# MONTHLY BULLETIN

## July 2005

### GENERAL OUTLOOK

***Turkey and the IMF…***

Hugh Bredenkamp, the IMF's Turkey representative said that Turkey should pass social security and banking reform bills for the Fund's Executive Board to meet and agree on the next loan tranche, adding that the two laws appeared to be the only outstanding issues awaiting progress.

However, although Turkey's Parliament has passed the banking reform law, fulfilling one of the IMF's conditions, parliamentary officials said that the social security reform, looked set to be carried over to the next parliamentary term scheduled to begin in October, as the assembly started its summer recess on July 3.

The banking law is designed to increase confidence and stability in financial markets, tightening up the monitoring of financial institutions and regulating the protection of savers' rights and interests.

***World Bank approves new loan for Turkey…***

The World Bank approved a new USD 465.4 million loan to Turkey, to help to alleviate the economic and social difficulties arising from the government's privatization program, through mitigating the social and economic impact of the privatization of state-owned enterprises.

***Saudi Oger-led group makes the highest bid for Turk Telekom…***

Privatization Administration (PA) chairman Metin Kilci said that a venture led by Saudi Oger Telecom and including Telecom Italia made the highest bid, at USD 6.55 billion, for a 55% stake in landline company Turk Telekom. Oger's bid values the whole of Turk Telekom at USD 11.9 billion. The other bidder in the final open auction stage of the tender, a group led by Emirates Telecommunications (Etisalat), declined to increase its final bid of USD 6.5 billion.

Oger Telecom, part of Saudi Arabia's Oger group, is owned by the family of the assassinated former Lebanese Prime Minister Rafik Hariri. PA chairman Metin Kilci told reporters after the conclusion of the tender that its results would be presented to the cabinet of ministers for approval after seeking the Competition Board's view on the tender.

If its bid is accepted, the Oger-led group will make a downpayment of USD 1.31 billion at the time of the handover and then the remaining 80% will be paid in five equal installments over five years, at an annual interest rate of libor plus 2.5.

***Mittal Steel started bid for Turkey's Erdemir…***

Mittal Steel, the world's biggest steel manufacturer, said that it had officially begun its bid to buy Turkey's state-owned Eregli Demir Celik (Erdemir). Mittal Finance Director Ondra Otradovec said that they bought the privatization list of conditions, and were carrying out their examination, adding that most of their consultants had been appointed.

Turkey launched the tender for a block sale of a 49.29% stake in Erdemir, the country's largest flat steel producer, on May 24. The bidding deadline for Erdemir is September 26, 2005. Currently, 47.17% of Erdemir is publicly traded.

Mittal Steel, owned by Indian-born magnate Lakshmi Mittal, operates in 14 countries and reported USD 22.2 billion turnover in 2004. A number of foreign firms, including Anglo-Dutch steel company Corus, Luxembourg-based Arcelor, US Steel, Russia's Novolipetsk and Severstal are interested in buying Erdemir. Turkish companies Borusan and Kibar Holding have also expressed interest in the tender.

***Turkey's Tupras draws 13 bidders…***
The PA said that thirteen bidders received pre-qualification for a block sale of 51% of Turkish oil refiner Tupras. Foreign companies included are Austria's OMV, British-Dutch Shell, Italy's ENI, Spain's Repsol, Poland's PKN Orlen, India's Indian Oil Company and Hungary's MOL. The Turkish companies that are interested in the block sale of Tupras are Tupras Acquisition Cons. OGG, OYAK, Zorlu Holding, Petrol Ofisi and two joint ventures, Anadolu Tasima and Enerji.

A previous attempt to privatize Tupras failed after labor unions challenged its legality in court. The bidding deadline for the sale is September 2, 2005.

***Turkey issued a new Eurobond maturing in 2012…***
The Treasury issued a new euro-denominated 7-year eurobond, with Deutsche Bank and CSFB as the leaders of the issuance. The sale amounted to EUR 650 million, bringing the total eurobond issue so far this year to USD 5.3 billion. With the latest issuance, Turkey has almost reached its annual borrowing target of USD 5.5 billion for 2005 as a whole.

***EU Commission adopted a negotiation framework for Turkey…***
The EU's Executive Commission reaffirmed that it aimed to bring Turkey into the 25-nation bloc, adopting a draft mandate to start negotiations despite internal and public debate. The draft mandate noted that the negotiations would be based on Turkey's own merits and the pace would depend on Turkey's progress in meeting the requirements for membership noting that the shared objective of the negotiations was accession.

