**International Monetary Fund**

Turkey and the IMF

**Press Release**:
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December 9, 2005

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# **Turkey:** Supplementary Letter of Intent

November 24, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington DC 20431
U.S.A.

Ankara, November 24, 2005

Dear Mr. de Rato,

1. Economic performance under our program remains strong. Inflation is in single digits and growth, though moderating, remains robust. Financial markets have performed well, supported by favorable global credit conditions, the timely start of EU accession negotiations, and successful privatization of key state economic enterprises. Benefiting from these developments and from continued fiscal discipline, the overall fiscal deficit has dropped below the 3 percent of GNP Maastricht criterion and net public debt has fallen below 60 percent of GNP.

2. These achievements reflect confidence in Turkey's economic prospects as well as strong policy implementation under our program (Annexes A and B).

- With respect to the *quantitative performance criteria*, the end-September targets for external debt and net international reserves were met. And while there was an overrun in the overall balance of the social security institutions, the primary surplus target of the consolidated government sector (excluding SEEs) was met by a small margin. Given continued increases in currency demand and further financial deepening, the end-September base money ceiling was exceeded.

- As regards *fiscal reforms* envisaged in the program, we have submitted to Parliament a budget for 2006 consistent with a public sector primary surplus target of more than 6½ percent of GNP, a linchpin of the program. However, approval of legislation introducing universal health insurance and making parametric changes to the pension formula across occupational groups faced a significant delay, mainly because of the summer recess of Parliament and the need to extend the consultation process to ensure its broad support. We also recently submitted to Parliament legislation improving social security contribution collections. To further improve fiscal control, a quantitative framework was developed for monitoring health expenditures and secondary legislation required under the Public Financial Management and Control Law is expected to be put in place shortly. However, legislation strengthening state enterprise governance could not yet be submitted to Parliament as more time is needed to find consensus on a draft law.

- In the area of *financial sector reforms*, Parliament has re-approved legislation that will bring the supervisory framework more closely in line with EU standards, and the BRSA has published, with a small delay, planned reforms to strengthen its organizational and governance structures. We have also recently adopted a restructuring and privatization strategy for state banks, and are expecting to adopt soon a timetable for phasing out the special privileges and obligations of these banks.

3. In light of this performance, we request the completion of the First and Second Reviews under the Stand-By Arrangement. On the basis of our strong disinflation performance, we are requesting a waiver of the end-September base money performance criterion. We are also requesting a waiver of nonobservance for the end-September target on the primary balance of the consolidated government sector including SEEs, given that through August the cumulative surplus of state enterprises was below programmed levels (we remain on track to meet the end-year targets). We are also requesting waivers for the end-June performance criteria for the banking law (passed with a slight delay on July 2) and the pension reform law, which is now expected to be approved by mid-February (structural performance criterion).

4. We are confident that the policies set out in the April 26, 2005 Memorandum of Economic and Financial Policies and this supplementary Letter of Intent are adequate to achieve the objectives of our program, and we stand ready to take further measures that may become appropriate for this purpose. We will continue to consult the Fund on the adoption of these measures and in advance of revisions to policies contained in this letter in accordance with the Fund's policies on such consultation.

**Macroeconomic framework 2005−06**

5. The economy is on track to grow by 5 percent this year and next and inflation is likely to come in somewhat below the 8 percent end-2005 target. As expected, growth has been moderating this year, but remains well supported by investment and construction activity. Non-agricultural employment has also picked up, with over 1 million new jobs created in the last 12 months, notwithstanding continued productivity increases. Inflation remains firmly under control—with both consumer and producer price inflation in single digits—though possible second round effects from high oil prices and stickiness in non-tradable prices will require continued vigilance in order to achieve next year's target.

6. The current account deficit has continued to widen and is now projected to reach 6 percent of GNP this year and to drop to 5.8 percent next year. Although this partly reflects outside factors—notably higher oil prices and the lifting of international quota restrictions on textiles—buoyant capital inflows and the resulting strong lira have also played a role. Importantly, the quality of external financing is improving, aided by successful privatization of state-owned enterprises, increased foreign direct investment, and borrowing at longer maturities. At the same time, the floating exchange rate will continue to serve as an important safety valve, and continued foreign exchange purchases by the central bank will allow a further build-up in international reserves. We will continue to review current account developments during the year and adjust policies as needed. The ¼ percent of GNP tightening embedded in the 2006 fiscal program goes in this direction.

**Monetary policy**

7. We will continue to pursue a prudent monetary policy, guided by our inflation targets. While inflation has fallen in line with expectations, base money growth has been stronger than expected, owing to declining interest rates and growing confidence in the lira. To reflect these developments, and since inflation remains under control, we are proposing base money targets for end-December that are slightly higher than the indicative targets envisaged at the outset of the program. To help improve our reserve coverage ratios, we also propose to lock in the much higher than programmed reserve build-up, and request that the floors for net international reserves be raised accordingly. We will continue to build reserves through the daily foreign exchange purchase auctions and we retain the option of using discretionary sterilized intervention to prevent excessive exchange rate volatility.

8. To further support disinflation, the CBT continues to prepare carefully for its move to formal inflation targeting in January 2006, including by improving its forecasting and policy analysis model and making the necessary organizational changes. The CBT recently hosted a regional workshop on inflation targeting and will make a detailed announcement on the operational framework in December. With the planned move to formal inflation targeting, the CBT plans to replace base money and net domestic asset ceilings—though these will continue to be monitored carefully—with an inflation consultation clause (Annex D).

**Fiscal policy**

9. Fiscal policy has remained prudent in 2005. Central government revenues are projected to be somewhat better than programmed, though expenditures have been under pressure mainly on account of additional transfers to the social security institutions (SSIs). These reflect the greater than expected costs of expanded access to drugs and medical services, administrative complications related to hospital and pharmacy reform, and contribution shortfalls linked to earlier rumors about an amnesty. Both of these latter effects we view as transitional and likely to subside over time. Thus, while the 4½ percent of GNP indicative ceiling on the SSI deficit is likely to be breached this year, we are confident that it is achievable in 2006. In addition, we remain committed to achieving the 6.5 percent of GNP primary surplus target in 2005 and, if needed, we will adjust budget allocations to ensure this target is met.

