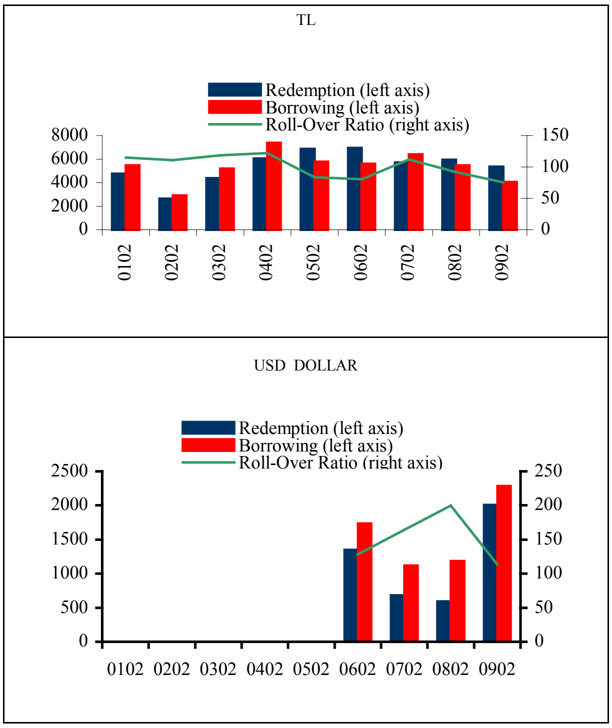
After the second half of May, domestic debt stock was influenced by the domestic and foreign political developments as well as foreign economic developments.

Figure.IV.4.1. The Distribution of Domestic Debt Stock as of September 2002 (Percent)



In May 2002, TL 3 quadrillion portion of the net proceeds of the Central Bank transferred to budget was used for the early redemption of government securities held by the Central Bank, which means there was no cash transfer to the Treasury. That the amount transferred from the net proceeds of the Central Bank exceeds TL 750 trillion –that is the budget target- has reduced the additional financing requirement of the budget and had a positive impact on the domestic debt stock.

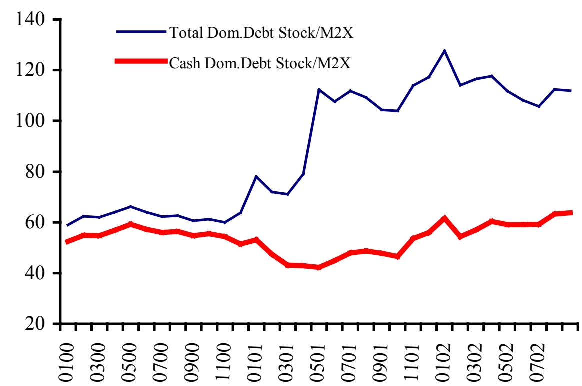
Figure IV.4.2.Roll-Over Ratio



In the January-September 2002 period, total payments to the market was TL 53.3 quadrillion, while the amount of borrowing realized at TL 54.5 quadrillion. In this context, the roll-over ratio reached 102.4 percent in the January-September 2002 period by an increase of 1.1 points compared to the December 2001 (Figure IV.4.2). However, due to unfavorable developments in May, the roll-over ratio in terms of Turkish Lira declined severely when compared to the previous months of the year and realized at 75.6 percent in September. Depending on high domestic borrowing in terms of FX during the June-September 2002 period led to increase in roll-over ratio in July and August. However, the roll-over ratio decreased severely in September. The reason behind this fall is the political uncertainity perception resulted in decreasing demand for TL domestic government securities. Additionaly, cost of long-term borrowing in terms of TL instruments increase following the decision for early general election. In this context, the market did not want to demand for long term TL borrowing instruments taking into account the political perception risk. Also, considering high cost of borrowing for the long-term, Treasury borrowed heavily by short term TL instruments.

When the ratio of total domestic debt stock to M2X is analyzed regarding the indications of pressure imposed by the domestic debt stock on the markets, this ratio decreased by about 5.4 points as of September 2002 when compared to the end of 2001. On the other hand, the ratio of cash domestic debt stock to M2X, another indicator of the pressure, increased by about 7.6 points. The Treasury borrowed at amount greater than its repayments to markets and especially the reflected exchange rate difference as a result of the coupon payments of securities held in the portfolio of Central Bank in August (Figure IV.4.3).

Figure.IV.4 3.The Ratio of Domestic Debt Stock to M2X



V. DEMAND AND PRODUCTION

It was estimated that Turkish economy would re-enter into growth period in 2002 and grow by 3 percent. GNP growth turned to positive the first quarter of the year and its growth accelerated in the second quarter. Thus, GDP rose by 4.7 percent in the first quarter of the year compared to the same period of the previous year, realizing a growth rate higher than forecasts. Indicators point out that growth rate will be higher than 3 percent.

Table V.1.1. Main Expenditure Groups (Annual % Change)

	2001					2002		
	I	II	III	IV	Annual	I	II	First Half
Total Consumption Exp.	-2.4	-10.9	-10.2	-11.2	-8.9	-1.6	3.1	0.7
Private Consumption Exp.	-2.5	-11.5	-9.7	-11.7	-9.0	-2.0	3.1	0.5
Public Consumption Exp.	-1.3	-6.6	-15.0	-8.9	-8.6	2.4	2.7	2.6
Gross Fixed Capital Formation	-13.1	-32.1	-37.3	-38.7	-31.7	-24.6	0.1	-11.8
Public Fixed Capital Investment	-5.8	-32.0	-23.4	-18.8	-22.0	-17.4	3.4	-4.3
Private Fixed Capital Investment	-14.4	-32.1	-41.5	-50.2	-35.1	-26.1	-1.0	-13.8
Machinery-Equipment	-18.3	-44.4	-61.7	-69.0	-49.6	-41.0	6.6	-19.3
Construction	-7.2	-8.9	-9.2	-9.2	-8.7	-2.2	-9.7	-6.3
Total Investment Expenditures	-29.0	-51.2	-38.4	-46.3	-42.1	1.5	56.5	28.6
Total Domestic Demand	-9.5	-23.9	-17.6	-21.4	-18.4	-1.0	14.1	6.6
Total Final Domestic Demand	-5.0	-17.0	-17.2	-18.9	-15.0	-6.7	2.4	-2.1
Exports of Goods & Services	9.7	8.2	5.9	6.4	7.4	9.1	4.2	6.4
Imports of Goods & Services	-14.5	-31.0	-26.5	-26.0	-24.8	1.4	19.4	10.3
GDP	-0.8	-9.6	-7.4	-10.4	-7.4	1.9	8.2	5.2

Source: SIS

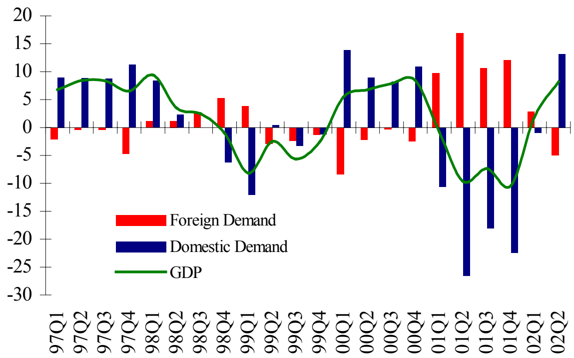
The current program has made considerable progress in recovering the stability in financial markets. This development contributed to the improvement of expectations, providing a growth process for the economy, which is swifter than expected. Due to rise of confidence to the economy, interest rates declined compared to the last year. It is observed that private firms started to employ more foreign financial resources under better conditions in this period.

Maintenance of stability in financial markets and the rise in optimistic expectations allowed the economy to re-enter into growth period.

V.1. Demand Developments

When examined as to demand components, it is observed that although net exports have contributed to the growth of the economy, contraction in domestic demand persisted in the first quarter of 2002. In the second quarter of the year, domestic demand increased due to base effect created by contraction of 2001. In this period, the contribution of net exports to growth was negative because of acceleration of intermediary goods imports caused by the increase in industrial output (Figure V.1.1).

Figure V.1.1. The Contributions of Demand Components to GDP Growth (Percentage Points)



Source: SIS, CBRT

In the first half of 2002, stock accumulation is observed as the demand component, which made the major contribution to growth. The final good stocks of private firms declined gradually in 2001 due to the contraction of domestic demand and decline in industrial production. As a consequence of this development, the contribution of stock accumulation to GDP was realized at minus 4 percent in 2001. However, CBRT Business Tendency Survey indicates that manufactured goods stocks increased in the second quarter of 2002. Nevertheless, manufactured goods stocks declined in line with the increase in private consumer expenditures in the second quarter of 2002. In the first half of 2002, the contribution of the stock accumulation to GDP was 8.5 percent (Table V.1.2.).

Recovery of stability in financial markets, mainly in foreign exchange market enabled the fulfillment of the postponed private consumption and investment expenditures albeit slightly. Especially the appreciation of Turkish lira in the first half of 2002 allowed the private firms to renew their raw material stocks through imports, which shrank in 2001. Moreover, expenditures for durable consumption goods, which declined in the first quarter of 2002, increased in the second quarter of 2002 when compared to the same period of the previous year.

Table V.1.2. Contributions of Demand Components to GDP Growth (Percentage Points)

	2001					2002		
	I	II	III	IV	Annual	I	II	First Half
Private Expenditure	-5.0	-14.9	-15.1	-16.5	-13.4	-6.4	1.9	-2.1
Public Expenditure	-0.3	-3.1	-2.5	-3.0	-2.3	-0.5	0.4	0.0
Net Exports	9.8	16.9	10.6	12.1	12.3	2.9	-5.0	-1.2
Stock Changes	-5.3	-8.6	-0.3	-2.9	-4.0	5.9	10.9	8.5
GDP	-0.8	-9.6	-7.4	-10.4	-7.4	1.9	8.2	5.2

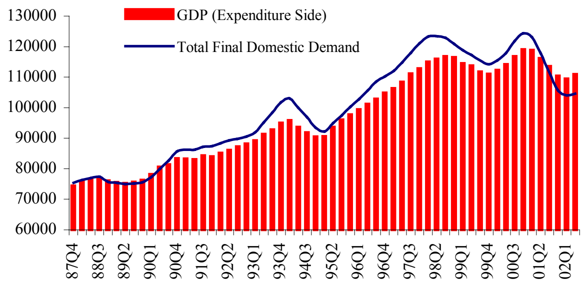
Source: SIS, CBRT

Although domestic demand recovered substantially, the downward trend in inflation rates continued and pointed out that consumer prices figure increase might be lower than the year-end inflation target 35 percent. The decline in total final domestic demand by 2.1 percent compared to the same period of the previous year and thus, still a low level of domestic demand eased the pressure on consumer prices. The fact that growth mainly stemmed from stock accumulation and increase in exports contributed to the decline of inflation.

Despite the fact that the economy entered into the growth period, unemployment rate continued to rise in the first half of 2002. Additionally, real wages per person working in the manufacturing industry, which declined in 2001 compared to the previous year continued to decrease in the first half of 2002 as well. Unfavorable developments in labor market are one of the main reasons for the decline in the private consumer expenditures in the first quarter of 2002 and the moderate increase in the second quarter of the year.

