

Turkey: Performance Criteria Test Dates and Review Schedule, 2004

Review	Purchase (SDR millions)	Primary balance of the CGS and external debt	PC Test Dates Primary balance of CGS minus SEEs	NIR, Base Money	Earliest Possible Purchase Date
Actual purchases	11,460.4				
8th Review	453.6	...	April 30, 2004	April 30, 2004	June 15, 2004
9th Review 1/	453.6	June 30, 2004	August 31, 2004	August 31, 2004	October 15, 2004
10th Review 1/	453.6	September 30, 2004	December 31, 2004	December 31, 2004	January 15, 2005
Total Purchases	12,821.2				

1/ The June 30, 2004 and September 30, 2004 test date ceilings for the CGS primary balance and external debt performance criteria become applicable for purchases 45 days after the actual test date in view of the time required to report comprehensive monitoring data.

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INTERNATIONAL MONETARY FUND

TURKEY

**Eighth Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance of Performance Criterion
Supplementary Information**

Prepared by the European Department in consultation with other departments

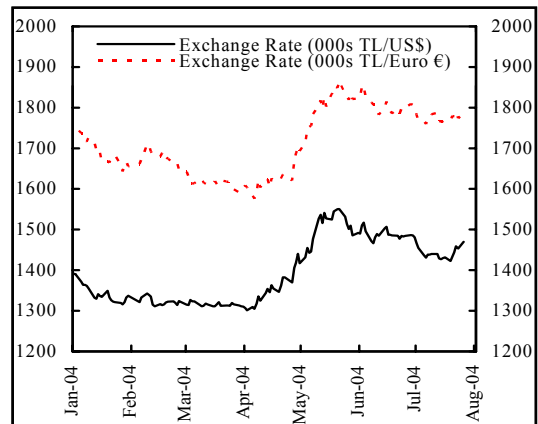
Approved by Michael Deppler and Liam P. Ebrill

July 27, 2004

This supplement provides an update on developments and on the implementation of program measures since the circulation of the staff report (July 16, 2004, (www.imf.org)). The authorities have now informed the staff that they intend to publish the Eighth Review staff report. The staff appraisal remains unchanged.

Recent developments

1. **Financial market sentiment has steadily improved.** After depreciating by 15 percent against the U.S. dollar in April and early-May, the Turkish lira has since re-gained some ground. The benchmark bond rate has fallen to 26 percent, after having risen to 30 percent in May, while Eurobond spreads have again fallen to about 400 basis points.



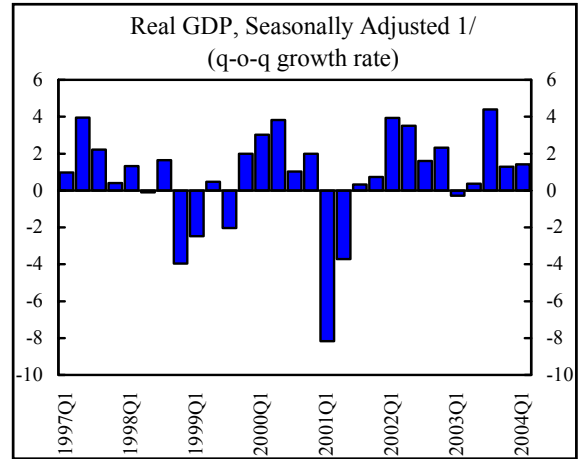
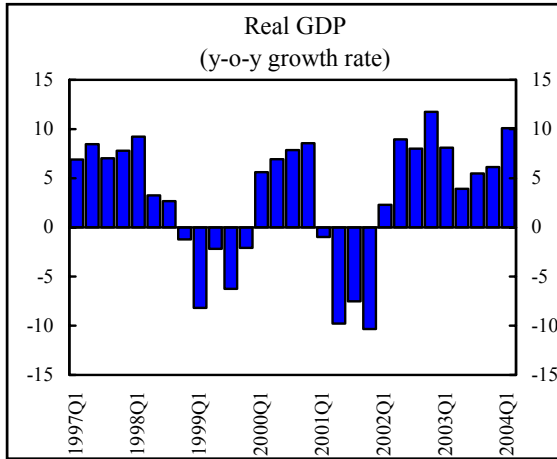
2. **First-quarter national accounts data released in end-June confirm that output has continued to grow strongly:**

- **Real GDP increased by 10.1 percent year on year, and real GNP by 12.4 percent.** Although agricultural output again declined, strong activity in manufacturing, and in domestic wholesale and retail trade contributed to the high overall output growth (Table 1). Construction experienced positive growth for the second quarter in a row, following eleven quarters of decline. In seasonally adjusted terms, GDP grew by 1.4 percent quarter on quarter (close to 6 percent annualized), similar to the last quarter of 2003, though seasonal factors are quite volatile.

