TS/EKO/2005-47 June 3, 2005

Brief Overview:

The marked improvements in economic indicators have helped boost the optimism and confidence in the Turkish economy. However, attaining lower inflation with high growth in 2005 and after will necessitate a better calibration in implementation. Renewed agreement with the IMF is one of the uppermost conditions to maintain the confidence atmosphere. Preserving fiscal discipline and proceeding structural reforms with determination will also contribute to the sustainability of positive expectations. Thus, there is certainly a need for going further with structural reforms for sustained macroeconomic stability. And, the renewed IMF agreement accompanied by EU harmonization process will provide a proper framework.

Of course, the EU is the ultimate anchor and catalyst for institutional evolution. The EU convergence will serve as a lighthouse for sustainable economic and institutional development. Therefore, the national referandas on European constitutional treaty was followed closely by both the public and private sector. Although we do not expect a delay in the beginning date of accession talks, we believe that the refusal of the constitution will bring uncertainty into the EU. The ultimate impact on Turkey's accession, we believe, will not be a change in the membership status but difficulty in the conditions.

The current state of Turkey's progress towards the sustainable stabilization is not sufficient to outweigh the whole risks arising from the exogenous developments. Besides, foreign investors remain wary of the risks to emerging markets from the external environment and therefore remain underweight the markets. Given Turkey's vulnerability to shifts in global investor risk appetite, the only way is to remain loyal to existing trajectory of structural reforms. The need for continued reform is an issue irrespective of the success Turkey has attained. We know that the countries do not have anymore the luxury to rest on the reforms that they achieved. Thus, there is still a lot that Turkey should accomplish on the structural reform front.

We believe that tax reform and struggle against unrecorded economy comes first in the agenda. Under the yearly inflation figure of less than 10%, there is no more tolerance for unfair competition and intolerable tax burden. Thus a bold tax reform is needed to correct the unrecorded economy, ensure competitive and fair tax rates by better tax codes. The tax reform will be deemed successful to the extent that it is instrumental in reducing the unrecorded economy and enlarging the tax base. Turkey, as further to what has been achieved, has to lower the tax rates, broaden the tax base and simplify the tax system with giving minimum exemptions. Besides tax reform, other structural fiscal reforms will ensure further correction in fiscal balances, which is an imperative not only for debt sustainability and investors' confidence, but also for reducing the rigidity of government expenditures and improving the quality of public services. We believe that, a lasting improvement in public finances will also help Turkey's convergence to EU. Besides approaching to Maastricht criteria, creating more space for public spending in areas such as education, health care, justice, R&D and innovation, will ensure the sustainability of the recent wave of productivity increases and thus high growth.

For the time being, foreign deficit can be singled out as the only area of deterioration. The strong growth process has fueled imports, which led to a widening in current account deficit in 2004. Nevertheless, the deficit was financed by international capital inflows thanks to increased credibility of the Turkish corporate and banking sector. Since efforts towards increasing the consistency of the legal framework with the EU, completion of the restructuring process accompanied by privatization of the public banks and development of modern risk management are on the reform agenda, as soon as they are implemented they will help smoothing out any erratic movements in capital inflows and ensure that the domestic economy makes efficient use of such financial resources.

The current account deficit is anticipated to widen in 2005 together with the vigorous trend in foreign trade, since Turkish economy is expected to continue to grow above its potential level. Considering the increasing trends in production and demand, exports and, thus, imports of intermediate goods are expected still to continue in the forthcoming term, leading to continuation of the deterioration in current account deficit. However, current account deficit is not expected to turn out to be harmful for economic balances, since no serious problems are envisaged to occur in its financing. The private sector is estimated to continue with long term foreign loans in 2005. Yet, foreign direct investments will continue to increase in 2005. In addition, with the increasing confidence in markets, equity investments of the foreigners will gain momentum.

The borrowings in terms of other investments have turned out to be the most significant financing source of 2004 and a capital inflow above the deficit level has occurred. Still in 2005, no severe impacts are expected to affect the capital flows negatively. Moreover, the declining trend of the interest rates will lay the groundwork for the long term fund inflow in 2005. While an increase is anticipated in credit usage in the financing of imports and exports in 2005, the long term borrowing of the private sector is expected to slide back in parallel to the slow down in investment trend.

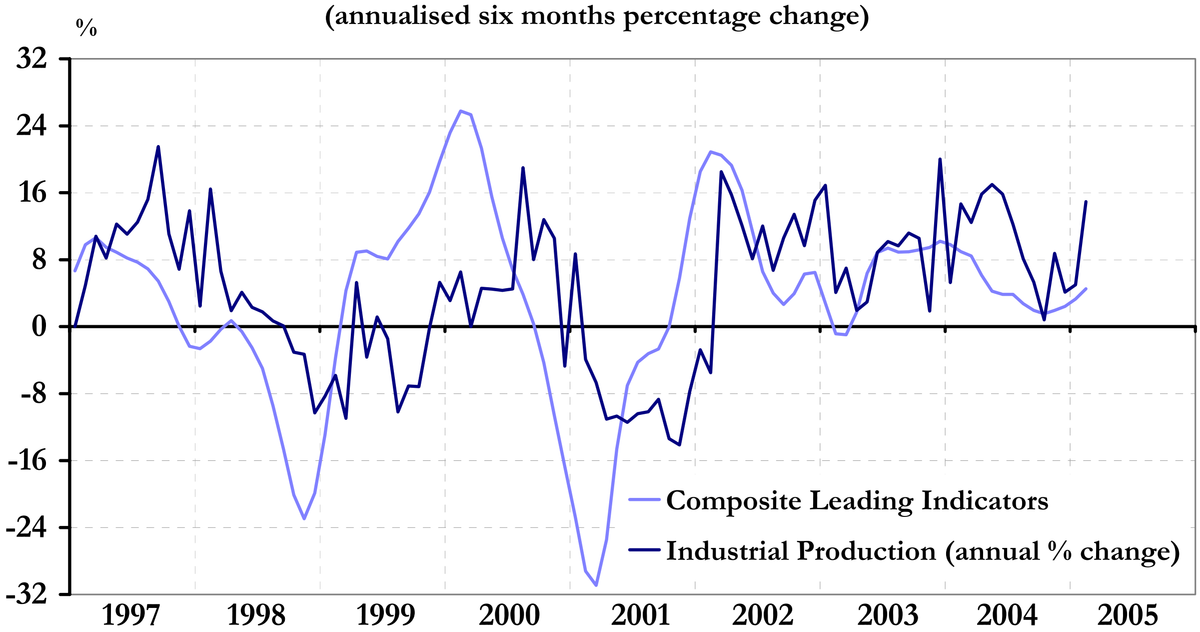
Further to a proper macroeconomic framework, what matters most is the business environment. Together with strong macroeconomic performance, the investment environment is on the way of improvement. The recent investment decisions of some major global companies signal the changing interest for Turkey as a destination for investments. However, the competition between countries to have a larger share from international foreign direct investment flows is getting more and tougher. This necessitates that Turkey should fortify its efforts towards a continuous improvement of the business environment. Improving the business environment will not only be a prerequisite for FDI, but also will be important for financing the growing current account deficit and decreasing the unemployment.