However, in the second quarter of 2002, non-agricultural employment increased when compared to the same period of last year. Number of persons employed in private manufacturing industry and the amount of working hours rose in the second quarter of 2002 compared to the same period of 2001. Continuance of growth in industrial output will stimulate employment. However, it is predicted that the main favorable effects of growth on the labor market will appear as of 2003.

Figure V.1.3. Annualized GDP and Total Final Domestic Demand (1987 Prices, Billion TL)



Source: SIS, CBRT

In the January-July 2002 period, exports rose by 6 percent when compared to the same period of last year. Moreover, according to Turkish Exporters' Assembly (TEA) data, exports maintained its upward trend in August and September. In the first half of 2002, while exports quantity index increased by 15 percent when compared to the same period of previous year, exports price index dropped by 5.7 percent.

Table V.1.3. Private Consumption Expenditures (Annual % Change)

	2001					2002		
	I	II	III	IV	Annual	I	II	First Half
PRIVATE	-2.5	-11.5	-9.7	-11.7	-9.0	-2.0	3.1	0.5
Food	1.5	-4.1	-4.9	-4.8	-3.4	-0.6	-0.5	-0.5
Durable Goods	-20.3	-36.1	-31.1	-33.2	-30.4	-5.2	8.8	1.2
Semi-durable & Non-	3.8	-12.5	-9.9	-19.0	-9.0	-3.9	5.7	0.2
Energy-Transpor.-	2.6	-0.7	0.5	4.7	1.8	-3.7	1.4	-1.1
Services	-1.9	-12.2	-9.1	-11.4	-9.1	1.6	8.7	5.4
Ownership of Dwelling	2.2	2.1	2.1	2.0	2.1	2.0	1.9	1.9

Source: SIS

Moreover, the annualized data indicates that despite the low level of total final domestic demand, a recovery is observed in the economy when compared to the deep contraction in 2001 (Figure V.1.2.).

In the first half of 2002, private consumer expenditures increased slightly by 0.5 percent compared to the same period of the year. However, food expenditures dropped by 0.5 percent in the same period. On contrary, expenditures for non-food consumption goods showed a rapid increase. In the second quarter of 2002, the rise in non-agricultural employment and increase in use of credit cards had favorable effects on private consumer expenditures (Table V.1.3.).

Table V.1.4. Public Expenditures (Annual % Change)

	2001					2002		
	I	II	III	IV	Annual	I	II	First Half
Total Public Expenditures	-2.9	-18.8	-18.9	-13.6	-14.7	-4.4	3.0	-0.1
Public Consumption	-1.3	-6.6	-15.0	-8.9	-8.6	2.4	2.7	2.6
Compens. of Employees	2.2	1.9	0.9	1.0	1.5	2.0	0.3	1.1
Purch. of Goods & Services	-9.4	-15.3	-29.8	-14.4	-18.0	3.5	5.6	4.9
Public Fixed Capital Inv.	-5.8	-32.0	-23.4	-18.8	-22.0	-17.4	3.4	-4.3
Machinery-Equipment	-4.6	-65.4	-26.7	-32.3	-39.1	-14.5	15.1	-1.2
Building Construction	-12.9	-2.1	-20.7	-27.3	-20.1	-17.9	27.1	13.6
Other Construction	-3.0	-8.2	-23.5	-0.8	-10.3	-21.0	-14.1	-16.0

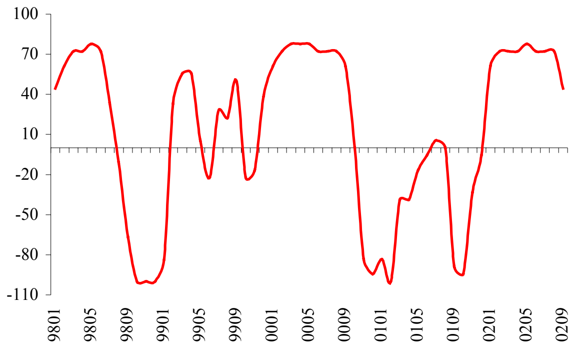
Source: SIS

Private investment expenditures, which contracted by 35.1 percent in 2001 compared to the previous year, dropped by 13.8 percent again in the first half of 2002 compared to the same period of last year. While the decline in construction investment continues, private machinery-equipment investments rose by 6.6 percent in the second quarter of 2002 when compared to the same period of 2001.

Public expenditures increased by 3 percent in the second quarter of 2002, after declining by 4,4 percent in the first quarter of 2001 (Table V.1.4). Increase in public expenditures in the second quarter of the year contributed to the recovery of domestic demand.

Expectations Index, which is prepared by aggregation of quarterly expectations of Business Tendency Survey, maintains its positive progress in the third quarter of 2002 as well. It is observed that private firms keep their optimistic expectations for output and demand following the rapid growth occured in the second quarter of 2002 and are optimistic of the continuance of growth in the third quarter of the year as well (Figure V.1.3.). However, Expectations Index showed a decline due to the increase in political uncertainties and potential effects of a possible Iraq operation.

Figure V.1.4. Expectations Index for Demand and Production (Private Industry Sector, Next Three-Months Period)



Source: CBRT Business Tendency Survey

V.1.1. Production Developments

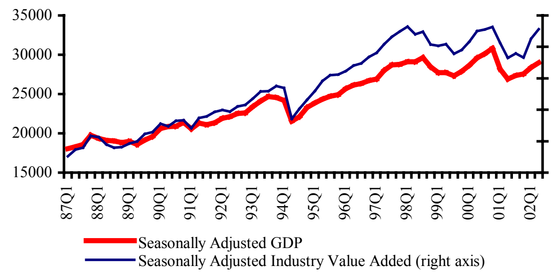
The agriculture sector value added increased by 1,9 percent in the first half of 2002 compared to the same period of the previous year. Significant increases realized especially in cereals, leguminous seeds and forestry sub-items. Increase in agricultural production has favorable effect on the trade, transportation and industrial production as well. Agriculture sector value added is also expected to increase in the third quarter of 2002 compared to the same period of the previous year.

Table V.1.5. GNP and Value Added by Sectors (Annual Percent Change)

	2001					2002		
	I	II	III	IV	Annua	I	II	First
AGRICULTURE	8.5	-2.9	-5.6	-13.6	-6.1	1.2	2.3	1.9
TOTAL INDUSTRY	0.8	-10.1	-8.9	-10.7	-7.5	3.0	12.2	7.7
Manufacturing	1.7	-11.0	-9.7	-12.0	-8.1	2.6	13.1	8.0
SERVICES	-1.5	-8.0	-5.5	-7.5	-5.8	1.7	5.8	3.9
Construction	-5.2	-5.8	-8.3	-3.6	-5.9	-2.7	-5.3	-4.2
Trade	-2.3	-12.1	-7.4	-14.3	-9.3	3.0	10.1	6.9
Wholesale and Retail	-2.3	-16.5	-12.6	-17.0	-12.7	2.2	13.9	8.3
Hotel & Restaurant	-2.2	14.0	20.1	0.8	10.0	8.4	-6.3	-0.8
Transportation -	-2.3	-8.8	-4.5	-3.7	-4.9	1.1	6.8	4.0
Financial Institutions	-5.3	-10.0	-9.8	-14.2	-9.9	-7.4	-9.6	-8.5
Ownership of	2.2	2.1	2.1	2.0	2.1	2.0	1.9	1.9
Business & Pers. Ser.	-0.3	-9.7	-7.8	-10.4	-7.4	2.1	8.0	5.3
Government Services	2.2	1.9	0.9	1.0	1.5	2.0	0.3	1.1
IMPORT TAX	-10.1	-32.1	-28.0	-28.4	-25.1	-2.2	21.9	8.8
GDP	-0.8	-9.6	-7.4	-10.4	-7.4	1.9	8.2	5.2
GNP	-3.1	-12.1	-9.0	-12.3	-9.4	0.3	8.8	4.7

Source: SIS

Figure V.1.2. Seasonally Adjusted GDP and Industry Sector Value Added



Source: SIS, CBRT

Industrial sector value added rose by 7.7 percent in the first half of 2002 compared to the same period of the previous year (Table V.1.5). In these periods, recovery in confidence due to easing of uncertainty in financial markets had positive effect on expectations of firms for production and demand. Moreover, revival in exports became an important factor in the increase in industrial production. Seasonally adjusted data reveal that GDP and industry sector value added increased in the first and second quarters of 2002 compared to the previous periods (Figure V.1.4).

Industrial sector value added rose by 7.7 percent in the first half of 2002 compared to the same period of last year.

The other development that led to increase in industrial production is the rise in private consumption expenditures, albeit at a low rate, in the second quarter of the year. Especially the rise in expenditures directed toward durable consumer goods contributed to the rise in production of motor vehicles and white goods. Uncertainties that appeared starting from May 2002 caused a partial deterioration in expectations for production and demand. It is predicted that this situation will lead to a slowdown in the growth rate of the industrial sector value added in the second half of the year, especially in the last quarter.

Table V.1.6 .Industrial Production (Annual Percent Change)

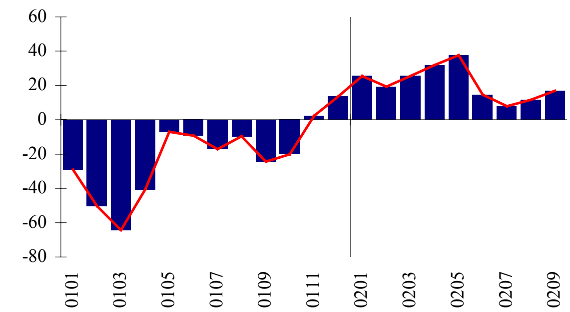
	August		January - August	
	2001	2002	2001	2002
Total Industry	-10.8	7.2	-7.4	8.0
Mining	-9.7	-12.7	-2.8	-9.4
Manufacturing	-12.1	8.7	-8.2	9.3
Energy	-0.9	4.8	-2.4	5.9
Non-petroleum Industrial Production	-12.9	6.2	-9.7	7.2

Source: SIS Monthly Industrial Production Index

In the January-August 2002 period, industrial production increased by 8 percent (Table V.1.6). Excluding petroleum products, the increase in industrial production declines to 7.2 percent in the same period. Manufacturing industry average capacity utilization ratio rose by 4.9 point in the January-September 2002 period compared to the corresponding period of last year and realized at 75.8 percent. Moreover, the results of SIS Manufacturing Industry Monthly Tendency Survey for September indicate that firms are expecting a high upsurge in manufacturing industry production in September as well. Therefore, industrial sector value added is forecasted to increase in the third quarter of 2002 as well.

In the business sentiment, which illustrates the expectations of private firms in the industrial sector on the course of economy, a deterioration was noted in the June-July period. However, optimistic expectations started to increase in August and continued in September as well (Figure V.1.5). The deterioration in the expectations mentioned above was due to the possibility that the economic program might be interrupted because of political uncertainty and resulting fluctuations in financial markets. However, favourable developments in business sentiment in August and September point out a relative decrease in these uncertainties.

Figure V.1.5. Business Sentiment in Business Tendency Survey



Source: CBRT Business Tendency Survey

Services sector value added rose by 3.9 percent in the first half of 2002 compared to the same period of the previous year (Table V.1.5). Increase in imports and expansion in the agricultural production contributed to the rise in services sector value added. Besides, the production rise in the industrial sector has been positively affecting the trade and transportation sectors both directly and indirectly. But an opposite development was experienced by construction and financial sectors. According to the data announced by SIS, the area of buildings, which were granted construction permits, recorded a high drop of 40 percent in the first half of 2002 compared to the same period of the previous year. The decline in house construction permits points out a further decrease in the construction sector value added in the third quarter of 2002 as well.

