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PRESS RELEASE

1. Various reforms, of which even the planning is difficult, have been implemented on both domestic and international scales for more than two years. This period beginning with social security reform has continued in 2001 with many reforms being implemented consecutively. The main significance of these reforms is that they are changing the distorted economic structure, which is one of the main reasons causing the crisis. We hope the positive effects of the reforms will be seen in the medium term.

2. Another significant point to be emphasized in terms of the program, which has been carried out, is the restructuring process of the banking sector. The number of public banks has been reduced and their capital has been increased in order to conform to international standards. The short-term borrowing of these banks from other banks, which caused their balances to deteriorate, has been wiped out and their management has been completely changed. Problematic banks have been removed from the system. During this process, the banks, which had been transferred to the Savings Deposit Insurance Fund, were consolidated and sold off. The private sector banks with the exception of State owned banks are also going through a combination process, taking on partners and/or implementing a plan to increase their capital.

3. Fiscal and monetary disciplines that are the main pillars of a stability program have been achieved. The improvements in the first half of the year indicate that the primary surplus of the budget, one of the two main determinants of debt dynamics, will reach the target level, which is a very challenging level in terms of international criteria. The improvements in the balance of the Central Bank are realized in accordance with the agreement made with the IMF. In other words, the monetary policy in question is achieving stability. The last aspect of Central Bank law is the assurance of this policy.

4. Under normal circumstances, in a country where the above-mentioned economic policy practices have been followed, both current economic indicators and medium and long-term expectations should have been extremely positive. However, the interest rate is high and the exchange rate stands above the equilibrium point in Turkey. There is no doubt that the negativities caused by the fact that the stability program put into practice in 2000 resulted in a crisis and the discussions which took place during the previous term have played a significant role in the present situation.

5. Besides these factors, at first sight there seem to be two more reasons for the high interest and exchange rates: The domestic debt stock problem that the existing program inherited from the past and the floating exchange rate regime.

6. The sustainability of domestic debt stock is not a new discussion. Particularly, the “borrowing syndromes”, which have often been brought to the agenda since the late 1990s, are still in the minds of the public. When a borrowing program that has been presented as problematic is implemented in the markets without any problems, some “new syndromes” may appear on the agenda. There is no doubt that domestic debt stock gradually increased in the said period. However, taken in terms of pure economic fundamentals, the current debt stock is an easily sustainable one. As a matter of fact, recent remarks by the Treasury have helped remove the concerns about the second half of 2001. Moreover, the Undersecretariat of Treasury is enriching its debt management policy and new borrowing instruments.

7. The elusive point is: A debt stock, which can be easily sustained in the framework of economic expectations to be formed at a favorable level deserved as a result of several economic policy implementations that are deemed highly successful in terms of all international criteria, may be perceived as a problem in the framework of totally undeserved economic expectations. Technically speaking, there may be more than one equilibrium in an economy at a time. Expectations of economic agents determine which one of the equilibria will be struck.

8. As for the floating exchange rate regime, considered to be another main reason for the unfavorable conditions currently prevailing, the following points

need emphasis: First of all, it is impossible to insist that “a certain exchange rate regime is far better than others”, in theory. All exchange rate regimes have both positive and negative aspects. The important thing is to ensure that the monetary authorities are aware of the positive and negative aspects of the exchange rate regime in implementation. Another important point is to keep the economic fundamentals strong, regardless of the exchange rate regime in implementation. The above-mentioned economic policy implementation is clear proof that the economic fundamentals are getting stronger.

9. Secondly, an increasing number of countries have abandoned the exchange rate regime they were implementing and adopted the floating exchange rate regime in the last ten years. Thirdly, the currency peg regime adopted in 2000, which is almost the opposite of the floating exchange rate regime, collapsed before the end of the eighteen-month-period of implementation, which had previously been determined. Although, in theory, it may be possible to try to maintain a collapsed exchange rate regime as it stands or as moderated with marginal changes, this is not a common practice. Fourthly, it is a fact that similar arguments were also put forward in countries that adopted the floating exchange rate regime following crises they had experienced. Fifthly, it should be understood that changing the rules of the game would naturally lead to uneasiness among players. This uneasiness will undoubtedly disappear as soon as the players get accustomed to new rules.