Table 1. Turkey - Quarterly Real Output and Expenditure, 2002-2004

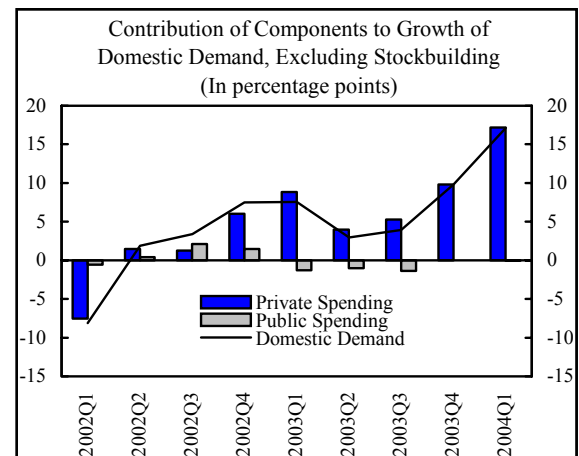
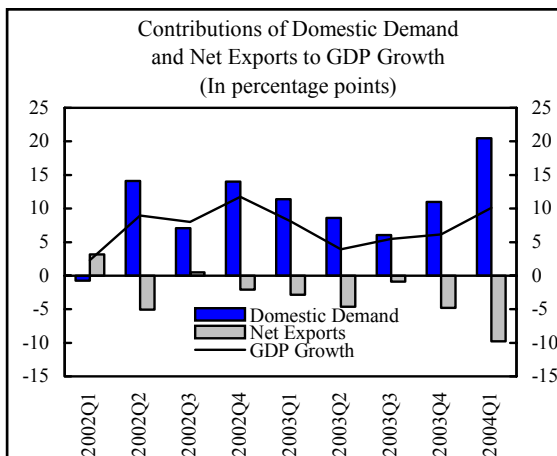
	2002				2002	2003				2003	2004
	March	June	Sept.	Dec.		March	June	Sept.	Dec.		March
	(year on year growth rate, in percent)										
Gross National Product	0.6	10.4	8.0	11.8	7.9	7.4	3.6	5.6	7.2	5.9	12.4
Gross Domestic Product (production side)	2.3	8.9	8.0	11.7	7.9	8.1	3.9	5.5	6.1	5.8	10.1
Agriculture	-1.2	1.9	5.8	16.2	6.9	2.0	-0.8	-0.6	-9.6	-2.5	-7.5
Industry	2.8	12.6	10.5	11.4	9.4	8.8	4.2	9.1	9.2	7.8	10.3
Manufacturing					8.8	10.4	4.9	9.5	10.0	8.1	11.3
Construction					-5.6	-13.8	-12.7	-12.3	1.3	-9.0	2.9
Services	3.5	9.8	9.0	12.2	8.8	9.8	5.9	8.2	8.6	8.1	11.9
Wholesale and retail commerce					1.3	11.7	8.2	10.3	11.0	-0.3	17.3
Gross Domestic Product (demand side)	2.3	8.9	8.0	11.7	7.9	8.1	3.9	5.4	6.1	5.8	10.1
Domestic Demand	-0.7	14.8	8.2	14.9	9.3	10.9	8.5	7.0	11.3	9.3	19.1
Consumption	-1.5	3.1	3.5	4.4	2.5	6.9	2.3	5.2	8.0	5.6	9.9
Private	-1.9	3.2	2.7	4.4	2.1	7.8	2.9	5.8	10.3	6.6	10.6
Public	2.2	2.6	12.0	4.5	5.4	-2.3	-2.0	-0.7	-4.2	-2.4	2.4
Gross Investment	2.1	58.9	27.7	57.9	35.9	25.2	23.9	13.1	20.5	20.4	47.0
Gross Fixed Investment	-28.5	-2.0	5.6	20.5	-1.1	11.7	6.3	3.0	19.2	10.0	52.6
Private	-30.6	-3.8	-3.2	31.0	-5.3	22.6	14.2	16.4	30.1	20.3	60.6
Public	-18.4	3.0	27.9	9.2	8.8	-34.8	-14.6	-22.7	5.0	-11.5	-11.3
Exports of goods & nonfactor services	10.6	5.1	15.9	12.5	11.1	14.5	12.3	19.4	16.9	16.0	10.3
Imports of goods & nonfactor services	2.5	20.4	19.2	22.1	15.8	22.0	24.7	28.3	33.0	27.1	31.2
	(contributions to growth)										
Gross Domestic Product (production side)	2.3	8.9	8.0	11.7	7.9	8.1	3.9	5.5	6.1	5.8	10.1
Agriculture	-0.1	0.2	1.4	1.9	0.9	0.1	-0.1	-0.1	-1.2	-0.3	-0.4
Industry	0.9	3.9	2.5	3.2	2.7	2.9	1.3	2.2	2.6	2.2	3.4
Manufacturing					2.5	2.8	1.3	1.9	2.4	2.1	3.2
Construction					-0.3	-0.6	-0.6	-0.5	0.1	-0.4	0.1
Services	2.0	5.4	4.3	6.6	4.6	5.6	3.2	4.0	4.7	4.3	7.0
Wholesale and retail commerce					0.2	2.2	1.6	1.9	2.1	0.0	3.4
Statistical Discrepancy	-0.1	-0.1	0.4	-0.1	0.1	-0.4	0.0	0.4	-0.1	0.0	-0.5
Gross Domestic Product (demand side)	2.4	9.1	7.5	11.9	7.9	8.5	3.9	5.1	6.2	5.8	10.6
Domestic Demand	-0.8	14.1	7.1	14.0	8.8	11.4	8.6	6.0	11.0	8.9	20.4
Consumption	-1.3	2.3	2.4	3.3	1.9	5.6	1.6	3.4	5.6	4.0	8.0
Private	-1.4	2.1	1.7	2.8	1.4	5.8	1.8	3.5	6.1	4.2	7.8
Public	0.2	0.2	0.8	0.6	0.5	-0.2	-0.2	0.0	-0.5	-0.2	0.2
Gross Investment	0.5	11.8	4.6	10.7	6.9	5.8	7.0	2.6	5.3	4.9	12.5
Gross Fixed Investment	-6.9	-0.5	1.0	4.1	-0.2	2.0	1.3	0.5	4.2	1.9	9.1
Private	-6.1	-0.7	-0.4	3.2	-0.8	3.1	2.2	1.8	3.7	2.6	9.4
Public	-0.7	0.2	1.4	0.9	0.5	-1.1	-0.8	-1.3	0.5	-0.7	-0.2
Change in Stocks	7.3	12.2	3.7	6.5	7.1	3.8	5.6	2.1	1.2	3.0	3.3
External Balance	3.2	-5.1	0.5	-2.1	-0.9	-2.8	-4.7	-0.9	-4.8	-3.1	-9.8
Exports of goods & nonfactor services	4.2	2.2	5.3	5.0	4.3	6.2	5.0	6.9	6.8	6.3	4.7
Imports of goods & nonfactor services	1.0	7.2	4.8	7.1	-5.1	-9.0	-9.7	-7.8	-11.6	-9.4	-14.5