We believe that FDI inflows received so far in 2005 is not the outcome of EU prospects, but rather the enhanced political stability and the increased macroeconomic predictability. Hence, when the effect of EU accession process on FDI take place, Turkey’s fundamentals will look much better. Within this context, extending the phase of its adjustment process to cover micro issues as well as macro issues will be the next challenge for Turkish economy.

In our view, although the IMF program has had and will have an important structural reform context, EU membership will be a lasting anchor for structural transformation and welfare creation in the long run. Indeed, the negotiation process will especially reshape the product markets and will provide an agenda for microeconomic reforms. The need for redefining the role of the government together with an accomplished privatization program including the banking sector, the ultimate liberalization of network industries and an efficient competition policy will play a pivotal role in this process. This comprehensive agenda will align the investment environment with the EU further to what has been achieved so far.

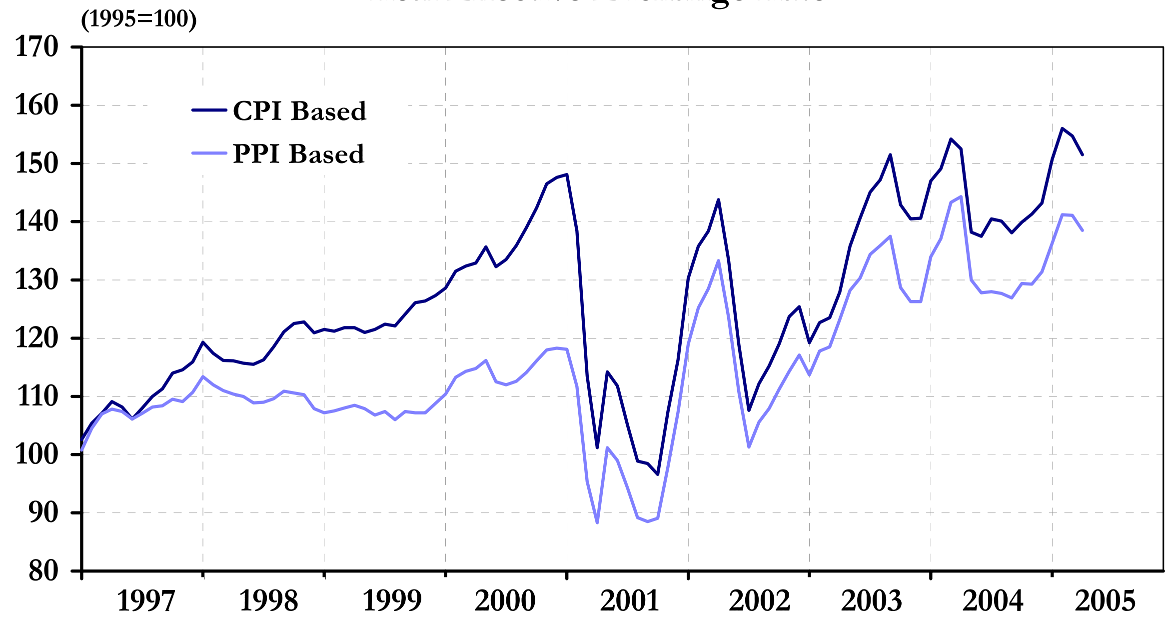
Selected Indicators:

CBRT-Composite Leading Indicators
(annualised six months percentage change)

