TÜSİAD

Quarterly Economic Survey

NO: 8

APRIL 1996

TÜSİAD TURKISH INDUSTRIALISTS' AND BUSINESSMEN'S ASSOCIATION

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İstanbul, April 25, 1996

(TÜSİAD-T/96, 04 - 199)

FOREWORD

TÜSİAD, stands for "Türk Sanayicileri ve İşadamları Derneği" ("The Turkish Industrialists' and Businessmen's Association") which was founded in 1971 by a group of leading names in Turkish industry and business. TÜSİAD is an independent, non-profit institution whose primary purpose is to promote public welfare. TÜSİAD is scientific and objective in its researches. It is emphasised that this study does not necessarily reflect the views of the TÜSİAD members nor, of course, is it to be considered in any way whatever to be an official publication.

The eighth issue of TÜSİAD Quarterly Economic Survey is prepared by utilising the most recent data and estimations available in January, February and March 1996 by Economic Research Department.

LIST OF TABLES AND GRAPHS

EFFECTIVE MEASURES MUST BE TAKEN IN 1996 THAT WILL RESTORE THE BALANCES IF SUSTAINED GROWTH IS TO BE ATTAINED.

Repeated deviations from the stabilization program in 1995 have brought about significant increases in foreign trade and budget deficits, halted the process of a meaningful and lasting reduction in the inflation and interest rates, and prevented the economy from moving forward onto a path of stable growth as required by the Customs Union. In 1996, if the necessary measures are not taken to restore the macroeconomic balances, and if in particular financial discipline is not rigorously maintained, the government's goals for this year will not be achieved and the endemic instability in the macroeconomic structure will continue unabated.

The economy, which had contracted by 6.1 percent in 1994, grew at a rate of 8.1 percent in 1995. However, despite the fast growth in 1995, GNP at constant prices was only 1.5 percent higher than its level in 1993. The reduction in per capita income which was brought about by the crisis of 1994 has not yet been offset and industrial production has not yet reached its long-term growth trend. Attainable medium term targets must be formulated, and monetary and financial policies consistent with these targets must be put into action without delay, for being able to check the excessive fluctuations in economic growth and to sustain a stable growth rate.

In a scenario of stable growth for the 1996-1998 period, included as an appendix with this report, it is shown that in order to arrive at a 6 percent growth rate and cut down the inflation rate to 40 percent in the span of three years, it is imperative to increase the budget revenues, decrease the budget deficit, diminish the rate of increase of the reserve money, and balance the overexpanded foreign trade deficit by means of the increases in the invisible revenues.

If the required structural transformations are not immediately set in motion, the predicted increase in the budget deficit for the year 1996 and its settlement by short-term domestic borrowing and monetary financing will result in increases in the rates of interest and inflation.

The deterioration in the foreign trade deficit will push up the current account deficit to alarming levels, if the increase in invisibles income is not sustained.

The result of the increasing budget and current account deficits, rising inflation rate, and unchecked real interest rates, will be a postponement, once again, of the goal of increasing Turkey's competitiveness and creating more employment.

Deviation from the stabilization program has brought about in the last quarter a growth rate higher than expected.

In 1995 the 8.1 percent GNP growth rate was higher than expected. TÜSİAD's prediction of the GNP growth rate was 7.4 percent for 1995 and 6.0 percent for the last quarter of the year. The reason for the higher-than-expected 7.7 percent GNP growth rate in the last quarter of 1995 was the rapid increase in the fixed capital investments of the private sector. As a result of these developments, the earlier prediction of 3.1 percent GNP growth rate for the first quarter of 1996 was revised up to 4.6 percent.

According to the production-based GNP data, the industrial sector achieved the highest growth rate with 12.1 percent. The trade sector grew at a rate of 11.6 percent and the rate of growth in the transportation sector was 5.9 percent. 1995 was an unfavorable year for the construction sector. The construction sector attained a positive growth rate only in the second quarter of the year, while it suffered a contraction of 11.1 percent in the first quarter and of 4.7 percent in the whole year. The agricultural sector shrank by 3.0 percent in the last quarter, but it achieved a yearly growth rate of 2.6 percent. The fact that the agricultural sector grew at a meager average annual rate of 1.4 percent in the 1988-1995 period is indicative of the serious problems that have been inflicting that sector in the past few years.

The fast increase in domestic demand that had started in the first quarter of 1995 continued through the last quarter. The expected cutback in domestic demand in the last quarter of the year did not materialize due to the early general elections of December 24, and the rate of increase of the expenditure-based GDP ended up being 6.4 percent. Private final consumption expenditures expanded by 8.4 percent in the last quarter of 1995 and the yearly rate of increase remained at 7.6 percent. Expenditures on durable consumer goods, a sub-item of private final consumption expenditures which is most sensitive to changes in income, grew at rate of 20.0 percent in 1995 while it had shrunk by 29.3 percent during the 1994 crisis.

The 6.7 percent rise in the final consumption expenditures of the government can be accounted by the 13.7 increase in the other current expenditures.

Public investment underwent a serious contraction as a result of the 1994 crisis. The share of public investment in GDP, which had remained at a yearly aver-

age of 8.2 percent between the years 1988 and 1993, fell down to 5.5 percent in 1994 and to an even lower 4.2 percent in 1995. Public sector fixed investment had been reduced by the very high rate of 34.8 percent in 1994, and the reduction rate in 1995 was 16.9 percent. The reason of this reduction was the sharp decline in the non-residental construction investment. The increase in total investment in 1995, on the other hand, was 22 percent.

Notwithstanding the cutback in public investment, private sector fixed capital investment rose by 14.9 percent. The increase in the last quarter of the year was 38.8 percent. 73.8 percent of this increase was generated by investment on machinery and equipment. This is indicative of the private sector's outstanding efforts to improve its competitive power on the eve of the Customs Union.

The production expansion of 1995 is slowing down

The rise in interest rates have slowed down the expansion of production in the first quarter of 1996, offsetting the impact of the monetary expansion, the escalation of public expenditures and the salary increases of the civil servants prior to the elections.

The monthly industrial production figures show that the annual industrial growth rate has fallen to 1.8 percent in February from 11.7 percent in January. The growth rate of industry has risen again to 11.4 percent in March. One reason for the rapid fall and rise of industrial production from February to March was the timing of the religious holiday, which had happened to be in March last year and fell on February this year. In view of the decline of the capacity utilization rate, industrial production is expected to slow down in the period ahead. The capacity utilization rate was 80.6 percent in January, and it fell down to 75.1 percent in February and to 70.0 percent in March. The figures for January and March 1995 had been 72.4 percent and 74.7 percent, respectively.

Manufacturing production, on the other hand, has gone up by 10.6 percent in March. The rise in manufacturing production was 11.9 percent in January and a meager 0.7 percent in February. Except for the subsectors of the chemicals and machinery, which together generate the bulk of the manufacturing production, all the other subsectors suffered production losses in February compared with their performances in the same month of 1995. In March, however, production has increased in all the subsectors, except for paper and the chemicals. The rise in the machinery and food sectors has been around 30 percent.

A lasting reduction in inflation can not be realized.

In the previous TÜSİAD report it was predicted that the annual rate of increase in the wholesale price index would be 72.7 percent in the first quarter of the year and 76.7 percent in the whole year, under the assumption that the necessary adjustments in the public sector prices would be made in the first quarter. Due to the delay in the formation of the government, and the resulting suspension of public sector price adjustments, the inflation rate in the first quarter of 1996 turned out to be 64.4 percent. Accordingly, the prediction for the annual inflation rate has been revised down to 75.1 percent instead of 76.7 percent.

The monthly rates of increase of the consumer price index have again fallen below the monthly rates of increase of the wholesale price index, as a result of the price hikes in the public sector. This trend is expected to continue through the coming months, if the slowdown in domestic demand and the adjustments in the public sector prices persist.

An anti-inflationary monetary policy is needed.

The monetary policy, which had been put into effect in 1995, fell behind the targets in the last quarter. The result was monetary expansion, accelerated increases in the exchange rates, losses in the Central Bank reserves, and rises in the interest rates.

By the end of the year the demand for foreign currency was pushed up by the expectation that following the general elections, the negative effects of monetary expansion would be felt, longrestrained public sector price adjustments would be finalized, and a devaluation would be made.

The Central Bank attempted to thwart the increase in foreign currency demand by launching forward foreign exchange sales. The fast depletion of the Central Bank reserves towards the end of the year required a more effective use of the interest rate instrument.

The rising trend in interest rates became most apparent in the Treasury auctions. The sales-weighted compound interest rate rose from 175 percent in November to 180 percent in December.

Uncertainty in the markets was magnified by the election results and by the long deliberations preceding the formation of the coalition government. In the 80

days that elapsed between the December 24 elections and the vote of confidence for the coalition government, no measures were taken. The only policy in this period was the daily operations to meet the financing requirements of the public.

Although there has occurred a fall in the interest rates since the end of January, the auction rates in February and March remained above the 1995 average. While the Treasury was borrowing at 130 percent with a three-month maturity in January, interest on bank deposits with the same term remained 45 points below this rate. This gap has fallen to 18 points in February and to 12 points in March.

Sales-weighted compound interest rates in the Treasury auctions rose from around 204 percent in January to 153 percent in February and the maturity was set to be longer. The formation of the coalition government in March has further dragged the interest rates down to a weighted average of 126 percent. The fluctuations in the interest rates at a time when there has been no significant changes in the economic indicators shows the importance of the risk factor and of the psychological element in the determination of the interest rates.

The amount of the Treasury bonds held by the banks fell from its level of TL 340 trillions in August to TL 258 trillions at the end of December, with the expectation that the interest rates would rise during the election period and that the prices of the bonds would be pulled down. The amount of the Treasury bonds held by the banks has risen again to TL 321 trillions in March, stimulated by the increase in the interest rates.

. The Treasury can make use of the short-term advances in accordance with the four-month budget figures. As of the end of March a TL 59 trillion portion of this amount has been used.

The use of the Central Bank resources in financing the public deficit can be confirmed by a look at the Bank's analytical balance-sheet. The cash credits given to the public sector, which comprise almost one third of the assets, has increased by an amount of 99 trillions in the January-March period. Foreign assets has increased by TL 225 trillions. The growth in assets have been financed by the increase in the foreign liabilities totalling TL 222 trillions, in the open market borrowings by TL 30 trillions, and in the reserve money by TL 38 trillions. Another interesting development in the balance-sheet is the decrease in the other items of the assets by an amount over TL 60 trillions. To sum up, in the first three months of the year the Central Bank has generated resources by creating reserve money and by making open market operations. The Central Bank has given

nearly threefourth of this amount as credits to the public sector and used the remaining part for improving its foreign currency position.

A real contraction can be observed by a look at the developments in the money supply as of March 22. The increase in M1 has remained at 5.7 percent, despite the 26 percent rise in the currency in circulation. M2, which comprises the more narrowly defined M1 plus time deposits, has grown by 12.5 percent in the first three months of the year. In the same period, while the interest rates on bank deposits have remained unchanged, time deposits have increased by 22.5 percent in parallel with the rising inflation.

