
OPENING SPEECH OF THE TURKISH DELEGATION

DR. AHMET TIKTIK

UNDERSECRETARY OF STATE PLANNING ORGANIZATION

2006 ECONOMIC REVIEW OF TURKEY

7 SEPTEMBER 2006

OUTLINE

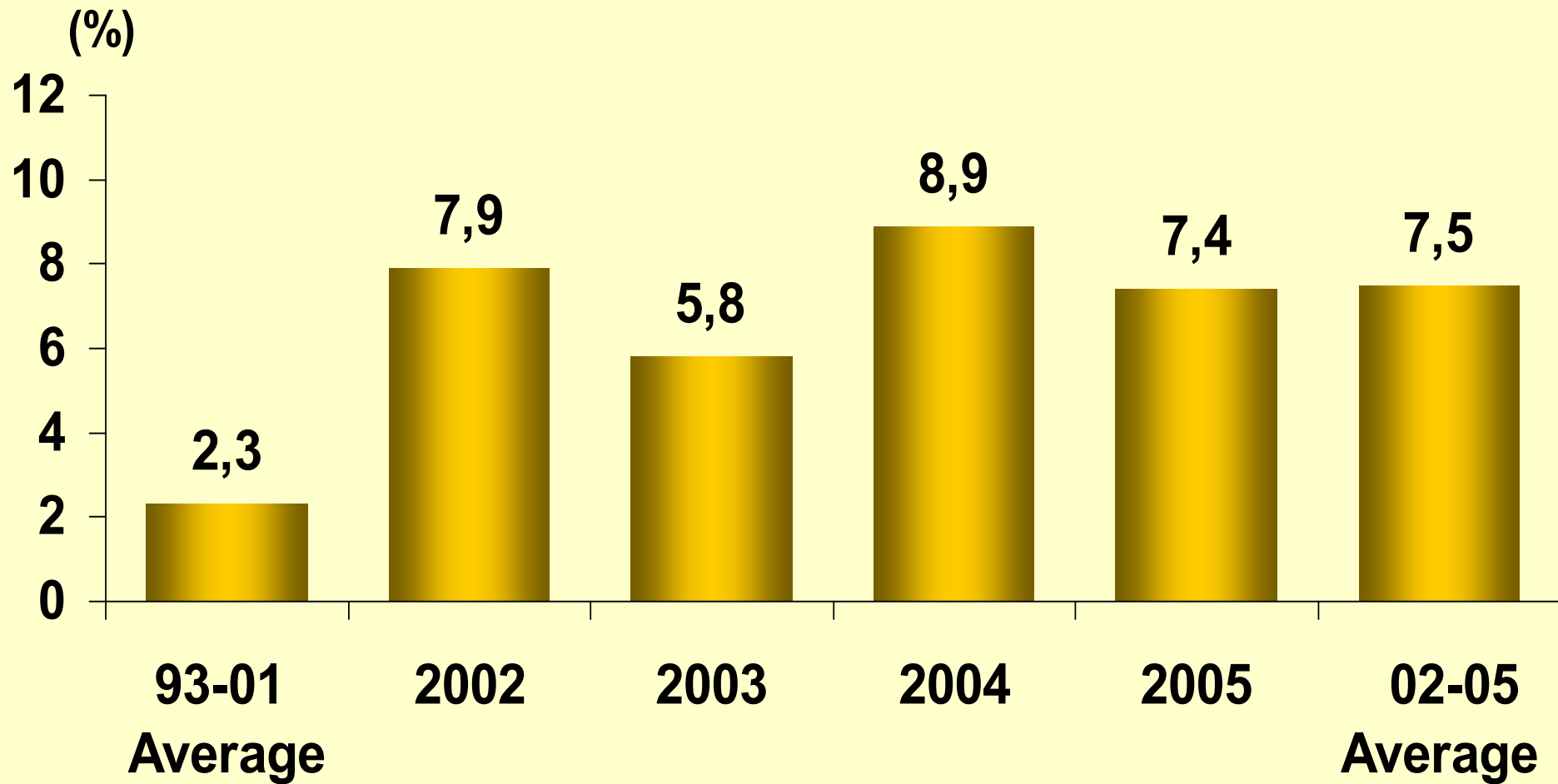
- 1. MACROECONOMIC DEVELOPMENTS AND STRUCTURAL REFORMS IN TURKEY***
- 2. RECENT DEVELOPMENTS IN GLOBAL AND DOMESTIC FINANCIAL MARKETS: POLICY RESPONSE AND POSSIBLE EFFECTS***