V.2 Developments in Labor Market

According to SIS Survey of Household Labor Force (HLF), in the second quarter of 2002, the labor force increased 1.7 percent and reached 23,086 thousand people compared to the same period of last year (Table V.1.5). Employment decreased by 1.2 percent in the second quarter of 2002 compared to the same period of the previous year and dropped to 20,869 thousand. Total employment increased in urban areas when compared to the same period of last year, while decreasing in rural areas. In this period, 53.9 percent of total employment was in urban areas, while 46.1 percent in rural areas. Thus, unemployment rate, which was 6.9 percent in the second quarter of 2001 reached 9.6 percent in the same period of 2002.

The number of unemployed people increased by 650 thousand people and reached 2,217 million people compared to the same period of previous year (Table V.2.1). 21.9 percent of unemployed people in Turkey are those who lost their jobs and 15.2 percent are those who are seeking job for the first time.

Table V.2.1. Labor Force and Employment

	2001					2002	
	I	II	III	IV	Mid Y.	I	II
Labor Force	21,031	22,694	23,782	22,077	22,269	20,929	23,086
Employment	19,222	21,127	21,875	19,742	20,367	18,467	20,869
Urban	56.6	52.2	51.2	55.7	53.8	57.2	53.9
Rural	43.4	47.8	48.8	44.3	46.2	42.8	46.1
Number of nemployed	1,809	1,567	1,907	2,335	1,902	2,462	2,217
Unemployment Rate	8.6	6.9	8.0	10.6	8.5	11.8	9.6
Urban	10.8	10.4	11.6	13.2	11.5	14.7	13.5
Rural	5.6	2.7	3.9	7.0	4.8	7.5	4.5
Educated Young Peop. Unemp.	23.7	23.2	28.7	27.0	25.8	29.4	27.2
Underempl./ L. Force(Percent)	6.0	6.0	5.7	6.1	6.0	5.9	5.8
Inactive Labor Force (Percent)	14.6	12.9	13.7	16.7	14.5	17.7	15.0

Source: SIS Household Labor Force Survey

The economic growth process in the second quarter of 2002, had a positive effect on employment level. Accordingly, unemployment rate, which was 14.7 percent in the first quarter of the year, decreased to 13.5 percent in the second quarter of the year. Yet this rate is higher than the last year's rate by 3.1 points. Moreover, non-agricultural employment rose by 5.8 percent (745 thousand people) compared to the same period of the last year. This increase supported the recovery of the economy. These favourable developments in labor force market are expected to continue in the third quarter of 2002 in line with the continuance of growth.

Despite all these encouraging developments, the unemployment rate of educated young people reached to a high level of 27.2 percent in the second quarter of this year. This rate realized at 29.1 percent in urban areas.

The continued growth process in the second quarter of the year, is expected to have a positive effect on the employment rate in the forth coming periods.

The rate of underemployed people, which is defined as persons who already have a job but looking for another job and who would prefer to work more hours in their current job was 5.8 percent in the second quarter of 2002. Therefore, in the same period, inactive labor force rate, which is the sum of underemployed and unemployed rate, increased by 2.1 points reaching to 15 percent compared to the same period of the previous year.

Sectoral distribution of employment reveals that the share of agricultural sector in overall employment is 34.6 percent in the second quarter of 2002. In the same period, the shares of industrial and services sectors were 18.7 percent and 42 percent, respectively (Table V.2.2).

Table V.2.2. Employment by Sectors (Thousand Person, Aged 15

	2001					2002	
	I	II	III	IV	Annual Average	I	II
TOTAL	19,222	21,127	21,875	19,742	20,367	18,467	20,869
Agriculture	6,268	8,222	8,676	6,432	7,217	5,624	7,219
Industry	3,628	3,584	3,764	3,843	3,734	3,658	3,907
Services	9,326	9,321	9,435	9,467	9,416	9,185	8,761
Construction	1,029	1,183	1,138	955	1,073	771	982
Urban Employm.	10,872	11,037	11,209	11,001	10,953	10,557	11,256
Rural Employm.	8,350	10,090	10,666	8,741	9,414	7,911	9,613

Source: SIS Household Labor Force Survey

As of the second quarter of 2001, almost 49.7 percent of overall employment in Turkey is comprised of workers getting salaries or daily wages. In the same period, the share of self-employed and unpaid family workers was 21.2 percent.

Table V.2.3. Employment by Economic Activity (Thousand Person, Aged 15+)

	2001					2002	
	I	II	III	IV	Annual Average	I	II
Total	19,222	21,127	21,875	19,742	20,367	18,467	20,869
Workers Getting Salaries	9,682	9,791	10,057	9,991	9,908	9,621	10,364
Self-employed	5,884	6,347	6,364	6,077	6,142	5,608	6,086
Unpaid Family Worker	3,656	4,989	5,454	3,674	4,317	3,238	4,418
Percentage Distribution							
Workers Getting Salaries	50.4	46.3	46.0	50.6	48.6	52.1	49.7
Self-employed	30.6	30.0	29.1	30.8	30.2	30.4	29.2
Unpaid Family Worker	19.0	23.6	24.9	18.6	21.2	17.5	21.2

Source: SIS Household Labor Force Survey

Reduction in the share of agricultural support allocated from the consolidated budget compared to the past years led agricultural income to decline. This resulted in shift of unpaid family workers in agricultural sector to workers getting salaries or daily wages.

Table V.2.4. Developments in Manufacturing Employment, Wages and Productivity (Annual Percentage Change)

	2001					2002		
	I	II	III	IV	Annual	I	II	First Half
Employment (1)	-1.3	-9.0	-11.1	-11.3	-8.3	-6.8	-0.1	-1.1
Public	-2.0	-5.5	-10.3	-7.2	-6.5	-11.4	-12.0	-11.7
Private	-1.1	-9.6	-11.2	-12.1	-8.6	-6.0	2.0	-2.1
Wage(2)	-4.1	-14.6	-15.8	-20.5	-14.6	-16.0	-4.2	-10.5
Public	4.3	-12.5	-15.2	-21	-12.5	-12.6	5.9	-4.2
Private	-5.9	-15.6	-15.9	-20.1	-15.2	-15.1	-3.3	-9.7
Productivity(3)	2.8	-0.5	2.2	0.1	1.0	9.8	10.8	10.3
Public	12.2	9.1	9.2	1.9	7.8	15.7	22.4	18.8
Private	0.7	-2.8	0.4	-0.7	-0.6	8.9	9.7	9.3

Source: SIS
(1) SIS, Index for Workers in the Manufacturing Industry, 1987=100
(2) SIS, Quarterly Index of Wages per Production Worked Hour, 1987=100
(3) SIS, Quarterly Index of Partial Productivity per Production Worked Hour, 1987=100

The employment decline in manufacturing industry in the second quarter of 2001 slowed down in line with the favourable developments in this sector's production. In the first half of 2002, manufacturing industry employment index reduced by 1.1 percent compared to the same period of the previous year. While public sector employment index dropped by 12 percent in the second quarter of 2002 compared to the same period of 2001, the private sector employment index rose by 2 percent compared to the same period of 2001 (Table V.2.4).

Real wages continued to decline in the first half of 2002 as well. High level of decline in real wages per hour in the first quarter of 2002 decelerated in the second quarter of the year in line with the economic recovery. In the second quarter of 2002, real wages declined in private sector, but increased in public sector. On the contrary, productivity per hour rose both in public and private sectors. Upsurge in the productivity in manufacturing industry is due to the higher level of increase in production compared to the level of increase in employment.

In the second quarter of 2002, real wages declined in private sector, but increased in public sector.

VI. BALANCE OF PAYMENTS

VI.1. Developments in Foreign Trade

In the January-July 2002 period, exports and imports rose by 6 percent and 8.1 percent, respectively, compared to the same period of the previous year. Foreign trade deficit realized as USD 7.1 billion. Hence, the exports/imports ratio decreased to 72.6 percent compared to the same period of 2001.

The growth rate of exports, which entered in a downward trend since November, started to accelerate as of June and July. Accordingly, exports reached USD 3 billion in July, increasing by 18.9 percent compared to the July 2001. Despite high increases in domestic industrial production, the limited recovery in domestic demand directed the production towards exports. However, the slowdown in economic activitiy in the Euro area and the limited growth in OECD industrial production appeared as factors that restricted foreign demand. On the other hand, the developments in the real exchange rate and euro/US dollar parity during June and July led to an increase in exports. In the said period, Turkish lira depreciated in real terms, while euro appreciated against US dollar.

Table VI.1.1. Foreign Trade (USD Million)

	July			January-July		
	2001	2002	Percentage Change	2001	2002	Percentage Change
EXPORTS	2483,8	2952,3	18,9	17844,4	18914,0	6,0
Agriculture	138,9	98,6	-29,0	1122,8	928,9	-17,3
Fishing	2,3	1,9	-17,8	14,2	19,4	36,9
Mining	40,3	27,1	-32,7	205,7	190,3	-7,5
Manufacturing	2300,7	2821,6	22,6	16488,1	17753,0	7,7
Other	1,6	3,1	97,9	13,6	22,3	63,8
IMPORTS	3436,6	4388,9	27,7	24107,3	26056,9	8,1
Consumption	316,9	423,2	33,5	2468,3	2513,3	1,8
Investment	713,0	699,9	-1,8	4291,7	4024,1	-6,2
Intermediate	2372,7	3213,9	35,5	17123,5	19377,0	13,2
Crude oil	347,6	341,0	-1,9	2278,2	2176,4	-4,5
Other	34,0	52,0	53,0	223,9	142,5	-36,3

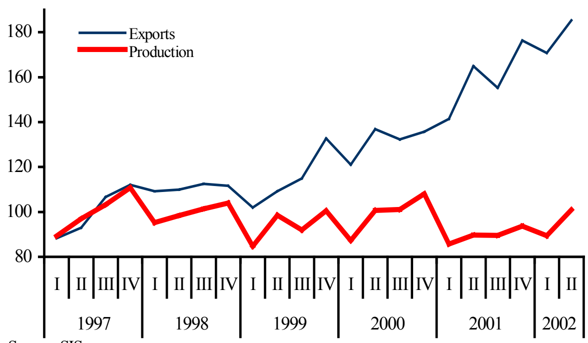
Source: SIS

In the January-July period, manufacturing industry products that comprise 93.9 percent of Turkey's overall exports achieved a more rapid increase. During the same period, manufacturing industry exports rose by 7.7 percent compared to the same period of the previous year. One of the main reasons of this increase is that firms directed their products to foreign markets because of the last year's crisis. Hence, in the first seven months of 2002, automotive sector exports boosted by 15.1 percent compared to the corresponding period of last year and the share of exports in production rose to 75 percent from 22 percent. According to the records of Turkish Exporters' Association, Italy, France and United Kingdom followed Germany, which took the first place in export to the European countries.

Exports of articles of iron and steel, knitted articles of apparel and clothing accessories and unknitted articles of apparel and clothing accessories made the highest contribution to the manufacturing industry products.