Sources: State Institute of Statistics; SPO; and CBT.



Source: Central Bank of Turkey.
1/ Using Tramo-Seats.

- Private sector demand continues to drive growth.** Private (fixed) investment increased by more than 60 percent year on year, and private consumption by more than 10 percent. After declining steadily in 2003, government consumption increased by 2.4 percent. In the data, inventory accumulation continues to make a significant contribution to growth. However, this likely reflects either an over-estimation of GDP from the production side or an under-estimation of the expenditure components.

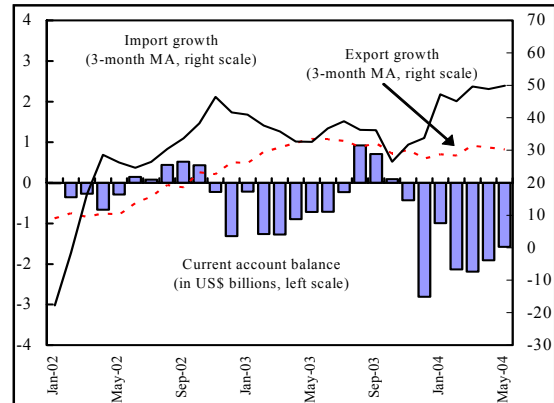


- Real sector indicators in the second quarter also remain strong.** Industrial production grew by 16.5 percent year on year in May, while capacity utilization increased in June to more than 84 percent. Motor vehicle production remains strong, rising more than 80 percent year on year in May, though the detailed June capacity

utilization figures have tentative signs that this may be slowing down. However, output growth in lower value added sectors, such as textiles, has been weak.