OUTLINE

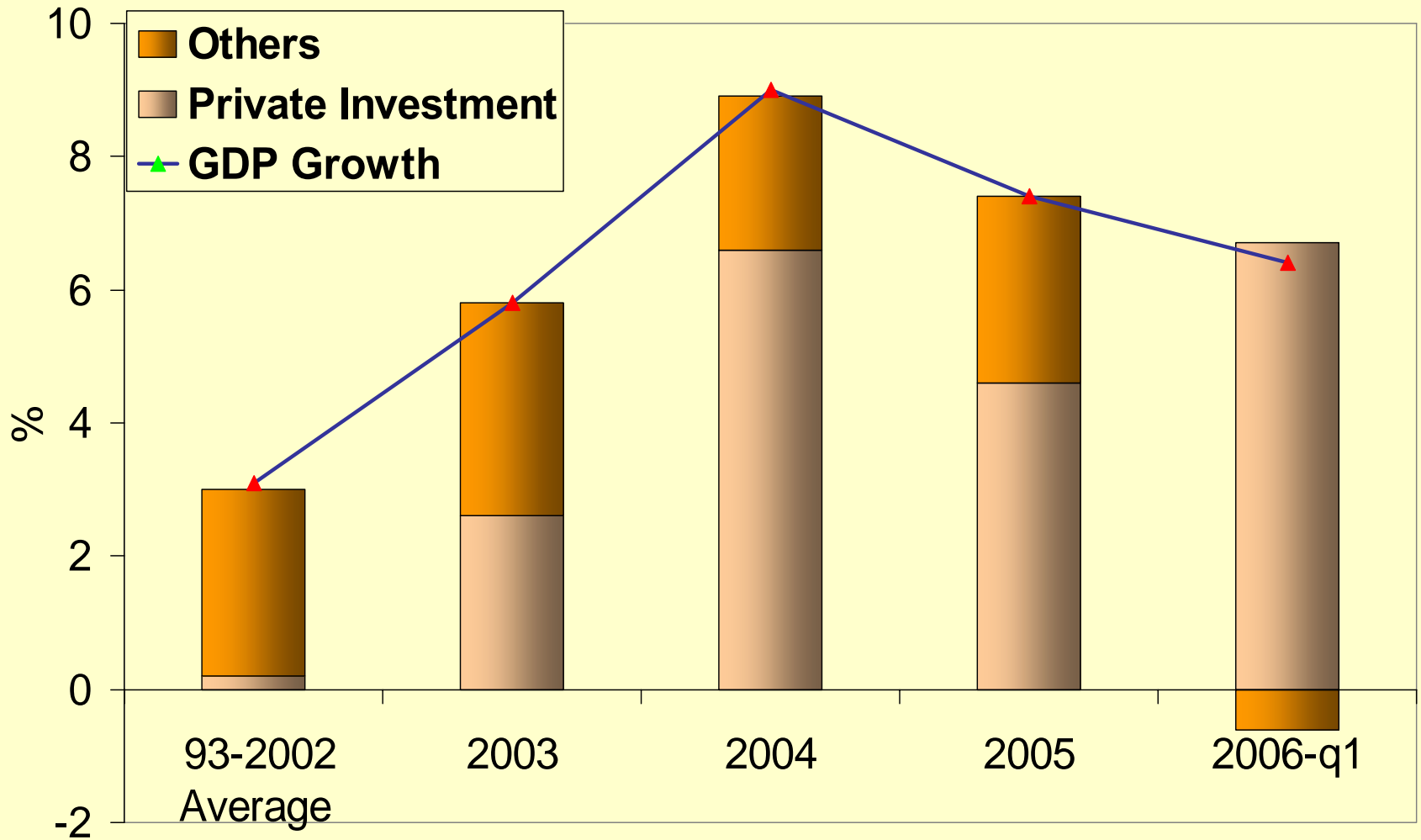
1. *MACROECONOMIC DEVELOPMENTS AND STRUCTURAL REFORMS IN TURKEY*

2. RECENT DEVELOPMENTS IN GLOBAL AND DOMESTIC FINANCIAL MARKETS: POLICY RESPONSE AND POSSIBLE EFFECTS

GDP Growth Rate



Contribution of Private Investment to GDP Growth

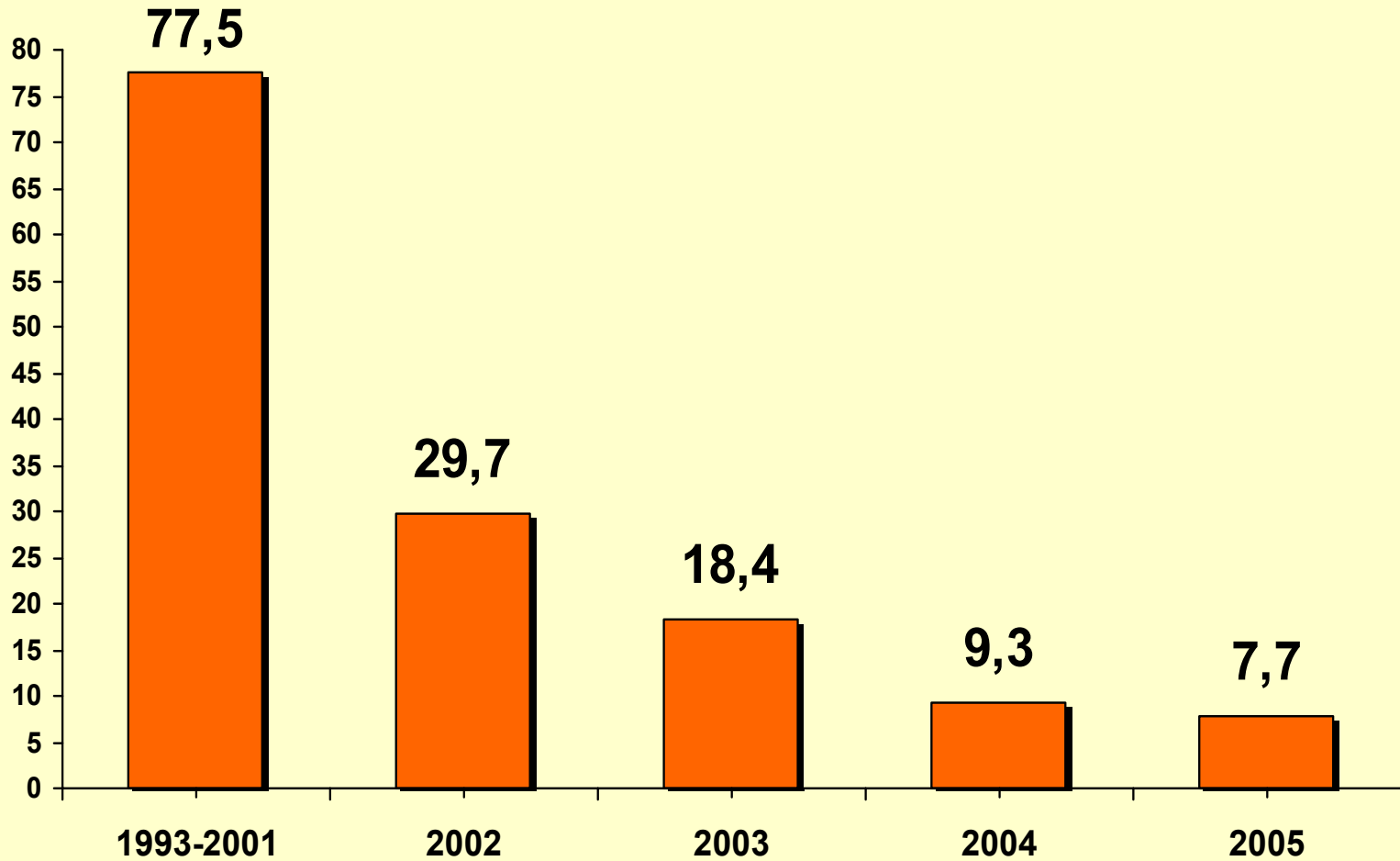


Productivity Based Growth

Contribution to Growth by Factors of Production (%)

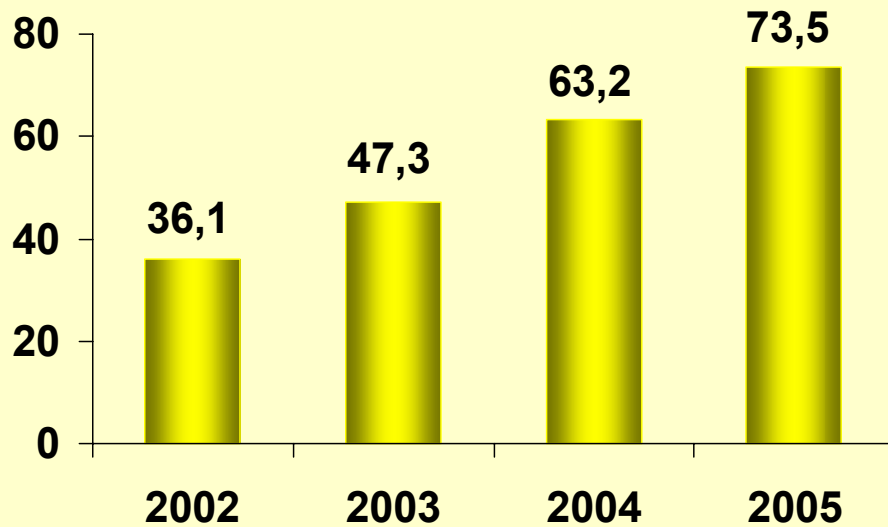
	1990-2000	2001-2005
Capital	73,2	51,7
Labor	23,5	6,3
TFP	3,3	42,0

Inflation (End Year CPI,%)

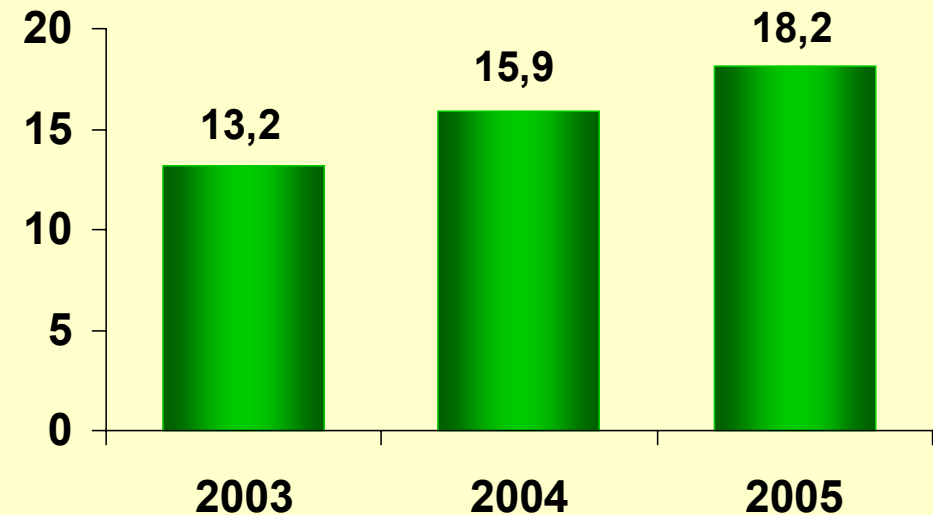


Exports and Tourism Revenues (Billion Dollars)