Export prices pursued a horizontal course as of the beginning of 2002, then increased by 1.9 percent in June compared to the previous month. Import prices, which declined starting from March 2002, rose by 1.6 percent in June. The terms of trade have been deteriorating since March.

Figure VI.1.1. Manufacturing Export Volume and Production Indices(1997=100)

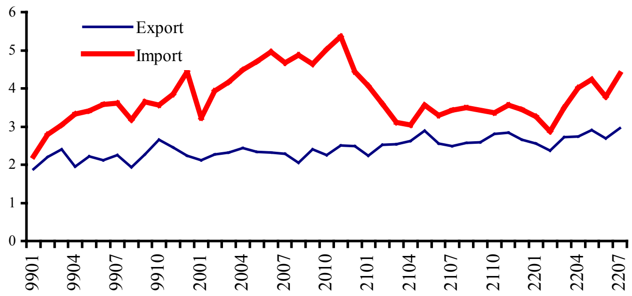


Source: SIS.

According to the results of CBRT Business Tendency Survey, the upward trend of exports in July is expected to continue in the following three months. Expectations for the volume of export orders improved compared to the previous month. Optimistic expectations in exports prospects increased in August. According to the records of Turkish Exporters' Association, exports rose to USD 3 billion in August and USD 3.3 billion in September increasing by 15.2 percent and 27.7 percent, respectively.

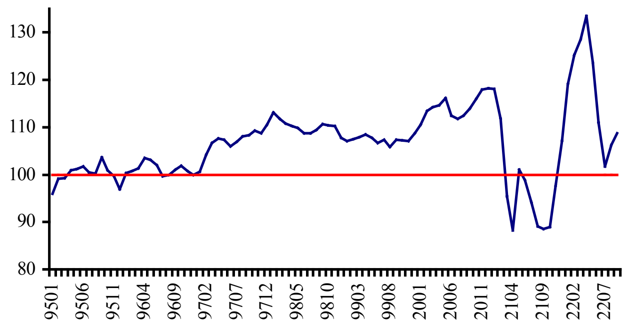
Preliminary indicators for August concerning OECD and Euro area point at the fact that foreign demand will not be able to recover to the expected extent. It is estimated that this situation will have somewhat unfavorable effect on exports in the coming period.

Figure VI1.2. Monthly Exports and Imports (USD Billion)



Source: SIS

Figure VI.1.3. Real Effective Exchange Rate (1995=100)

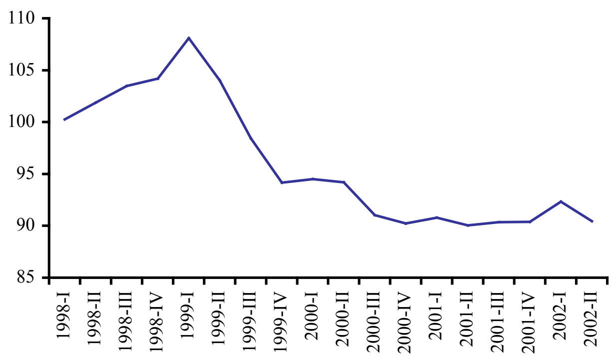


WPI based real effective exchange rates calculated by using IMF weights based on the trade flows of 17 countries from 1988-1990. An increase in index denotes an appreciation of Turkish lira. Source: CBRT.

The composition of the increase in exports among export markets in the first seven months of 2002 was not homogenous. While exports to Germany and USA that comprised 28 percent of exports declined by 0.5 percent and 8.4 percent in the January-July period, respectively, exports to United Kingdom and Russia rose by 24.6 percent and 87.9 percent, respectively during the same period. It is expected that encouraging developments in the Russian economy will boost Turkey's exports to that country and thus, may compensate for the negative effects of slowdown in the OECD countries on our exports.

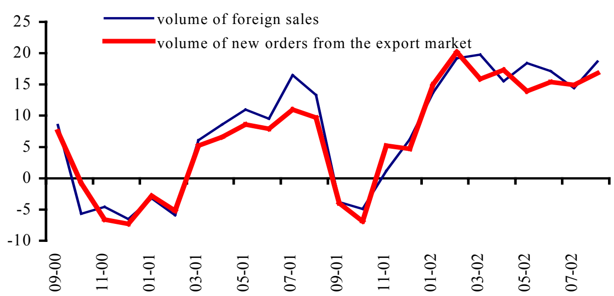
In the January-July 2002 period, imports rose by 8.1 percent compared to the same period of the previous year and reached USD 26.1 billion. The downward trend in imports was replaced by a strong tendency towards growth since March 2002. Accordingly, the rate of increase in imports realized at 21.2 percent in July.

Figure VI.1.4. Terms of Trade (Export Prices/Import Prices)



Source: SIS

Figure VI.1.5. Export Expectations for the next Three Months (Percentage)
(Optimists minus Pessimists)



Source: CBRT Business Survey.

In the first seven months of 2002, the rate of increase in intermediate goods, which comprised 74.4 percent of total imports, realized at a higher level when compared to the growth in total imports due to increase in exports and domestic industrial production.

BOX: VI.1.1. SECTORAL ANALYSIS OF VARIOUS TERMS OF TRADE INDICATORS

Terms of trade is a significant indicator that is used to assess the revenues of a country from foreign trade or its losses arising from foreign trade. There are different concepts of terms of trade in literature. Three different concepts are examined here. These are: net barter terms of trade, income terms of trade and single factoral terms of trade.

Terms of trade can simply be defined as the ratio of export prices to import prices. Terms of trade, which are defined in this respect, are called net barter terms of trade. Improvement in terms of trade boosts the purchasing power of a country in foreign markets via one-unit exports of that country.

Income terms of trade, which are calculated by multiplying net barter terms of trade by export quantity index, show the capacity of imports of that country based on its export revenues. The rise of export prices as to the prices of imported goods will demonstrate the revenues from foreign trade, in case there is not any declining trend in export volume.

Variation in income terms of trade is highly important for developing countries, in which capital goods imports is the leading imports that is essential for development. If net barter terms of trade show evidence of adverse changes in a country, this can be eliminated by increase of export volume.

Net barter terms of trade and income terms of trade do not reflect the productivity increases in exports sector. Therefore, single factoral terms of trade are used in indicating revenues arising from foreign trade. Single factoral terms of trade are calculated by multiplying net barter terms of trade by productivity index in the exports sector. Single factoral terms of trade are more reliable indicators in finding out the real revenues arising from foreign trade. An unfavorable development in net barter terms of trade can be eliminated by increase of productivity in exports sector and thus the country may not suffer from any losses in real terms.

Three different terms of trade calculated for Turkey's leading sectors in foreign trade for the 1998-2002 period are given below. Accordingly,

NET BARTER TERMS of TRADE (1997=100)*

	1998	1999	2000	2001	2001				2002	
					I	II	III	IV	I	II
General	**100.0**	**98.7**	**90.3**	**88.3**	**88.7**	**88.0**	**88.2**	**88.2**	**90.2**	**88.3**
Manufacturing	**95.1**	**96.0**	**94.2**	**92.3**	**92.8**	**92.3**	**93.4**	**90.6**	**92.4**	**91.0**
Food products and beverages	*90.9*	*107.1*	*112.8*	*105.4*	*113.4*	*106.7*	*101.7*	*100.6*	*100.4*	*93.2*
Textiles	*98.0*	*98.4*	*95.4*	*92.0*	*94.8*	*90.1*	*92.4*	*90.6*	*91.3*	*94.0*
Wearing apparel	*83.0*	*83.1*	*86.5*	*102.7*	*81.9*	*100.8*	*119.0*	*124.0*	*115.6*	*111.6*
Chemical and chemical products	*97.4*	*95.6*	*96.2*	*92.6*	*92.7*	*91.4*	*96.3*	*90.2*	*91.4*	*87.4*
Manufacture of basic metals	*98.2*	*93.9*	*91.8*	*96.0*	*91.0*	*93.9*	*98.8*	*100.9*	*98.6*	*95.5*
Manufacture of machinery and equipment	*91.7*	*88.2*	*90.8*	*84.4*	*88.1*	*86.3*	*83.5*	*79.9*	*82.3*	*79.6*
Electrical machinery and apparatus	*80.5*	*103.0*	*98.9*	*101.0*	*98.9*	*97.0*	*105.2*	*103.5*	*112.8*	*106.0*
Motor vehicles and trailers	*101.3*	*104.4*	*99.6*	*102.4*	*102.1*	*104.2*	*101.4*	*102.0*	*103.4*	*100.4*

** $N = P_x / P_m * 100$, N indicates net barter terms of trade. P_x and P_m indicate export and import prices, respectively.*

INCOME TERMS of TRADE (1997=100)*

	1998	1999	2000	2001	2001				2002	
					I	II	III	IV	I	II
General	**109.7**	**111.6**	**113.7**	**135.8**	**119.9**	**137.2**	**133.1**	**153.0**	**146.5**	**152.2**
Manufacturing	**105.4**	**110.1**	**123.8**	**147.1**	**131.2**	**152.2**	**145.0**	**159.6**	**157.8**	**168.6**
Food products and beverages	*83.8*	*86.4*	*85.3*	*99.2*	*95.4*	*100.5*	*91.2*	*109.0*	*83.3*	*70.9*
Textiles	*113.0*	*120.8*	*132.4*	*141.3*	*132.5*	*140.3*	*140.3*	*151.4*	*146.2*	*167.4*
Wearing apparel	*87.1*	*81.9*	*89.9*	*118.8*	*86.2*	*111.4*	*147.8*	*152.2*	*145.6*	*146.3*
Chemical and chemical products	*102.2*	*93.9*	*104.8*	*114.8*	*105.3*	*116.7*	*109.5*	*127.0*	*118.8*	*128.4*
Manufacture of basic metals	*83.9*	*92.5*	*101.8*	*137.7*	*105.8*	*141.1*	*137.5*	*169.5*	*183.6*	*153.8*
Manufacture of machinery and equipment	*108.1*	*119.0*	*153.3*	*180.6*	*154.7*	*193.4*	*174.2*	*197.8*	*173.0*	*219.9*
Electrical machinery and apparatus	*116.7*	*101.8*	*141.9*	*197.6*	*184.5*	*202.7*	*195.8*	*207.6*	*216.3*	*218.2*
Motor vehicles and trailers	*119.6*	*192.2*	*233.9*	*382.8*	*348.6*	*463.6*	*320.2*	*400.9*	*429.2*	*486.0*

** $G = N * Qx$, G indicates income terms of trade. N and Qx indicate net barter terms of trade and export quantity index, respectively.*

SİNGLE FACTORAL TERMS of TRADE (1997=100)*

	1998	1999	2000	2001	2001				2002	
					I	II	III	IV	I	II
Manufacturing	**94.5**	**102.9**	**111.1**	**108.1**	**100.1**	**108.8**	**115.5**	**108.0**	**108.6**	**117.6**
Food products and beverages	*90.8*	*116.7*	*127.4*	*133.4*	*120.1*	*131.5*	*145.0*	*134.9*	*114.5*	*124.7*
Textiles	*94.1*	*103.8*	*111.2*	*111.6*	*103.3*	*112.9*	*118.3*	*111.2*	*106.8*	*122.5*
Wearing apparel	*90.6*	*101.2*	*112.3*	*139.1*	*106.9*	*143.6*	*162.0*	*164.7*	*151.8*	*144.6*
Chemical and chemical products	*93.6*	*95.0*	*112.2*	*103.7*	*104.9*	*101.4*	*108.4*	*100.2*	*121.0*	*124.6*
Manufacture of basic metals	*95.5*	*95.6*	*98.8*	*115.0*	*96.6*	*115.0*	*126.9*	*123.6*	*123.6*	*133.0*
Manufacture of machinery and equipment	*87.5*	*81.2*	*89.1*	*74.8*	*74.2*	*77.9*	*74.2*	*72.7*	*82.4*	*90.0*
Electrical machinery and apparatus	*70.3*	*93.8*	*105.4*	*97.3*	*85.9*	*91.0*	*113.2*	*100.5*	*129.2*	*118.7*
Motor vehicles and trailers	*93.8*	*92.2*	*107.5*	*72.6*	*68.5*	*74.4*	*75.5*	*72.2*	*72.2*	*91.9*

** $T = N * Vx$. T indicates single factoral terms of trade. N and Vx indicate net barter terms of trade and productivity index, respectively.*

As of the first half of 2001, a deterioration is observed in net barter terms of trade in overall manufacturing industry when compared to 1997. However, the said deterioration in net barter terms of trade was recovered by the increase both in income terms of trade and single factoral terms of trade. In other words, this sector could eliminate the impact of developments in prices that were against Turkey through two types of responses: firstly, the increase in export volume and secondly, the increase in productivity. The increase by 68,6 percent and 17,6 percent in income terms of trade and single factoral terms of trade compared to 1997, respectively, reflect this response.