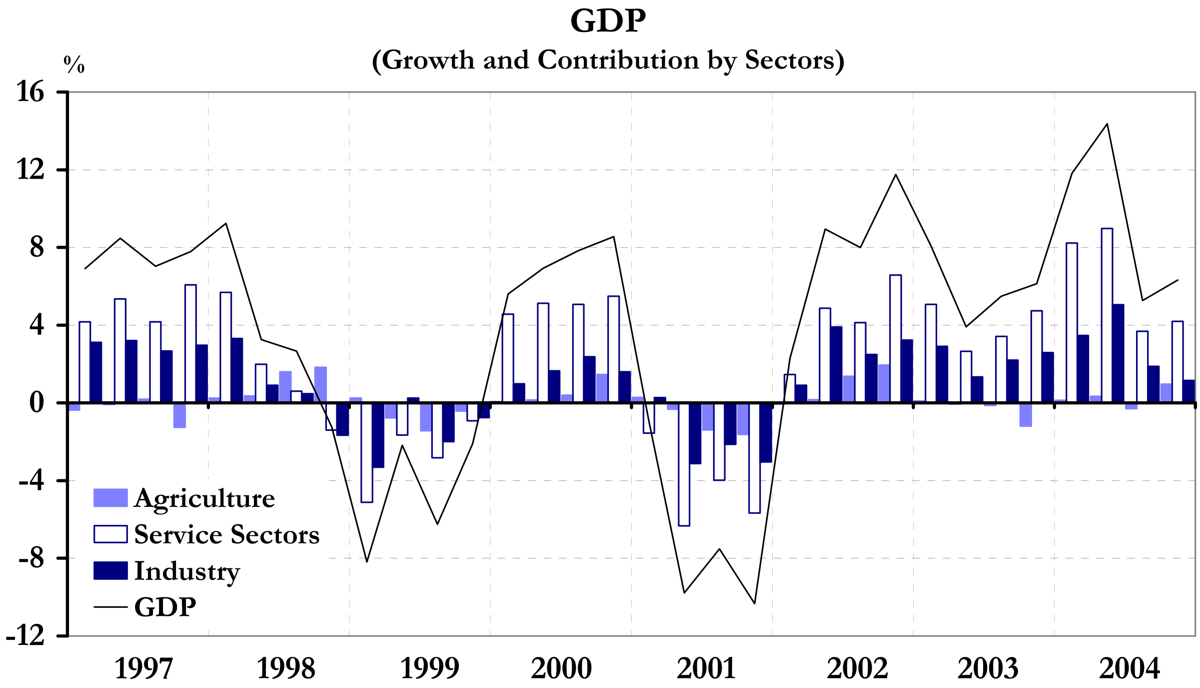


Source: CBRT

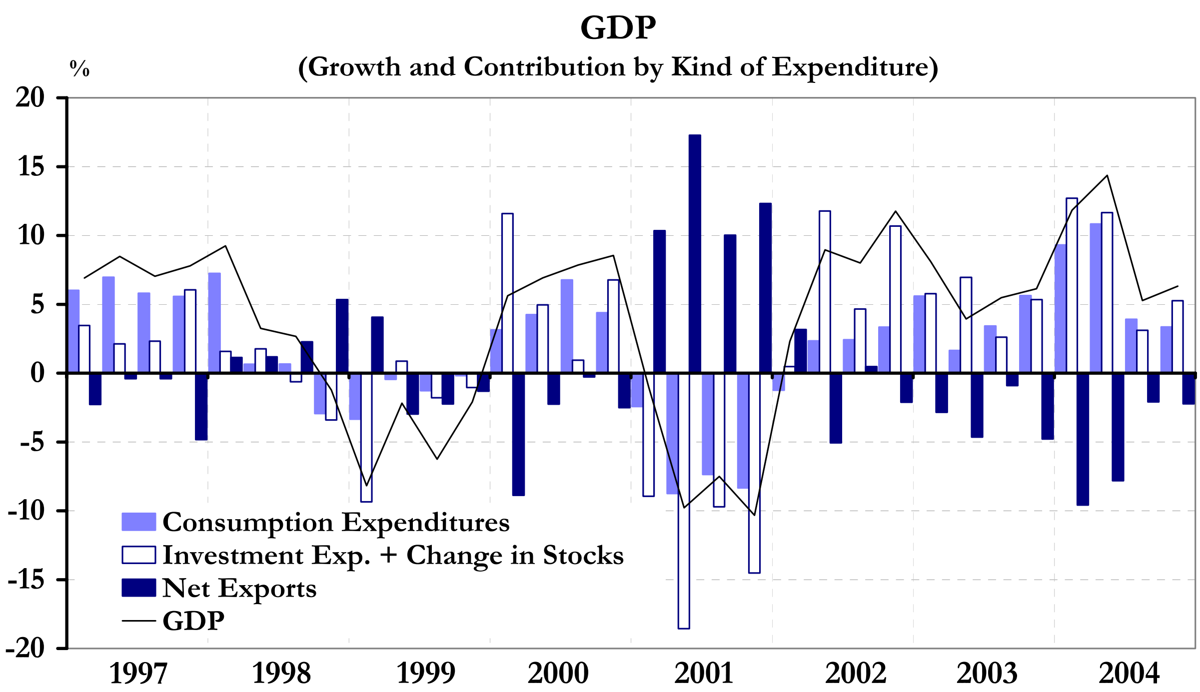
Real Effective Exchange Rate*



** An increase in the index denotes a real appreciation of Turkish Lira.*
Source: CBRT



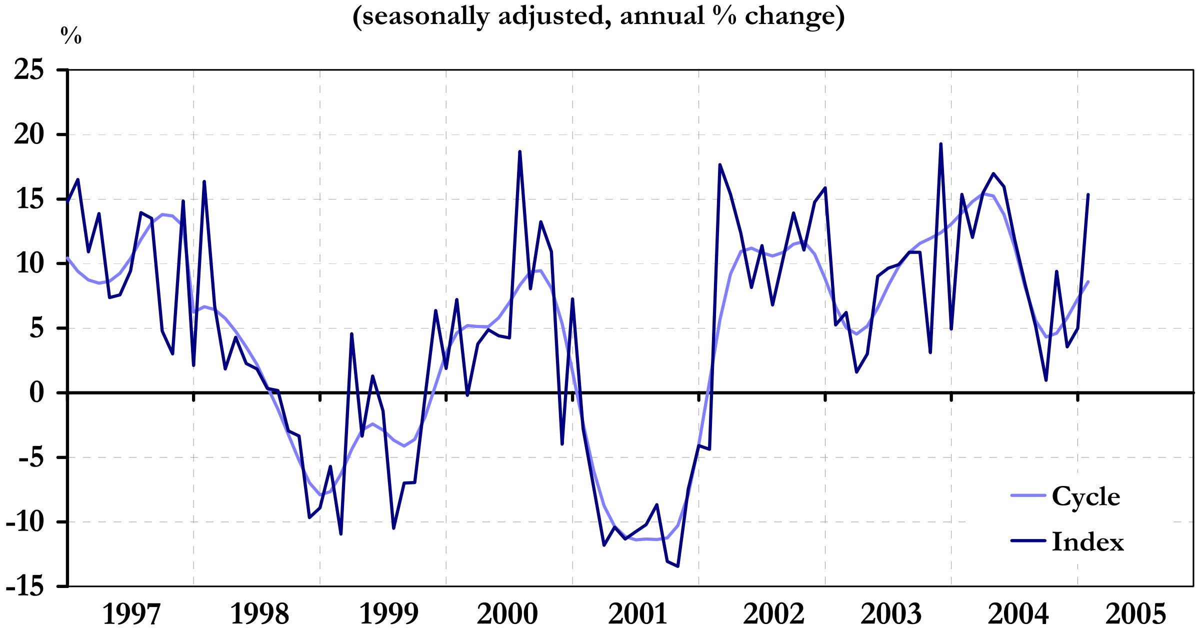