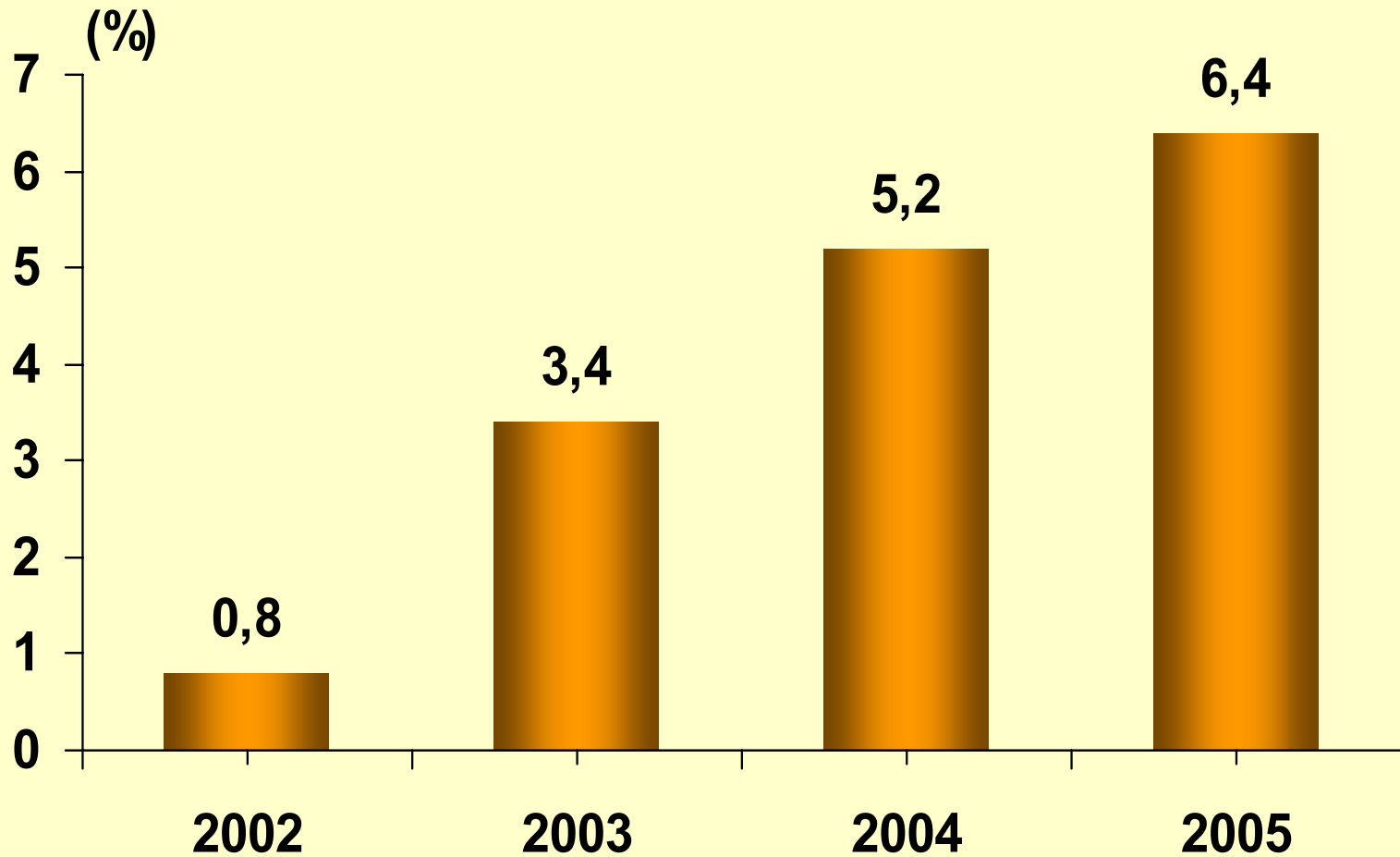
Exports (FOB)



Tourism Revenues



Current Account Deficit (% of GNP)



Current Account Deficit

Main Factors Behind

- *High growth rates; 87.5 percent of total import consists of investment and intermediate goods.*
- *Appreciation of Turkish Lira.*
- *China effect.*
- *Changing composition of export*
- *Increases in oil prices*

Oil price (\$/barrel) 23,4(2002) 50,1(2005) 61,7(1H06)

Every \$10 increase in crude oil prices results in approximately \$4.2 billion increase in energy (fuel, oil and oil products) imports of Turkish economy (1.2% of GDP in 2005).

Export

	2002	2005
China Imports / Total Imports (%)	2.7	5.9
Changing Composition of Exports (%)		
Textiles and Wearing Apparel	33.7	25.4
Motor Vehicles and Transportation	11.5	16.2
Metal Industry	11.6	13.0
Machinery and Equipment	5.8	6.6
Refined Petroleum Products	1.9	3.4
Others	35.6	35.3

Composition of Export is changing

Capital Account

Billion dollars	2002	2003	2004	2005	2006 H1
CAPITAL ACCOUNT	1.2	7.2	17.8	44.1	26.2
Direct Investment, Net	1.0	1.3	2.0	8.7	8.8
Portfolio Investment, Net	-0.6	2.5	8.0	13.4	-1.0
Other Investment, Net (loans and deposits)	0.8	3.5	7.7	22.0	18.3
Short-term liabilities	-0.5	5.3	8.5	8.0	5.6
Long-term liabilities	2.1	-0.9	6.2	13.7	15.7
Increase in Reserves	-6.2	-4.1	-0.8	-17.9	-4.1
Use of IMF Credit, Net	6.4	-0.1	-3.5	-5.4	-3.6

The quality of capital account financing is improving

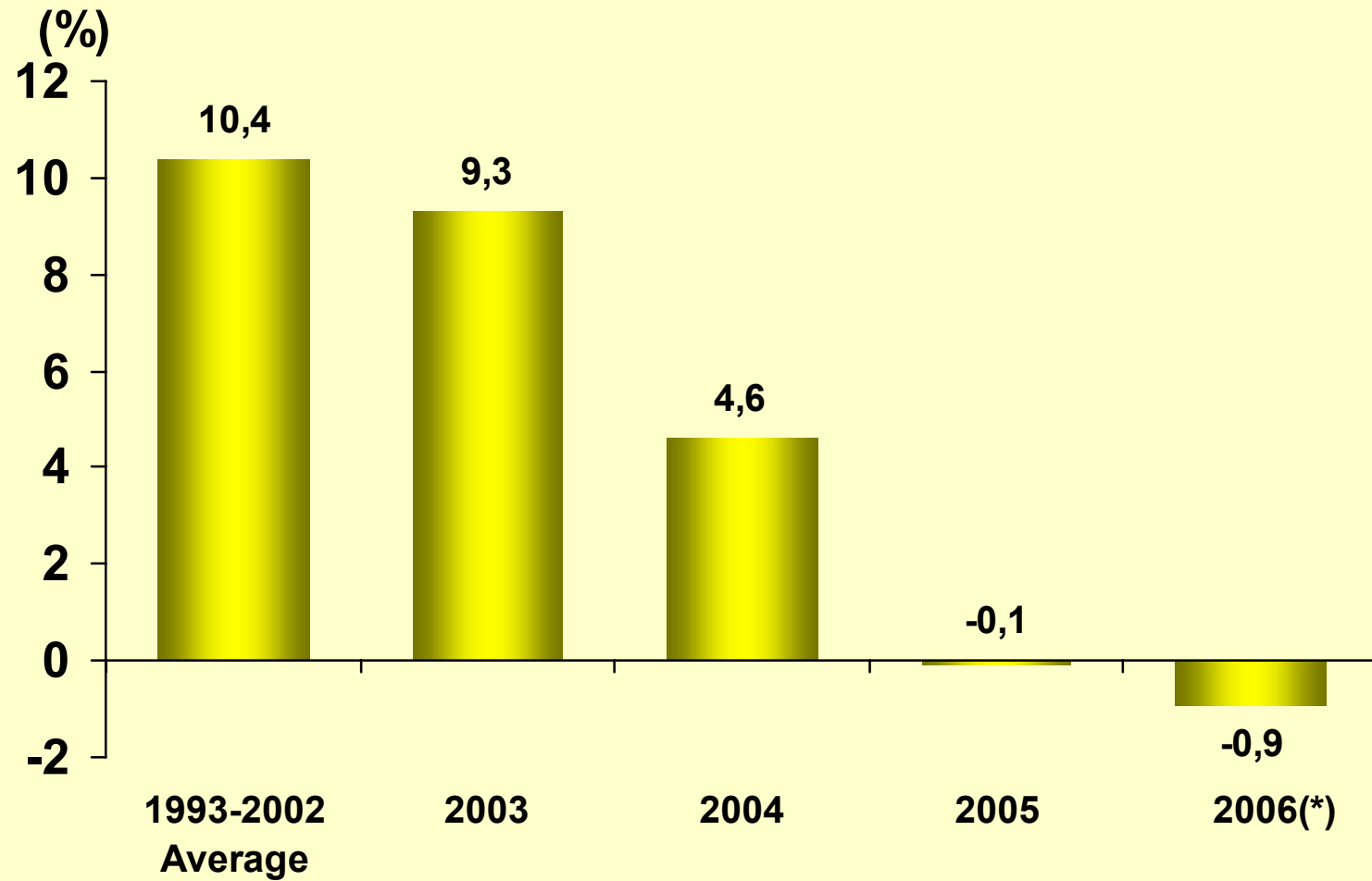
Developments in the Labor Market (%)