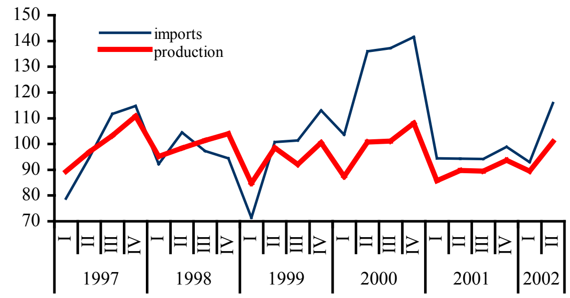
As of the second half of 2002, while the net barter terms of trade realized against Turkey in sub-sectors of food and beverages, textiles, chemicals, basic metal industries and machinery and equipment, the developments in net barter terms of trade were in favor of Turkey in wearing apparel, electrical machinery and apparatus and, motor vehicles.

The income terms of trade increased in all sub-sectors, excluding food products and beverages. This situation indicates rise in export volume in these sectors in the first half of 2002 compared to 1997. Especially in motor vehicles sector, the tendency towards increase is clearly observed. As of the first half of 2002, index increased by five times compared to 1997. Considering the steady course of net barter terms of trade in this sector, the increase in income terms of trade proves the growth in exports in motor vehicles sector.

When the single factoral terms of trade, which takes the productivity as basis, is examined, an improvement is observed in all sub-sectors, excluding machinery and equipment manufacturing and motor vehicles. Single factoral terms of trade, which realized against Turkey especially in motor vehicles sub-sector until the first quarter of 2002, increased by 27,3 percent in the second quarter of 2002 when compared to the first quarter. The basic factor in this development is the increase in productivity. Another outstanding point in the Table is the large dimension of developments against Turkey in both net barter terms of trade and single factoral terms of trade for machinery and equipment sub-sector until the first quarter of 2002. This sector recovered the impacts of deterioration through the increase of export volume.

The political uncertainty environment that appeared in May had an unfavorable impact on investment plans of firms for the next period. Consequently, capital goods imports that increased by high rates in April and May dropped by 0.4 percent and 1.8 percent, respectively, compared to the same months of the previous year. In the January-July period, capital goods imports declined by 6.2 percent compared to the corresponding period of last year.

Figure VI.1.6. Manufacturing Import Volume and Production Indices (1997=100)



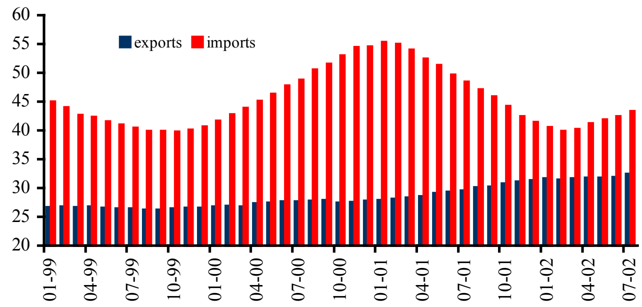
Source: SIS.

The increase of private final consumption expenditures with 1987 prices by 3.1 percent in the second quarter of the year compared to the same period of the previous year reflected to the consumption goods imports as well and in the second quarter, consumption goods import volume rose by 23.7 percent according to the SIS Import Volume Index. In the January-July period, consumption goods imports increased by 1.8 percent compared to the same period of 2001.

World crude oil prices rose by 5.2 percent in July, 3.2 percent in August and 6.7 percent in September. Increasing crude oil prices will likely raise Turkey's import costs in this period.

According to the August results of CBRT Business Tendency Survey, in the following three months, an increase is predicted both in the volume of orders and the volume of goods, which are expected to be sold in domestic market. The same survey results point out a downward trend in raw material stocks. In the coming quarter, it is predicted that the demand for imports will increase in the following three months in line with the expectation that domestic production will increase due to increase in exports and the recovery in the domestic demand.

Figure VI.1.7. Exports and Import (Annual, USD Billion)



Source: SIS

VI.2. Current Account Balance

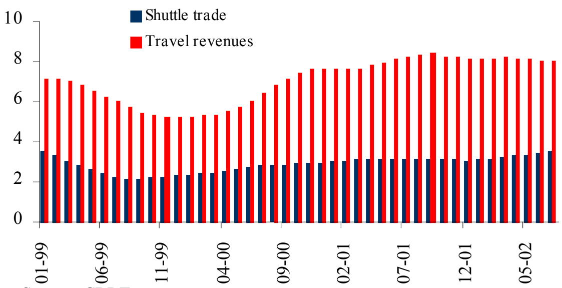
Current account balance produced a deficit of USD 193 million in the first quarter of 2002. The deficit reached USD 718 million in the January- July 2002 period due to high increase in imports in the second quarter stemming from the upturn in industrial output. Nevertheless, there was no such development in other revenue generating items of income that might compensate for the increase in foreign trade deficit.

In the January-July 2002 period, the current account deficit reached USD 718 million, since the other revenue generating items of income failed to compensate for foreign trade deficit.

Despite the increase of 4.4 percent in the number of foreign visitors in the first seven months of 2002, their average expenditures dropped. While the average expenditure of foreign visitors was USD 723 per person in the January-July 2001 period, it fell to USD 671 during the same period of 2002. Hence, tourism revenues fell below the level of the same period of the previous year.

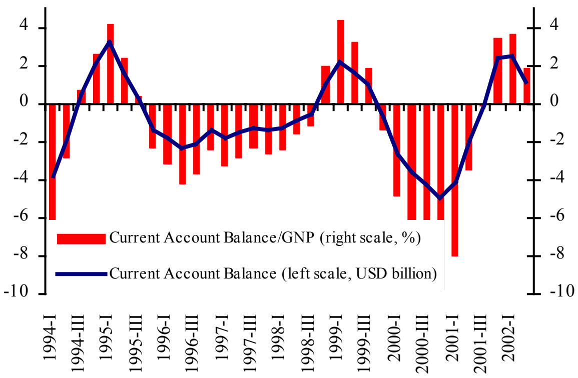
The downward trend in other services income persisted as well. With the contraction of other services income by 45.4 percent and the decline in tourism revenues had negative impact on services balance. In this period, other services expenditures and interest payments dropped by 14.2 percent and 22.1 percent, respectively. Decline in interest payments mainly stemmed from the drop in short-term borrowing interest rates.

Figure VI.2.1. Shuttle Trade and Travel Revenues (Annual, USD billion)



Source: CBRT

Figure VI.2.2. Current Account Balance (Annual)



Source: CBRT, SIS

Similar to services income, there appeared no improvement in unrequited transfers that might compensate for the foreign trade deficit. Unrequited transfer income, which was in a downward trend as of the second half of 1999, maintained its position in the first half of 2002 as well. However, workers' remittances rose by 6.7 percent in July compared to the same period of last year. Although it will be untimely to determine whether the said development is temporary or not, the slowdown in long-lasting downtrend is considered as an encouraging development.

Table VI.2.1.Balance of Payments (USD million)

	July		January-July	
	2001	2002	2001	2002
Foreign Trade Balance (fob)	-544	-892	-3112	-3427
Other Goods and Services Balance	679	655	2016	807
Transfers Balance	300	302	2313	1902
Current Account Balance	435	65	1217	-718
Capital Flows	-758	-138	-10158	517
Foreign Direct Investments (Net)	110	-22	1793	114
Portfolio Investments (Net)	-762	24	-3978	-954
Long-Term (Net)	637	322	-988	1343
Short-Term (Net)	-743	-462	-6985	14
Net Errors and Omissions	-813	-51	-2113	-1605
Shuttle Trade	*215*	*276*	*1695*	*2128*
Travel Revenues	*1113*	*1100*	*4215*	*4081*
Workers' Remittances	*198*	*210*	*1750*	*1219*
Other Invisible Items Revenues	*622*	*424*	*4787*	*2612*

Source: CBRT

IV.3. Capital Flows

Apart from reserves and IMF credits, capital inflow in the first seven months of 2002 realized USD 0.5 billion.

Table VI.3.1. Net Capital Inflow by Sectors (USD Million)

	July		January-July	
	2001	2002	2001	2002
GENERAL GOVERNMENT	1074	-89	-1116	-285
Bond Issues	0	0	-169	493
Medium and Long-Term	1074	-89	53	-778
Short-Term	0	0	-1000	0
BANKS	-1947	-168	-5480	-672
Bond Issues	-3	-75	-3	-187
Medium and Long-Term	-241	40	-879	-67
Short-Term	-1703	-133	-4598	-418
PRIVATE SECTOR	-475	604	-1390	1933
Bond Issues	0	0	0	0
Medium and Long-Term	-265	272	-267	1841
Short-Term	-210	332	-1123	92
OTHER	590	-485	-2172	-459
Securities (Liability)	-454	112	-3568	433
Foreign Direct Investment (Inside the country)	143	17	2159	179
Other	901	-614	-763	-1071
NET CAPITAL INFLOW	-758	-138	-10158	517

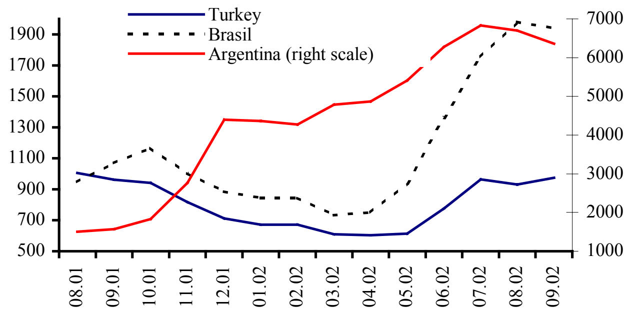
Source: CBRT

While non-residents made net investments worth of USD 179 million in this period, the total of investments made abroad by residents was USD 65 million. Hence, net direct investments realized as USD 114 million.