Foreign exchange deposits have exceeded $21.1 billions as of March 22. The increase has been 23 percent on the dollar base and 97 percent on the TL base compared to the same period of the last year. In the first three months of the year foreign exchange deposits have increased by 8 percent on the dollar base and decreased by 4 percentn on the TL base. The share of foreign exchange deposits in M2Y, on the other hand, rose from its level of 48.5 percent in March 1995 to 51.6 percent in December 1995, and it has come down to 50.6 percent in March 1996. This means that there has been no significant change in FX deposits/M2Y ratio, which has been used as an indicator of currency substitution, since the last year.

In a situation where domestic debt payments are increasing at a spiralling rate while the deepening of the financial markets remains relatively slow, there will be additional difficulties in the financing of the cash requirements of the public.

In the first months of the year the expectations of a high rate of inflation gave further impetus to the increase in the exchange rates. In the first three months of the year, the basket composed of $1+DM1.5 appreciated by 16.8 percent. However, on the basis of monthly averages, there has not occurred any notable change in the real value of exchange rates in the past threemonth period. In March, the real value of the basket has more or less remained at the level of March 1995.

The credit stock has expanded by 18 percent in the first three months of the year. The increase in the deposit bank credits, however, has been affected by the rising interest rates and has remained at 16 percent. When the comparison is made between December 22, 1995 (the last Friday of 1995) and March 22, 1995, it can be seen that the credit stock has expanded by 32 percent and the deposit bank credits by 31 percent.

The stock exchange proved to be the market which was most sensitive to the political uncertainty prior to and after the elections. The Istanbul Stock Exchange (ISE) composite index, which had closed 1995 at a level of 40,000, rose by 23.6 percent in January following its cyclical movement. The rise in the ISE composite index stopped and then reverted back in a situation of political uncertainty created by the endless efforts to form a coalition government, and it began rising again by the last week of February. The index exceeded the 67,000 level at the end of March.

The ISE composite index increased by 67 percent in the first three months of the year and brought a real return of 35 percent to the investors. The transaction volume, on the other hand, reached the level of 4.8 billions on the dollar base, highest since October 1995.

The deterioration in foreign trade deficit has been caused by the increase in the volume of imports and by the deterioration in the terms of trade.

Foreign trade deficit is particularly noticeable among the problems that has been transferred from 1995 to 1996. The main causes of the growth of the foreign trade deficit were, on the one hand, the increase in domestic demand and, on the other hand, the deterioration of the terms of trade.

Exports grew by 19.5 percent in excess of their 1994 level and reached the total of $21.6 billions, while imports rose by 53.4 percent to attain the amount of $35.7 billions. As a result, foreign trade deficit was realized as $14 billions with a 173 percent increase over its 1994 level, and the export-import ratio fell down to 55.5 percent in 1995 from its higher level of 85 percent in 1994.

The rise in exports was driven by the increase in the industrial exports. The share of the industrial exports in the total exports rose up to 87 percent.

A look at the composition of imports reveals that there were fairly close rates of increase in the imports of consumer goods, investment goods, and raw materials. It should be noted, however, that the greatest increase of 59 percent was realized in the consumer goods, and this was followed by 53 percent in the raw materials and 52 percent in the investment goods.

During the same period both import as well as export prices rose sharply. On the basis of the 12-month averages, the rise in the import prices was 17.2 percent

while the corresponding increase in the export prices remained at 13.6 percent. Real increases in exports and imports were therefore much lower. After the adjustment of the price effect, the net increase in exports, based on the 12-month averages, turned out to be 3.8 percent in 1995, and the net figure for the imports was 28.3 percent.

Compared with the year 1993, with a similar $14 billion foreign trade deficit, imports were higher by 82.4 percent and exports by 41 percent. If the computations are made on the basis of the quantity index, however, the rise in the exports would be found to be 19.2 percent and that of the imports by only 0.7 percent. In other words, measured in terms of the quantity index, foreign trade deficit actually improved by a factor of 20 percent compared with the year 1993.

While the foreign trade deficit was as high as $14 billions, the current account deficit in 1995 remained at a low $2.3 billions. In 1993, which had witnessed a similar foreign trade deficit, the current account deficit had been $6.4 billions. The increases in the transfers and in the other invisibles largely accounted for the lower current account deficit in 1995 relative to 1993.

Among the resources that were used for the financing of the current account deficit there were the $0.7 billion of direct foreign investment and the $1.7 billions of portfolio investment; there was no net inflow of other long-term capital; the net shortterm capital inflow remained at the level of $2.3 billions; and thus total capital movements reached the sum of $4.3 billions. Together with the $2.3 billions of unregistered foreign exchange inflow, which was included in the net errors and omissions, the increase in the reserves came to a total of $4.7 billions.

In 1996 the growth rate is predicted to be 4.5 percent and the foreign trade deficit is expected to rise up to $16 billions under the impact of the Customs Union. It is expected that the fast increase in 1995 in the revenues from the goods and services, and in particular from tourism, will continue and that the current account deficit will come out to be $3.8 billions with a 2.2 percent share in GNP. As shown by the medium-term forecasts, included in an appendix with this report, during the next threeyear period the Turkish foreign trade deficit will amount to $17 billions. The financing of this foreign trade deficit will require the continuation of the fast increase in the invisible revenues.

There is no indication that the real exchange rates appreciated relative to the 1990-1993 period.

Despite the lower deficit in real terms, the reason for the nominal deterioration in the foreign trade deficit was not the loss of competitiveness of the domestic goods relative to the foreign goods; the deterioration was brought about by an increase in the unit price of imports and thereby by a higher amount of payment in return for the same amount of imports. Indeed, the real exchange rates were not at a level that would create problems for exports. The average real value of the foreign exchange basket in 1995 was equal to its average value in the 1987-1994 period.

Beginning with October 1995 the rate of devaluation gained speed and the monthly increases in the exchange rates parallelled the rate of inflation. In 1995 the TL's real appreciation was slower relative to the DM and faster relative to the dollar. In March 1996 the foreign exchange basket of $1+DM1.5 has appreciated only 3.6 percent in real terms compared to its level in March 1995.

The decline in the Central Bank reserves, which has been in effect since November 1995, has come to a stop and even marked a partial improvement from mid-February to mid-March. The reason behind the end of the decline has been the dissipation of the devaluation expectation with the formation of the new government and the elimination of the foreign exchange demand by the speedy increases in the exchange rates. The Central Bank reserves have begun expanding again, the commercial bank reserves have shrunk down, and the total reserves have remained constant.

Alarming increase in the consolidated budget deficit

The 12 month consolidated budget deficit, which was at a level of TL 317 trillions at the end of 1995, reached the amount of TL 362 trillions in February 1996 and the cash deficit rose up to TL 441 trillions. The 12-month consolidated budget deficit, which had been held at around $5 billions during the first ten months of 1995, began to rise in November and December. In February 1996 the consolidated budget deficit increased to $6.7 billions and the cash deficit to $8 billions. The increase in the budget deficit was brought about to a large extent by payments of interest on domestic debt and personnel expenditures.

While the budget deficit was being financed by short-term domestic borrow-

ing, net foreign debt payments continued. With the persistence on the policy of domestic borrowing, the stock of bonds and bills has risen from TL 1,143 at the end of 1995 up to TL 1,532 trillions in February 1996. In addition to Treasury bonds financing, short-term advances from the Central Bank has been increasingly used since December 1995.

The average interest rate on Treasury bonds, which had been on a rising trend since September 1995, has begun falling in the postelection period with the emergence of a political environment which has been deemed more suitable for the implementation of stabilization measures. The compound interest rate, which touched the high level of 240.3 percent in the first auction of the year, has declined to 125 percent on April 16, thereby falling down to the level of the period prior to the fourth quarter of 1995 when the interest rates had begun rising. However, the 60 percent gap between the inflation rate and interest rate is still too high compared to the 20-30 percent of the period preceding the 1994 crisis. The major factor which is inhibiting the fall in the interest rates is the growing budget deficit and its financing by domestic borrowing.

During the deliberations on the budget, the projected deficit for 1996 has been announced as $10 billions. In view of the 12month cash deficit of $8 billions inFebruary, of the continuing rises in the interest payments on domestic debt due to the policy of domestic borrowing, and of the persistent increases in the transfers to the social security organizations, it becomes apparent that the realization of the budget goals of 1996 will preclude any real increases in the personnel and investment expenditures. On the other hand, the consolidated budget deficit, which has usually deviated from the target, has to be held at least at the projected level for 1996 if serious deteriorations are not to occur in the foreign and savings balances. From the perspective of the composition of the total national savings, the financing of a budget deficit in excess of $10 billions will only be made possible by the rises of the current account deficit and of the private sector savings surplus to levels which are not sustainable in the longterm. It is estimated that in 1996 the current account deficit will approximate $4 billions. Therefore, the savings pressure on the private sector will be in the amount of $6 billions. A savings surplus as high as $6 billions can be realized only in the years of crisis and it can be sustained for only one year. It is expected that, taking economic growth and the Customs Union into consideration, the current account deficit will be on average $3 billions in the next three years. It is therefore imperative for the budget deficit to be pulled down to the sustainable level of $5-6 billions.

TABLE 1.1 MAIN ECONOMIC INDICATORS
PRODUCTION AND PRICES

	1995									1996		
	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March
INDUSTRIAL PRODUCTION INDEX (SIS, 1992=100)												
Annual % increase	13.6	13.9	24.1	19.8	13.5	5.9	2.2	10.9	15.7	11.7	1.8	11.4
Monthly % increase	9.8	-5.7	12.3	-1.7	2.1	1.9	0.3	8.9	0.6	-10.4	-17.1	14.8
Monthly % increase (Seasonally Adjusted)	11.0	4.4	15.1	8.3	2.1	6.3	3.7	10.0	0.6	1.6	-7.4	9.3
CAPACITY UTILIZATION RATIO (SIS, %)	79.0	79.4	81.5	83.4	82.6	84.3	80.7	79.4	81.4	79.7	78.1	70.0
WHOLESALE PRICE INDEX (SIS, 1994=100)												
Annual % increase	90.1	77.7	76.6	79.0	78.2	76.9	71.7	67.0	60.9	64.9	63.0	65.3
Monthly % increase	5.1	1.9	1.3	2.3	2.3	4.6	3.7	3.5	4.4	9.7	5.8	7.0
Monthly % increase (Seasonally Adjusted)	3.2	2.4	3.5	4.0	4.1	4.9	4.4	4.1	4.5	9.0	3.4	4.1
EXCHANGE RATE ($)												
TL/US$ (Monthly Average)	42,227	43,024	43,061	44,399	44,691	47,703	49,970	52,413	56,827	60,428	64,066	68,333
Annual % increase	31.3	27.0	35.9	43.4	46.8	40.6	42.9	44.4	51.5	50.1	56.2	63.9
Monthly % increase	1.3	1.9	0.1	3.1	5.2	2.2	4.8	4.9	8.4	6.3	6.0	6.7
INTEREST RATES (Yearly Simple Rate)												
Deposits (End of period)												
1 month	60.0	60.0	60.0	55.0	55.0	55.0	55.0	73.5	81.0	81.0	81.0	77.3
3 months	72.0	70.8	70.8	68.0	68.0	68.0	68.0	77.5	86.5	86.5	86.5	82.8
6 months	77.0	75.8	75.8	73.0	73.0	73.0	73.0	84.3	88.0	88.0	88.0	88.0
12 months	90.0	90.0	90.0	85.0	85.0	85.0	85.0	89.8	93.5	93.5	93.5	93.5
Treasury (Monthly Average)*												
1 month	-	-	-	-	-	-	-	-	105.9	-	-	-
3 months	77.4	80.9	71.9	69.0	68.5	92.7	96.3	98.9	120.3	131.1	104.6	94.2
6 months	80.6	89.6	91.7	85.8	81.0	93.9	-	-	-	134.0	111.4	101.9
9 months	86.1	100.7	-	-	83.2	-	-	-	-	-	-	-
12 months	99.0	115.8	-	105.0	99.8	-	-	-	-	-	-	-
Compound interest rate (all maturities)	97.2	110.7	100.0	98.3	92.1	117.0	130.6	135.6	183.7	201.5	148.4	126.8
Average daily maturity of papers sold (weighted by sales volume)	287	198	153	240	221	149	109	97	84	123	142	140