Source: SIS



Source: SIS

Industrial Production Index

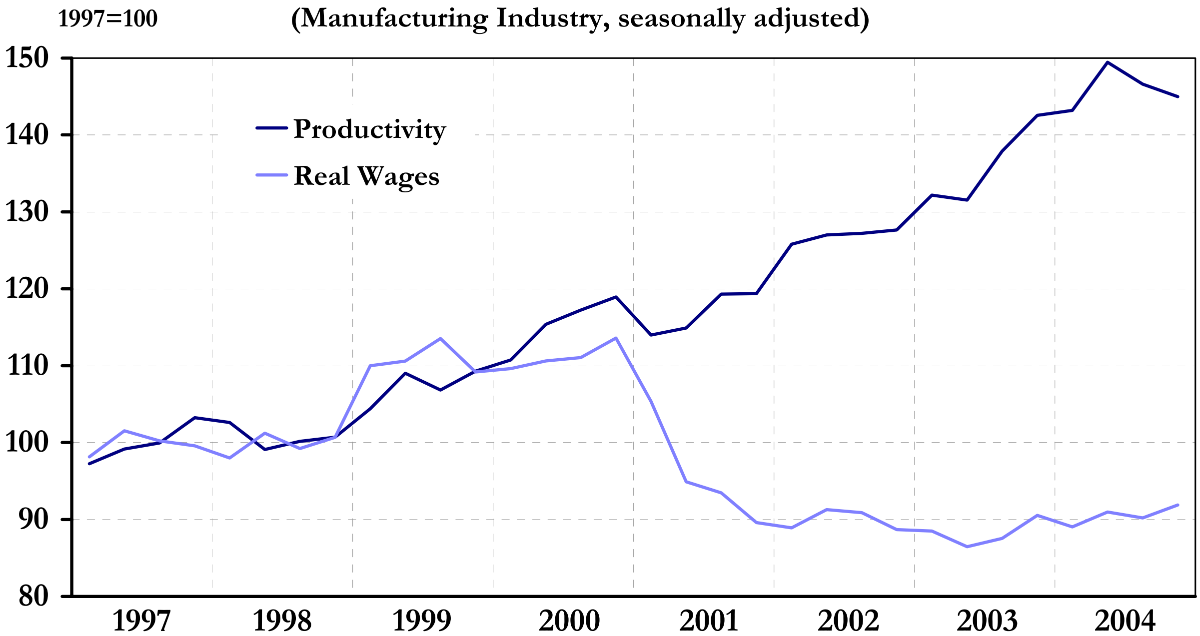
(seasonally adjusted, annual % change)



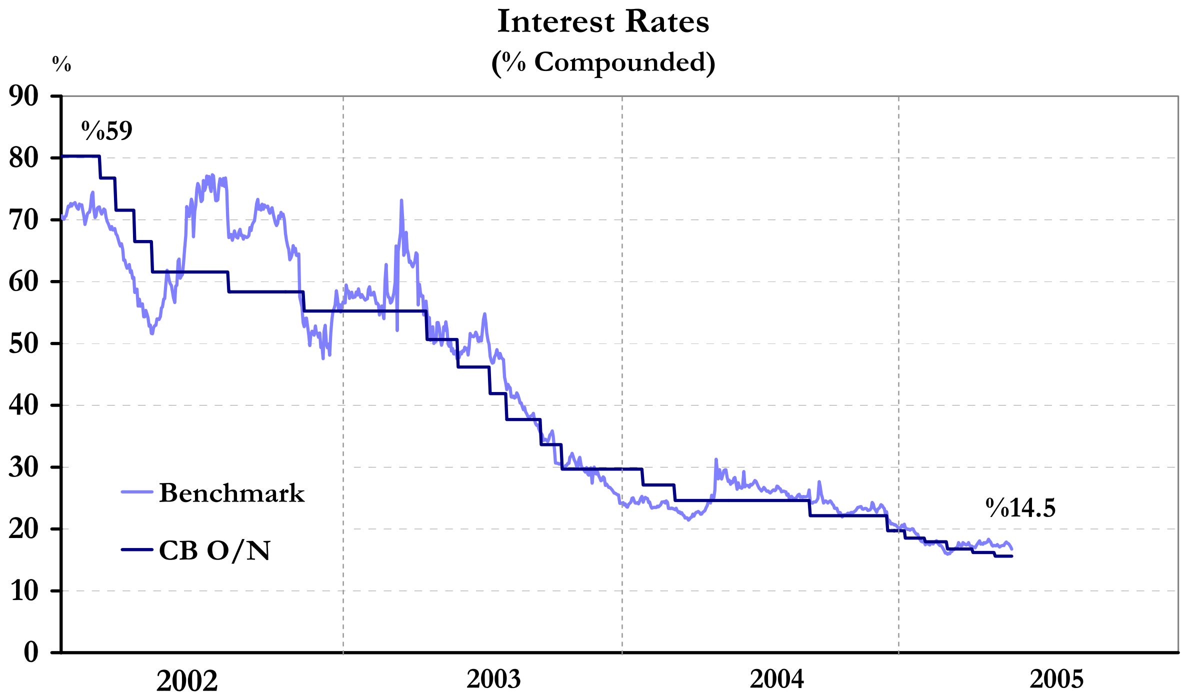
Source: DİE, TÜSİAD Economic Researches Department