	2002	2003	2004	2005
<i>Unemployment Rate</i>	10,3	10,5	10,3	10,3
<i>Non-agricultural Unemployment Rate</i>	15,0	15,0	14,7	13,6
<i>Agriculture Employment Share in Total Employment</i>	34,9	33,9	34,0	29,5
<i>Informal Employment Share in Total Employment</i>	52,1	51,7	53,0	50,1

Causes of the High Unemployment Rate

- *Declining trend of agricultural employment.*
- *Increases in the productivity. Annual average increase in labor productivity in the period of 2002-2005 was realized as 7,8 percent.*
- *Annual average increase in the civilian labor force was 1,1 percent.*
- *Delayed revival in the construction sector.*

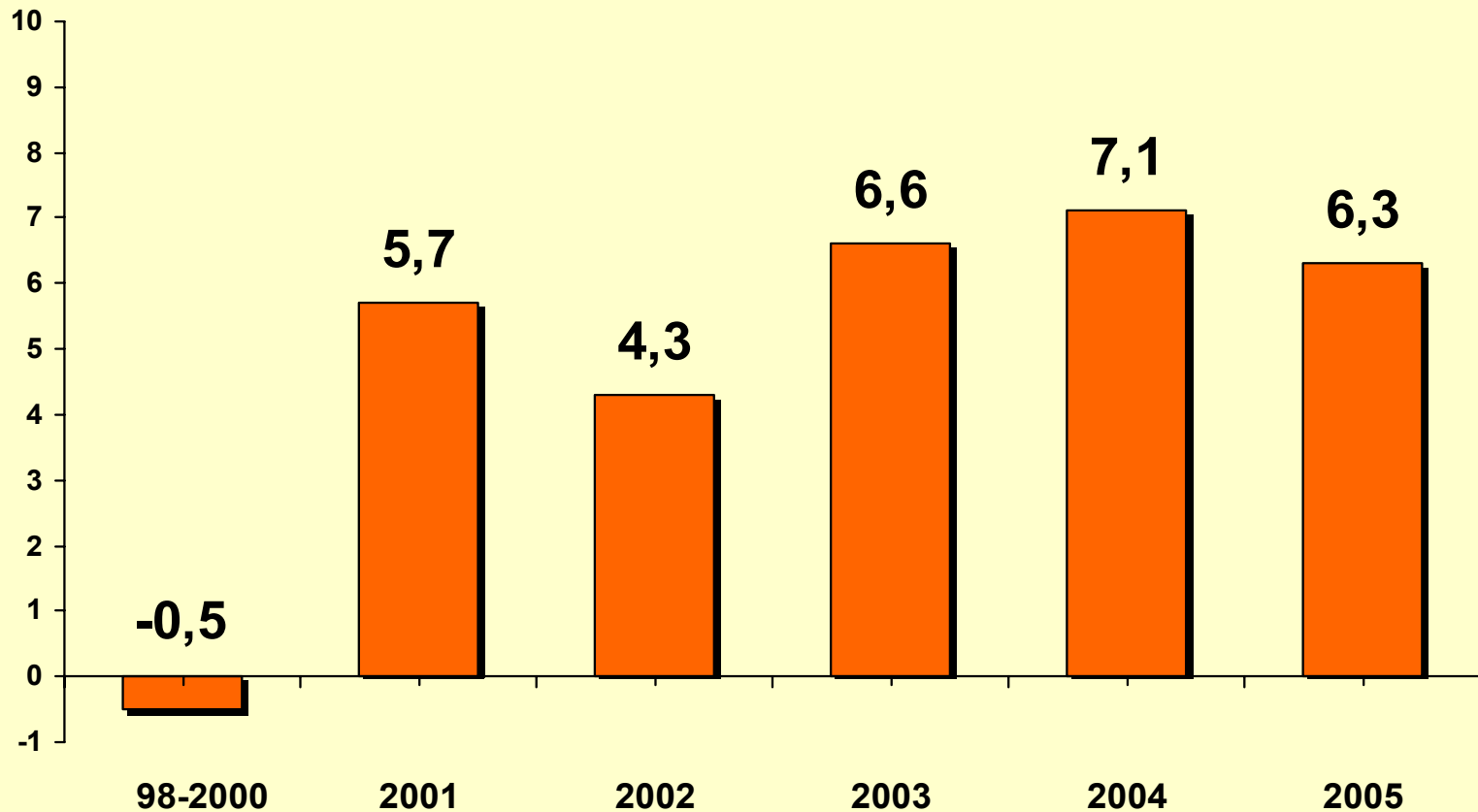
Public Sector Borrowing Requirement (% of GNP)