(.): not available
(-): no auction
* include bills with irregular terms

TABLE 1.2 MAIN ECONOMIC INDICATORS
BALANCE OF PAYMENTS

1995	Jan.	Feb.	March	April	May	June	July	Agust	Sept.	Oct.	Nov.	Dec.
FOREIGN TRADE												
Value (Current $ prices)												
Imports (Annual % increase)	-2.6	30.3	24.9	73.1	78.4	71.1	79.1	68.9	59.7	56.0	59.0	59.6
Exports (Annual % increase)	18.1	29.9	25.4	50.9	23.3	33.1	13.4	15.2	1.8	16.0	24.2	3.9
Price Index (1989=100)												
Imports (Annual % increase)	11.1	19.9	23.6	22.8	22.7	30.5	21.0	19.7	17.7	11.2	-2.5	11.6
Exports (Annual % increase)	4.6	-4.7	10.5	18.0	18.4	13.7	13.7	17.8	16.6	17.9	14.5	11.2
Quantity Index (1989=100)												
Imports (Annual % increase)	-9.7	-6.3	14.2	37.2	35.1	56.3	50.3	50.4	35.9	36.6	44.0	20.2
Exports (Annual % increase)	14.7	17.2	20.8	32.2	4.2	13.2	-7.7	1.9	-14.1	-8.5	6.9	-11.0
FOREIGN TRADE BALANCE ($ Million)												
Imports (Monthly)	2,097	2,283	2,474	2,985	2,584	3,046	2,876	3,192	3,066	3,213	3,574	4,319
Exports (Monthly)	1,550	1,551	1,656	1,861	1,504	1,835	1,790	1,748	1,750	1,937	2,059	2,396
Foreign Trade Balance (Monthly)	-547	-732	-818	-1,124	-1,080	-1,212	-1,086	-1,444	-1,316	-1,276	-1,515	-1,922
Imports (Last 12 months)	23,214	23,744	24,237	25,497	26,633	27,898	29,168	30,470	31,617	32,770	34,095	35,708
Exports (Last 12 months)	18,343	18,700	19,036	19,664	19,948	20,404	20,616	20,847	20,877	21,144	21,545	21,635
Foreign Trade Balance (Last 12 months)	-4,871	-5,044	-5,201	-5,833	-6,685	-7,494	-8,552	-9,623	-10,740	-11,626	-12,551	-14,073
BALANCE OF PAYMENTS ($ Million)												
Current Account Balance (Monthly)	608	-21	-159	-194	-259	10	-4	-183	212	-19	-877	-1,453
Current Account Balance (Last 12 months)	3,053	3,302	3,764	3,660	2,818	2,341	1,537	859	352	-6	-757	-2,339
Capital Account and Reserve Movements (Last 12 months)												
Net Foreign Direct Investment (Last 12 months)	541	519	508	611	636	638	629	598	665	639	592	772
Portfolio Investment (Last 12 months)	841	762	-252	-665	-998	-783	74	752	1,110	1,363	1,072	1,723
Net Long-Term Capital (Last 12 months)	-884	-876	-859	-822	-797	-639	-389	-206	-225	-370	-419	-96
Net Short-Term Capital (Last 12 months)	-4,936	-4,363	-4,426	-655	575	1,940	2,797	3,481	4,138	4,390	3,744	2,306
Net Errors and Omissions (Last 12 months)	2,298	2,656	4,451	5,471	5,341	4,346	-3,389	3,067	2,554	3,150	2,572	2,292
Reserve Changes *(Last 12 months)	-913	-2,000	-3,186	-7,600	-7,575	-7,843	-8,037	-8,551	-8,594	-9,166	-6,804	-4,658

(*): Positive sign indicates decrease in reserves

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TABLE 1.3 MAIN ECONOMIC INDICATORS
CONSOLIDATED BUDGET

	1995										1996	
	March	April	May	June	July	Agust	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
Monthly (Billion TL)												
Revenues	91,394	86,468	134,721	105,964	123,278	124,391	121,960	155,679	146,722	148,121	157,629	123,937
Expenditures	109,006	160,824	121,777	103,664	113,546	130,391	98,287	100,323	271,383	310,745	225,452	137,727
Primary Balance (Current price)	31,626	-11,018	47,344	19,809	35,364	42,459	29,978	63,643	16,149	-62,056	25,899	15,942
Budget Balance (Current price)	-17,612	-74,356	12,944	2,300	9,732	-6,000	23,673	55,356	-124,661	-162,624	-67,823	-13,790
Budget Balance (At 1994 prices)	-10,496	-42,152	7,203	1,264	5,229	-3,153	1,184	26,855	-57,840	-72,893	-27,705	-5,322
Budget Balance (Cur. price billion $)	-0.423	-1.761	0.301	0.053	0.219	-0.129	0.496	1.108	-2.378	-2.862	-1.122	-0.215
Financing	24,649	66,511	-5,777	-12,116	-14,908	40,514	9,886	-7,280	21,970	121,217	91,497	105,012
Foreign Borrowing (Net)	-20,971	1,870	-23,494	-13,557	-14,165	-15,958	26,433	-14,976	-14,677	28,005	-16,256	-17,201
Domestic Borrowing (Net)	43,732	52,869	-12,755	-10,226	12,256	28,250	-5,573	-3,770	-14,247	-3,874	-11,326	-18,456
Short-term Borrowing	329	-4,360	33,346	23,993	6,269	5,284	-3,840	31,953	30,485	77,866	251,967	85,954
Central Bank (Net)	3,873	34,687	-18,720	-6,666	-5,843	-11,058	31,473	1,424	11,938	58,263	10,472	16,326
Treasury Bills (Net)	-3,544	-39,047	52,066	30,659	12,112	16,342	-35,313	30,529	18,548	19,602	241,495	69,628
Other	1,559	16,132	-2,874	-12,326	-19,268	22,938	-7,134	-20,487	20,409	19,219	-132,888	54,715
Last 12 months (Billion TL)												
Revenues	897,682	936,672	1,013,255	1,051,637	1,106,400	1,154,215	1,204,331	1,282,026	1,347,502	1,403,071	1,478,377	1,520,264
Expenditures	1,046,284	1,155,370	1,225,344	1,269,431	1,300,277	1,351,186	1,367,790	1,383,637	1,594,210	1,720,647	1,869,307	1,883,125
Primary Balance (Current price)	236,798	217,165	243,912	237,388	263,886	277,609	284,870	326,602	315,727	258,539	257,402	255,139
Budget Balance (Current price)	-148,602	-218,698	-212,089	-217,794	-193,877	-196,971	-163,459	-101,611	-246,708	-317,576	-390,930	-362,861
Budget Balance (At 1994 prices)	-104,359	-141,921	-140,981	-147,486	-128,610	-129,042	-108,460	-76,208	-150,014	-156,744	-188,174	-167,170
Budget Balance (Cur. price billion $)	-3,907	-5,536	-5,422	-5,621	-4,944	-4,981	-4,195	-2,901	-5,843	-6,258	-7,518	-6,712
Financing	162,081	222,333	227,838	216,791	192,408	223,400	218,657	191,901	206,431	294,256	366,866	441,175
Foreign Borrowing (Net)	-116,715	-121,973	-138,561	-141,421	-144,761	-150,486	-107,768	-112,832	-121,211	-81,238	-86,323	-94,947
Domestic Borrowing (Net)	-27,307	28,452	20,113	10,472	24,395	70,213	73,205	87,059	75,713	85,657	75,289	56,880
Short-term Borrowing	336,563	324,948	352,569	351,996	341,619	297,282	263,261	244,023	257,303	291,941	496,952	539,246
Central Bank (Net)	-739	34,746	22,953	38,021	28,219	11,168	48,376	40,771	43,757	94,723	108,734	126,169
Treasury Bills (Net)	337,302	290,202	329,616	313,975	313,400	286,114	214,885	203,252	213,547	197,218	388,218	413,077
Other	-30,460	-9,094	-6,283	-4,256	-28,845	6,391	-10,041	-26,349	-5,374	-2,105	-119,053	-60,005

TABLE 1.4 MAIN ECONOMIC INDICATORS
MONEY SUPPLY

| | 1995 | | | | | | | | | 1996 | | |
	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March
(Annual percentage change)												
M1	120.6	107.3	104.1	85.7	87.7	81.4	73.8	76.0	65.7	76.3	90.8	79.9
Currency in circulation	105.7	105.4	97.1	95.2	83.2	81.5	78.7	89.5	81.6	81.7	88.5	71.6
Currency+coins	100.1	92	102.1	91.1	81.4	78.0	79.5	87.6	86.6	81.7	95.1	74.7
Cash in vault (-)	70.1	19.1	141.8	59.9	66.1	55.8	88.6	69.8	117.7	82.5	154.2	92.9
Commercial sight deposits	119.1	109	107.2	70.3	98.5	81.2	57.1	44.9	54.4	68.6	97.8	89.5
Savings sight deposits	141.8	102.8	101	96.2	88.8	84.1	88.2	88.8	56.4	88.0	81.6	89.1
Other sight deposits	239.4	134.9	170.3	54.8	76.4	72.3	87.9	93.5	46.3	49.0	103.0	84.8
Central Bank's deposits	-23.5	123.1	-51.3	-15.4	-39.8	378.4	-89.4	-80.7	-72.4	-82.8	-62.3	-66.3
M2	159.9	130	105.9	87.4	100.8	100.1	97.4	101.9	97.7	103.9	100.5	87.5
Commercial time deposits	381.1	239.7	137.9	97.4	141.6	141.5	148.4	189.5	197.3	187.4	126.3	105.0
Savings time deposits	201.6	149.3	104.6	88.6	108.5	111.1	112.3	114.9	117.8	123.6	114.2	96.4
Other time deposits	107.6	102.3	108.5	87.9	99	103.9	98.6	99.8	91.4	76.6	70.8	68.3
Certificates of deposits	103	107	85.9	36.4	56.4	55.8	80.0	70.5	49.6	47.5	35.6	21.0
M2Y	110.5	108.8	101.9	91.8	94.4	92.0	86.1	93.7	106.5	97.4	96.2	96.2
Foreign exchange deposits (TL)	72.9	88.4	97	97.7	86.7	83.0	75.0	85.5	115.5	91.3	91.7	105.3
Foreign exchange deposits ($)	36.4	38.6	39.4	36.6	26.8	28.0	24.5	27.2	35.6	25.6	23.1	21.9
TL/USD Buying Rate	26.8	35.9	41.3	44.7	47.3	43.0	40.6	45.8	58.9	52.2	55.8	68.5
M3Y	111.6	114.3	103.5	92.1	95.1	93.0	88.1	93.3	106.8	102.2	97.3	97.2
M3	159.8	140	108.7	88.2	101.7	101.5	100.5	100.6	98.6	113.1	102.3	90.0
Foreign exchange deposits (TL)	72.9	88.4	97	97.7	86.7	83.0	75.0	85.5	115.5	91.3	91.7	105.3
Credit Stock	92.5	110.7	119.8	78.8	88.8	95.3	92.6	96.5	119.4	108.1	118.2	128.7
Central Bank Direct Credits	37.4	48.1	-.4	-12.4	-5.1	1.9	-2.6	-13.7	30.9	30.4	64.6	72.8
Deposit Bank Credits	71.1*	91.5*	100.2*	109.0*	117.9	121.6	125.3	136.1	149.9	132.1	135.5	146.1
Invest. and Develop. Bank Credits	69.1	65	86	49.1	47.1	51.7	49.9	57.4	62.4	66.5	75.6	81.7