Productivity and Real Wages

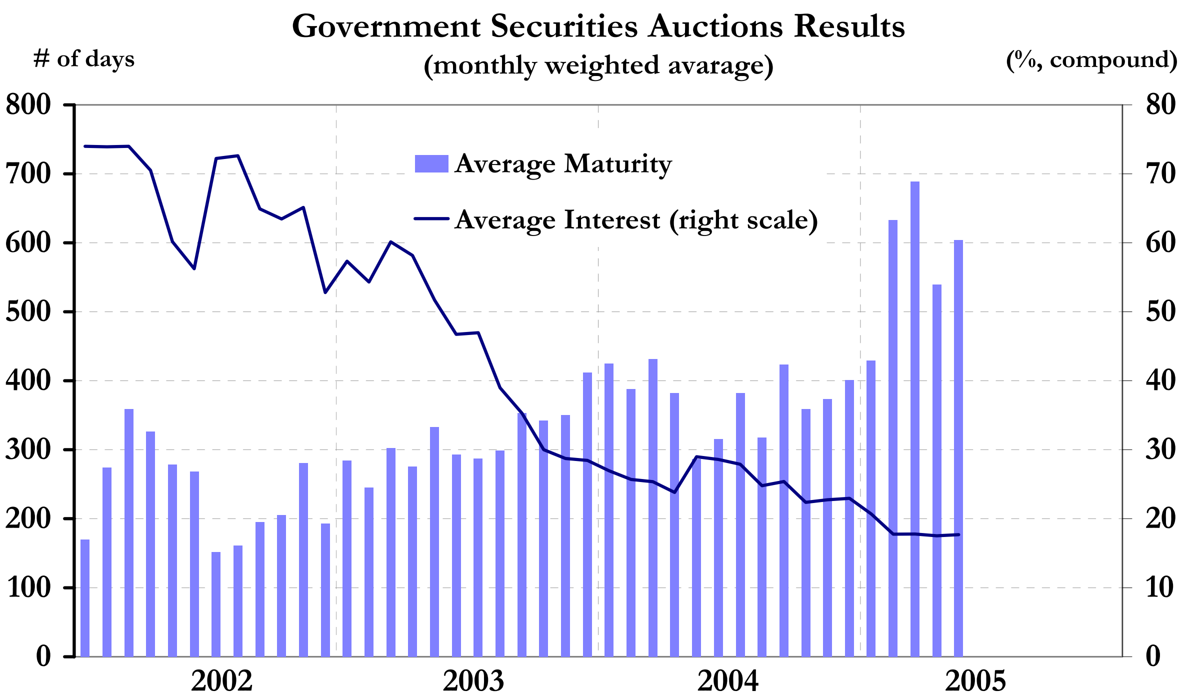
(Manufacturing Industry, seasonally adjusted)