Treasury's eurobond issue intensified in the first half of the year. In the January- July 2002 period, while Treasury borrowed USD 2.1 billion from international capital markets, its total redemption reached USD 1.6

billion. Thus, the net borrowing of the Treasury realized as USD 0.5 billion

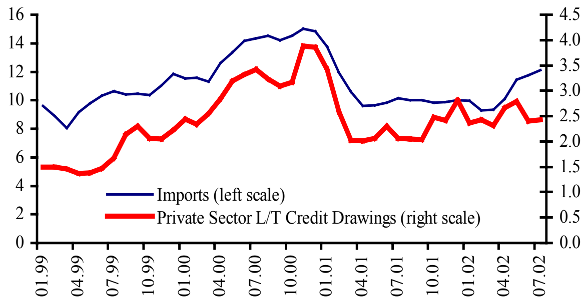
Figure VI.3.1. Secondary Market Bond Spread (monthly average)



Source: JPMorgan

The spreads of Turkey's international bonds (Figure VI.3.1) points at a likely increase in the costs of foreign financing. Moreover, it is predicted that widening spreads of Argentine and Brazilian bonds will shake the confidence in emerging markets and thus will restrict the capital inflows.

Figure VI.3.2. Private Sector Long-Term Credit Drawings (quarterly, USD billion)



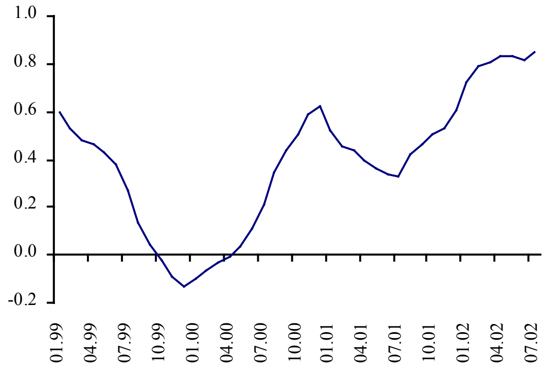
Source: CBRT

Due to the foreign securities purchases made by the residents, especially by the banks, there was a net capital outflow of USD 1.7 billion in the January-July period.

In the long-term capital movements, a net inflow of USD 1.3 realized in the January-July period. This development mainly resulted from the increase in long-term credit drawings. In this period, the amount of long-term credit drawings reached USD 8 billion. The said increase largely stemmed from loans received by the private sector for financing imports. On the other hand, capital remained below the principal payments, which was USD 7 billion during the same period, for long-term credit was lower than drawings.

Foreign exchange deposits of Turkish workers abroad with the Central Bank, which shows an upward trend as of August, 2001 increased by net USD 347 million in the January-July period.

Figure VI.3.3. FX Deposits with the Central Bank (Annual, USD billion)



Source: CBRT

Short-term capital movements, which pursued a fluctuating course in the January-July period, rose by USD 14 million in this period. The basic reason of this fluctuating trend was the rapid movements in foreign exchange reserves of banks that they hold with their foreign correspondents. Banks' drawings of short-term credit dropped by 82.5 percent and realized as USD 15.1 billion in this period. The fall in short-term credits provided from abroad mostly resulted from the sharp decline in real domestic credit following the 2001 crisis and the growth in liquid assets of banks. Stagnation observed in both commercial and consumer credits in August and September appears as the factor that will restrict direction of banks towards short-term foreign resources.

Both in July and August, two tranches of the IMF credit, USD 1.1 billion IMF each, were released. Hence, the IMF credits that were used in the January-August 2002 reached USD 6.3 billion. Consequently, the Central Bank reserves increased by USD 6.4 billion compared to the the end of 2001 level and realized as USD 25.1 billion as of September.

In the light of the developments above, predictions for the upcoming period can be summarized as follows:

According to the Exporters' Association records, exports rose by 15.2 percent and 27.7 percent, respectively, in August and September. Estimations related to the last quarter of the year and announcements of respective sector representatives point at the continuance of performance of exports beyond expectations. On the other hand, high rates of increase in industrial output and growing exports revived import demand as well. Along with the economic recovery, the possible pick up in the consumption expenditures is expected to lead a parallel increase in the demand for consumption goods imports.

Tourism revenues failed to improve in the first seven months of 2002 and fell behind the previous year. Persisting downtrend in average expenditures despite the increase in foreign visitors has negative impact on tourism revenues. The increasing possibility of USA's operation against Iraq since the second half of the year will probably have an unfavorable effect on tourism. However, it predicted that the said negative effect will possibly manifest itself in 2003 due to the fact that the active tourism season is closed in the last quarter of the year.

The major source of capital inflows in the first half of 2002 was the credit extended within the framework of stand-by agreement with IMF. On the other hand, especially foreign credit volume received by the private sector for financing imports expanded with the recovery of economy.

Table VI.3.2. Foreign Debt Indicators

	2000	2001	2002-II*
Foreign Debt Stock			
USD	119.7	115.2	125.9
Ratio to GNP	60.0	79.7	78.9
Short-Term Foreign Debt Stock			
USD	28.3	16.2	15.2
Ratio to Reserves	122.9	85.2	68.4
Medium Long-Term Foreign Debt Stock (USD)	91.4	99.0	110.7
International Institutions	11.5	22.2	27.5
Private Creditors	71.3	69.0	74.9
Commercial Banks	28.3	27.0	28.6
Short-Term Debt and Medium Long-Term Repayments			
USD	43.5	32.6	31.7
Ratio to Reserves	189.0	171.3	142.8
Debt Service Ratio	35.7	40.6	41.2

* GNP is annualized and converted into USD by using average exchange rate.
Source: CBRT

The ratio of debt service failed to show a notable evidence of improvement. On the other hand, recovery in the ratio of short-term debt to reserves and the ratio of total medium-long term debts to reserves, which was observed in the first quarter of 2002 continued in the second quarter as well. It is predicted that the said developments will continue in the second half of the year.

VII. DEVELOPMENTS IN THE WORLD ECONOMY

In the first half of the year, global recovery process slackened with respect to the first quarter and incurred a number of risks. While the growth rate of the US economy decreased significantly in the first quarter, the growth rates announced in the Euro Zone revealed that the recovery process drastically slowed down. In Japan, where the increase in export revenues are the only source of growth, the structural reforms are still pending. Current situation of Latin American economies strike as another significant variable of global growth. In the event the risks in these countries happen to occur, fragile and sluggishly progressing global growth process is expected to be affected adversely. In the second quarter of the year, the Asian economies managed to maintain their growth rate that they attained in the first quarter of the year. In the last quarter of the year, the tension between USA-Iraq and hence the developments in the petroleum prices are expected to have a negative impact on global recovery.

United States of America

The growth rates announced by the US government for the first quarter of the year led to expectations that the regression that started in March 2001 will be replaced by vigorous growth environment. However, in the second quarter of 2002, the announced growth rate aroused concerns whether the economy will once more hit the bottom. Slackening of the consumption expenditures, which comprise 67 percent of the GDP and the hike in imports have been the essential incentive of the slump in the second quarter. The growth trend which still persists in the economy, can lose its pace again due to the investments which still have not responded to buoyant consumption expenditures. Negative developments in the equities market have made future revenues unpredictable and this in turn, have caused difficulty for the firms to increase employment and investments. Meanwhile, the unfavorable conditions concerning unemployment and equity prices resulted in decrease in the consumer confidence. It is still ambiguous if this drop will be compensated by the fall back of the long-term credit interests and increase in productivity. In the US economy, where inflationary pressure is not a matter of question, it is not expected for FED to change its current stance which is currently more concerned about growth rather than inflation. In 2002, while an excess budget of 3 percent of the GDP was foreseen, now, a deficit of 1.8 percent is expected. Under these circumstances, fiscal policies in the forthcoming periods will have less room to support the growth process. In the IMF report published in September the growth predictions for 2002 and 2003 has been lowered according to the April estimates. According to the mentioned report, the US economy is expected to grow by 2.2 percent in 2002 and 2.6 percent in 2003.

Europe

Recovery in the Euro Area is rather sluggish compared to those in North America and Asia. The growth trend observed in the area since the end of 2001 is mainly originated from the increase in net exports. However, as also indicated by the sluggish import demand, domestic demand in most countries of the region in the second half of 2002 has exhibited a weak performance. Private consumption expenditure in those countries is still sluggish and investment expenditures are yet to compensate the decrease in 2001. The indicators pertaining to economic activities and confidence announced recently foretells that the economic recovery will be more feeble than expected.

Table VII.1. World GDP Growth Rates

(Annual Percentage Change))

	2001	2002	2003
World	2,2	2,8	3,7
Developed Countries	0,8	1,7	2,5
U.S.A.	0,3	2,2	2,6
Canada	1,5	3,4	3,4
Euro Area	1,5	0,9	2,3
Germany	0,6	0,5	2,0
France	1,8	1,2	2,3
Italy	1,8	0,7	2,3
U.K.	1,9	1,7	2,4
Japan	-0,3	-0,5	1,1
Developing Countries	3,9	4,2	5,2
Developing Asian Countries	5,6	6,1	6,3
Newly Industrialized Asian	0,8	4,7	4,9
ASEAN-4***	2,6	3,6	4,2
China	7,3	7,5	7,2
India	4,1	5,0	5,7
Developing Countries in America	0,6	-0,6	3,0
Argentina	-4,4	-16,0	1,0
Brazil	1,5	1,5	3,0
Chile	2,8	2,2	4,2
Mexico	-0,3	1,5	4,0
EU members	..	3,0	4,1
Turkey	-7,4	3,9	5,0
Czech Republic	3,3	2,7	3,2
Hungary	3,8	3,5	4,0
Poland	1,0	1,0	3,0
Bulgaria	4,0	4,0	5,0
Romania	5,3	4,3	4,9
CIS	6,3	4,6	4,9
Russia	5,0	4,4	4,9
Africa	3,5	3,1	4,2
Middle East	4,2	3,5	4,6

* Newly Industrialized Asian economies are Hong Kong. Korea. Singapore and Taiwan.
**ASEAN-4 includes Indonesia. Malaysia. The Philippines and Thailand.
Source: IMF. World Economic Outlook, September 2002

Still, there exist some factors that might support growth in the region. Starting from the year end the stock cycle is expected to support economic activities. Meanwhile, private consumption which is believed to increase with the effect of recent increase in incomes, drop in inflation and strong labor force market performance, is expected to support growth. Improvement in company profits and capacity utilization are also believed to increase investment expenditures.

With regard to economic performance, there are significant differences between the region countries. These differences mainly emerge from the dissimilar effects of global shocks, the financial conditions and structural circumstances in each individual country. While domestic demand in Germany and Italy, the two biggest economies in the region, stayed sluggish, that in France became more stronger thanks to the increasing employment following the labor force markets reforms in the recent years.

Growth rate of British economy, has increased in the second quarter. Unlike the other countries in the Euro area, in Britain, private consumption seems much stronger. Manufacturing industry is giving out signals of recovery after a slump in production and fixed investments in 2000.