10. Looking ahead, fiscal discipline remains a cornerstone of the program and is essential to underpin our medium-term debt reduction targets, reduce Treasury's rollover rates, and ease pressure on the external current account deficit. Our 2006 budget, submitted to Parliament in mid-October, is fully consistent with these objectives. The consolidated budget and extrabudgetary funds are expected to deliver a combined primary surplus of 5.3 percent of GNP, which corresponds to a tightening of the fiscal stance when compared to this year's expected outturn of 5.0 percent of GNP. This adjustment will allow the government to maintain the primary surplus target for the public sector at just over 6½ percent of GNP, notwithstanding the privatization of Türk Telekom and TÜPRAŞ, which will reduce the contribution of the state enterprise sector to the overall primary target. The overall public sector deficit (program definition) is expected to improve further by ½ percentage point next

year, falling to around 1 percent of GNP, helped by lower interest rates and a declining debt burden.

11. Our fiscal program for 2006 also includes a number of steps aimed at improving the composition of revenues and expenditures. On the revenue side, these include: (i) initiating reforms of the personal and corporate income taxes; (ii) harmonizing the withholding tax regime for financial investment income; and (iii) permitting a real decline in petroleum excises. In terms of expenditures (relative to GNP), the budget: (i) reduces social security transfers, both by controlling health costs and by improving collections; and (ii) allows investment spending and capital transfers to increase over 2005 levels.

12. During the year, we will monitor closely macroeconomic developments and the implementation of our fiscal program. In the event that strong economic performance allows higher than expected revenue collection, we intend to spend additional revenues on high priority investment projects, provided that the overall primary surplus, the social security deficit, and the external current account position are evolving in line with program projections. Revenue overperformance will otherwise be saved.

13. Achieving the objectives of the 2006 budget depends crucially on our ability to contain the social security deficit. Consequently, we propose to replace the indicative targets on the social security deficit with semiannual performance criteria.

- To gain greater control over health spending, we have prepared a realistic annual lump-sum budget for the state hospitals under which each hospital will be expected to finance all of its patient expenditures. This lump-sum budget will be granted at the beginning of the year and it will be set as an upper limit for the total payments of social security institutions to public hospitals. At the same time, we plan to strengthen the auditing and payment mechanisms of the social security institutions as well as the management of public hospitals to preserve the amount and quality of services provided. We are conscious that containing health spending is key to preserving a sound budgetary position. To this end, we intend to monitor closely developments in this area and, if overruns emerge early next year, we stand ready to take additional measures.

- We are also introducing a new framework to strengthen social security contribution collections and provide a permanent solution to the problem of past arrears. These reforms include the following key components: (i) introducing a uniform statute of limitations of five years for all arrears; (ii) requiring recipients of government subsidies to be current on their tax and social security obligations; (iii) improving collection through prioritizing arrears by age and size and substantially increasing the number of employees in Bağ-Kur and SSK dedicated to collections; (iv) outsourcing collection of arrears on a commission basis, starting no later than June 2006; (v) reforming the penalty and interest regime so as better to discourage late filing and payment; and (vi) introducing an installment payment facility to clear the existing stock of arrears.

- To benefit from the installment payment facility, and to ensure that payments under the scheme are not diverted from other obligations, participants must remain current on their tax and social security obligations. The length of repayments will be linked to the age of the debt, and the size of repayments to contributors' ability to pay (at least in the case of large SSK debtors, whose capacity to pay is feasible to assess). To ensure fairness and transparency, this facility will not apply to payment arrears accumulated since end-March 2005. We recently submitted supporting legislative and regulatory frameworks to Parliament. Implementation will begin immediately following enactment of the supporting legislation and will be closely monitored under the program.

- Pending the implementation of the new pension law, we will ensure that pension increases and any changes to tax rebates to pensioners will be consistent with the inflation objective and the social security envelope provided for in the 2006 budget.

**Structural fiscal reforms**

14. We are making further progress in the area of tax policy reform, with the stage set for important changes that will simplify the tax structure, broaden the tax base and align tax policy more closely with EU practices.

- The *corporate income tax* will be overhauled by lowering the tax rate and phasing out exemptions and allowances, including to remove a significant anti-employment bias in the tax code. The reduction in the headline rate will make Turkey more competitive with its neighbors, while weakening taxpayers' motivation to engage in tax avoidance schemes. We believe that in the long run this reform will be revenue neutral but we have already identified expenditure savings that will be immediately put in place in case shortfalls emerge in the near term. We stand ready to take additional policy measures to ensure that the budget targets are preserved. We aim to make effective the proposed changes to the corporate income tax for fiscal year 2006. To this end, legislation will be submitted to Parliament soon.

- The *personal income tax* will be reformed in two steps: (i) by end-December 2005, legislative changes will be adopted to streamline the structure of the tax by unifying the schedules for wage and nonwage income and reducing the number of tax brackets, (structural benchmark). These changes are expected to be revenue neutral. (ii) We are planning to introduce additional reforms later in 2006 aimed at broadening the base and increasing the efficiency of the personal income tax. To this end, we are considering streamlining existing allowances and exemptions and reforming the existing system of consumption credits to make the tax structure more progressive. Any changes will be designed so as to increase—or at least, leave unchanged—the overall revenue yield. As these reforms are far-reaching and technical preparations are at an early stage, their introduction has been phased as follows: legislation will be submitted to cabinet by end-April 2006 and to Parliament by end-May 2006 (structural performance criterion). With extensive lead time needed for taxpayer education, parliamentary approval of the law is expected by end-September 2006 (structural performance criterion).

- We remain committed to phasing out the financial transaction taxes during the program period, starting with the *Banking and Insurance Transaction Tax* by end-2006 as budgetary conditions permit.

- Finally, from January 1, 2006, interest and capital gains—including on government securities—will be subject to a flat 15 percent final *withholding tax*, helping to further harmonize, simplify, and broaden the base of the income tax system.

15. To strengthen tax administration, we plan to: (i) establish a tax policy unit in the Ministry of Finance by end-December 2005 (structural benchmark); (ii) complete the functional restructuring of the newly established Revenue Administration by end-April 2006 (structural benchmark); and (iii) establish a large taxpayer unit, although this will now be possible only by end-June 2006 (structural benchmark). We are also improving coordination between the new Revenue Administration and the social security institutions (Bağ-Kur and SSK), in line with our intention to give increasing responsibility for social security contribution collection to the Revenue Administration.

16. To support these tax reforms, and in line with program objectives, we will refrain from introducing targeted incentives and sectoral tax cuts. In particular, we will continue to preserve the structure of the VAT and avoid introducing exemptions. To assist poorer (registered) farmers, we have, however, introduced subsidies on diesel fuel, fertilizer and on grain, resulting in a net overrun in the agricultural budget of less than 0.1 percent of GNP. We remain committed to controlling strictly the overall envelope for agricultural subsidies.