* Adjusted for changes in data definition between 1.7.1994-1.7.1995

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TABLE 2 GROSS DOMESTIC PRODUCT (EXPENDITURE BASED)

(At 1987 Prices)	Growth Rate			% Share			Annual Growth Rate (%)							
	1993	1994	1995	1993	1994	1995	1994-1	1994-2	1994-3	1994-4	1995-1	1995-2	1995-3	1995-4
Private Final Consumption Expenditure	8.4	-5.3	7.6	69.5	69.0	69.0	5.8	-10.2	-7.4	-7.4	-4.6	12.2	13.0	8.4
Food-Beverages	3.3	-0.7	7.4	25.6	26.7	26.6	4.9	-3.8	-2.2	0.0	-0.5	10.4	10.6	7.1
Durable Goods	23.2	-29.3	20.0	10.1	7.5	8.4	6.9	-44.9	-39.0	-36.0	-18.9	39.8	50.8	30.6
Semi-Durable&Non-Durable Goods	7.0	-12.6	11.6	11.6	10.6	11.0	6.6	-18.9	-23.3	-12.4	-11.0	18.5	25.6	16.8
Energy-Transportation-Communication	14.7	4.2	-1.7	9.9	10.9	10.3	7.5	3.9	3.9	2.3	0.9	5.6	2.7	-1.9
Services	8.6	5.2	-2.7	6.5	7.1	6.8	7.0	-2.2	9.1	6.1	2.9	7.6	3.9	-3.3
Ownership of Dwelling	2.6	2.8	2.1	5.7	6.2	5.9	2.9	3.0	2.9	2.4	2.2	2.0	2.0	2.2
Government Final Consumption Expenditure	5.4	-3.5	6.7	7.6	7.7	7.9	0.8	-4.5	-0.4	-7.6	7.1	9.6	2.3	7.8
Compensation of Employees	1.8	0.8	2.5	4.6	4.8	4.6	2.0	2.0	-0.6	-0.2	2.7	2.9	2.7	1.8
Purchases of Goods&Services	11.4	-10.0	13.7	3.0	2.8	3.0	-3.1	-16.9	-0.1	-13.8	22.2	25.5	1.5	13.7
Gross Fixed Capital Formation	24.9	-15.9	8.3	30.1	26.5	26.7	8.2	-20.1	-18.7	-25.3	-15.1	14.2	11.1	22.1
Public Sector	3.5	-34.8	-16.9	8.0	5.5	4.2	-7.9	-47.1	-38.9	-31.6	-37.5	-1.4	-15.2	-17.3
Machinery&Equipment	3.7	-63.9	3.2	3.1	1.2	1.1	-41.0	-70.3	-72.3	-58.9	-21.8	4.7	3.5	17.4
Building Construction	11.4	-35.7	4.2	1.5	1.0	1.0	-8.6	-64.1	-34.2	-19.7	-7.7	34.6	1.6	-2.2
Other Construction	0.1	-8.2	-30.5	3.4	3.3	2.1	25.3	-11.3	-4.9	-18.2	-53.8	-12.8	-26.1	-34.1
Private Sector	35.0	-9.1	14.9	22.1	21.1	22.5	11.4	-10.7	-10.8	-22.2	-11.4	17.4	18.1	38.8
Machinery&Equipment	60.5	-22.5	28.1	12.2	9.9	11.9	14.9	-26.1	-32.3	-37.5	-23.8	33.3	45.1	73.8
Building Construction	12.8	7.6	2.1	9.8	11.1	10.6	7.1	7.9	8.0	7.3	4.5	4.1	3.4	-0.6
Change in Stocks	-	-	-	1.6	-3.2	1.4	-	-	-	-	-	-	-	-
Exports of Goods & Services	7.7	15.2	6.7	18.4	22.2	22.1	6.1	10.1	26.7	15.4	19.9	12.2	2.3	-1.8
Imports of Goods & Services	35.8	-21.9	30.0	-27.1	-22.2	-26.8	7.5	-34.0	-31.9	-22.4	-2.6	37.7	41.4	48.0
Gross Domestic Product (Expenditure based)	7.7	-4.7	7.5	100.0	100.0	100.0	4.3	-9.6	-6.1	-5.4	-0.8	14.3	9.0	7.0
Statistical Discrepancy	-	-	-	1.6	0.8	0.6	-	-	-	-	-	-	-	-
Gross Domestic Product (Production based)	8.0	-5.5	7.3	-	-	-	5.2	-10.7	-7.8	-5.5	-1.5	13.5	9.6	6.4

TABLE 3 TÜSİAD ESTIMATES

	94-1	94-2	94-3	94-4	94	95-1	95-2	95-3	95-4	95	96-1	96-2	96-3	96-4	96
		Realization					Realization						Estimate		
(25 January 1996)															
Growth Rate	4.0	-9.6	-8.6	-6.8	-6.0	-0.2	12.4	10.0	6.0*	7.4*	3.1	0.9	3.4	5.6	3.3
Inflation	67.8	133.9	128.3	141.3	120.7	149.9	82.0	79.8	70.3	88.5	72.7	77.3	78.4	77.6	76.7
(25 April 1996)															
Growth Rate	4.1	-9.7	-8.7	-6.9	-6.1	-0.3	12.6	10.7	7.7	8.1	4.6	0.9	3.4	4.4	3.3
Inflation	67.8	133.9	128.3	141.3	120.7	149.9	82.0	79.8	70.3	88.5	64.4**	74.5	78.6	80.2	75.1

Estimate
*Realization**

GNP GROWTH RATE　　　　GRAPH 1

* Estimate

WHOLESALE PRICE INDEX　　　GRAPH 2
(Average Annual Percentage Change)

* Estimate

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SEASONALLY ADJUSTED INDUSTRIAL PRODUCTION (Level)

GRAPH 3

(1992=100)

Index ——— Cycle ——— Trend (1989-1993 exponential trend, yearly increase % 5.7)

SEASONALLY ADJUSTED INDUSTRIAL PRODUCTION INDEX (Annual Percentage Increase)

GRAPH 4

(%)

——— Index ——— Cycle

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INDICES OF PRODUCTION AND PRODUCTION WORKERS GRAPH 5
IN MANUFACTURING INDUSTRY

(1992=100)

Manufacturing Industry Production Index ——— Index of Production Workers in Manufacturing Industry

MANUFACTURING INDUSTRY PRODUCTIVITY INDEX GRAPH 6

(1992=100)

GRAPH 7

SAVING - INVESTMENT BALANCE (*)
(Cumulative for the last 12 months)

($ Million)

| ■ Private Sector Saving Surpuls | ——— Current Account Balance | ——— Consolidated Budget Balance |

(*) Consolidate budget balance is used as a proxy for the public sector saving gap due to lack of monthly data on the latter. Private sector saving surplus figures are cal-culated as the sum of budget deficit and current account balance.

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WHOLESALE PRICE INDEX AND MONTHLY AVERAGE US DOLLAR EXCHANGE RATE
EXCHANGE RATE
(Annual Percentage Change)

GRAPH 8

Legend: —— WPI　—— TL/$

REAL EXCHANGE RATE INDEX
(Level)

GRAPH 9

(12/87=100)

Legend: —— USD　—— DM　—— 1USD+1.5DM

STOCK EXCHANGE INDEX AND TRANSACTION VOLUME

GRAPH 10

(1986=100)

($ Million)

Stock Exchange Index (right scale) — Transaction Volume (left scale)

CENTRAL BANK FOREING EXCHANGE RESERVES & US DOLLAR NOMINAL EXCHANGE RATE

GRAPH 11

(TL/$)

($ Million)

US $ Buying Rate (left scale) — Central Bank Foreing Exchange Reserves (right scale)

CURRENCY IN CIRCULATION (Annual Percentage Increase)   GRAPH 12

M1 (Annual Percentage Increase)   GRAPH 13

M2 (Annual Percentage Increase)   GRAPH 14

M2Y (Annual Percentage Increase)   GRAPH 15

TIME DEPOSITS & FOREIGN EXCHANGE DEPOSITS
(Annual Percentage Increase)

GRAPH 16

Time Deposits — Foreing Exchange Deposits ($)

DEPOSIT BANK CREDITS & DEPOSITS
(Annual Percentage Increase)

GRAPH 17

Deposit — Credits *

Adjusted for changes in data definition between 1.7.1994 - 1.7.1995.

DEPOSIT BANK CREDITS* / TOTAL DEPOSITS RATIO

GRAPH 18

Adjusted for changes in data definition. Total deposits include Foreing Exchange Deposits in M2Y.

CENTRAL BANK MONEY AND RESERVE MONEY
(Annual Percentage Increase)

GRAPH 19

(%)

Reserve Money   Central Bank Money

LIABILITIES DUE TO OPEN MARKET OPERATIONS

GRAPH 20

(TL Billion)

CONSOLIDATED BUDGET DEFICIT
(At 1994 Prices)

GRAPH 21

Monthly (left scale) — Cumulative for the last 12 months (right scale)

BORROWING BY TREASURY BILLS (NET)
(At 1994 Prices)

GRAPH 22

Monthly (left scale) — Cumulative for the last 12 months (right scale)

CONSOLIDATED BUDGET EXPENDITURES
(At 1994 Prices, Cumulative for the last 12 months)

GRAPH 23

(TL Billion)

Legend: Investment — Interest Payments on Domestic Debt — Personnel — Other Transfers

CONSOLIDATED BUDGET FINANCING
(At 1994 Prices, Cumulative for the last 12 months)

GRAPH 24

(TL Billion)

Legend: Treasury Bills (Net) — Central Bank (Net) — Domestic Borrowing (Net) — Foreing Borrowing (Net)

CONSOLIDATED BUDGET DEFICIT
(At 1994 Prices, Cumulative for the last 12 months)

GRAPH 25

(TL Billion)

Legend: Primary Balance — Interest Payments — Budget Balance

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NOMINAL EXPORTS AND IMPORTS
(Cumulative for the last 12 months)

GRAPH 26

($ Million)

Export ———— Import

FOREIGN TRADE DEFICIT
(Cumulative for the last 12 months)

GRAPH 27

($ Million)

———— At Current Prices   ———— At 1989 Prices

FOREIGN TRADE PRICE INDEX
(Cumulative for the last 12 months)

GRAPH 28

(1989=100)