Figure VII.1. The USD-Euro Parity

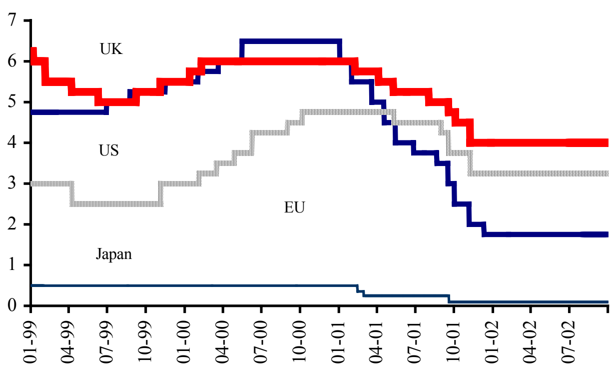
Japan

The Japanese economy seems to recover from recession trend. In the first half of 2002, economic activities revived with the positive effect of net exports, however domestic private consumption remained relatively weak. The most recent indicators show that private sector investments will make a rebound until the end of the year, however retail sales are unlikely to accompany this rebound. The ongoing deflation further aggravates the debt burden in real terms. Meanwhile, shaped by the uninterrupted slump in equities market and decline in real estate prices, the negative wealth effect creates pressure on the banks' balance sheets.

According to IMF estimations, the Japanese economy is expected to grow by 1 percent in 2003 after a 0.5 percent contraction in 2002. The private expenditures are expected to increase slightly in the second half of the year and domestic demand is expected to revive gradually towards the end of the year in line with recovery in private investments. The contribution of net exports is estimated to diminish due to increased imports owing to increased domestic demand and decrease in competitiveness owing to the appreciation of Japanese Yen. Public investments are estimated to decelerate in the second half because of the financial policies implemented. Meanwhile the structural financial deficit is calculated to decrease by 1 percent of the GDP and this drop is expected to be compensated by the tax abatement to be announced soon.

There are two major risks in the recovery tendency of the Japanesse economy. First, the revival of the economy is still exposed to external factors. The recent appreciation of the Japanesse yen and the slow recovery of the world economy than expected has restricted the economic growth of the country. The second risk is considered as, the distortion of the confidence environment in the country for the declining tendency of the equity prices since the beginning of the year and the present weak economic growth and the declining equity prices having a negative impact on the banking sector causing even further weakness.

Grafik VII.1. . Main Central Bank Interest Rates (Percentage)



Source: Corresponding Central Banks

Asia

The economic activities of the developing countries of Asia have improved apparently since the beginning of the year. Industrial production and exports have increased depending on the revival of the world economy and the developments in information technology sector. The data pertaining to the second quarter have realized above expectations and the increasing domestic demand with the supportive macroeconomic policies have effected the GDP growth expectations of the countries of the region. According to the IMF expectations the economies of the region are expected to grow 6 percent. However, it is considered that the rebound of the region to a large extent depends on external developments. The growth opportunities of the regional countries will be restricted with the probability of a recovery less than expected in the US and European economies together with the reduction in the accelaration of the information technology sector. Besides, the emerging countries in Asia are also liable to petroleum price shocks.

Table VII.2. CPI Inflation for Selected Country Groups (Annual Percentage Change)

	2001	2002	2003
Developed Countries	2,2	1,4	1,7
U.S.A.	2,8	1,5	2,3
Canada	2,5	1,8	2,1
Euro Area	2,6	2,1	1,6
Germany	2,4	1,4	1,1
France	1,8	1,8	1,4
Italy	2,7	2,4	1,8
U.K.	2,1	1,9	2,1
Japan	-0,7	-1,0	-0,6
Developing Countries			
Developing Asian Countries	2,5	2,0	3,1
Newly Industrialized Asian Countries**	1,9	1,1	2,2
ASEAN-4***	6,6	6,2	5,5
China	0,7	-0,4	1,5
India	3,8	4,5	5,1
Developing Countries in America	6,4	8,6	9,3
Argentina	-1,1	29,0	48,0
Brazil	6,8	6,5	4,3
Chile	3,6	2,1	2,8
Mexico	6,4	4,8	3,7
EU members	21,2	16,8	11,9
Turkey	54,4	47,1	28,6
Czech Republic	4,7	2,7	3,0
Hungary	9,2	5,5	5,2
Poland	5,5	2,1	2,3
Bulgaria	7,5	6,4	4,3
Romania	34,5	24,2	19,1
CIS	19,9	14,6	10,7
Russia	20,7	15,8	11,0
Africa	13,1	9,6	9,5
Middle East	8,0	9,4	9,2

* Newly Industrialized Asian economies are Hong Kong. Korea. Singapore and Taiwan.
**ASEAN-4 includes Indonesia. Malaysia. The Philippines and Thailand.
Source: IMF. World Economic Outlook, and September 2002.

Latin America

Latin American economies are yet to recover from recession. What is more important than the slow growth pace is the persisting fragile economic environment in some countries in the region. While capital is flowing out of the country, the depreciating national currencies continue to make upward pressure on inflation.

In Brazil, concerns about the results of elections held in October created substantial fluctuations in financial markets via expectations. With the long-term persistence of unfavorable course of financial markets, concerns about reimbursement of high amounts of public and private sector debts were started to be voiced more seriously. Following these developments, IMF extended a new credit facility of USD 30 billion to Brazil in August and signed a new 15-month stand-by agreement with her. However, it was observed that this support could only change the pessimistic atmosphere in financial markets to some extent. Interest rates are still at high levels. Because of the depreciation of real, inflation rates showed upward trend. Inflation, which realized at an annual rate of 7,5 percent as of August, is expected to exceed the 2002 year-end target.

It is understood that in Argentina, crisis environment can only be overcome by an agreement with IMF. The Argentine economy is expected to shrink by 16 percent in 2002. Negotiations for a new agreement with IMF is still in progress. The most outstanding development in the economy is that current balance has started to produce high amounts of surplus due to depreciation of peso. However, it is observed that peso, which depreciated against foreign currencies, has a negative effect on inflation at the same time.

The Argentine crisis and the gloomy situation of Brazilin economy have negative effects on Mexican economy. It is expected that the growth rate , which was 1.2 percent in the second quarter of the year in real terms will realize as 1.5 percent in overall 2002. The Mexican economy is also being affected negatively by the sluggish growth in the USA, her major trade partner. The depreciation of peso as of the end of March led to inflationary pressures..

Table VII.3. Current Account Balance to GDP ratio for Selected Country Groups Percentage

	2001	2002	2003
Developed Countries	-0,8	-0,8	-0,9
USA	-3,9	-4,6	-4,7
Canada	2,8	1,7	1,9
Euro Area	0,4	1,1	1,0
Germany	0,1	1,9	2,1
France	1,8	1,9	1,4
Italy	0,1	0,2	0,2
UK	-2,1	-2,1	-2,3
Japan	2,1	3,0	2,9
Developing Countries			
Developing Asian Countries	3,0	2,6	2,1
Newly Industrialized Asian Countries**	6,0	5,7	5,5
ASEAN-4***	5,9	3,8	2,1
China	1,5	1,5	1,0
India	..	0,1	..
Developing Countries in America	-2,8	-1,9	-1,6
Argentina	-1,6	10,8	15,4
Brazil	-4,6	-3,8	-3,6
Chile	-1,9	-1,6	-2,0
Mexico	-2,9	-2,8	-3,2
EU members	-2,6	-3,4	-3,5
Turkey	2,3	-0,8	-1,0
Czech Republic	-4,6	-5,2	-4,6
Hungary	-2,2	-3,8	-3,7
Poland	-4,0	-3,6	-4,2
Bulgaria	-6,1	-5,6	-5,5
Romania	-5,9	-5,1	-4,9
CIS	7,5	4,9	4,3
Russia	10,3	7,0	6,3
Africa	0,3	-1,7	-1,6
Middle East	7,6	4,4	3,2

* Newly Industrialized Asian economies are Hong Kong, Korea, Singapore and Taiwan.
**ASEAN-4 includes Indonesia, Malaysia, the Philippines and Thailand.
Source: IMF World Economic Outlook, September 2002..

Eastern Europe

According to the recent data, Eastern European (except Poland) countries are sustaining their high growth rates despite the global stagnation environment. Inflation rates of these countries are in downward trend despite high growth rates. High current deficits in the countries of region are continuing as of 2002. However, direct foreign investments, which are a healthy resource in financing current deficits, are still on the road to the countries of region in an intensive way.

The Polish economy has been experiencing low growth rates in 2002 as in 2001. Industrial output grew by 1,1 percent on annual basis in the May-July period 2002, while exports increased by 6,6 percent in the same period. In the second quarter of the year, rate of growth realized at 0,8 percent. A growth rate of 1 percent is expected for overall 2002. In Poland, where the National Bank of Poland is trying to keep the interest rates at lower levels, the final interest rate cut was effected on 25 September and official interest rates dropped to 7,5 percent. The increase in oil prices appears as the most significant factor that may risk the achievement of inflation targets in the economy, which dropped in overall 2002.

Hungarian economy grew by 3 percent in the first half of the year, realizing below the expectations. However, growth performance is expected to improve in the second half of the year. Strong course of demand lies behind the ongoing growth environment. However, in the first seven months, due to the strong demand, import increase, with its percentage of 8.3, exceeded the exports increase of 6.6 percent. Despite a relative decline when compared to 2001, direct capital inflow realized so as to recover substantial part of current deficit (of its 70 % for July). Due to slackening of fiscal policy before the elections and lack of measures, which should be taken by the new government towards the fiscal discipline, budget started to produce high deficits. In spite of the vigorous domestic demand and increasing budget deficits, inflation is expected to realize within the scale of 3,5-5,5, which was targeted for 2002.

Flood disaster had a negative impact on growth trend of 2002 in Czech Republic. It is expected that the flood disaster, which caused severe losses in fundamental sectors, will lead to a downward revision in official growth forecasts. On the other hand, exports that increased substantially in the first half of the year is expected to show less increase in the second half of the year. Inflation rates in Czech Republic display a decline trend similar to other economies of the region. Central Bank cut interest rates in line with the downtrend in inflation since the beginning of the year and reduced interest rate to 3 percent from 4,75 percent.

As of the beginning of the year, global stagnation had a limited impact on Commenwealth of Independent States (CIS) countries. These countries maintained their high growth rates of 2001 in the first half of 2002 as well. It is set forth that this situation was stemmed from the ongoing high level of domestic demand in Russia, the largest economy of region and Ukraine. Despite the high growth rates, inflation rates continued to drop in CIS countries in 2002 due to the progress achieved in financial consolidation. In the rest of the year, Russia, whose foreign trade balance was strengthened and whose country risk continued to decrease also in 2002 due to the increasing oil prices, is expected to maintain its favourable contribution to the growth of union countries.

Crude Oil Prices

Partial recovery in the world economy, restrictions in OPEC production targets and, political uncertainty and tension especially in Middle East led to increases in crude oil prices yet again.

OPEC members, at their meeting of 19 September 2002, announced that they will maintain the prevailing production level until the end of the year, asserting that production in the world economy failed to revive at expected levels and that demand for crude oil would increase in the last quarter of the year due only to seasonal factors. OPEC also announced that they will monitor the developments in the markets and will take all kinds of measures in order to keep crude oil prices at 22-28 US dollar band per barrel.