17. Passage of the pension reform law had to be delayed to ensure additional consultations with social partners and is now expected to be approved by mid-February (structural performance criterion). Submission to Parliament of the social security administrative reform law is expected by end-November (prior action), with passage by end-January 2006 (structural performance criterion).

18. A key fiscal objective in the area of decentralization is to improve spending efficiency and accountability, while ensuring strict financial discipline and local government fiscal sustainability. Sustainability of municipal finances going forward will be ensured by adherence to the newly established legal limits on personnel spending, borrowing, and debt stocks, improved financial management and accountability and, where needed, additional revenue or spending measures. We are mindful that the devolution of spending and the provision of transfers and revenue authority must proceed in tandem to avoid fiscal imbalances. Debt restructuring of municipalities is underway, although progress has been slower than expected, and a comprehensive report of municipalities' restructured debts will be made available by end-June 2006.

19. We have drafted legislation on governance of the state economic enterprises, but further consultations with stakeholders are needed to garner the necessary consensus before the draft law can be submitted to Parliament.

20. We are in the process of amending the Public Financial Management and Control Law to define internal audit and internal control requirements adequately and consistently with EU requirements. These amendments—which are consistent with our commitment to respect budget appropriations—have been submitted to Parliament and implementing regulations are expected to be adopted by year-end (structural benchmark). Finally, the comprehensive review of civil service wage and employment structure is on track to be completed by end-2005 (structural benchmark).

**Financial sector reforms**

21. We are further strengthening BRSA's supervision by bringing it closer to best international practices. To this end, Parliament has re-approved the banking law originally passed in early July. Given that more than 50 supporting regulations have to be issued within one year of the passage of the banking law (structural benchmark), the BRSA has prepared an action plan setting out the timetable and priorities for their drafting and implementation, and will publish on its web site a quarterly report on progress made in this area. Taking into account the findings of the Imar inquiry, on October 11 the BRSA published a set of actions to strengthen its organizational structure, including by merging onsite and offsite supervision, creating auditing teams and adopting a number of far-reaching measures to improve transparency and accountability. Implementation of the BRSA's organizational changes envisaged in the banking law will be completed by year-end. The transfer of supervision of non-bank financial institutions from the Treasury to the BRSA will also be completed before end-2005. The committee to assess whether further integration of financial sector supervision is warranted will soon be formed with a view to present its findings by end-March 2006 (structural benchmark).

22. Further progress is being made on preparations for the possible privatization of state banks. On June 30, 2005, bank-specific strategies were adopted by both the government and the boards of the state banks. Terms of reference for the hiring of a financial advisor for Halk were agreed in September and the relevant authorization by the High Privatization Council was obtained in November. The financial advisor will be hired by early January and an announcement setting out a timetable and modalities is expected by end-June 2006 (structural benchmark). In this context, and to take into account the input of the financial advisor, we are delaying to end-March 2006 the adoption of a timetable for phasing out special privileges and obligations of the state banks (structural benchmark). We intend to follow a similar process for Ziraat during 2006. In addition, Vakifbank completed successfully its first IPO in November 2005 (end-December 2005 structural benchmark).

23. SDIF is making good progress on the resolution of assets in its portfolio (end-2005 structural benchmark). The SDIF recently successfully auctioned the remaining non-related-party loans through profit sharing arrangements, which ensure that the recovery rate will be

substantially above that achieved in the previous auction. Reflecting asset sales to date, the SDIF has already repaid US$2 billion of its debt to the Treasury. Looking forward,

- Following the successful sale of 9 cement factories, and several media companies during September and October, the SDIF is on track to complete the sale of assets seized from the former owner of the failed Imar bank before end-2005.

- By end-2007, the SDIF will dispose through competitive bids its holdings of shares in companies and other assets. A strategy for its operational restructuring will be developed as assets are sold, but no later than end-September 2007.

- The resolution of Bayındırbank will be concluded by end-2007.

- The Treasury will, by end-March 2006, resolve its receivables from the SDIF that arise from the earlier costs of restructuring the banking system.

24. As part of our efforts to strengthen the financial sector and deepen financial intermediation, we plan to introduce new legislation establishing a framework for mortgage lending and securitization. Given the large expected increase in lending resulting from this reform, we plan to phase in gradually the implementation of the law, including by adapting the supervisory framework and prudential regulations as needed. It is envisaged that during a transitional period only banks will be allowed to extend mortgage loans and that loans will be restricted to purchases of dwellings, and a prudent limit for the size of the loan relative to the purchasing price will be set in implementing regulations.

**Enhancing the investment climate**

25. Our efforts to raise the quality of the investment climate have gained further momentum after the second meeting of the Investment Advisory Council (IAC) on April 29, 2005. We have also made some modifications to the Coordination Council for the Improvement of the Investment Climate (CCIIC) with a view to enable this platform to achieve quick results. To this end, in July 2005 we amended the Law on Municipalities and the Law on Organized Industrial Zones to streamline procedures for certain business permits and, in August 2005, we put in place the regulation on Opening Business and Operating Permits to further simplify and decentralize required procedures. In the period ahead, we intend to continue building on IAC advice to strengthen the investment climate, including in priority areas such as corporate governance and the social security system.

26. We are making good progress in our privatization program. As a result of the sale of 23 state-owned enterprises, US$3.2 billion in privatization revenues has been raised this year, of which US$2.7 billion has been transferred to the Treasury. This includes an initial payment for Türk Telekom (telecommunications), for which the tender process has been completed at a sale price of US$6.55 billion, bringing the total value of privatizations completed in 2005 to US$16 billion. The technical work on TÜPRAŞ (refineries) and Erdemir (steel) has also been concluded, and we expect to finalize these privatizations by

early 2006. Looking further ahead, we aim to complete the privatization of the remaining state-owned companies under the portfolio of the Privatization Administration by end-2006.