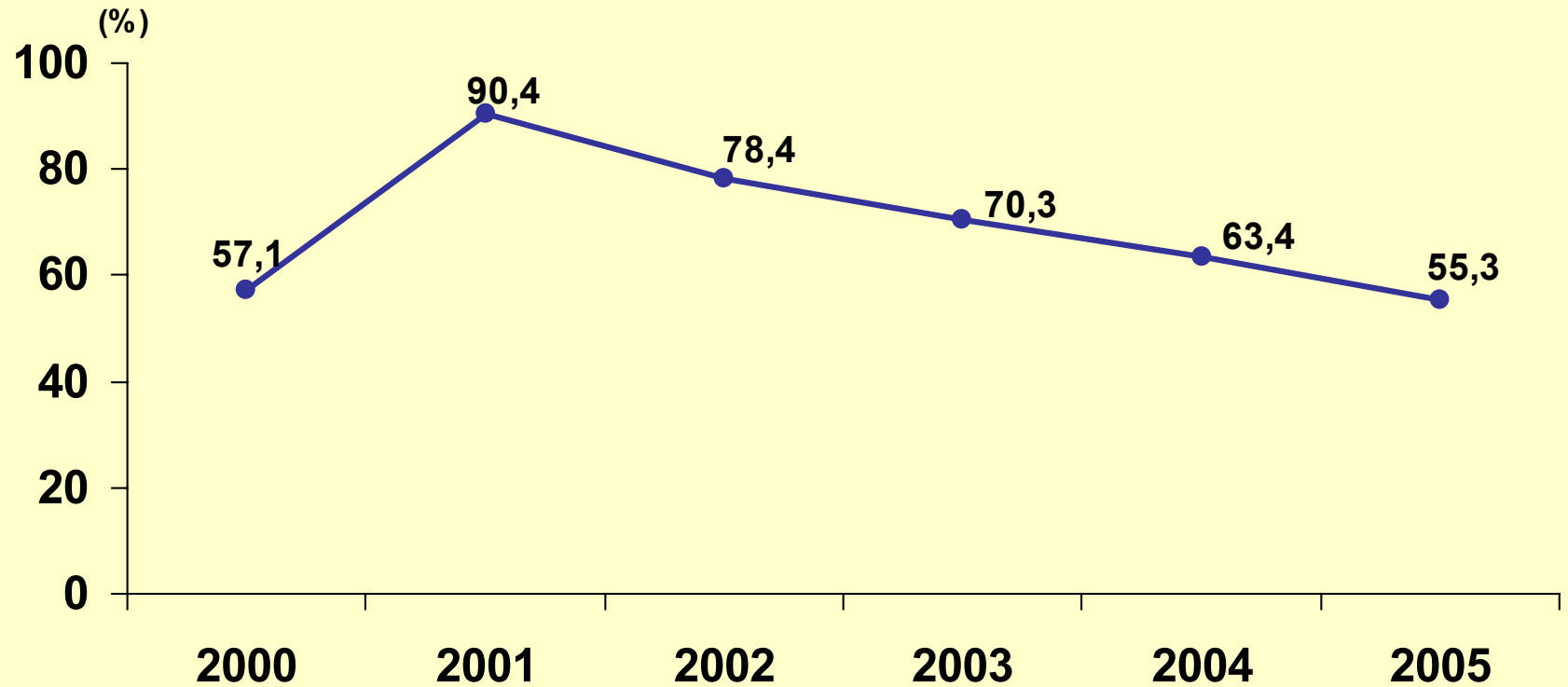
(*) Estimate

Fiscal Discipline :

Primary Surplus / GDP (%)



Public Sector Net Debt Stock (% of GNP)



The Structure of Domestic Debt Stock

(Shares in Total)

	2001	2002	2003	2004	2005
Total	100,0	100,0	100,0	100,0	100,0
Fixed Rate	14,5	25,1	35,3	42,3	41,4
Floating Rate	49,9	42,8	42,8	40,1	43,1
FX Denominated	35,6	32,1	21,9	17,6	15,5

Interest Rates and Maturity of Domestic Debt

	2001	2002	2003	2004	2005
Interest Rates (%) Nominal	96,2	63,8	45,0	25,7	16,9
Maturity (Days)	148	252	299	372	560

- Nominal interest rates, which was 96,2 in 2001, declined to 16,9 in 2005.
- Average maturity, which was 148 days in 2001, increased to 560 days in 2005.

Structural Reforms

Key Elements of Structural Reform Agenda

- ✓ **Public Sector Reform**
- ✓ **Financial Sector Reform**
- ✓ **Social Security Reform**
- ✓ **Tax Reform**
- ✓ **Improving Business Environment**
- ✓ **Privatization**
- ✓ **EU Process**

Structural Reforms

Public Sector Reform:

- ✓ **Public Financial Management and Control Law**
- ✓ **Public Procurement Law**
- ✓ **Rationalizing Public Sector Budget & Investment**
- ✓ **Law on Freedom of Information for Citizens**

EU Accession Process

- Accession negotiations started in October 2005

- Screening Process continuing:

Chapters completed : 25

Chapters ongoing : 4

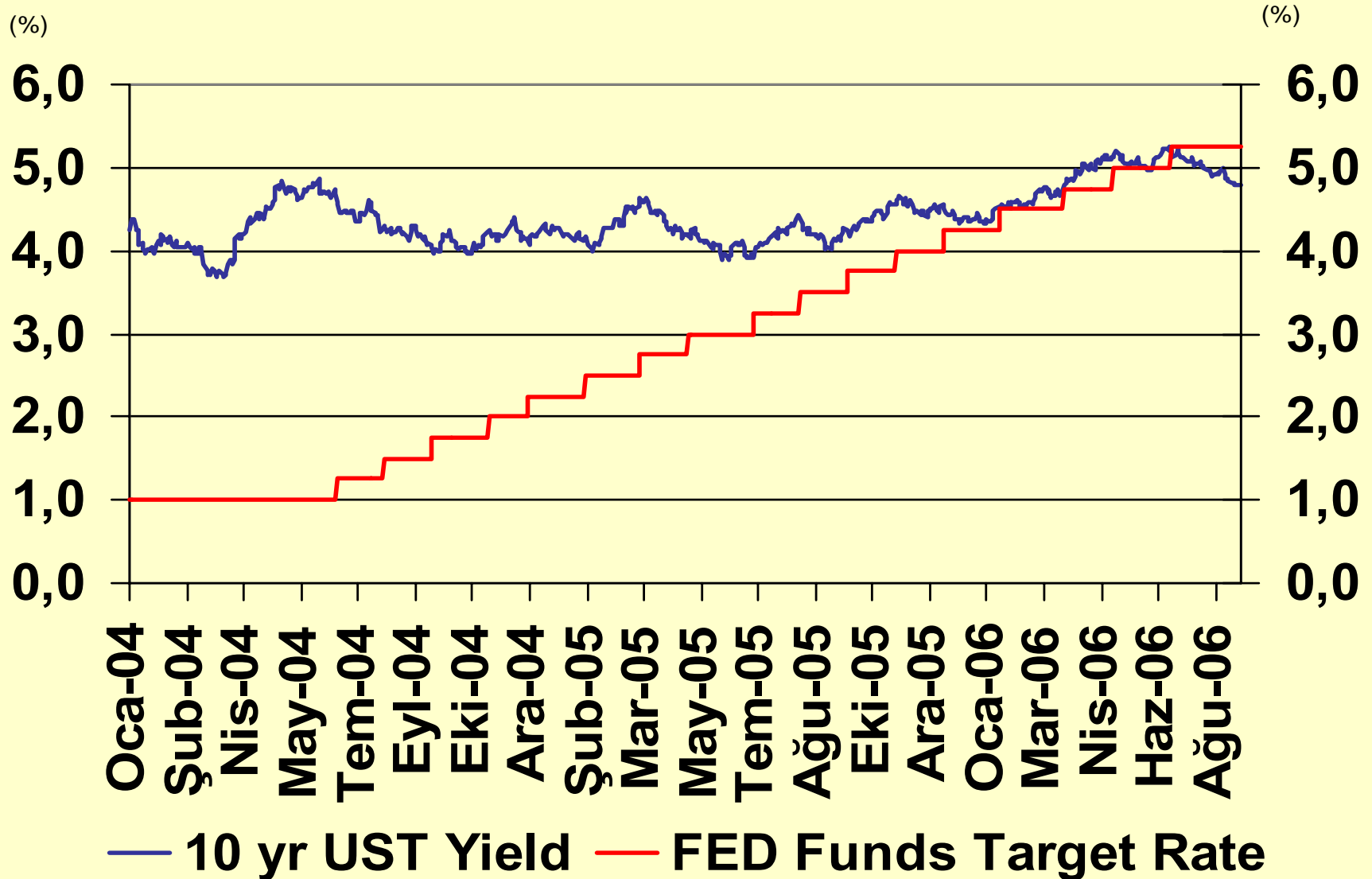
Chapters to be started: 4

- Chapter(s) closed: 1

OUTLINE

1. *MACROECONOMIC DEVELOPMENTS AND STRUCTURAL REFORMS IN TURKEY*
2. ***RECENT DEVELOPMENTS IN GLOBAL AND DOMESTIC FINANCIAL MARKETS: POLICY RESPONSE AND POSSIBLE EFFECTS***