Exports ———— Imports ————

TERMS OF TRADE
(12 Months Average)
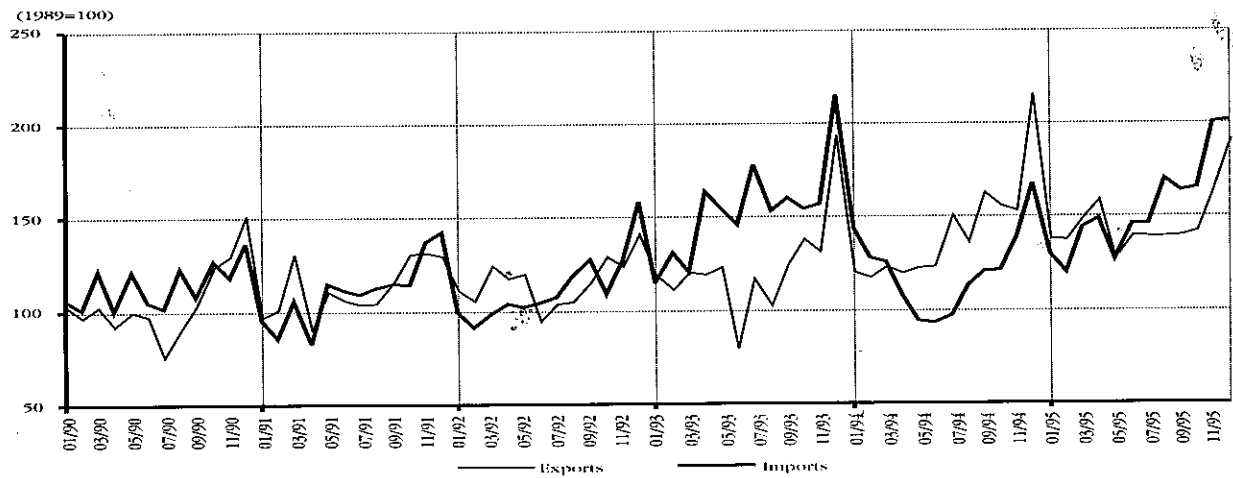
GRAPH 29

(1989=100)

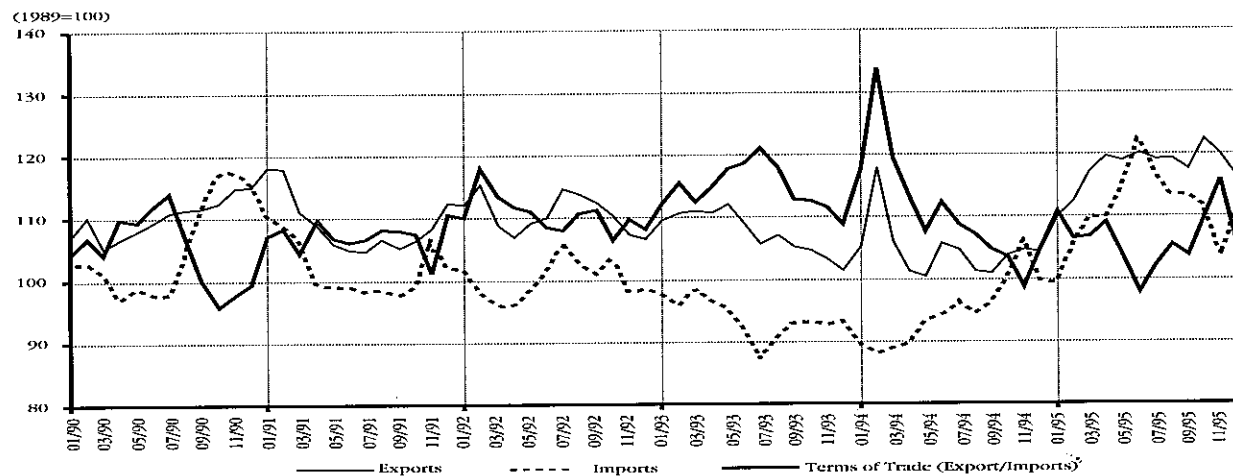# FOREIGN TRADE

GRAPH 30

FOREIGN TRADE QUANTITY INDICES
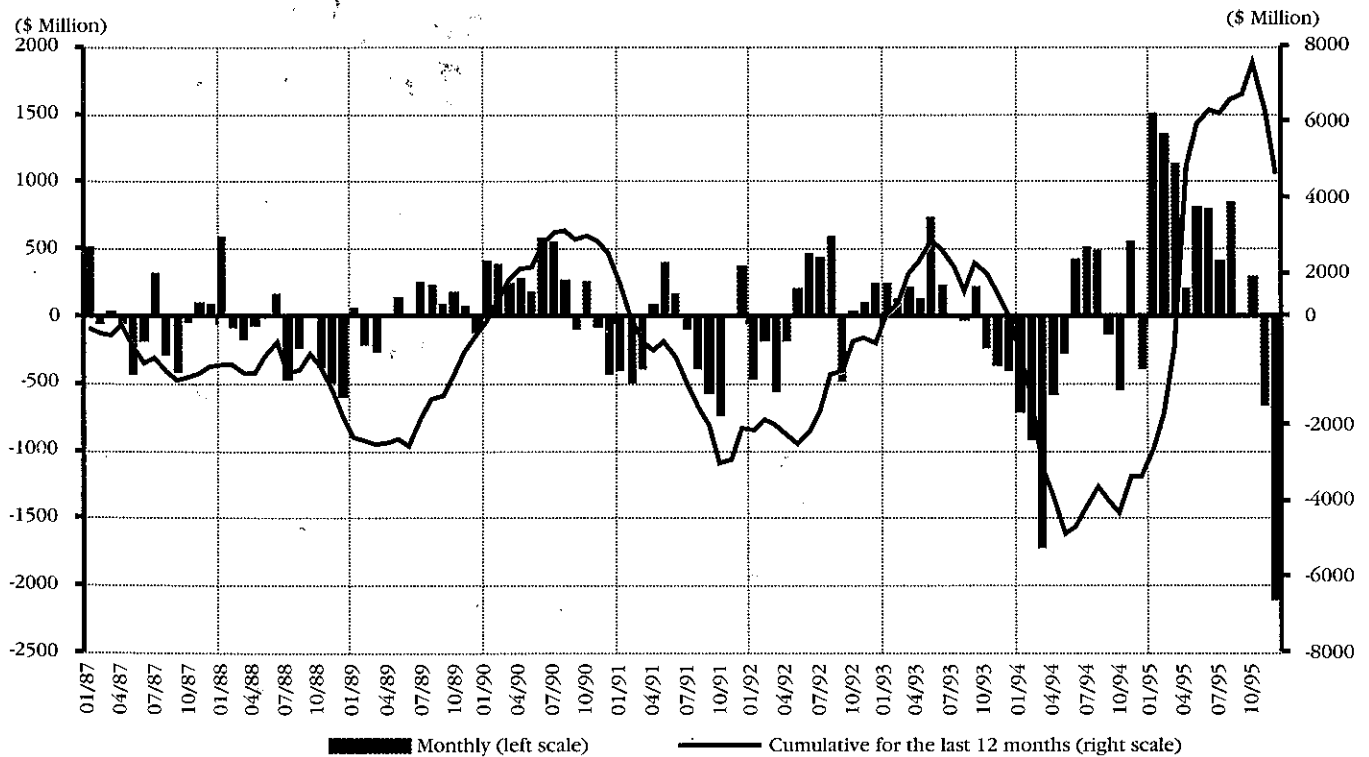
GRAPH 31

FOREIGN TRADE PRICE INDICES

GRAPH 32

CURRENT ACCOUNT BALANCE

GRAPH 33

Monthly (left scale) ▬▬▬ Cumulative for the last 12 months (right scale) ——

TOTAL OF SHORT-TERM CAPITAL AND
NET ERRORS AND OMISSIONS

GRAPH 34

Monthly (left scale) ▬▬▬ Cumulative for the last 12 months (right scale) ——

AVERAGE YEARLY NOMINAL INTEREST RATE

GRAPH 35

(%)

Average Compound Interest Rate on Treasury Bills   Annual Inflation Rate
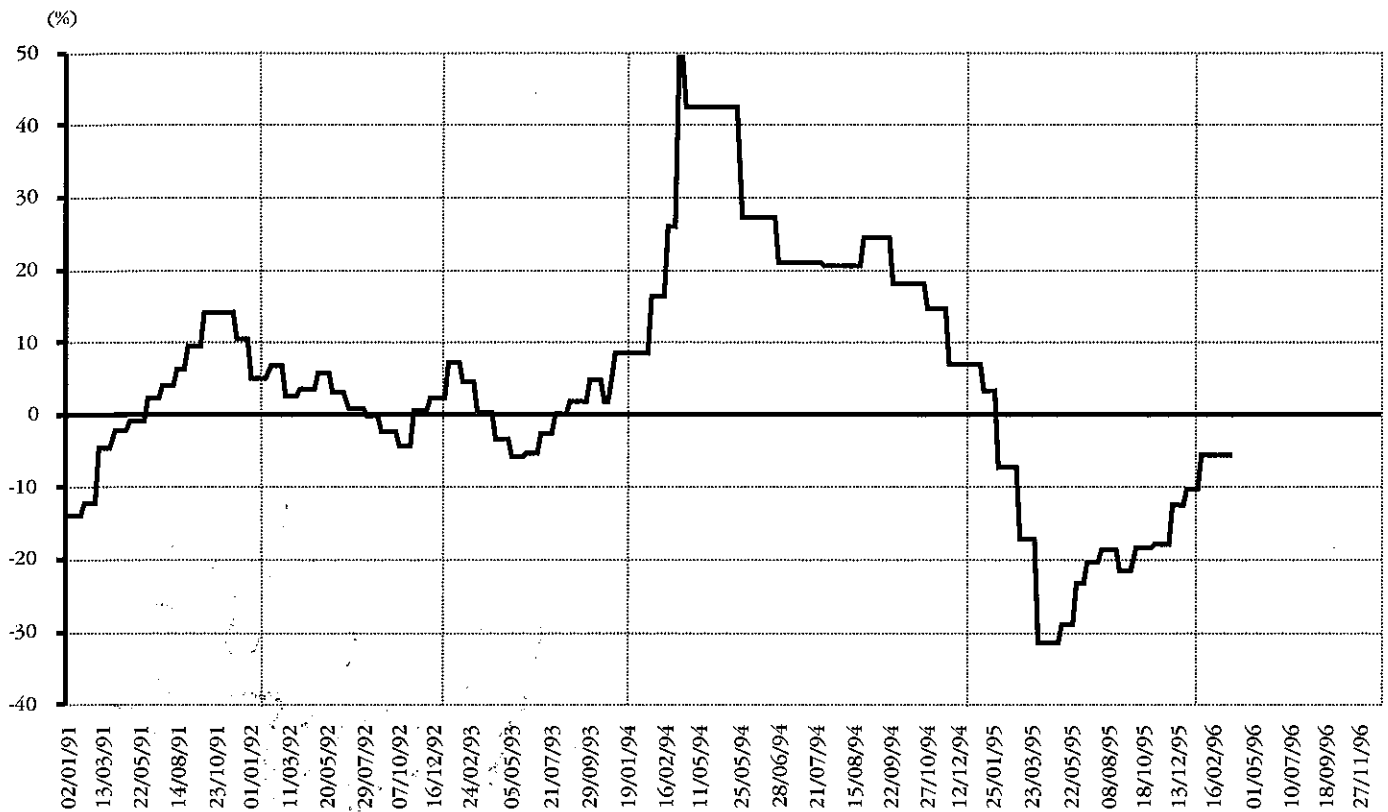
REAL INTEREST RATE ON GOVERNMENT PAPER (*)