Very truly yours,

| | |
|---|---|
| /s/ | /s/ |
| Ali Babacan | Süreyya Serdengeçti |
| Minister of State for Economic Affairs | Governor of the Central Bank of Turkey |

Attachments

Turkey: Quantitative Performance Criteria and Indicative Targets for 2005−06

| | Ceiling/ Floor | Outcome | Ceiling/ Floor | Outcome | Ceiling/ Floor | Outcome | Ceiling/ Floor | Ceiling/ Floor | Ceiling/ Floor | Ceiling/ Floor | Ceiling/ Floor |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | May 31, 2005 2/ | | June 30, 2005 | | Sept. 30, 2005 | | Dec. 31, 2005 | Mar. 31, 2006 | June 30, 2006 | Sept. 30, 2006 | Dec. 31, 2006 |
| I. Quantitative Performance Criteria 1/ | | | | | (In millions of YTL, unless otherwise stated) | | | | | | |
| 1. Floor on the cumulative primary balance of the consolidated government sector 3/ | 8,779 | 12,336 | 15,745 | 17,320 | 25,995 | n.a. | 30,460 | 7,550 | 17,250 | 28,550 | 33,500 |
| 2. Floor on the cumulative primary balance of the consolidated government excluding SEEs sector 3/ | 8,079 | 9,879 | 14,145 | 16,023 | 23,295 | 23,331 | 26,660 | 7,250 | 16,350 | 26,950 | 30,800 |
| 3. Ceiling on contracting or guaranteeing of new external pubic debt with original maturities of more than one year (in millions of US$) | 7,000 | 4,527 | 10,000 | 5,795 | 13,000 | 6,855 | 16,000 | 8,500 | 14,000 | 18,000 | 21,500 |
| 4. Ceiling on the stock of external public debt with original maturities of up to and including one year (in millions of US$) | 1,000 | 0 | 1,000 | 0 | 1,000 | 0 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| 5. Floor on level of net international reserves of CBT and Treasury combined (in billions of US$) | 2.0 | 5.8 | 2.0 | 10.5 | 2.8 | 13.2 | 14.0 | 17.2 | 19.9 | 20.3 | 22.6 |
| 6. Ceiling on base money (in billions of YTL) | 23.6 | 23.0 | 23.6 | 22.6 | 24.7 | 27.7 | 29.2 | ... | ... | ... | ... |
| 7. Ceiling on the cumulative overall balance (before transfers) of the social security institutions (SSK, BK, and ES) 4/ | -7,200 | -7,303 | -10,500 | -11,224 | -16,500 | -17,792 | -21,500 | -6,100 | -12,000 | -18,400 | -24,300 |
| II. Inflation Consultation Bands | | | | | | | | | | | |
| Outer Band (upper limit) | ... | ... | ... | ... | ... | ... | ... | 9.4 | 8.5 | 7.8 | 7.0 |
| Inner Band (upper limit) | ... | ... | ... | ... | ... | ... | ... | 8.4 | 7.5 | 6.8 | 6.0 |
| *Central Point* | ... | ... | ... | ... | ... | ... | ... | 7.4 | 6.5 | 5.8 | 5.0 |
| Inner Band (lower limit) | ... | ... | ... | ... | ... | ... | ... | 6.4 | 5.5 | 4.8 | 4.0 |
| Outer Band (lower limit) | ... | ... | ... | ... | ... | ... | ... | 5.4 | 4.5 | 3.8 | 3.0 |
| III. Indicative Targets | | | | | | | | | | | |
| 1. Floor on the cumulative overall balance of the consolidated government sector 3/ | -8,121 | -817 | -8,755 | 562 | -10,205 | n.a. | -19,590 | -3,650 | -4,050 | -6,900 | -7,800 |
| 2. Ceiling on the stock of net domestic assets of the CBT and Treasury combined | 37.7 | 31.3 | 37.7 | 24.0 | 37.8 | 23.7 | 25.5 | ... | ... | ... | ... |
| 3. Privatization Proceeds (in millions of US$) | ... | ... | 300 | 886 | 1,250 | 1,200 | 1,900 | 1,900 | 2,800 | 3,200 | 4,200 |

1/ Cumulative targets are set from January 1, 2005 for targets within 2005 and from January 1, 2006 for targets within 2006. The targets through June 30, 2006 are performance criteria; the remaining targets are indicative.

2/ End-April for floor on the cumulative primary balance of the consolidated government sector and for floor on the cumulative primary balance of the consolidated government excluding SEEs, and for the fiscal indicative target.

3/ After being adjusted for program adjusters.

4/ Indicative targets, except for end-June 2006 figure, which is a performance criterion.

| Turkey: Structural Conditionality 2005–06 1/ | |
|---|---|
| Action | Timing |
| **Prior Action** | |
| 1. Parliamentary submission of social security administrative reform law (¶17) | Five days before Board meeting |
| **Fiscal Measures** | |
| 2. No new amnesties of arrears on public sector receivables as defined in Annex F, with the exception of companies in the privatization administration's portfolio (¶19 April 26 LOI) | Continuous PC |
| 3. At most, 10 percent of those leaving through attrition in the state enterprise sector will be replaced (¶17 April 26, LOI) | Continuous SB |
| 4. Maintain excise taxes and SEE prices in line with program assumptions (¶11) | Continuous SB |
| 5. Adopt implementing regulations for the Public Financial Management and Control Law (¶20) | SB. End-December 2005 |
| 6. Establish tax policy unit at Ministry of Finance (¶15) | SB. End-December 2005 |
| 7. Complete comprehensive review of civil service wage and employment structure (¶20) | SB. End-December 2005 |
| 8. Adopt legislative changes to streamline the structure of the PIT by unifying the schedules for wage and nonwage income and reducing the number of tax brackets (¶14) | SB. End-December 2005 |
| 9. Parliamentary approval of the administrative social security reform law (¶17) | PC. End-January 2006 |
| 10. Parliamentary approval of pension reform legislation (¶17) | PC. February 15, 2006 |
| 11. Complete functional restructuring of Revenue Administration, including reorganization of local tax offices (¶15) | SB. End-April 2006 |
| 12. Submit to parliament legislation to reform the personal income tax (¶14) | PC. End-May 2006 |
| 13. Establish a large-taxpayers unit within the Revenue Administration (¶15) | SB. End-June 2006 |
| 14. Parliamentary approval of legislation to reform the personal income tax (¶14) | PC. End-September 2006 |
| **Financial Sector Measures** | |
| 15. SDIF to sell all remaining non-related-party loans by auction (¶23) | SB. End-December 2005 |
| 16. Set up a committee to assess whether integrated financial sector supervision is warranted, with findings to be presented by end-March 2006 (¶21) | SB. End-March 2006 |
| 17. Adopt a timetable for the phasing out of special privileges and obligations of the state banks (¶22) | SB. End-March 2006 |
| 18. Announcement of detailed state bank privatization strategies and timetables (¶22) | SB. End-June 2006 |
| 19. Completion of implementing regulations for the Banking Law (¶21) | SB. End-September 2006 |

1/ PC=structural performance criterion, SB=structural benchmark. Paragraph numbers refer to the Supplementary Letter of Intent.