US Interest Rates



Reflections of Monetary Tightening

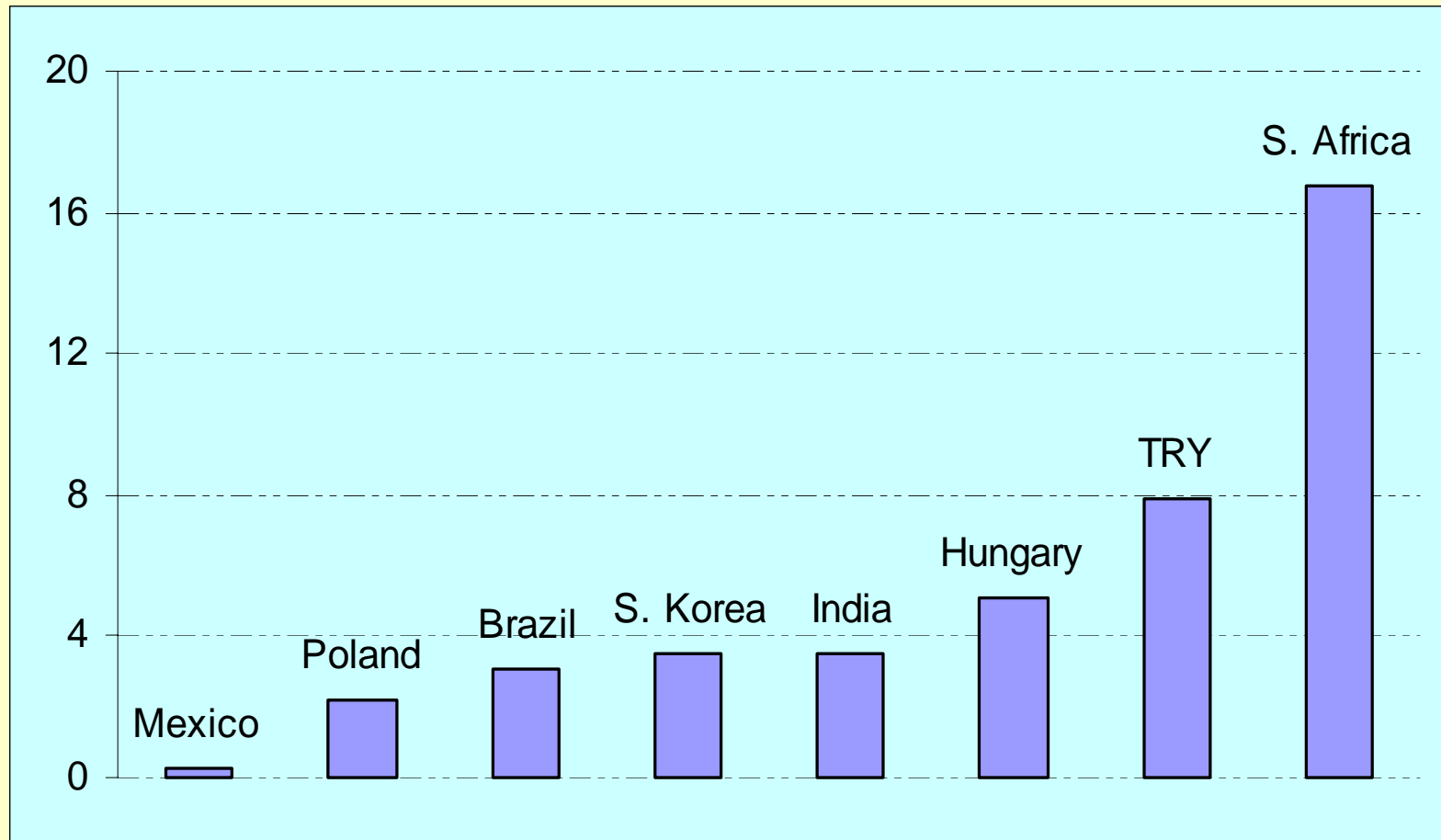
Monetary tightening in developed countries has led to;

- ✓ **Reallocation of portfolio investments,**
- ✓ **Reassessment of Emerging Market risks,**

and resulted in;

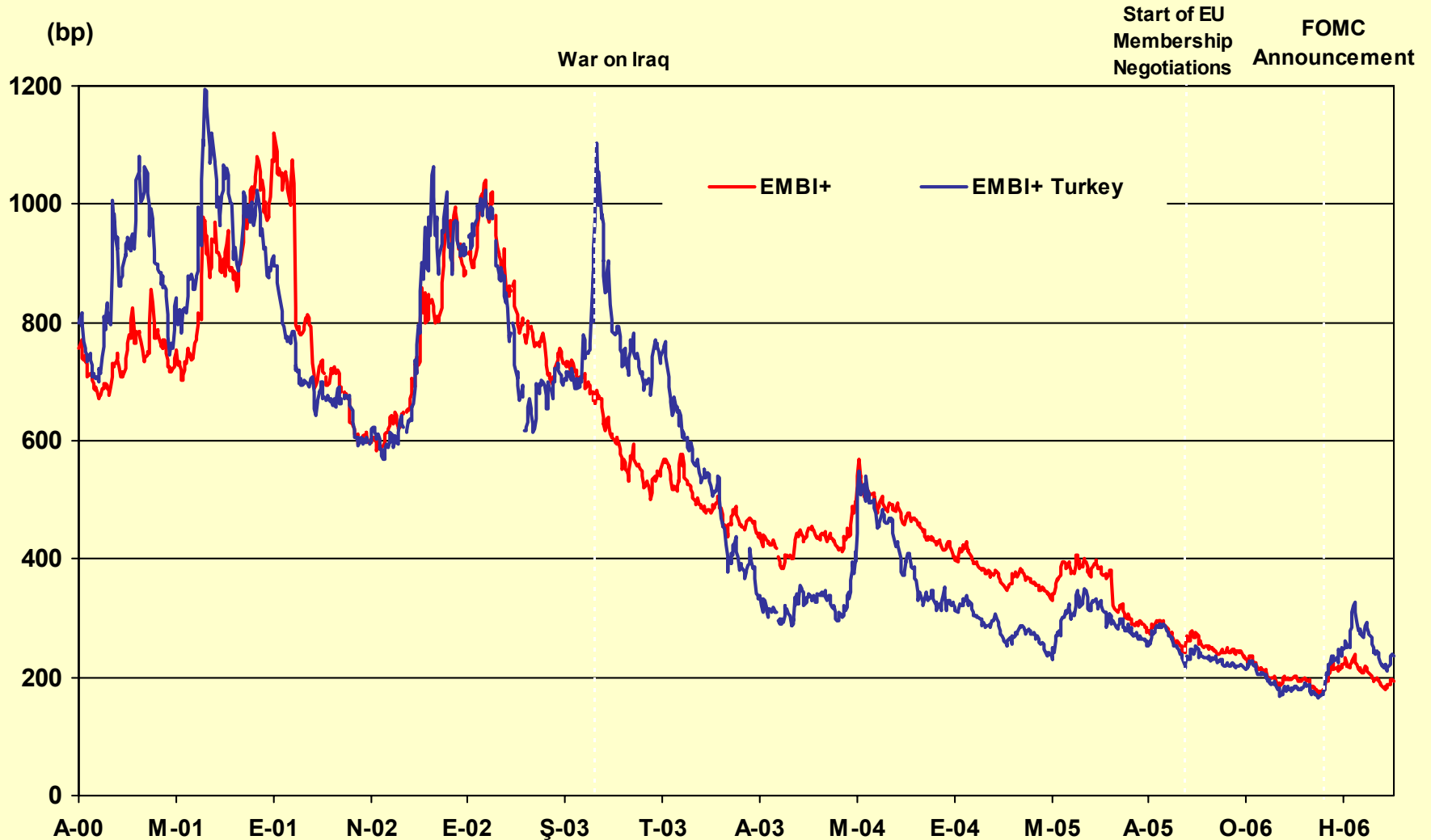
- ✓ **Capital outflows from Emerging Markets,**
→ Triggering a sharp fall in Emerging Market assets prices (equities, external and local bonds and currencies)