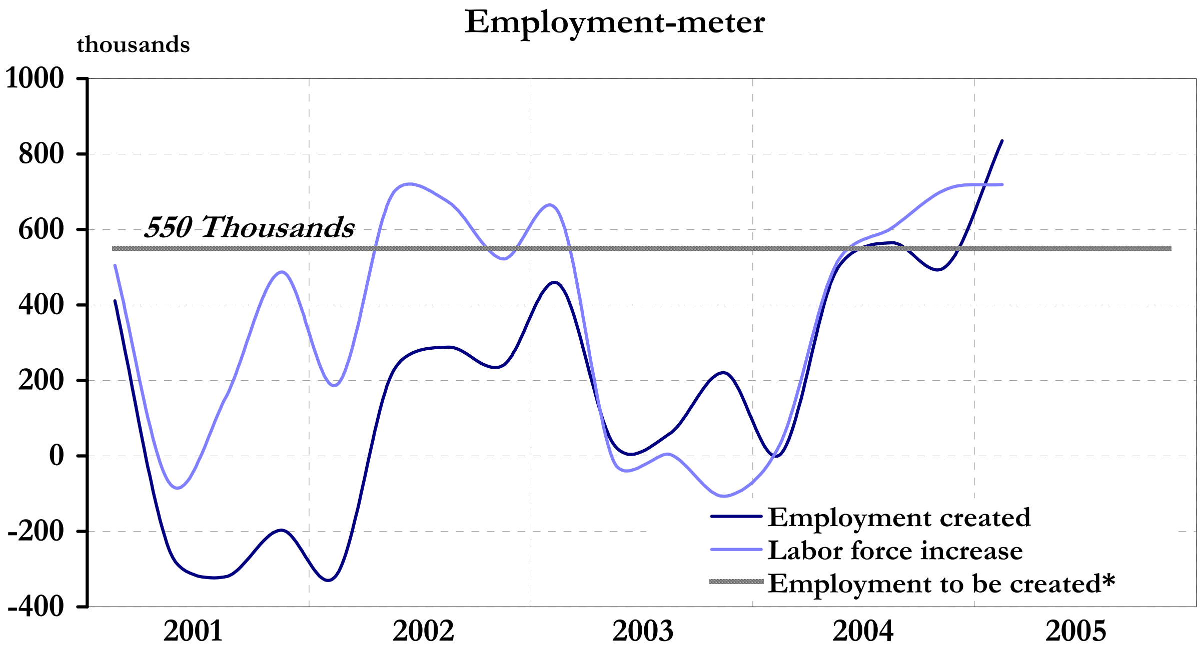
Source: SIS



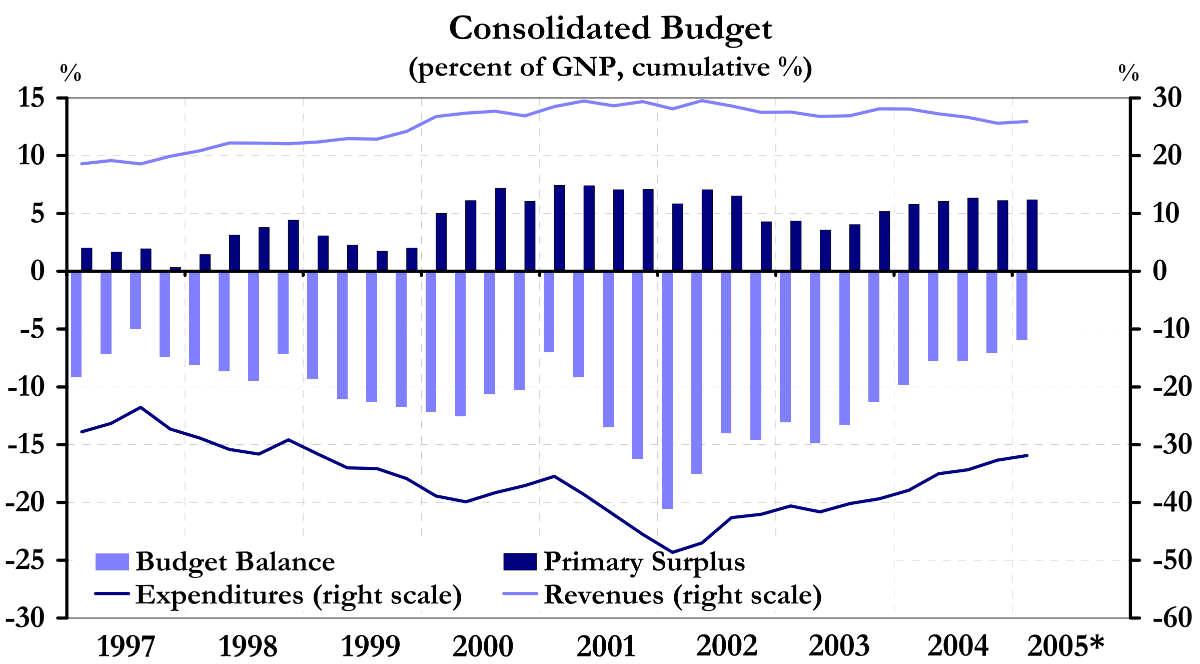
Source: Treasury, CBRT



Source: Treasury

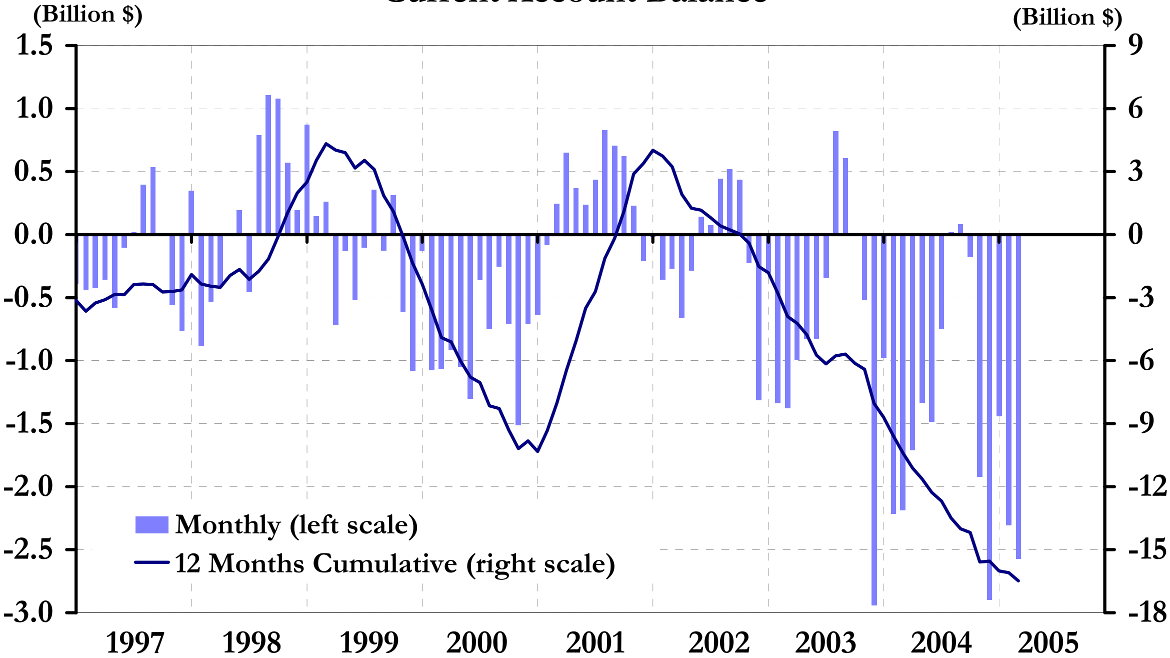


** 4 period cumulative (thousands, Urban)*
Source: TÜSİAD Economic Researches Department



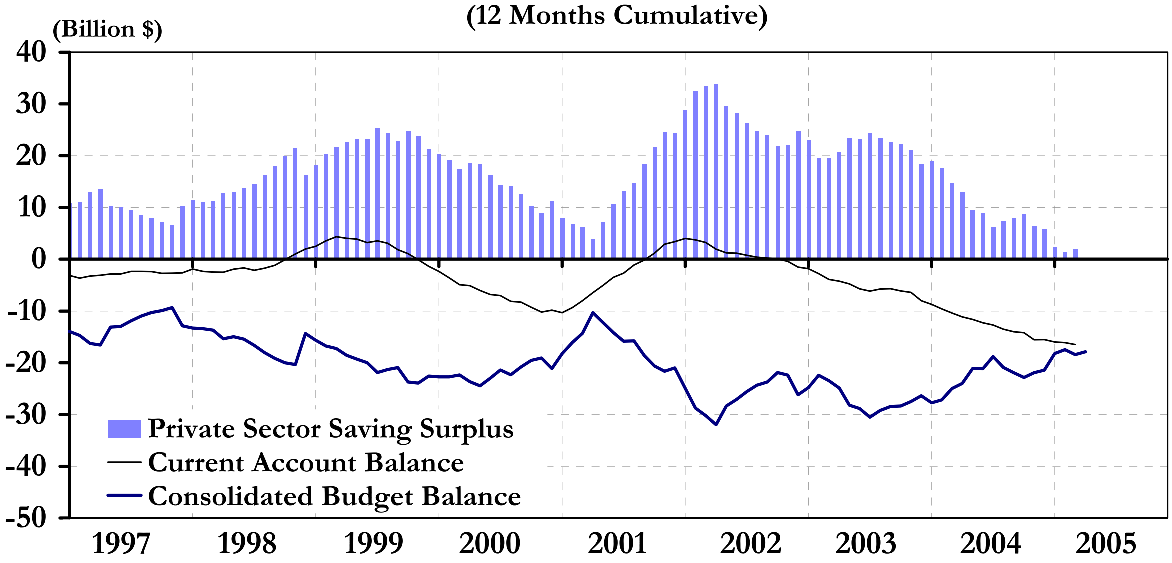
** First quarter figure is TÜSİAD estimate.*
Source: Treasury