Turkey: Proposed Schedule of Purchases

| Existing schedule | | | | Proposed schedule with rephasing 1/ | | | | Earliest possible purchase date |
|---|---|---|---|---|---|---|---|---|
| Review | SDR millions | Percent of quota | Test date | | SDR millions | Percent of quota | Test date | |
| **Approval** | 555.2 | 57.6 | | **Approval** | 555.2 | 57.6 | | |
| **2005** | | | | **2005** | | | | |
| 1st Review | 555.2 | 57.6 | 31-May-05 | | | | | |
| 2nd Review | 555.2 | 57.6 | 30-Jun-05 | 1st & 2nd Reviews | 1,110.3 | 115.2 | 30-Sep-05 | Upon fulfillment of prior action |
| 3rd Review | 555.2 | 57.6 | 30-Sep-05 | | | | | |
| **2006** | | | | **2006** | | | | |
| 4th Review | 555.2 | 57.6 | 31-Dec-05 | 3rd Review | 624.6 | 64.8 | 31-Dec-05 | 1-Mar-06 |
| 5th Review | 555.2 | 57.6 | 31-Mar-06 | 4th Review | 624.6 | 64.8 | 31-Mar-06 | 1-Jun-06 |
| 6th Review | 555.2 | 57.6 | 30-Jun-06 | 5th Review | 624.6 | 64.8 | 30-Jun-06 | 1-Sep-06 |
| 7th Review | 555.2 | 57.6 | 30-Sep-06 | 6th Review | 624.6 | 64.8 | 30-Sep-06 | 1-Dec-06 |
| **2007** | | | | **2007** | | | | |
| 8th Review | 555.2 | 57.6 | 31-Dec-06 | 7th Review | 624.6 | 64.8 | 31-Dec-06 | 1-Mar-07 |
| 9th Review | 555.2 | 57.6 | 30-Apr-07 | 8th Review | 624.6 | 64.8 | 30-Apr-07 | 1-Jul-07 |
| 10th Review | 555.2 | 57.6 | 30-Aug-07 | 9th Review | 624.6 | 64.8 | 30-Aug-07 | 1-Dec-07 |
| **2008** | | | | **2008** | | | | |
| 11th Review | 555.2 | 57.6 | 31-Dec-07 | 10th Review | 624.6 | 64.8 | 31-Dec-07 | 1-Mar-08 |
| Total | 6,662.04 | 691.1 | | | 6,662.04 | 691.1 | | |

1/ Due to rounding amounts do not add up exactly to total.

## MONETARY TARGETS

Table 1. Turkey: Performance Criteria and Indicative Targets for Base Money of the Central Bank of Turkey 1/

(In billions of YTL)

| | Ceilings | Actual |
|---|---|---|
| Outstanding base money as of September 30, 2005 | | 27.7 2/ |
| December 31, 2005 (performance criterion) | 29.2 | |

1/ These ceilings are based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.
2/ Base money outturn at September 30, 2005.

1. This Annex sets out performance criteria for base money, and indicative targets for net domestic assets of the Central Bank of Turkey (CBT) and Treasury combined. These remain applicable until December 31, 2005, after which monetary policy will be monitored through consultation bands (see below).

2. Base money is defined as currency issued by the CBT, plus the banking sector's deposits in Turkish lira with the CBT. The net domestic assets (NDA) of the CBT are defined as base money less net foreign assets of the CBT. The net domestic assets of the CBT and Treasury combined are defined as net domestic assets of the CBT plus (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year.

3. Net foreign assets of the CBT are defined as the sum of the net international reserves of the CBT (as defined in Annex E), medium- and long-term foreign exchange credits (net), and other net foreign assets (including deposits under the Dresdner scheme of original maturity of two years or longer and the holdings in accounts of the Turkish Defense Fund, but excluding CBT's net lending to domestic banks in foreign exchange). As of September 30, 2005, net foreign assets of the CBT amounted to US$17.5 billion, net domestic assets of the CBT YTL 24.6 billion, and base money YTL 27.7 billion.

4. Net domestic assets of the Treasury are equal to Treasury liabilities to the International Monetary Fund and Treasury foreign exchange denominated borrowing with an original maturity of less than one year. As of September 30, 2005, these amounted to US$15.4 billion, or YTL 23.0 billion (evaluated at program exchange rates).

5. All assets and liabilities denominated in foreign currencies will be converted into Turkish lira at program exchange rates (Annex J).

6. NDA ceilings will be adjusted for any change in the definition of the aggregate to which the reserve requirement applies according to the following formula:

$$\Delta NDA = R^{*}\Delta B,$$

where: R denotes the 6 percent reserve requirement and ΔB denotes the change in base generated by a change in the definition of the reserve aggregate, or due to any change in the averaging period. Base money ceilings will also be adjusted to reflect these changes.

7. NDA ceilings will be adjusted for any change in the reserve requirement coefficient according to the following formula:

$$\Delta NDA = B * \Delta R$$

where: B is the level of the base to which the reserve requirement applies on the test date and ΔR is the change in the reserve requirement coefficient and the liquidity requirement coefficient. Base money ceilings will also be adjusted to reflect these changes.

8. The NDA and base money ceilings will be adjusted downward for any waiver of reserve requirements for any additional bank intervened by the BRSA. The adjustment will be equal to the existing reserve requirement coefficient times the amount of liabilities at these banks subject to reserve requirements.

Table 2. Turkey: Indicative Targets on the Net Domestic Assets of the Central Bank of Turkey and Treasury Combined 1/

(In billions of YTL)

| | Ceilings | Actual |
|---|---|---|
| Outstanding NDA as of September 30, 2005: | | 23.7 |
| December 31, 2005 | 25.5 | |

1/ These targets are based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.

**Consultation mechanism on the 12-month rate of inflation**

The quarterly consultation bands for the 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the State Institute of Statistics), are specified as follows:

| | March 2006 | June 2006 | September 2006 | December 2006 |
|---|---|---|---|---|
| Outer band (upper limit) | 9.4 | 8.5 | 7.8 | 7.0 |
| Inner band (upper limit) | 8.4 | 7.5 | 6.8 | 6.0 |
| *Central point* | 7.4 | 6.5 | 5.8 | 5.0 |
| Inner band (lower limit) | 6.4 | 5.5 | 4.8 | 4.0 |
| Outer band (lower limit) | 5.4 | 4.5 | 3.8 | 3.0 |

Inflation prospects will be an important part of each review under the arrangement. In line with our accountability principles, we are committed to report to the public the reasons for any breach of the outer bands, and our policy response. In this vein, should the observed year-on-year rate of CPI inflation fall outside the outer bands specified above, the authorities will complete a consultation with the Fund on their proposed policy response before requesting further purchases under the program. In addition, the CBT will conduct discussions with the Fund staff should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter in the table above.