Currencies



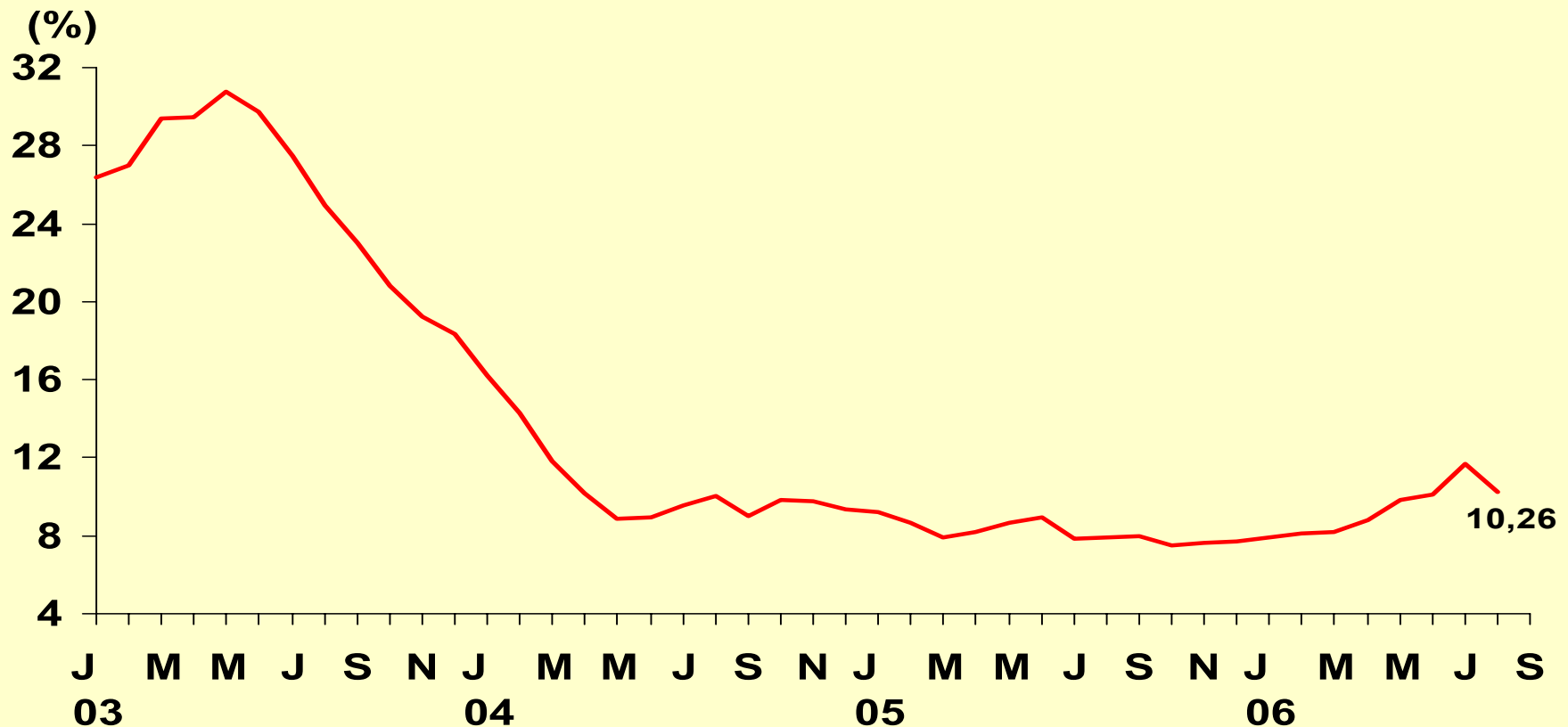
* Percentage change since the FOMC meeting held on May 10, 2006. (As of August 30, 2006)

Comparison of EMBI+ and EMBI+ Turkey



Turkey: Inflation

Annual Inflation



In the second quarter of 2006 inflation rate started to increase mainly due to the high depreciation of TRY.

Turkey's Policy Response to Global Developments

- ✓ Further strengthening the fiscal policy framework
- ✓ Monetary tightening
- ✓ Prudent debt management policy and flexibility

Fiscal Policy

❖ *Strong commitment to the existing key pillars:*

- ✓ Primary surplus target of 6.5% of GNP for the consolidated public sector

- ✓ Social Security Institutions' total deficit not to exceed above 4.5% of GNP

❖ *Introducing a new pillar:*

- ✓ Saving revenue over-performance

- Setting a ceiling for the non-interest expenses of the Central Government and Social Security Institutions

Monetary Policy

- ✓ Increasing CBT's overnight borrowing rate by 425 bps to 17.50%
- ✓ Increasing CBT's lending rate by 625 bps to 22.50%
- ✓ Proactive liquidity management
 - ✓ Deposit Purchase Auctions of 1 and 2 week maturity
 - ✓ Foreign Exchange Interventions

Debt Management

- ✓ Issuance policy in line with demand conditions
- ✓ Strengthening non-debt creating resources
- ✓ Close coordination with the monetary policy
- ✓ Decreasing the average maturity of fixed rate notes
- ✓ Increasing financing via floating rate notes
- ✓ Decreasing the roll-over ratio as low as 50% in May-June

Foreign Exchange Rates

	08-May-06	23-June-06	04-Sept-06
\$/TRY	1,3431	1,6934	1,4507
% Change since 8th May		26,1	8,0

Source: CBRT

As a result of monetary policy response, foreign exchange rates started to fall at end of June with the help of declining worries in the international markets.

Interest Rates

	08-May-06	26-June-06	04-Sept-06
<i>Benchmark government bond interest rate (compound rate, %)</i>	14,13	22,80	19,26

Source: ISE

Upward trend in interest rates stopped by the end of July with more favourable conditions raised in international markets.

Inflation Expectations

Current Period	Expected annual CPI by the end of the year	Expected annual CPI by the end of the next 12 months	Expected annual CPI by the end of the next 24 months
2006 May	6,75	5,83	4,93
2006 June	9,78	7,48	5,95
2006 July	10,28	8,07	6,07
2006 August	10,46	7,94	6,02