The negotiations are due to start on October 3, 2005 as agreed last December by the EU leaders, provided the bloc's 25 foreign ministers unanimously approve the mandate by then. The document states that negotiations for Turkish EU membership can't be concluded before 2014, when the bloc's next long-term budget that runs from 2007 to 2013 ends.

Presenting the negotiating framework, Olli Rehn, EU's Commissioner in charge of enlargement said that it was in Europe's interest to have a stable, democratic, prosperous Turkey adopting and implementing all the EU values, policies and standards. He noted that the opening of the accession negotiations was the recognition of the reforms already achieved in Turkey, giving Turkey a chance to demonstrate, through a fair and rigorous negotiation process, whether it was able to meet fully all the criteria required to join the EU. He added that they all knew that it would be a long and difficult journey and the EU leaders had to take into account the concerns of citizens.

Meanwhile, Murat Mercan, the head of Turkey's delegation to the Council of Europe, said the negotiating mandate appeared to contain no nasty shocks for Turkey, most notably any reference to the “privileged partnership” that was being proposed by some political leaders in France, Germany and Austria.

***Britain seeks low-profile path to Turkey EU talks…***

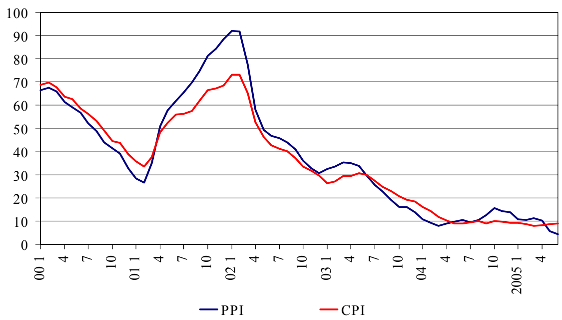
British officials said that Britain planned a low-profile route to start EU accession talks with Turkey, keeping the issue below the political radar screen until the last minute. Prime Minister Tony Blair made clear on the first day of London's EU presidency on July 1st, that launching the membership negotiations on October 3rd was one of his top priorities and he would not let increasingly skeptical West European public opinion get in the way. Blair said that it was important that the EU carried through the obligation that had been entrusted to the presidency.

In practical terms, British officials have mapped out a path to the start of talks that avoids any further ministerial discussion as far as possible. EU Enlargement Commissioner Olli Rehn will be invited to give a presentation to the EU's 25 foreign ministers on the proposed negotiating framework with Turkey, on July 18th. British Foreign Secretary Jack Straw said that he would not allow a political discussion at that meeting. After that, British officials said the aim was to put the draft negotiation mandate to the committee of the EU ambassadors in September with the aim of having it nodded through without discussion by ministers at the end of that month.

## AN OVERVIEW OF ECONOMIC DEVELOPMENTS

***CPI increased by 0.1%, while PPI declined by 0.48% in June…***

ANNUAL INFLATION RATES (%)




* 1994=100 based indices for 2004 and before; 2003=100 based indices for 2005.

June inflation figures are mixed in the sense that inflation in terms of producer prices (PPI) was better than our expectation, while consumer prices (CPI) recorded an increase contrary to our expectation of a moderate decline. Accordingly, the CPI rose by 0.1% and the PPI declined by 0.48% in June. This brought the annual inflation in terms of CPI to 8.95%, while the annual inflation in terms of PPI declined to 4.25%. These figures do not suggest a deviation from the government’s year-end target of 8%.

Examining the components of the CPI, it is observed that considerably high price increases were registered in the services sectors. Highest monthly inflation was recorded in recreation and culture, as well as education sectors, by 4.01% and 3.24%, respectively. The rise in the former stemmed from the price adjustments in the tourism sector. In the education sector, on the other hand, price adjustments in private schools, which are usually done in August and September, seem to have begun early this year. Besides, it is worth to mention that increases in the international oil prices continued to be reflected in the transport prices, which include goods and services such as fuel oil, flight and bus tickets. The rate of increase in the transport prices in June amounted to 0.71%, higher than the previous two years' average in the same month. Furthermore, prices seem to be rather sticky in household equipment, clothing and footwear, hotels-cafes-restaurants in June. Overall, based on these information, we believe that domestic demand developments should be closely watched in the coming months.

