INTERNATIONAL MONETARY FUND

TURKEY

Third and Fourth Reviews Under the Stand-By Arrangement, and Requests for Waiver of Nonobservance and Applicability of Performance Criteria and Modification of Performance Criteria

Supplementary Information

Prepared by the European Department in consultation with other departments

Approved by Susan Schadler and Matthew Fisher

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This supplement provides an update on policy implementation since the circulation of the staff report. The thrust of the staff appraisal remains unchanged.

1. **The central bank raised the overnight policy rate by a further 25 basis points—to 17.5 percent—on July 20**. The accompanying statement maintained the hawkish tone of last week's letter to the IMF (Staff Report, Appendix II), noting that some further tightening may be needed to rein in inflation expectations and secure the medium-term inflation targets. Analysts welcomed the move as a signal of the CBT's resolve.

2. **The authorities have reallocated spending in favor of higher farmer subsidies**. Income support was increased by just under 0.2 percent of GNP, with offsetting cuts targeting capital spending. This shift is undesirable from a structural perspective, but the fact that the authorities took steps to keep spending within programmed levels is welcome.

3. **With all prior actions already completed, progress has also been made on meeting pending end-July benchmarks** (Staff Report, Annex B).

- The **tax policy unit** at the Ministry of Finance was made operational by assigning staff and drawing up work programs. The associated benchmark was therefore met.
- The functional reorganization of the **Revenue Administration** has been completed at the headquarters level, but restructuring of local offices will take more time. As a result, the associated benchmark will not be fully met by end-July. The authorities viewed this as a temporary delay and reiterated their commitment to the tax administration reform goals. FAD technical assistance scheduled for early August will assess prospects in this and other reform areas.
- On **state bank reform**, the authorities have adopted a timetable for phasing out special privileges and obligations, thus meeting the associated benchmark.
- The authorities have informed staff that they plan to announce a detailed **privatization strategy for Halkbank** on July 31, in line with the letter of intent.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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IMF Executive Board Completes Third and Fourth Reviews Under the Stand-By Arrangement for Turkey and Approves US$1.85 Billion Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third and fourth reviews under the three-year SDR 6.66 billion (about US$9.87 billion) Stand-By Arrangement with Turkey approved on May 11, 2005 (see Press Release No. 05/104). The Board also approved Turkey's request for the waiver of the nonobservance of performance criteria pertaining to the parliamentary approval of administrative and social security reforms, the parliamentary approval of the pension reform legislation, the submission to parliament of the legislation to reform personal income tax as well as the continuous performance criterion on grants of amnesties of arrears on public sector receivables.

The completion of the reviews will enable Turkey to draw immediately an amount equivalent to SDR 1.25 billion (about US$1.85 billion).

Following the completion of the Board's discussion, Mr. Rodrigo de Rato, Managing Director and Chairman made the following statement:

"Turkey's economic performance has been strong. Rapid growth was accompanied until recently by record-high capital inflows, declining debt ratios, and lira strength. In tandem with a number of adverse supply shocks, these outcomes also led to a widening of the current account deficit and a pick up in inflation. Against this backdrop, the rise in global risk aversion since last May had a larger impact on Turkey than on many other emerging market countries. The authorities have responded appropriately to these challenges by tightening macroeconomic policies and reinvigorating structural reforms. The recent lira adjustment should help reduce the current account deficit, but it also makes for a more challenging inflation outlook.

"The central bank's commitment to rein in inflation is welcome. The recent interest rate hikes and the accompanying active withdrawal of lira liquidity have helped restore stability to financial markets and should re-anchor inflation expectations. The authorities' continued adherence to the floating exchange rate regime is also appropriate, as this has acted as a helpful safety valve, including during the latest episode of market turbulence. Looking ahead, the central bank stands ready to adjust its policy stance, should this be needed, to keep the medium-term inflation targets within reach.