## TARGETS FOR NET INTERNATIONAL RESERVES

Table 1. Turkey: Performance Criteria and Indicative Floors on the Level of Net International Reserves

(In billions of U.S. dollars)

| | Floor on level of NIR | Actual | Memo item: NIR of the CBT |
|---|---|---|---|
| Outstanding stock as of September 30, 2005: | | 13.2 | 28.6 |
| December 31, 2005 (performance criterion) | 14.0 | | ... |
| March 31, 2006 (performance criterion) | 17.2 | | ... |
| June 30, 2006 (performance criterion) | 19.9 | | ... |
| September 30, 2006 (indicative target) | 20.3 | | ... |
| December 31, 2006 (indicative target) | 22.6 | | |

1. For program purposes, net international reserves is defined as net international reserves of the CBT minus (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year.

2. Net international reserves of the CBT comprise its gross foreign assets excluding encumbered reserves less its gross international reserve liabilities plus the net forward position of the central bank, denominated in U.S. dollars. Encumbered reserves are reserves that are not readily available.

3. For the purpose of the program, gross foreign assets are all short-term foreign (convertible) currency denominated claims on nonresidents, monetary gold valued at the September 30, 2004 average London fixing market price of US$414 per troy ounce, foreign bank notes, balances in correspondent accounts, and any reserve position in the IMF. At present encumbered reserves consist of foreign asset holdings in accounts of the Turkish Defense Fund (amounting to US$0.33 billion on September 30, 2005). Reserve assets as of September 30, 2005 amounted to US$43.62 billion (evaluated at program exchange rates).

4. Gross international reserve liabilities include all foreign currency-denominated liabilities (or TL/YTL-denominated liabilities indexed to any exchange rate) to residents and non-residents with an original maturity of up to and including one year (including reserves against foreign currency deposits of the banking sector), claims from central bank letters of credit, overdraft obligations of the central bank, and central bank liabilities arising from balance of payments support borrowing irrespective of their maturity. Government foreign exchange deposits with the CBT are not treated as an international reserve liability. On September 30, 2005 reserve liabilities thus defined amounted to US$15.07 billion (evaluated at program exchange rates).

5. The net forward position is defined as the difference between the face value of foreign currency-denominated or indexed central bank off-balance sheet (forwards, swaps, options on foreign currency, and any future contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents. As of September 30, 2005 these amounts were zero.

6. As of September 30, 2005 the sum of: (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year amounted to US$15.38 billion.

7 All assets and liabilities denominated in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at the program cross exchange rates specified (Annex J).

8. The projected Net International Reserves path from the fourth quarter of 2005 to the fourth quarter of 2006 is based, inter alia, on the following projections for foreign exchange receipts resulting from privatization:

| | Privatization receipts, in $ millions, cumulative from 2005 Q4 |
|---|---|
| 2005 Q4 | 800 |
| 2006Q1 | 2,800 |
| 2006 Q2 | 3,700 |
| 2006 Q3 | 4,200 |
| 2006 Q4 | 5,200 |

9. Privatization receipts are defined in this context as the proceeds from sale or lease of (all or a portion of) entities and properties held by the public sector, including the Privatization Authority and the Savings Deposit and Insurance Fund, that are deposited in foreign exchange at the Central Bank of Turkey, either directly, or through Treasury.

10. In the event that realized foreign exchange receipts resulting from privatization depart from projected receipts, the NIR floor for each quarter will be revised upward (downward) by the excess (shortfall) of cumulative realized receipts compared to the projected cumulative receipts in paragraph 8 above.

## FISCAL TARGETS

### A. Primary Balance of the Consolidated Government Sector

Table 1. Turkey: Performance Criteria and Indicative Targets on the Cumulative Primary Balance of the Consolidated Government Sector and Consolidated Government Sector Excluding SEEs.

| | Floor (In millions of YTL) |
|---|---|
| Cumulative primary balance from January 1, 2005, to: | |
| December 31, 2005 (performance criterion) | 30,460 |
| Cumulative primary balance from January 1, 2006, to: | |
| March 31, 2006 (performance criterion) | 7,550 |
| June 30, 2006 (performance criterion) | 17,250 |
| September 30, 2006 (indicative target) | 28,550 |
| December 31, 2006 (indicative target) | 33,500 |
| Cumulative primary balance (excluding SEEs) from January 1, 2005, to: | |
| December 31, 2005 (performance criterion) | 26,660 |
| Cumulative primary balance (excluding SEEs) from January 1, 2006, to: | |
| March 31, 2006 (performance criterion) | 7,250 |
| June 30, 2006 (performance criterion) | 16,350 |
| September 30, 2006 (indicative target) | 26,950 |
| December 31, 2006 (indicative target) | 30,800 |

1. The primary balance of the *consolidated government sector* (CGS), Table 1, comprises the primary balances (primary revenue minus noninterest expenditures) of the consolidated central government (consolidated budget), the 3 extra budgetary funds (EBFs) identified below, the 25 state economic enterprises (SEEs) identified below, the social security institutions (SSIs), and the unemployment insurance fund. A second set of performance criteria excludes the SEEs. The floors on the primary balance of the CGS will be monitored:

a) For the central government from above the line on a modified cash basis (including both special revenues and special expenditures). In this definition, reported transfers to social security institutions will be replaced by cash transfers reported by the social security institutions.

b) For the EBFs from above the line on a modified cash basis, counting non-transferred shared tax revenues, to the extent these are not already recorded as reserves by other elements of the CGS.

c) For the SSIs, and the unemployment insurance fund from above the line on a cash basis.

d) For the SEEs, from below the line as described in paragraph 6.

2. For the purposes of the program, the primary revenues will exclude interest receipts of the consolidated central government (including on tax arrears, although combined penalty/interest charges associated with tax payments will be counted as primary revenues starting with the March 2006 test date), SEEs, and of the unemployment insurance fund (UIF), profit transfers of the Central Bank of Turkey (CBT) and net special revenues of the Turkish mint, proceeds from the sale of assets of the CGS (privatization proceeds or transfers thereof), and state bank dividend payments. Late payment penalties of the UIF will be understood to be part of UIF interest receipts (and thus excluded from primary revenues) in 2005, but not in 2006, when they will be included as primary revenues. Revenues of the CGS from sales of immovables will be included up to an aggregate cap of YTL 500 million. Interest receipts of EBFs and SSIs will not be excluded. As well, the floor on the primary balance will be adjusted upwards for any increase in revenues arising from changes in the revenue sharing agreement between any components of the CGS and other elements of the public sector, including local authorities. For the purposes of the program, revenues of the CGS will exclude payments-in-kind and other nonmonetary forms of payments.