GRAPH 36

(%)

(*) Real interest rate is computed as: $[(1+i)/(1+p)-1]* 100$
i: Average compound rate of interest on government paper (for all maturities), p: inflation rate $[(pt/p(t-12)-1]$
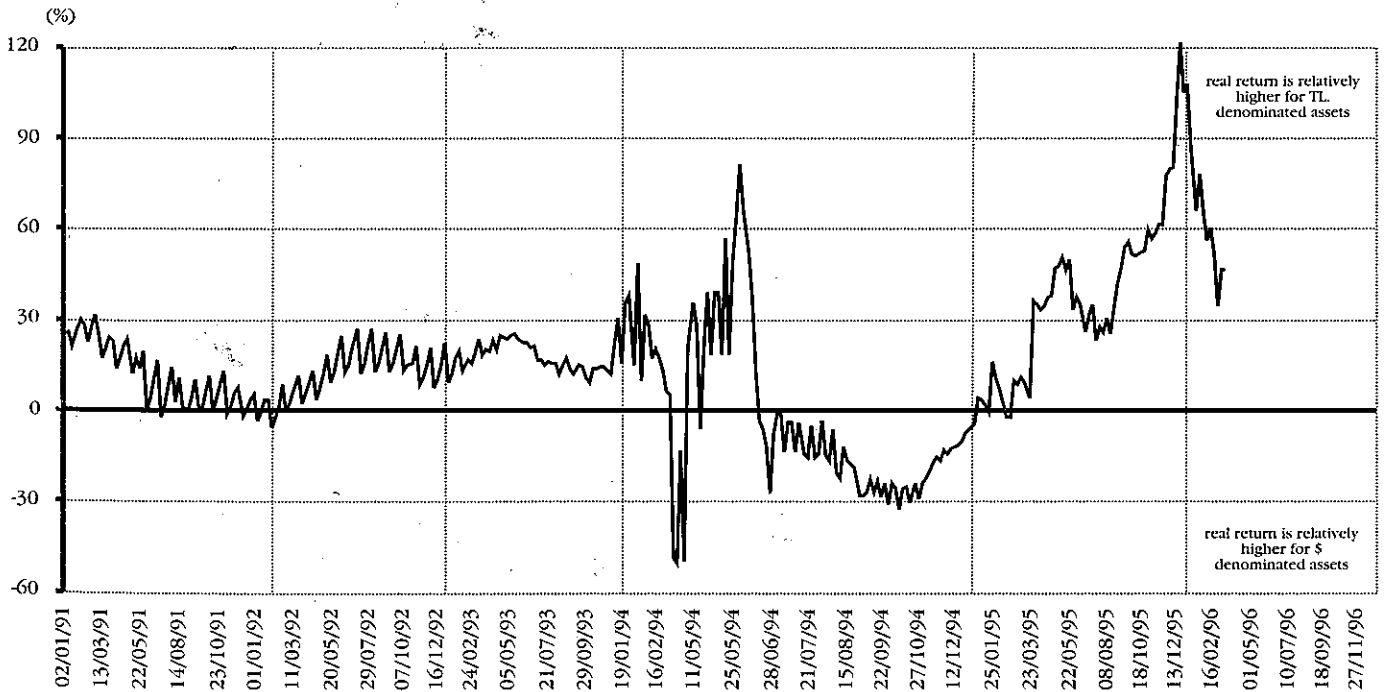
REAL RATE OF RETURN ON US $ (*) GRAPH 37

(%)

(*) Real rate of return is calculated as the yearly increase of the index (TL/$) / WPI (1994=100)

REAL INTEREST RATE MINUS REAL RATE OF RETURN ON US $ GRAPH 38

(%)

real return is relatively higher for TL denominated assets

real return is relatively higher for $ denominated assets

TREASURY AUCTIONS (3 Months Maturity) (*) GRAPH 39

(TL Billion)

Total bids (left scale)　Allocation (left scale)　Average Interest Rate (right scale)

(*) Include bids with irregular terms

TREASURY AUCTIONS (6 Months Maturity) (*) GRAPH 40

(TL Billion)

Total bids (left scale)　Allocation (left scale)　Average Interest Rate (right scale)

(*) Include bids with irregular terms

TREASURY AUCTIONS (9 Months Maturity) (*)   GRAPH 41

(TL Billion)   (%)

Total bids (left scale)   Allocation (left scale)   Average Interest Rate (right scale)

(*) Include bids with irregular terms

TREASURY AUCTIONS (12 Months Maturity)   GRAPH 42

(TL Billion)   (%)

Total bids (left scale)   Allocation (left scale)   Average Interest Rate (right scale)

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TREASURY BOND REPAYMENTS (*)

GRAPH 43

(TL Billion)

* As of end of March 1996

THE AMOUNT OF GOVERNMENT PAPERS
SOLD IN TREASURY AUCTIONS

GRAPH 44

($ Billion)

($ Billion)

Monthly (left scale) ———— Cumulative for the last 52 weeks (right scale)

APPENDIX 1
A MACROECONOMIC SCENARIO
OF STABLE GROWTH
FOR THE 1996-1998 PERIOD

Basic characteristics of the transition to a stable growth path:

The aim of this study is to determine, within the framework of a macro-economic model and under certain assumptions, the path that a series of fundamental macroeconomic indicators of the Turkish economy have to follow in the next three-year period, if stable growth is to be attained.[1]

For the Turkish economy to achieve macroeconomic stabilty there needs to be a political approach that would end the stop-and-go policies observed between the years 1988-1995. In other words, the main goal should be to follow policies that would gradually put the Turkish economy in the 1996-1998 period on the road towards the long-term growth rate of 6.0 percent.

Certain fundamental conditions have to be fulfilled in order to reach the long-term growth rate. These conditions are:

a) The financing of the foreign trade deficit which is expected to gradually rise up to $19.6 billion by the end of 1998

It is expected that exports that were in the amount of $21.6 billions at the end of 1995 will move up to $28.1 billions by the end of 1998, and that imports will rise during the same period from $35.7 billions to $47.7 billions. Therefore, a large proportion of the foreign trade deficit, which will rise up to $19.6 billions, needs to be compensated for by invisible revenues, and the current account deficit by capital inflows.

Exports rose in 1994, partly as a consequence of the deterioration of the real value of the TL, but mostly because of the contraction of the domestic market. It is observed that this rising trend persisted in the first half of 1995 and that the export drive slowed down in the second half of the year. The revival of domestic demand played an important role in this development. During the 1994 crisis, the contraction of the domestic market was sought to be compensated for by opening up to the foreign markets, and the result was the realization of a significant portion of the existing export potential. For this reason, the Customs Union is not likely to push up the exports in the short term if new investments are not made.

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[1] *The model used in this study is a constrained BVAR (Bayesian Vector Autoregression) model consisting of three blocks with five variables each.*

Imports came up to the level of $35.7 billion in 1995. This was 21.4 percent more than the comparable figure in 1993. The rise in imports is striking, given the fact that the size of the GNP in 1995, measured in constant prices, was only 1.5 percent greater than its level in 1993. However, the increase in imports was nearly completely accounted for the increase in the import prices. According to the foreign trade quantity index, the 1995 imports exceeded that of 1993 by only 0.7 percent. One factor that stimulated imports in both 1993 and 1995 was the rapid rise in private sector investment. A large portion of the import rise was accounted for by the investment drive of the private sector, which was striving to enhance its competitiveness before joining the Customs Union. It is estimated that the increase in private sector investment, and with it the rising trend in imports, will continue in 1996.

The share of the foreign trade deficit in GNP, which had remained at an average annual level of 5.3 percent between the years 1988-1993, rose up to 8.6 percent in 1995. It is predicted that this ratio will grow up to an historically high level of 10.2 percent in 1998.

There is the need of the financing of the foreign trade deficit which will be generated by the rise in imports, which themselves are necessary for the investments that will enhance the competitive power of the economy. In order to achieve this goal, the invisible revenues must be increased at a faster rate. If the invisible revenues follow the rising trend of the last years, it can be safely expected that the financing of the foreign trade deficit will not run across any serious bottleneck. The increase in the invisible revenues was the factor behind the fact that although the foreign trade deficit of 1995 was only $1.0 billion lower than that of 1993, the current account deficit in 1995 was lower than the comparable figure of 1993 by the much larger margin of $4.3 billions.

Another important development concerning the financing of the foreign trade deficit is related to the developments in terms of trade. From the beginning of 1994 through September 1995, as the import prices rose sharply, the terms of trade deteriorated contributing to the high foreign trade deficits in nominal terms. If the terms of trade improve, this will ease the burden of the financing of the foreign trade deficit.

It is estimated that, notwithstanding the increase in the invisible revenues, the next three years will witness current account deficits. This deficit will have to be financed by capital inflows. Net long-term and short-term capital movements,

which had amounted to $9.0 billions in 1993, fell down to $4.7 billions in 1995. On the other hand, 1995 was a much more favorable year in terms of the rises in the foreign exchange reserves. The increase in the foreign exchange reserves had been only $308 millions in 1993, and the figure for 1995 was $4.7 billions. This development was to a large extent produced by the rise in the net errors and omissions, from a low $-2.2 billions in 1993 to $2.3 billions in 1995.

It is expected that by 1996 there will be increases in the net capital inflows. If the macroeconomic balances can be maintained, the Customs Union will exert a very positive effect on the direct as well as portfolio investment.[2]

b) Raising the share of the budget revenues in GNP from 20 percent to 24 percent

The size of the public deficit constitutes by far the major obstacle which is blocking the Turkish economy from advancing towards macroeconomic stability. Revenue increasing measures have to be urgently taken if the deficit is to be reduced. In the 1996-1998 period the share of the budget revenues in GNP will have to be raised from 20 percent to 24 percent by means of revenues from taxation and in part from privatization.

Tax revenues have to be raised by way of expanding the tax base. Turkey ranks lowest among the OECD countries in terms of the share of the tax revenues in GNP.

The swift implementation of the privatization program will make a positive contribution to the increase in revenues. Privatization will be particularly helpful in closing the deficit which has been brought about by the deficits of the SEEs and which is now constituting some 25 percent of the public sector borrowing requirement.

c) Reducing the consolidated budget deficit from its expected level of 6.4 percent of GNP in 1996 to 3.1 percent of GNP in 1998

Budget deficit must be cut back if the private sector savings are to be channelled to investment and if the private sector is to borrow from the financial markets at more favorable rates. In line with this target, expenditure cutting measures must be formulated, in addition to the policies that are aimed at increasing rev-

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[2] *Developments in the foreign trade and capital movements in the case of Spain, which has joined the Europen Community in 1986, is summarized in the Appendix 2.*

enues. A look at the budget expenditures in the last two years provides enough proof that the prospects of effecting real reductions in the investment and personnel expenditures are very limited. Any reduction in the expenditures will likely to come from the cuts in the transfers. For this reason, new regulations in the area of social security appear as important as privatization. Interest payments constitute the largest portion of the transfers. The share of interest payments in budget expenditure had remained at an average level of 21.2 percent in the 1988-1993 period, and it rose up to 34 percent in the years 1994-1995. This rapid escalation was the outcome of the increases in the payments of interest on domestic debt. A sound and sturdy structure must be devised for the financing of the Treasury if this harmful development is to be stopped.