3. The current account deficit continues to weaken, but has been financed by capital inflows.

- **The current account deficit in April and May remained large.** A surge in import growth (mostly finished consumption and investment goods), not matched by growth in exports, widened the current account deficit to US\$8.8 billion in the first five months of 2004.



- **The deficit has been financed by higher private capital inflows, albeit mostly short-term.** After an outflow of nearly US\$½ billion in non-resident holdings of equities and treasury bills in April (the first significant monthly outflow for over a year), inflows returned in June. At the same time, domestic banks increased their open foreign exchange position (excluding forwards) during June by about US\$1.5 billion.

4. Although the authorities have not yet revised their official projections, the data suggest that both output growth and the current account deficit are likely to be higher than projected. Given positive carry-over from the last quarter of 2003, rapid growth in the first quarter of 2004, and demand and output indicators pointing to a strong second quarter, the 5 percent annual target for 2004 is likely to be exceeded by at least 1-2 percentage points. At the same time, current staff estimates suggest that the external current account deficit will also increase to at least US\$11 billion, or around 4 percent of GNP (about ½ percentage point higher than in the staff report).

5. June inflation data are consistent with achieving the 12 percent annual target. In June consumer prices fell by 0.1 percent month on month, wholesale prices by 1.0 percent, both well below market expectations. Annual consumer price inflation remained at 8.9 percent, as in May, while wholesale price inflation rose slightly to 10.5 percent. While the latest increase in petroleum prices has yet to feed through, the low June figures together with the recent stability of the exchange rate suggest that the end-year target is likely to be met. This is borne out by the latest CBT survey of market expectations, which projects end-year inflation of 10.9 percent.

6. Although the primary surplus in June was slightly below program, the consolidated budget for the first half of 2004 continued to overperform. Although strong domestic demand meant that direct tax and VAT revenues remained strong in June, spending on investment and current transfers was higher than expected. Also, delays in adjusting petroleum excises in the first half of the year have cost 0.2 percent of GNP. Despite some

slight weakening in June, the budget still seems well on track. In the first six months, the cumulative primary surplus of the consolidated budget reached TL 13.3 quadrillion (an overperformance of TL 1.8 quadrillion (0.4 percent of GNP)), more than 60 percent of the annual target.

Turkey: Primary surplus (program definition), Jan-June 2004
(in TL trillions)

	Jan-June		
	Prog.	Act.	Diff
Consolidated budget primary surplus	11,548	13,304	1,756
Revenues	47,243	47,840	597
Primary expenditures	35,695	34,535	-1,160
Rest of Public Sector primary surplus (CGS) 1/	2,711	1,806	...
EBFs	-223	235	...
Soc Sec	413	109	...
UI	861	491	...
SEEs	1,660	971	...

1/Actual data is as of April. SEEs April data is provisional.

7. **The High Planning Council approved the 2005 budget call.** Main macroeconomic parameters for preparation of the 2005 budget include: 5 percent real GNP growth, 8 percent year-end inflation, 10.1 percent GNP deflator, and an average dollar exchange rate of TL 1.67 million. The budget call does not specify any target for the primary surplus, but it does set ceilings on certain expenditure categories, and would imply a decline in primary spending of 0.5 percent of GNP. Key categories such as personnel and purchase of goods and services are assumed to rise with end-year inflation (but below average inflation). Investment spending is projected to increase, but only modestly.

8. **Banking sector developments have been mixed.** The Cukurova Group (the former owners of Yapi Kredi and Pamuk banks) reached agreement in principle with the BRSA and SDIF that would reduce its payments from US\$6.2 billion over 15 years to US\$4 billion over less than 2 years. Yapi Kredi's balance sheet will be further strengthened by the Group's purchase of US\$1 billion in non-core assets. Although the full details (including the safeguards in case of non-compliance) are not yet known, market reaction has been positive. However, negotiations on the sale of a majority stake in Garanti bank to Banca Intesa have failed, a set-back to foreign involvement and restructuring of the banking system. The authorities passed legislation to allow the merger of Halk and Pamuk banks; they are expected to announce further details of their new state bank strategy shortly.

9. **Since completion of the review discussions, the authorities have passed new EU reform legislation.** The 9th EU harmonization package was passed by Parliament on July 14. This removes the death penalty from the penal law and eliminates the seat reserved for the military on the higher education, radio/television, and communications boards.