Source: CBRT

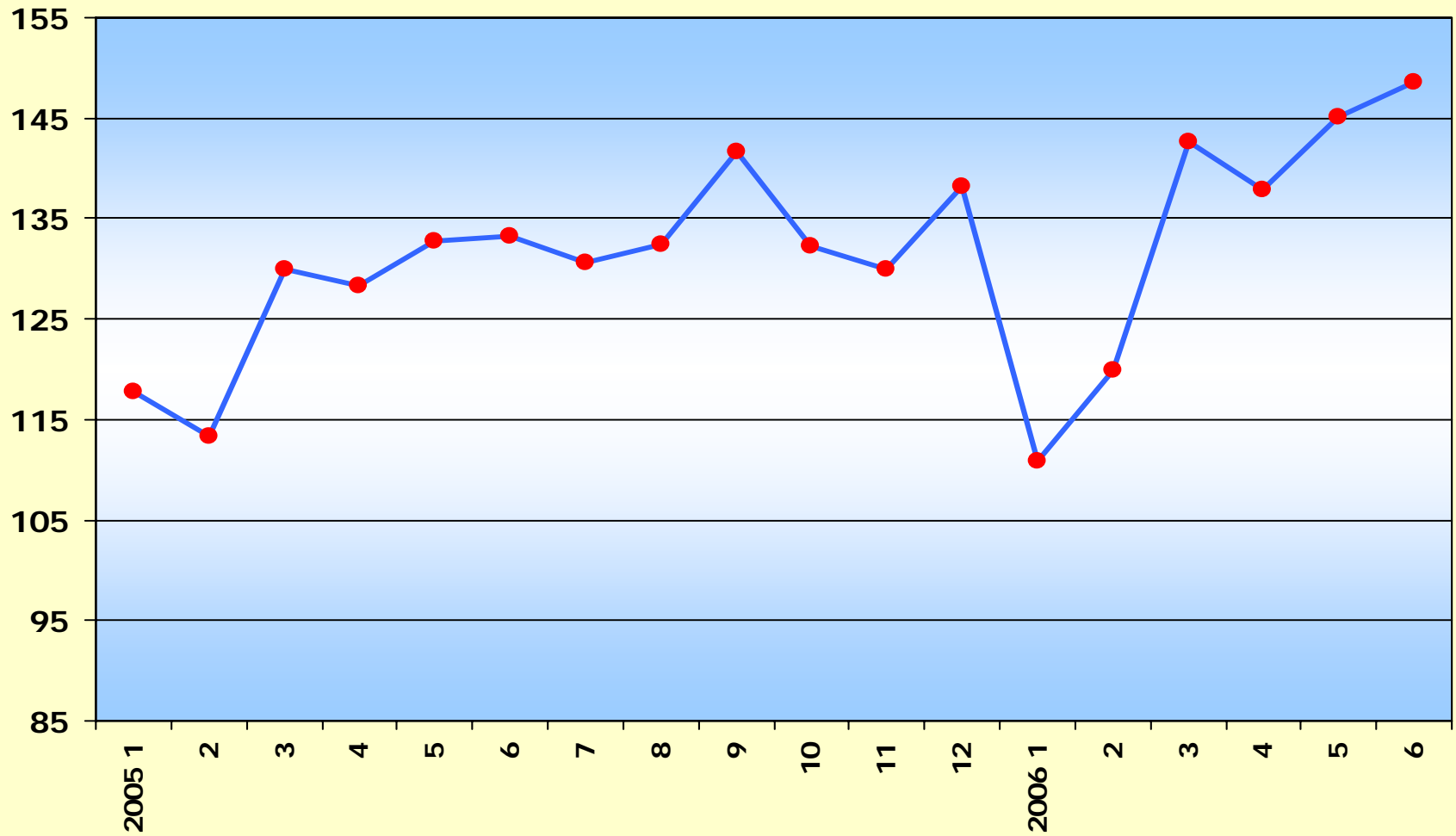
Inflation Prospects

- ✓ The pass-through impact on 2006 inflation is computed as 3.5 percentage points.
- ✓ An additional 1 percentage point can overlap to 2007 inflation due to inertial effects.
- ✓ However, inflation target of 4 percent for 2007 has been kept.

Resilience to Shocks

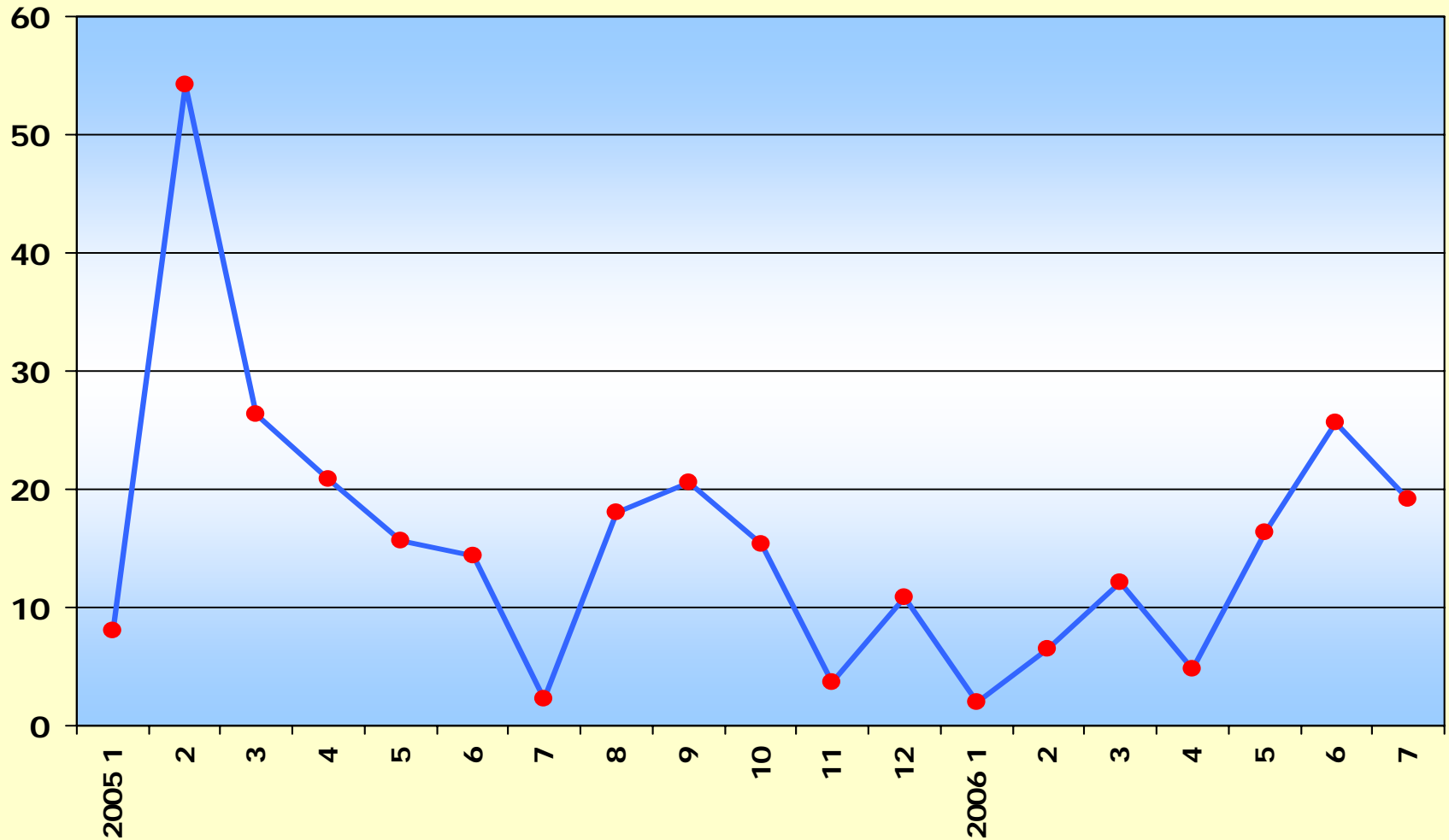
	<i>Change in Net Debt Stock/GNP Ratio</i>
<i>10% Real Appreciation / Depreciation of YTL</i>	<i>+ / - 1.5 Points</i>
<i>3 Points Increase / Decrease in Real Interest of YTL Denominated Debt</i>	<i>+ / - 1.2 Points</i>
<i>2 Points Increase / Decrease in GNP Growth</i>	<i>+ / - 1.1 Points</i>
<i>1 Point Increase / Decrease in Primary Surplus</i>	<i>+ / - 1.0 Points</i>

Monthly Industrial Production Index



Source: Turkstat

Export Growth Rates (%)



Source: Turkstat

In May, June and July export growth reached to high rates

To sum up

- ✓ Domestic demand is expected to slow down in 2H06
- ✓ Foreign demand will pick up
- ✓ Growth rate for 2006 is estimated around 6 percent
- ✓ Inflation expectation has started to converge to medium term official target
- ✓ Exchange rate volatility reduced
- ✓ Interest rates started to decrease slightly

**Proving resilience of the economy to
the shocks**