One of the most important findings of this study is that a fast moving inflationary process will definitely set in if the consolidated budget revenues and the consolidated budget expenditures are not brought to the desired levels. The consolidated budget deficit/GNP ratio will come out to be 6.4 percent in 1996 according to the most optimistic estimations, and if the ratio remains at this level in the coming years this will conflict with the requirements of a stable growth process.

d) Reducing the growth of reserve money, which is strongly and positively correlated with inflation, to 45 percent by the end of 1998

The rate of increase in the reserve money must be pulled down if the rate of inflation is to be reduced. A necessary condition of this is to cut back the use of the short-term advances in the financing of the budget deficit. Measures will have to be taken that would push down the consolidated budget deficit/GNP ratio to the desired levels, discount the significance of resorting to the shortterm advances in financing the deficit, and improve control over monetary expansion.

Results that will be obtained if the assumptions of the scenario come to be true

The following results will be obtained if the assumptions of the scenario come to be true:

1) The rate of growth will gradually increase and reach the long-term trend value of 6.0 percent after 1998.

2) The rate of inflation will be reduced from 90s percent to 40s percent.

3) Real interest rate will be reduced from 20s percent to around 6 percent.

4) Real exchange rate will be stabilized.[3]

5) Capital movements will increase.

The final word of this study is that steps must be taken in the year 1996 for achieving the goal of structural transformation if Turkey is to settle firmly on the road of stable growth.

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[3] *A seemingly contradictory element in this scenario is the fast reduction in the real interest rates in a situation where stabilization measures are being implemented. Three developments are to be mentioned that exert some effect on this process. The first development is the decrease in the borrowing requirement with the increase in budget revenues. The second is the near stability of the real money supply. The third, and perhaps the most important development is the decrease in the risk premium in the financial markets as a result of the measures that are being put into action.*

A MACROECONOMIC SENARIO FOR STABLE GROWTH BETWEEN 1996-1998

	1988	1989	1990	1991	1992	1993	1994	1995	1996*	1997*	1998*
Level											
GNP (at 1987 prices)	76,108	77,347	84,592	84,887	90,322	97,677	91,733	99,164	102,436	106,636	111,861
WPI (1987=100)	170	280	426	661	1,072	1,698	3,747	7,063	12,367	18,415	25,431
Reserve Money (TL Billion)	7,905	13,821	20,446	29,842	48,507	83,865	150,646	278,913	469,078	723,947	1,058,800
Nominal Interest Rate	65.9	57.4	52.2	85.8	94.4	84.7	152.5	126.6	106.3	58.6	45.6
Real Interest Rate (Level)	-2.7	-4.0	-0.1	19.6	19.9	16.6	14.4	20.2	17.8	6.5	5.5
Real Exchanging Rate (WPI (1987=100)/US$)	0.121	0.131	0.163	0.160	0.156	0.155	0.127	0.157	0.166	0.170	0.173
Budget Revenues (TL Billion)	17,587	31,369	56,685	99,105	179,449	359,850	753,440	1,403,072	2,534,192	4,737,200	7,015,793
Budget Expenditures (TL Billion)	21,447	38,871	68,169	130,865	223,055	489,256	899,376	1,720,648	3,345,296	5,476,250	7,902,228
Budget Deficit (TL Billion)	3,860	7,502	11,484	31,760	43,606	129,406	145,936	317,576	811,104	739,050	886,435
Import (US$ Million)	13,706	15,999	22,581	21,007	23,082	29,772	22,606	35,187	40,395	43,222	47,717
Export (US$ Million)	11,929	11,780	13,026	13,667	14,891	15,610	18,390	21,974	23,864	25,821	28,093
Foreign Trade Deficit (US$ Million)	1,777	4,219	9,555	7,340	8,191	14,162	4,216	13,213	16,531	17,402	19,625
Annual Average Percentage Increase											
GNP	1.5	1.6	9.4	0.3	6.4	8.1	-6.1	8.1	3.3	4.1	4.9
WPI	70.5	64.0	52.3	55.3	62.1	58.4	120.7	88.5	75.1	48.9	38.1
Reserve Money	61.0	74.8	47.9	46.0	62.5	72.9	79.6	85.1	68.2	54.3	46.3
Real Exchange Rate	3.4	8.8	24.0	-1.9	-2.1	-0.7	-18.1	23.6	5.9	1.9	1.8
Import	1.1	16.7	41.1	-7.0	9.9	29.0	-24.1	55.7	14.8	7.0	10.4
Export	15.6	-1.2	10.6	4.9	9.0	4.8	17.8	19.5	8.6	8.2	8.8
Percentage Share in GNP											
Budget Revenues	13.6	14.5	15.7	17.7	18.5	21.7	21.9	20.0	20.0	24.1	24.7
Budget Expenditures	16.5	18.0	18.9	23.3	23.0	29.5	26.2	24.6	26.4	27.9	27.8
Budget Deficit	3.0	3.5	3.2	5.7	4.5	7.8	4.2	4.5	6.4	3.8	3.1
Foreign Trade Deficit	1.9	4.2	6.9	5.4	5.8	9.3	3.6	8.6	9.7	9.6	10.2

(*) These values are obtained from a three block conditional Bayesian Vector Autoregression Model (BVAR)
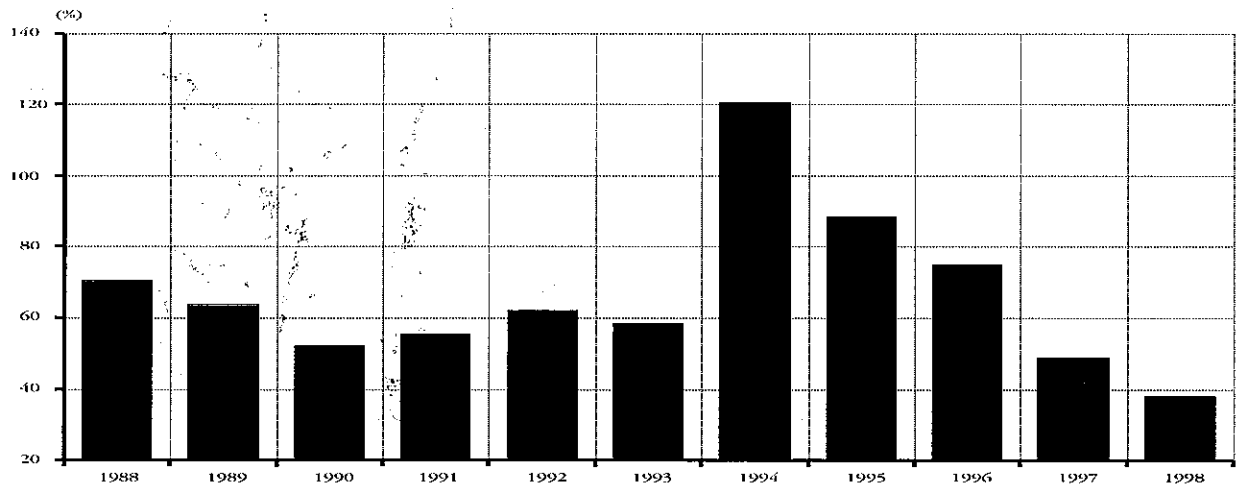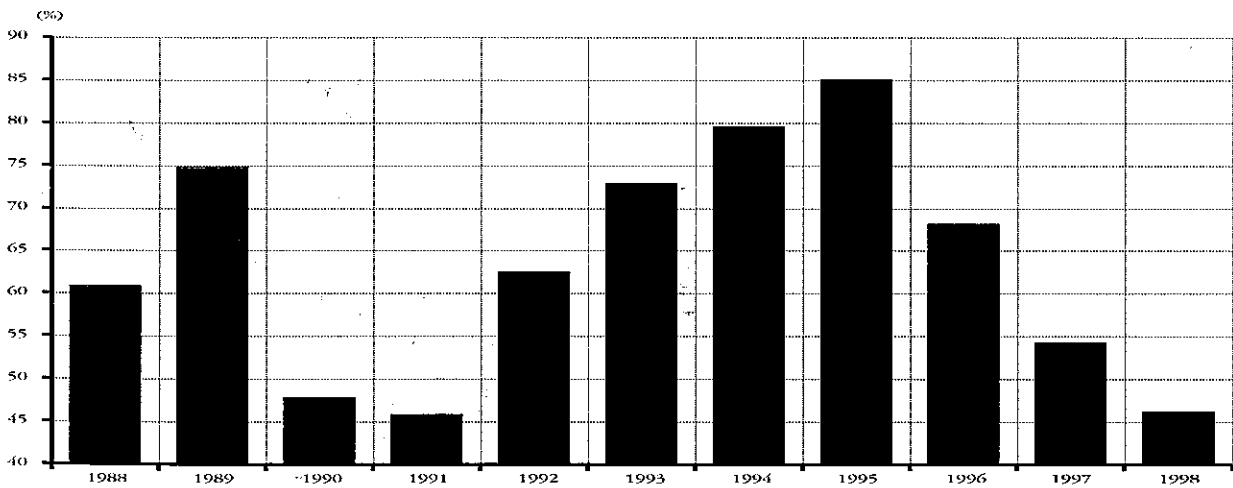
GNP (Annual Percentage Increase)

GRAPH 1

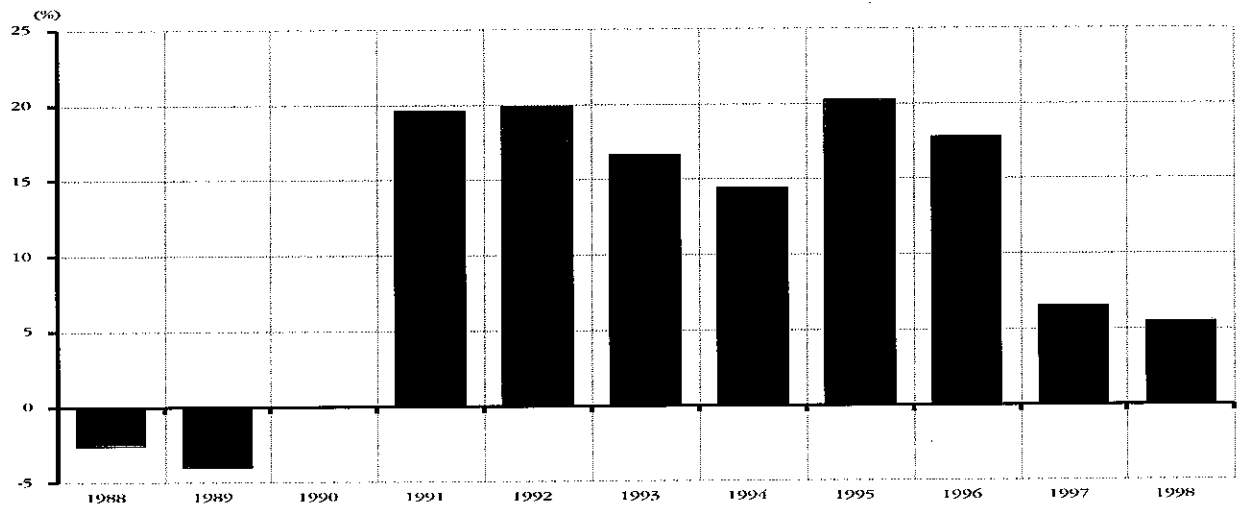# WPI (Annual Average Percentage Increase)