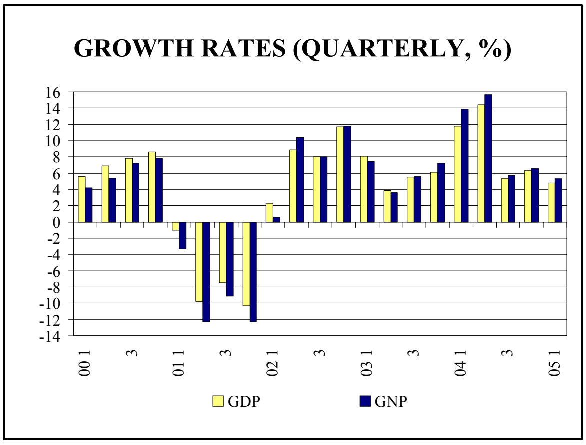
Finally, had the food and beverages prices not declined by 1.63% in June due to seasonal factors, the rate of increase in the CPI would have been much higher. This can be observed obviously from the 0.68% rise in the CPI excluding unprocessed food products and the 0.78% rise in the CPI excluding seasonal products.

The decline in the PPI stemmed from the considerable decline in the agriculture prices, namely 3.37%, as well as a moderate 0.03% decline in the electricity-gas and water prices. In the meantime, the industrial prices rose by a limited rate of 0.34% in June and the manufacturing industry price increase was also moderate (0.42%) despite the continuing increase in the oil prices. In addition to the declining production costs due to the appreciation of the YTL and fall in the electricity-gas and water prices, price declines registered especially in the food, textile and clothing sectors were the major reasons limiting the inflation in the manufacturing industry.

| SELECTED INFLATION FIGURES | | |
|---|---|---|
| | June 2005 (monthly % change) | June 2005 (annual % change) |
| **CONSUMER PRICES (CPI)** | **0.10** | **8.95** |
| **Food and non-alcoholic beverages** | -1.63 | 5.95 |
| **Alcoholic beverages and tobacco** | 0.07 | 3.47 |
| **Clothing and footwear** | 0.81 | 9.34 |
| **Housing, water, electricity, gas and other** | 0.57 | 10.51 |
| **Transport** | 0.71 | 16.07 |
| **PRODUCER PROCES (PPI)** | **-0.48** | **4.25** |
| **Agriculture** | -3.37 | -3.30 |
| **Manufacturing Industry** | 0.42 | 6.70 |
| **Mining** | -2.26 | 7.58 |
| **Electricity, gas, water** | -0.03 | 3.29 |

*Consequently, these developments suggest that the official CPI target in 2005 is still within reach, probably with a margin. Accordingly, we project the 2005-end CPI projection as 7.5%.*

***The GDP grew by 4.8% in the first quarter of 2005…***




The gross domestic product (GDP) grew by 4.8% in the first quarter of 2005, with respect to the same period of the previous year, while the gross national product (GNP) growth amounted to 5.3%. A slowdown in the growth figures was already expected, considering the strong base effect stemming from the double-digit growth rates in the first half of 2004. However, due to the weak performance of the services sector, the GDP growth in the first quarter of 2005 remained below our expectation. While the industrial output grew by 5.5% in the first quarter, the growth in the services sector amounted only to 4.1% and remained below expectations. The main factor behind this slowdown was the weak growth figure of 1.6% in the transportation sector.

One of the most remarkable aspects of the first quarter figures is the 16.5% growth in the construction sector. With this performance, the sector made a 0.5 percentage point contribution to the overall GDP growth, which supported our view that construction activity would exhibit strong improvement in 2005 (after years of sluggish performance) and contribute significantly to the overall growth throughout the year. On the other hand, the value added of the agricultural sector did not increase in the first quarter. In the following quarters of 2005, this sector is expected to display negative growth rates due to its cyclical behaviour.

On the expenditures side, private consumption expenditures increased by 4%. Contrary to the notable -but expected- slowdown in the growth of durable goods consumption, semi-durable and non-durable goods consumption registered a strong increase of 12%. Falling interest rates, confidence in the economic stability and positive expectations owing to the EU perspective enabled private investment expenditures to keep growing, albeit at a smaller rate compared to the previous quarters. Private investment expenditures, which grew by 4.8%, made a contribution of 1.1 percentage points to the overall growth rate. One important aspect of the private investment expenditures is that contrary to the trend in the previous quarters, its growth stemmed mainly from construction and not from machinery and equipment investments.