Prices that realized in futures markets indicate that crude oil prices may decline in the next several quarters. The decrease in volatility of future transactions points at the easing of pressure on crude oil prices created by uncertainty. However, despite all these, developments in crude oil prices depend on the political conditions in Middle East in the short-term and thus the uninterrupted supply of crude oil supply.

VIII. ASSESMENT OF INFLATION OUTLOOK FOR FUTURE

In this chapter, we will assess the economic developments of the last three months sequentially, which have shaped the future course of inflation in the following period. According to the medium-term targets of current economic program, CPI increase, which was targeted as 35 percent for the 2002 year-end, will be reduced to 20 percent in 2003 and to 12 percent in 2004. Factors and risks that affect inflation trend will be assessed under these predictions.

VIII.A FUNDAMENTAL FACTORS AFFECTING INFLATION

VIII.A.1 Developments in Overall Demand and Overall Supply

In the second quarter of 2002, GDP rose by 8,2 percent and GNP by 8,8 percent when compared to the same period of the previous year. Expectations related to the course of economy made a favorable progress until May. In the June-July period however, pessimism was dominant in expectations for demand and output due to rise in political uncertainty. After the date of general elections was set, a relative recovery was observed in both expectations and in financial markets.

With the restricted recovery of domestic demand in the second quarter of the year in addition to the encouraging developments in exports, capacity utilization in manufacturing industry rose and industrial output achieved high rates of increase.

Manufactured goods stocks of firms, which decreased sharply in 2001, started to pull through in 2002. Due to the lack of an apparent recovery in domestic consumption demand, increasing production is directed towards exports and stock accumulation. This trend continued in the second quarter of the year as well and the contribution of stock accumulation to GDP growth increased compared to the first quarter and realized at 10,9 percent. Within the framework of assumptions that domestic demand will grow slower than production and because of the seasonal factors, the increase in stocks is expected to continue in the third quarter of the year as well.

Contribution of net export to GDP growth became negative in the second quarter. It is expected that because of the slowdown in recovery trend in the world economy and increase in domestic output and so in import demand, net exports will have an unfavorable impact on GDP growth the rest of the year.

Agricultural sector value added rose by 2,3 percent in the second quarter of the year. An increasing growth in agricultural production is expected for the third quarter of the year by the effect of the seasonal factors as well. Thus, favorable developments in agriculture and food prices that resulted from the increase in supply of agricultural product in the third quarter of the year restricted the rate of change of consumer and whole sale prices.

Despite the decline in private sector fixed capital investments by 0,1 percent in the second quarter of 2002 when compared to the same period of the previous year, the drop in investments highly decelerated compared to the first quarter. Persistent decline in capital goods imports in spite of substantial growth in intermediate goods proves that expectations of firms did not improve enough for new investments. Hence, according to CBRT Business Tendency Survey, expectations of firms for investment expenditures display a negative picture as of June.

Private consumer expenditures increased by 3,1 percent in the second quarter of the year when compared to the corresponding period of 2001. Strengthening of Turkish lira in real terms and the positive effect of stability environment re-established in financial markets on suspended private consumer expenditures played important role in improvement of non-agricultural employment. Basic reasons of slower growth in private consumer expenditures in comparison with GDP are the lack of consumer confidence, sluggish employment level and declining real wages.

The maintenance of increase in output will have encouraging effect mainly on industrial sector employment. Increase in real wages in line with the increasing employment will affect the private consumer expenditures favorably.

Ease in political uncertainties after the date of General Elections were set reflected to the expectations of firm positively. Various indicators related to demand and output expectations given in Business Tendency Survey maintain their optimistic course in the third quarter of the year as well.

As a result, the announced up-to-date data and expectations confirm the views that the encouraging course in industrial output and exports will continue the rest of the year as well.

On the assumption that political uncertainty will weaken progressively, the anticipated drop in real interest rates is predicted to have a favourable effect on investment and consumer expenditures. The decline that was observed in investment goods imports and significant rise in capacity utilization rates in sectors except motor vehicles in recent months are considered as factors that will affect the pricing decisions of firms in the following period.

VIII.A.2. Developments in Exchange Rate

In the April-July period, Central Bank held programmed FX purchase auctions in order to increase its foreign exchange reserves in such a way not to conflict with floating exchange rate and not to impede the long-term trend of exchange rate. However, because of the political uncertainty and stagnation in reverse currency substitution process, programmed FX auctions were suspended in July.

In the July-October period, exchange rates changed due to the increase in risk evaluation of market participants. Risk premium that rose in the May-July period due to political uncertainty declined after the date of election was set and EU adaptation laws were introduced in August. On the other hand, risk premium increased as a consequence of the possibilities of operation to Iraq and postponement of elections in September and continued to rise until October during which the certainty of exchange rate basket relatively relieved. In the third quarter of 2002, Turkish lira depreciated by 9,4 percent against exchange rate basket in nominal terms, which comprised of 1 USD and 0,77 Euro. However, it was noted that exchange rate pursued a steady course compared to July 2002.

VIII.A.3. Developments in Public Prices

In the first and second quarters of 2002, public sector pricing policy was mapped out consistent with the inflation target to a large extent. But acceleration was observed in the rate of increase in public prices in June so as to achieve financial balance targets of SEEs. In the July-September period, although there was a relative slowdown in public price adjustments, price adjustments in oil products manufacturing and energy sectors however, accelerated in line with the rise in international crude oil and natural gas prices.

VIII.A.4 Global Economic Conditions

Recovery trend in the world economy is continuing slower than expected and it is losing momentum as of the second quarter of the year. Stock prices in most countries, mainly in industrialized countries are in downward trend since the end of March. In line with the risk averse behaviour of investors, many developing countries are facing financing problems. Besides, data and preliminary indicators, which were announced recently especially in the USA and European economies, give discouraging signs about the recovery trend in global economy.

Risks related to the recovery in global economy in the short-term are dominant over the favourable effects of coordinated monetary and fiscal policies implemented in international level. Negative developments in stock markets are expected to have unfavourable effects especially on the USA economy, the leading economy in recovery. It is highly possible that depreciation of US dollar against euro and Japanese yen and will cause difficulties during recovery period in Euro Area and

Japan that realized a growth derived from mainly foreign demand up to now.

On the other hand, if the tension between USA and Iraq escalates to a military operation, it is considered that a possible deterioration in consumer and producer confidence will likely have a negative effect on real economy. Additionally, in case of a military operation, it is highly possible that crude oil prices in international markets will increase further. Moreover, the possibility of such an unfavorable response of financial markets in this case will increase the pressure on global economy.

Domestic producers may confront with both domestic and foreign demand deficiencies because of gloomy picture of world economy. Hence, it is unlikely for producers who face with both domestic and foreign demand deficiencies to increase prices. Besides, in the light of the predictions that overall demand in the world economy will maintain its low level, no significant increases are excepted in prices of goods, except crude oil. Therefore, it is predicted that import prices will not be a risk for domestic prices in the coming period.

VIII.A.5 Developments in Prospects for Inflation

According to the CBRT Expectations Survey and Business Tendency Survey results, CPI and WPI inflation expectations for the year-end declined as of January. General downtrend in expectations mainly resulted from economic policies that are carried out within the framework of current program, inflation developments that boost the possibility of achieving year-end inflation target and the fact that domestic demand is not at a level that may lead to inflationary pressure.

According to CBRT Expectations Survey results of the first period of October, inflation expectations of financial and real sectors for year-end are 33,4 percent and 34,3 percent, respectively. Thus, survey results reveal that both financial and real sectors believe that inflation will realize below the target at the end of the year.

On the other hand, according to the Business Tendency Survey results, WPI inflation expectation for year-end declined to 43,5 percent in September from 58,1 percent predicted in the beginning of the year.

VIII.B. FUNDAMENTAL ASSUMPTIONS AND POSSIBLE RISKS

In this part, assumptions on fundamental factors that affect inflation will me made and their possible effects on the course of inflation in the following period will be examined.

In the June-September 2002 period, the depreciation of Turkish lira had unfavorable effect on wholesale price increases, mainly manufacturing industry prices and endurable goods group within the consumer prices. However, it was noted that due to the floating exchange rate regime and lack of demand-oriented pressure, the size and timing of pass-through from exchange rate movements to prices diminished. In the following period, it is predicted that exchange rates will pursue a steady course owing to the confidence re-established by the implementation of economic program with determination after elections and the decline in uncertainty about the operation to Iraq. Hence, it is considered that the relative stability in exchange rates will contribute to the disinflation process in the following period with the weakening of contagiousness from exchange rates to prices.

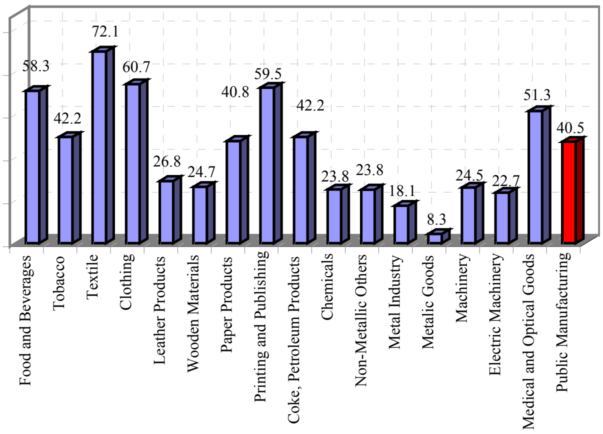
It is predicted that risk premium increase, which emerged in summer and did not depend on economic fundamentals, will decrease gradually by the determined implementation of current program. Due the fact that the unfavorable developments resulted from the increase in risk are of temporary nature, it seems likely to achieve the inflation target set for the next year, within the framework monetary and fiscal policies to be implemented.

Crude oil prices that increased due to the possibility of an operation to Iraq may affect the course of inflation directly and indirectly. Considering the fact that domestic energy prices are decided within the framework of developments in exchange rates and international oil prices, it is predicted that potential increases in crude oil and thus in natural gas will have a negative effect on the downward trend in inflation. On the other hand, increase in crude oil prices may impose a supply-side pressure on prices, raising the input costs in manufacturing industry. In addition to all these, economic losses and costs that may arise from a possible operation to Iraq will deeply affect the financing needs and costs, thus leading to unfavorable developments in exchange rates, interest rates and inflation in the economy.

In the January-September period, rates of increase in prices in sub-items of public manufacturing industry realized within an extremely wide range. In the said period, prices in sub-items of public manufacturing industry increased within the range of 8,3 percent and 72,1 percent (Figure VIII.B.1.). The possibility that price adjustments, which were partially suspended during the election period because of the wide range of the percentage differences and substantially high price increases, may accelerate towards the end of 2002, is considered as a factor that may affect inflation dynamics of 2003.

Monetary and fiscal polities that are carried out with determination and ongoing structural reforms allowed the achievement of targets involved in the economic program up to now. Both the achievements of monetary aggregate and consolidated budget primary surplus targets became important instruments in fight against inflation. Alongside with the current programs, the favorable developments in agriculture and food prices and deficiency in domestic demand faciliated approaching towards inflation target. But the start of election process led to suspensions in structural reforms and non-programmed increases in some expenditure items.

Figure VIII.B.1. Rate of Change of Public Manufacturing Prices by Sub-items: January – September Period (percentage)



When the inadequate investment trend and high level of capacity utilization rates in some sectors are considered, the control of domestic demand maintains its high importance as to the inflation rate in the following period.