GRAPH 2

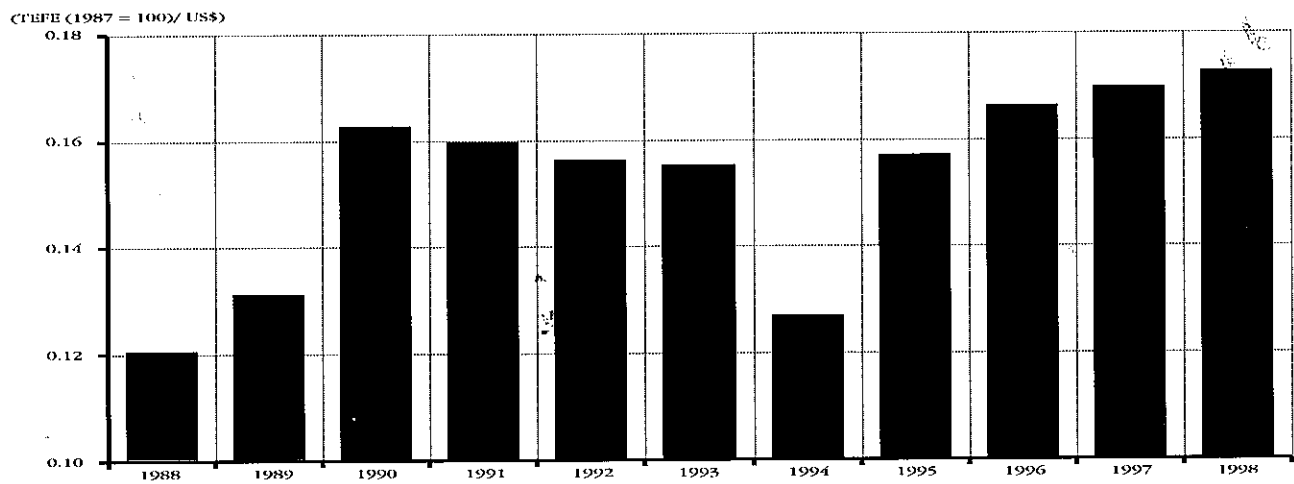# RESERVE MONEY (Annual Average Percentage Increase)

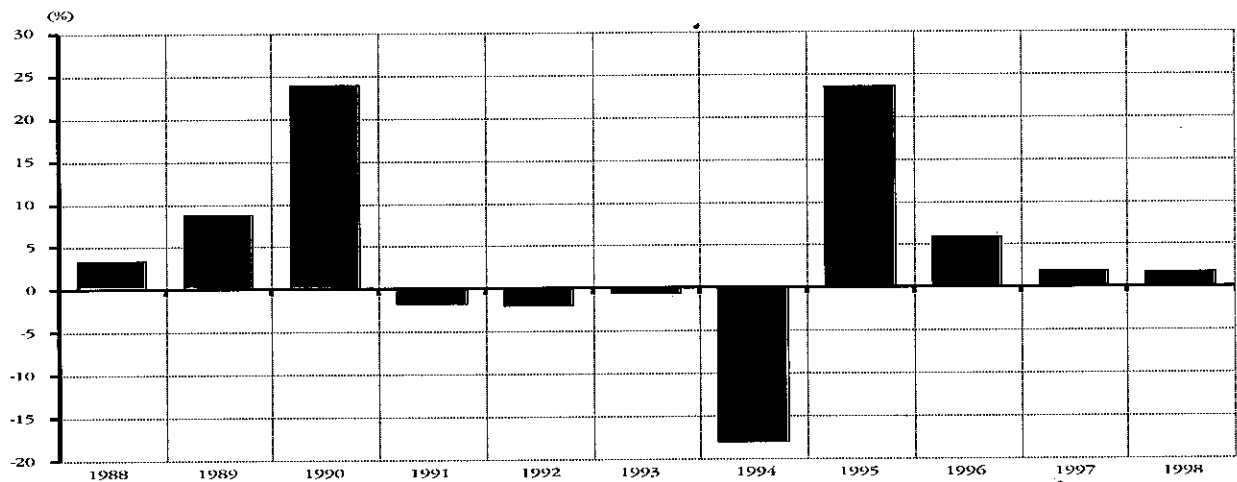GRAPH 3

REAL INTEREST RATE (Annual Average)   GRAPH 4

(%)

25
20
15
10
5
0
-5

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

REAL EXCHANGE RATE (Annual Average)   GRAPH 5

(TEFE (1987 = 100)/ US$)

0.18
0.16
0.14
0.12
0.10

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

REAL EXCHANGE RATE (Annual Average Percentage Increase)   GRAPH 6

(%)

30
25
20
15
10
5
0
-5
-10
-15
-20

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

BUDGET REVENUES/GNP

GRAPH 7

(%)

1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998

BUDGET EXPENDITURES/GNP

GRAPH 8

(%)

1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998

CONSOLIDATED BUDGET DEFICIT/GNP

GRAPH 9

(%)

1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998

53

EXPORTS (FOB)

GRAPH 10

(US$ Million)

30,000

25,000

20,000

15,000

10,000

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

IMPORTS (FOB)

GRAPH 11

(US$ Million)

50,000

45,000

40,000

35,000

30,000

25,000

20,000

15,000

10,000

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

FOREIGN TRADE DEFICIT

GRAPH 12

(US$ Million)

21,000

17,000

13,000

9,000

5,000

1,000

1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998

APPENDIX 2
FOREIGN TRADE AND CAPITAL MOVEMENTS IN SPAIN IN THE AFTERMATH OF EC MEMBERSHIP

Spain experienced very high levels of foreign trade deficit after her accession to the European Community in early 1986. Spain's foreign trade deficit, which was $4.8 billions at the end of 1985, gradually increased until 1992 and finally reached the level of $30.4 billions. The reduction in imports in 1993 and the surge in exports in 1994 pushed down the foreign trade deficit in these two years to around $14.8 billions.

In the 1986-1989 period, swift rises in the income from the services and transfers stopped the further deterioration of the current account balance. The current account balance scored a surplus of $2.8 billion in 1985 and $3.9 billion in 1986. In the years 1987 and 1988, however, the current account balance showed deficits of $0.3 billion and $3.8 billions, respectively. In 1989, when the increase in the invisibles came to a halt, the deterioration of the foreign trade deficit was completely reflected upon the current account deficit and the current deficit rose up to $10.9 billions. In 1990, the invisible revenues began to fall, with the consequence that the deterioration of the current account deficit went beyond the deterioration of the foreign trade deficit. No improvements in the invisibles income were witnessed in 1991 and 1992, and as a result the current account deficit continued to rise and reached the level of $21.3 billions in 1992.
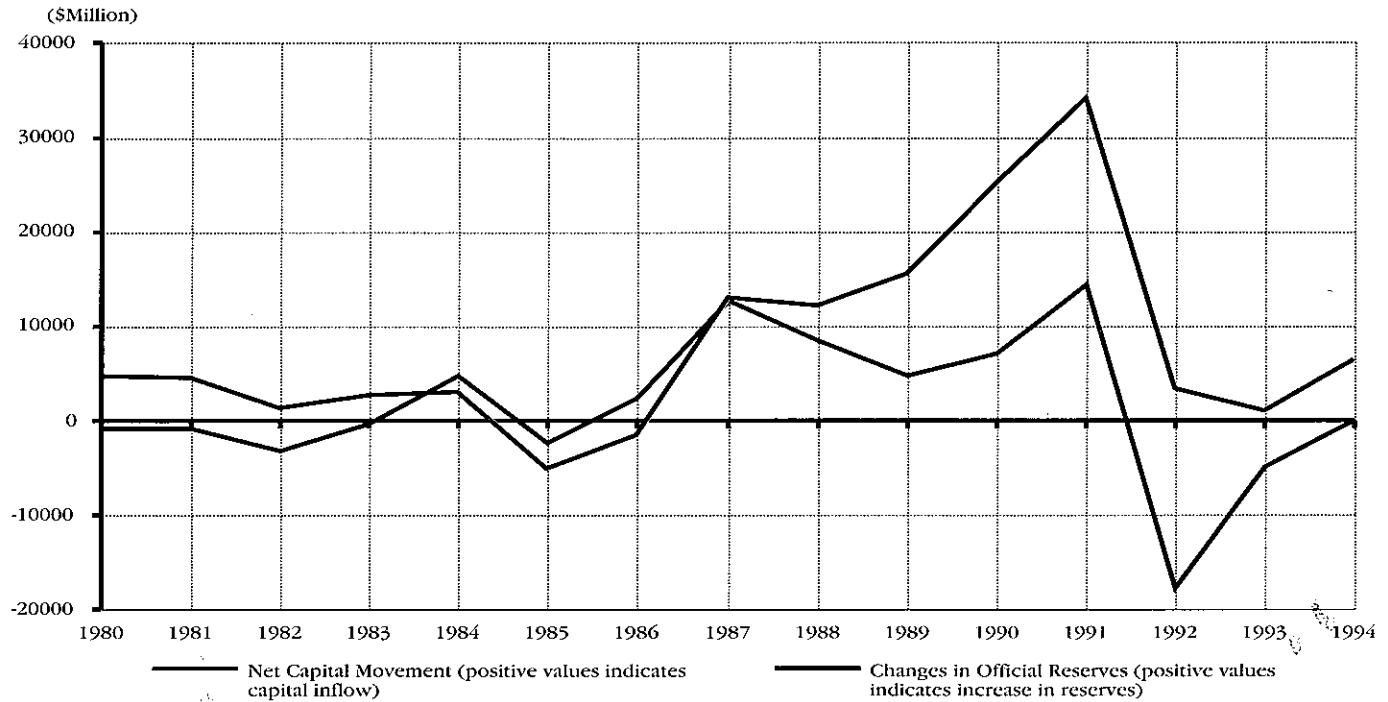
The rapid depreciation of the Spanish Peseta following the September 1992 crisis in the ERM was highly effective in the curtailment of the foreign trade deficit. Imports fell down from their 1992 level of $96.2 billion to $77.0 billion in 1993; the decline in exports from 1992 to 1993 was only $3.8 billions; and as a result the foreign trade deficit, which had been at a level of $30.4 billions in 1992, decreased to $15 billions in 1993. With this quick improvement in the foreign trade deficit, the current account deficit reverted back to $5.8 billions in 1993.

What is notable in the case of Spain is that, with the accession to the EC, the net services income rapidly increased through 1989 and remained at that high level thereafter. As the net transfers were also on a rising trend in this initial period, there occurred only a limited deterioration in the current account deficit until the year 1989.

One advantage of the EC membership for Spain was the high amounts of capital inflows. Although the current account deficit regularly increased between the years 1987-1991, the official foreign exchange reserves exhibited a continual expansion in this same period. Very high levels of capital inflows in the form of direct investment and portfolio investment contributed to the financing of the current account deficit as well as to the growth of the reserves. In 1992 and 1993 on the other hand, decreases in direct investment, coupled with net other long-term capital outflows, led to a relative shrinking of the reserves.

SPAIN
NET CAPITAL AND RESERVE MOVEMENTS

GRAPH 13

($Million)

Net Capital Movement (positive values indicates capital inflow)

Changes in Official Reserves (positive values indicates increase in reserves)

SPAIN
FOREIGN TRADE AND CURRENT ACCOUNT BALANCE

GRAPH 14

($ Million)

Foreign Trade Deficit   Current Account Balance