3. For the purposes of the program, primary expenditure of the CGS will exclude any payments related to bank recapitalization and to the restructuring of private and state banks. Privatization-related expenditure of the Privatization Fund will not be excluded, starting with the March 2006 test date. Current carryover appropriations are not included as expenditures when constructing the program targets, while spending against such appropriations will count as primary expenditures for the purposes of calculating both primary and overall balances.

4. Net lending of any component of the CGS will be considered as a non-interest expenditure item. (If this net lending is negative, it will be considered as a non-interest revenue item.) Payment of guaranteed debt by treasury on behalf of non-CGS components of the public sector will not be treated as net lending up to the baseline reported in Annex G.

**Extrabudgetary funds**

5. The three EBFs included in the definition of the performance criterion are the Defense Industry Support Fund, the Privatization Fund, and the Social Aid and Solidarity Incentive Fund.

**State economic enterprises**

6. The 25 SEEs whose primary balances will be included in the definition of the performance criterion are: TTK (coal), T. ŞEKER FAB (sugar), TMO (soil products office), TEKEL (tobacco), TCDD (railways), Türk Telekom (telecommunications), BOTAŞ (natural gas), TEDAŞ (electricity distribution), EÜAŞ (electricity generation), TETAŞ (electricity trade), TEİAŞ (electricity transmission), TPAO (petroleum exploration and extraction), ETİ

Maden İŞL., MKEK, TKİ, ÇAYKUR, DHMİ, PTT, PETKİM, THY, TÜPRAŞ, TİGEM, KIYEM, TDİ, and DMO.

7. The primary balance of these SEEs will be monitored as the sum of net financing minus accrued interest made by the SEEs. Net financing will be monitored as: net financing from the banking system (excluding pre-export financing from Eximbank) plus net external borrowing (excluding normal trade financing), plus the change in net arrears to and net advances from the private sector and to/from the non-CGS public sector (including subsidiaries and joint ventures), plus net interest payments undertaken by the Treasury. The net change in arrears on tax liabilities will be excluded.

8. Net financing from the banking system (excluding pre-export financing from Eximbank) is defined as the change in all claims of these institutions on the SEEs listed above, including loans and capitalized interest arrears, less the change in deposits and repos of SEEs in these institutions, as reported by these SEEs. Changes in claims and deposits denominated in foreign currency will be valued at the average of the exchange rates between the Turkish lira and each corresponding currency prevailing during the quarter in question. As of December 31, 2004 the stock of net banking claims on SEEs as defined above stood at YTL 499 million, valued at the exchange rates on that day.

9. Net external borrowing is defined as the receipt of external loans (including guaranteed debt and on-lending, and excluding normal trade financing) less amortization (excluding repayments of guaranteed debt and on-lending undertaken by the Treasury), valued at the exchange rate at the time of transaction. As of December 31, 2004 the stock of external loans stood at YTL 8,207 million, valued at the exchange rates on that day.

**Social security institutions**

10. The three social security institutions (SSIs) included in the definition of the performance criterion are SSK, Bağ-Kur, and Emekli Sandığı. The deficits of the SSIs will be covered by transfers from the central government budget, and they are thus expected to be in primary balance.

**Adjusters**

11. The floor on the primary surplus of the CGS will be adjusted upwards for any increase in the expenditure arrears of the SSIs. Arrears of the SSIs are defined as the sum of (i) overdue pension payments; (ii) medicine payments overdue by more than 45 days for both imported and domestic medicine (from the date of invoice receipt); (iii) other payments overdue by more than 30 days and payments to hospitals overdue by more than 60 days (from the date of invoice receipt). In the case of Bağ-Kur they exclude the arrears to the common retirement fund. The stock of arrears for Bağ-Kur stood at YTL 0 million; for SSK stood at YTL 0 million; and for ES stood at YTL 0 million on September 30, 2005. These stocks of arrears will be used for the purpose of calculating the adjustor.

12. The floors for the primary surplus of the CGS will be adjusted upward:

a) For any issue of noncash debt other than for bank recapitalization and securitization of duty losses and for the restructuring of the Agricultural Sale Cooperative Units and military foreign financed in-kind spending;

b) For any off-balance sheet expenditure of any component of the CGS (excluding military foreign financed in-kind spending).

c) For cumulative interest receipts of the Defense Industry Support Fund in excess of YTL 100 million.

13. The floor on the primary surplus of the CGS will be adjusted upwards (downwards) in line with the projected surplus (deficit) of the primary balance of any fund or entity that is incorporated in the CGS after January 1, 2004.

14. The floor on the primary surplus of the CGS will be adjusted by the primary balance projected at the time of approval of the program for any state economic enterprise (included in the performance criterion) when there is a change of control due to privatizations. The adjustor will be calculated as the difference between the primary surplus generated by the company while in public control and the annual projection. This adjustor does not apply to Türk Telekom or TÜPRAŞ in 2006.

### B. Overall Balance of the Consolidated Government Sector

Table 1. Turkey: Indicative Floors on the Cumulative Overall Balance of the Consolidated Government Sector

| | Floor (In millions of YTL) |
|---|---|
| Cumulative overall balance from January 1, 2005 to: | |
| December 31, 2005 | -19,590 |
| Cumulative overall balance from January 1, 2006 to: | |
| March 31, 2006 | -3,650 |
| June 30, 2006 | -4,050 |
| September 30, 2006 | -6,900 |
| December 31, 2006 | -7,800 |

15. The overall balance of the consolidated government sector (CGS), Table 1, comprises (i) the primary balance of the CGS as previously defined in this annex, (ii) the net interest payments of the central government (excluding in 2006 those combined penalty/interest charges associated with tax payments and already included as primary revenues), the UIF, and the SEEs, (iii) the interest payments of SSIs and EBFs, (iv) transfers of profits from the

CBT and net special revenues of the Turkish Mint to the consolidated central government, and (v) state bank dividends payments and expenditures under the risk account (net lending).

16. The monitoring of the different components of the overall balance will be as indicated in paragraph 1 of this Annex.

17. All definitions and adjusters specified earlier in this Annex to apply to the primary balance of the CGS will also apply to the overall balance of the CGS. In particular, the overall balance will be adjusted for the overall balance of any new government funds and institutions established after January 1, 2004.