Current Account Balance



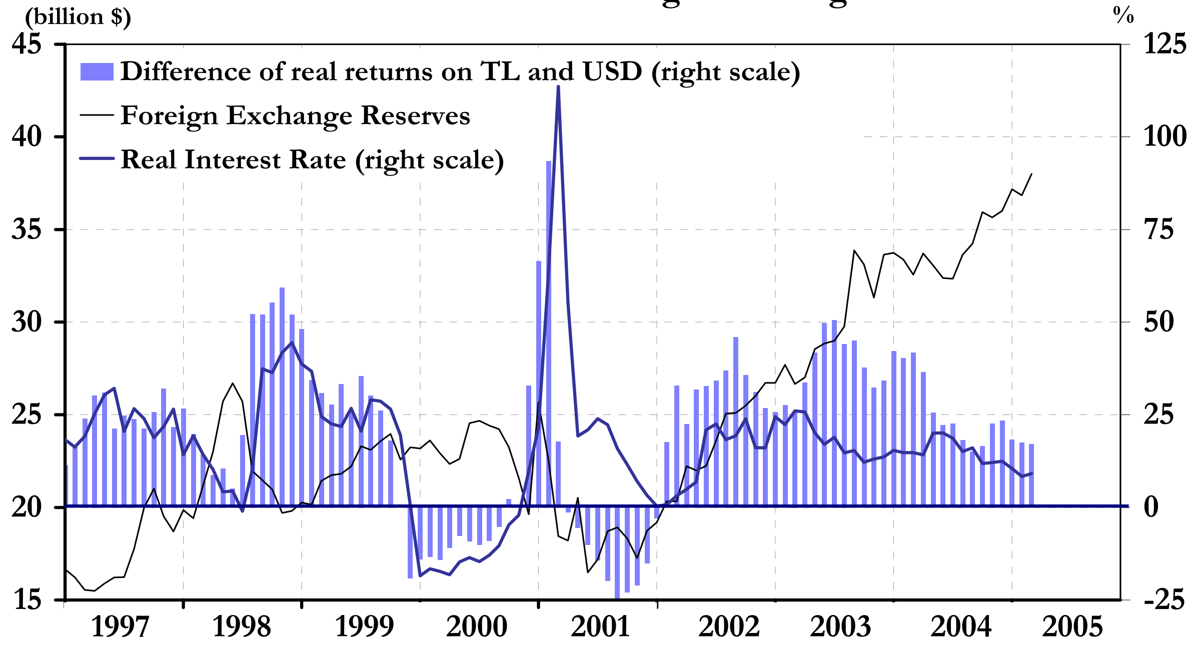
Source: CBRT

Saving-Investment Balance*
(12 Months Cumulative)



(*) Budget Balance is used as a proxy for the Public Sector Deficit due to lack of monthly data on the latter. Private Sector Saving Surplus figures are calculated as the sum of Budget Deficit and Current Account Balance.
Source: CBRT

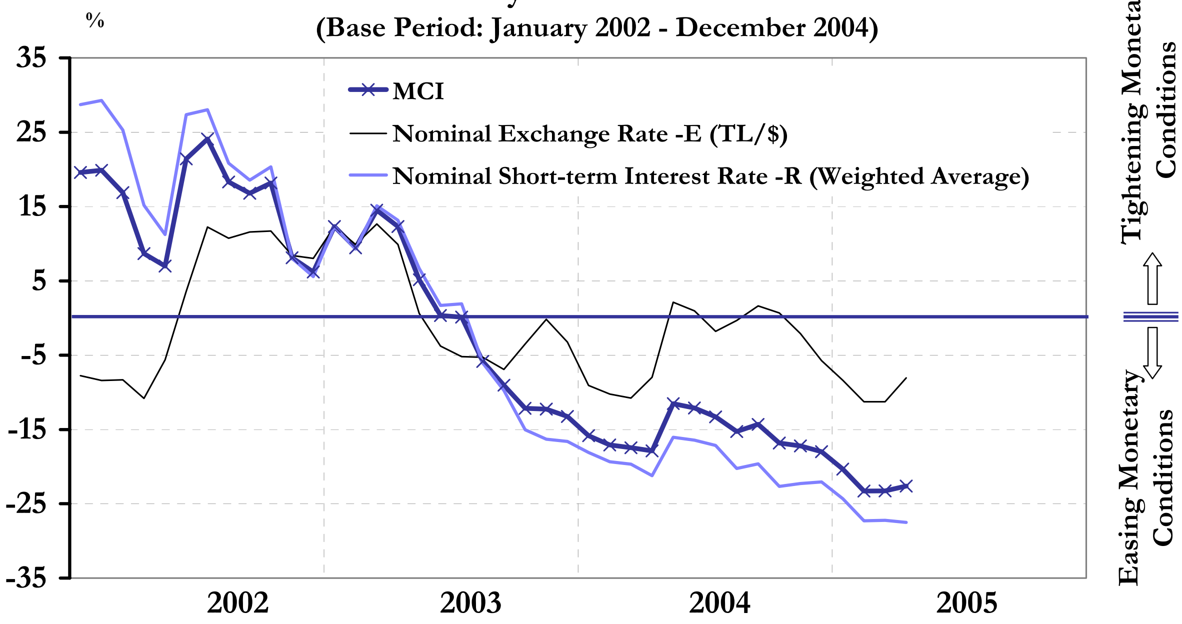
Real Interest Rate and CB Foreign Exchange Reserves



Source: CBRT

Monetary Conditions Index*

(Base Period: January 2002 - December 2004)



Zero axis denotes weighted sum of short term interest rates and exchange rates of the base period.
Source: TÜSİAD Economic Researches Department

$$*MCI_t = W_R(R_t - R_0) + W_E(E_t/E_0)$$
$$W_R : W_E = 0.75 : 0.25$$

TÜSİAD Macroeconomic Scenario (*Quarterly and Yearly Averages*):