10. It should always be remembered that the monetary and exchange rate policy of the Central Bank is very clear. This policy is not carried out due to pressure exerted by an institution, but because it is the most suitable policy for Turkey’s conditions when considered along with the other economic policies in the current conjuncture and its theoretical foundations are very strong.

11. Under the current floating exchange rate regime and in the framework of the latest version of the related Law, the primary objective of the Central Bank is to maintain price stability. The Central Bank has no commitment to the level of the exchange rate. The main instruments that the Central Bank would use against the developments that may hinder price stability are the short-term interest rates. Interest rates are and will only be determined as to the concerns regarding price stability and in no other circumstances. In this framework, the

Central Bank does not follow a policy of selling foreign exchange in order to keep foreign exchange at a certain level. The Central Bank may conduct FX interventions for two reasons. Firstly, the Central Bank may sell foreign exchange in scheduled auctions in terms of Turkish Lira in order to siphon off the liquidity, which enters the system due to the disbursement of foreign credits by the Treasury extended by institutions such as the IMF and the World Bank. Secondly, the Central Bank may both sell and purchase foreign exchange in order to prevent excess volatility in exchange rates. The important point is that the second intervention is not continuously made in one direction.

12. The Central Bank supplied a total of USD 7 billion to the market via these aforementioned interventions, between 22 February and 31 July 2005. In this process, the number of open FX positions in the banking sector decreased significantly along with the borrowing policy of the Undersecretariat of Treasury. A proportion of these sales was conducted in order to reduce the excess volatility in exchange rates deriving from developments, which were not predicted in the design of the “Transition Program for Strengthening the Turkish Economy”, but generated a series of shocks to the economy, the consequences of which are well known to the public. As these exogenous shocks are totally eliminated, it is inevitable that the Central Bank minimizes the number of its interventions and the floating exchange rate regime finds its normal course. Thus, the interventions that were made to reduce FX volatility remained very limited in the last three weeks.

13. There is another important point to be emphasized about the exchange rate. A country’s own currency gains value against foreign currencies in the long run. Economic foundations determine this value. An exchange rate that is not confirmed by economic foundations and its upward trend are merely “bubbles” in technical terms. Bubbles are bound to burst.

14. It is obvious that the current account deficit will yield a substantial amount of surplus in 2001. According to the latest data, the foreign exchange balance has already started to register a surplus. However, this excess foreign exchange appears as demand for foreign exchange in the market. We firmly believe that the foreign exchange market will start to operate like a normal

market when the positive expectations that this program actually deserves are finally seen and the essence of the movements in the FX market is fully understood.

15. At this point, it would be wise to briefly talk about the leading inflation indicators that are monitored by the CBT within the framework of its primary objective of achieving price stability. The first group of indicators contains indicators pertaining to demand. Monetary developments, credits extended by the banking sector, developments in public budget, net capital inflow and stocks, orders received from domestic and international markets and surveys pertaining to expectations of the sector and other expectations are the leading indicators in the first group. The second group comprises cost factors. The analysis based on past data demonstrate that –even if its effects change according to domestic demand conditions- foreign exchange is the most important variable in this group.

16. We would like to reiterate one point. The Central Bank has no commitment to the level of exchange rates, however it has a commitment to price stability. Therefore, the Central Bank would naturally take the necessary measures in case a permanent trend emerges that could jeopardize price stability and there is no development in the leading indicators that could compensate this trend.

17. Another function of monetary policy is to shed light on economic units about inflation expectations by means of the selected nominal anchor. “Inflation targeting” is such an anchor. Obviously, it is not possible to reduce inflation only by means of adopting “inflation targeting” strategy. However, when taken into account with the economic policy explained above and when coupled with the deserved expectations of this policy, inflation target will become a very strong nominal anchor. Inflation targeting is not confined to announcing an inflation target. It is a well-known fact from other country experiences that when all institutional arrangements necessitated by a policy in the shape of inflation targeting are conducted, markets will be able to receive extensive information about the monetary policy.