### C. Overall Balance (before transfers) of the Social Security Institutions

Table 1. Turkey: Performance Criteria and Indicative Floors on the Cumulative Overall Balance (before transfers) of the Social Security Institutions

| | Floor (In millions of YTL) |
|---|---|
| Cumulative overall balance (before transfers) from January 1, 2005 to: | |
| December 31, 2005 (indicative target) | -21,500 |
| Cumulative overall balance (before transfers) from January 1, 2006 to: | |
| March 31, 2006 (indicative target) | -6,100 |
| June 30, 2006 (performance criterion) | -12,000 |
| September 30, 2006 (indicative target) | -18,400 |
| December 31, 2006 (indicative target) | -24,300 |

18. The overall balance (before transfers) of the social security institutions (SSIs), Table 1, comprises the balances of SSK, Bağ-Kur, and Emekli Sandığı.

### D. Amnesties and Public Sector Receivables

19. Amnesties will be understood as a reduction in the net present value of a public receivable, without any reference to individual ability to pay, or attempt to enforce individual payment. A public receivable will be understood as an obligation to general government (GFS definition) or to a state economic enterprise or state bank.

20. This performance criterion will not apply to companies in the Privatization Administration's portfolio.

## PROGRAM BASELINE FOR TREASURY NET LENDING

Table 1. Turkey: Program Baseline for Treasury Net Lending

| | Baseline (In millions of US$) | Baseline (In millions of YTL) |
|---|---|---|
| Cumulative net lending from January 1, 2005 to: | | |
| December 31, 2005 | 770 | 1,100 |
| Cumulative net lending from January 1, 2006 to: | | |
| March 31, 2006 | 95 | 140 |
| June 30, 2006 | 180 | 265 |
| September 30, 2006 | 265 | 390 |
| December 31, 2006 | 335 | 490 |

1. Net lending (risk account) by Treasury to other (non-CGS) components of the public sector is defined as the sum of guarantee payments made by Treasury on behalf of these entities minus repayments obtained by Treasury from them.

2. Other components of the public sector include: extrabudgetary funds not in the CGS, revolving funds, associations or foundations, state economic enterprises not in the CGS, state banks (including Eximbank and Iller bank), special provincial administrations, municipalities, municipal enterprises, build-operate-transfer projects, and build-operate projects.

3. Repayments include those obtained in cash directly from municipalities. Repayments, obtained through claw-back mechanisms, either directly, by withholding of transfers of tax shares from the MoF, or indirectly, via withholding of transfers to be made by Iller Bank, and proceeds from privatization, direct or indirect, are not included as repayments.

4. For the purposes of program monitoring, the flows in U.S. dollars will be converted at the average YTL/US$ exchange rate between test dates.

## SHORT-TERM EXTERNAL DEBT CEILINGS

Table 1. Turkey: Performance Criteria and Indicative Ceilings on the Stock of Short-Term External Debt Outstanding

| | Ceilings (In millions of US$) |
|---|---|
| December 31, 2005 (performance criterion) | 1,000 |
| March 31, 2006 (performance criterion) | 1,000 |
| June 30, 2006 (performance criterion) | 1,000 |
| September 30, 2006 (indicative target) | 1,000 |
| December 31, 2006 (indicative target) | 1,000 |

1. The limits specified in Table 1 apply to the stock of debt of original maturity of one year or less, owed or guaranteed by the consolidated government sector (as defined in Annex F). The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt or Borrowing in Fund Arrangements (Decision No. 6230-(79/140), August 3, 1979 as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85), August 24, 2000). Excluded from this performance criterion are external program financing, sales of treasury bills denominated in Turkish lira or foreign exchange to nonresidents in either the domestic primary market or the secondary market, normal import-related credits, reserve liabilities of the Central Bank of Turkey, and forward contracts, swaps, and other future market contracts. Debt falling within the limit shall be valued in U.S. dollars at the program cross exchange rates specified in (Annex J).

## MEDIUM- AND LONG-TERM DEBT CEILINGS

Table 1. Turkey: Performance Criteria and Indicative Ceilings on Contracting and Guaranteeing of New External Debt

| | Limits (In millions of US$) |
|---|---|
| Cumulative flows from end-December 2004 | |
| December 31, 2005 (performance criterion) | 16,000 |
| Cumulative flows from end-December 2004 | |
| March 31, 2006 (performance criterion) | 8,500 |
| June 30, 2006 (performance criterion) | 14,000 |
| September 30, 2006 (indicative target) | 18,000 |
| December 31, 2006 (indicative target) | 21,500 |

1. The limits specified in Table 1 apply to the contracting or guaranteeing by the consolidated government sector (as defined in Annex F) of new, nonconcessional external debt with an original maturity of more than one year. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the Executive Board of the International Monetary Fund on August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. The term "nonconcessional" means containing a grant element of less than 35 percent on the basis of the currency-specific discount rates based on the OECD commercial interest reference rates in place at the time at which the contract is entered into, or guarantee issued.

2. Excluded from this performance criterion are credits extended by the IMF, adjustment lending from the World Bank, and other external program financing, long-term liabilities of the Central Bank of Turkey and sales of treasury bills and bonds denominated in TL/YTL or FX to nonresidents in either the domestic primary market or the secondary market. Also excluded from this performance criterion is debt or the guaranteeing of debt if the proceeds from that debt have been used to retire other debt as part of a liability management operation that results in an improvement of the debt profile, either through a lengthening of maturity or a reduction in net present value of the debt stock; this could include direct swaps of one debt instrument for another and new debt issues whose proceeds are used to retire other debt; to qualify for exclusion from the PC, the debt that has been retired pursuant to such liability management operations must have a maturity date at least one year past the contract date of the new debt that has been undertaken.

3. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract is entered into, or guarantee is issued.

## PROGRAM EXCHANGE RATES

Table 1. Cross Exchange Rates for Program Purposes

| | TL value | YTL value | U.S. dollars per currency unit |
|---|---|---|---|
| Program exchange rates | | | |
| U.S. dollar | 1,497,696 | 1.497696 | 1.0000 |
| Euro | 1,845,162 | 1.845162 | 1.2320 |
| Japanese yen | 13,469 | 0.013469 | 0.0090 |
| Swiss franc | 1,186,643 | 1.186643 | 0.7936 |
| U.K. pound | 2,707,645 | 2.707645 | 1.8086 |

1. This table sets out the program exchange rates referred to in earlier Annexes. They shall apply to the performance criteria/indicative ceilings or floors for the period May 31, 2005–May 31, 2008. Currencies not specified here will be converted at the representative exchange rates reported to the IMF as of September 29, 2004.

2. Constituent currencies of the euro shall be converted into euro at the official European Union conversion rates and then converted into the U.S. dollar value.