	2003					2004					2005					Government Program
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	
INCOME and PRICES*																
GNP (1987 prices)	7.4	3.6	5.6	7.2	5.9	12.4	14.4	4.7	6.6	9.9	*6.0*	*6.5*	*6.5*	*7.0*	*6.5*	5.0
GDP (1987 prices)	8.1	3.9	5.5	6.1	5.8	10.1	13.4	4.5	6.3	8.9	*5.9*	*6.4*	*6.4*	*6.9*	*6.4*	4.8
Inflation (WPI)	33.7	32.8	22.4	15.4	25.6	9.3	9.7	10.8	14.6	11.1	--	--	--	--	--	
Inflation (CPI)	27.6	30.0	25.1	19.4	25.3	14.1	9.3	9.5	9.7	10.6	*9.1*	*8.6*	*8.7*	*7.3*	*8.4*	8.0 (a)
Base Money	46.1	38.4	42.7	44.4	42.9	41.8	50.9	42.6	29.2	40.4	*29.0*	*27.2*	*27.8*	*34.8*	*29.8*	
CONSOLIDATED BUDGET																
Budget Revenues (billion YTL)	20.4	24.3	27.1	28.5	100.2	23.9	26.0	30.0	30.1	109.9	28.3	*31.0*	*32.0*	*31.0*	*122.3*	126.3
Budget Expenditures (billion YTL)	31.3	38.2	32.1	38.5	140.1	30.8	33.6	36.5	39.3	140.2	31.3	*36.0*	*37.0*	*41.0*	*145.3*	155.5
Budget Balance (billion YTL)	-10.9	-13.9	-5.1	-10.0	-39.8	-7.0	-7.6	-6.5	-9.2	-30.3	-3.0	*-5.0*	*-5.0*	*-10.0*	*-23.0*	-29.1
Interest Expenditures (billion YTL)	15.8	19.1	11.7	12.0	58.6	14.9	14.8	15.6	11.3	56.5	11.9	*13.0*	*13.0*	*12.0*	*49.9*	56.4
Primary Surplus (over GNP, %)					5.3					6.1					*5.5*	5.0
Budget Balance (over GNP, %)					-11.2					-7.1					*-4.7*	-6.1
EXCHANGE RATES																
Nominal Exchange Rate (YTL/$)	1.648	1.507	1.388	1.437	1.495	1.326	1.450	1.472	1.439	1.422	1.322	*1.365*	*1.423*	*1.413*	*1.381*	
Nominal Exchange Rate*	21.8	6.8	-15.5	-10.9	-0.7	-19.5	-3.8	6.0	0.1	-4.9	-0.3	*-5.8*	*-3.3*	*-1.8*	*-2.9*	
Real Exchange Rate (1999=100)**	103.9	120.4	131.7	132.6	122.2	147.3	136.9	136.2	145.2	141.4	161.3	*157.9*	*153.1*	*158.7*	*157.7*	
Real Exchange Rate *	4.8	21.7	48.1	34.0	26.6	41.8	13.6	3.3	9.5	15.7	9.5	*15.3*	*12.4*	*9.3*	*11.5*	
Nominal Exchange Rate (YTL/€)	1.768	1.709	1.562	1.713	1.688	1.658	1.747	1.799	1.862	1.767	1.734	*1.777*	*1.893*	*1.950*	*1.839*	
Nominal Exchange Rate*	49.1	31.5	-3.4	6.0	18.1	-6.2	2.3	15.1	8.7	4.7	4.6	*1.7*	*5.2*	*4.7*	*4.1*	
Real Exchange Rate (1999=100)	103.3	113.3	124.9	118.6	115.0	125.6	121.1	118.8	119.6	121.3	131.1	*129.3*	*122.7*	*122.6*	*126.4*	
Real Exchange Rate*	-14.4	-1.2	29.4	12.7	5.3	21.7	6.9	-4.9	0.8	5.5	4.4	*6.8*	*3.3*	*2.5*	*4.3*	
€/$	1.07	1.13	1.13	1.19	1.13	1.25	1.21	1.22	1.29	1.24	1.31	*1.30*	*1.33*	*1.38*	*1.33*	
GOVERNMENT SECURITIES AUCTI																
Nominal Int. Rate (compounded, %)	57.3	52.2	40.4	29.1	46.3	26.0	27.1	26.0	22.7	25.5	18.8	*18.0*	*16.5*	*15.0*	*17.1*	
Real Int. Rate (compounded, %)	23.2	17.2	12.7	8.2	16.8	10.5	16.3	15.0	11.9	13.5	8.8	*8.7*	*7.2*	*7.1*	*8.0*	
FOREIGN TRADE and CURRENT ACC																
Imports (cif) (billion $)	14.4	16.5	18.4	20.1	69.3	20.9	24.4	25.1	27.1	97.5	25.7	*28.3*	*28.9*	*30.4*	*113.3*	104.0
Exports (fob, excl. shuttle trade) (billion $)	10.4	11.3	12.2	13.4	47.3	13.5	15.5	16.0	18.1	63.1	17.1	*19.0*	*19.2*	*21.2*	*76.5*	71.0
Foreign Trade Balance (billion $)	-4.0	-5.2	-6.3	-6.7	-22.1	-7.4	-8.9	-9.1	-9.0	-34.4	-8.6	*-9.3*	*-9.7*	*-9.2*	*-36.8*	-33.0
Invisibles (other current) (billion$)	1.0	2.5	7.3	3.2	14.0	2.1	4.3	8.5	4.1	19.0	*2.4*	*4.9*	*8.9*	*3.7*	*19.9*	
Current Account Balance (billion$)	-3.0	-2.6	1.1	-3.5	-8.0	-5.4	-4.5	-0.6	-4.9	-15.4	*-6.2*	*-4.5*	*-0.8*	*-5.5*	*-17.0*	-10.6
Current Account Balance (over GNP, %)					-2.9					-5.1					*-4.7*	-3.6
Imports (cif)*	36.5	32.3	36.4	32.3	33.5	45.6	48.1	36.1	35.3	40.7	22.9	*16.0*	*15.1*	*12.1*	*16.2*	
Exports (fob, excl. shuttle trade)*	30.8	32.9	31.0	29.5	30.5	30.2	37.1	31.1	35.4	33.6	26.4	*22.4*	*20.2*	*16.9*	*21.1*	

Red italic figures are TÜSİAD estimates

(*) Denotes annual avrage percentage change on the same period of previous year

(**) Decrease in Real Exchange Rate index reflects the devaluaiton of TL against US dollar.

(a) TÜSİAD's end year forecast for CPI is 7.3%