One of the most distinctive points in the expenditures side is the high increase in consumption and investment expenditures of the public sector. Despite the real decline in personnel expenditures, the rise in purchasing of goods and services led to a considerable increase in public consumption expenditures. The surge in public investment expenditures, on the other hand, was mainly caused by increasing construction activity of the public sector. Consequently, after a long time, the public sector made a significant contribution to the GDP growth, namely 0.9 percentage points.

| **SELECTED ITEMS FROM NATIONAL INCOME ACCOUNTS** | | |
|---|---|---|
| | **% Growth (2005. I / 2004. I)** | **Contribution to the GDP growth, % points** |
| **Production side** | | |
| Agriculture | 0.0 | 0.0 |
| Industry | 5.5 | 1.8 |
| Services | 4.1 | 2.5 |
| *Trade* | *5.8* | *1.4* |
| Construction | 16.5 | 0.5 |
| **Expenditures side** | | |
| Private consumption | 4.0 | 2.9 |
| Public consumption | 4.3 | 0.3 |
| Private investment | 4.8 | 1.1 |
| Public investment | 36.6 | 0.6 |
| Exports | 11.3 | 5.1 |
| Imports | 9.3 | -5.1 |
| **GDP** | **4.8** | |
| **GNP** | **5.3** | |

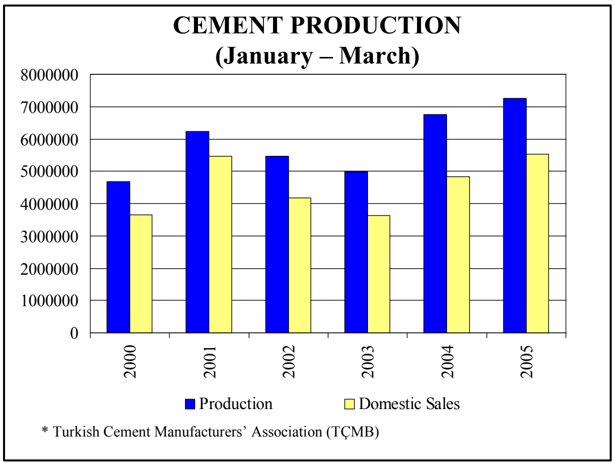
*We expect the strong growth to continue in 2005, albeit with a slowdown. Taking into account the recent data and trends, we are revising our GDP growth forecast for 2005 from 6.5% to 5.5%.*

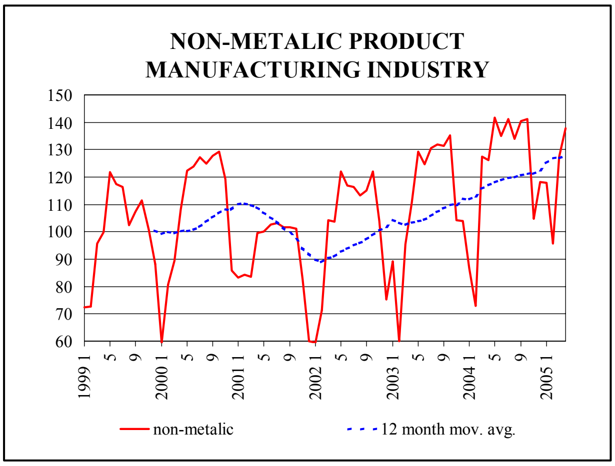
***Export-oriented production continues to be the engine of strong industrial production in April and May…***

Industrial production growth amounted to 5.1% in April and 5.9% during the first four months of 2005. According to these figures, the strong pace of industrial output growth seems to continue. The underlying trends in the industrial sector did not change, with the export-oriented sectors being the engine of output growth. In this context, the best performers in the industrial sector were once again automobile, electrical machinery, metallic goods and plastic-rubber goods sectors.

| MONTHLY INDUSTRIAL PRODUCTION * | | | | | | |
|---|---|---|---|---|---|---|
| **%** | **Jan-Dec 2004** | **Jan-2005** | **Feb-2005** | **Mar-2005** | **Apr-2005** | **Jan-Apr 2005** |
| Total Industry | 10 | 5.0 | 10.7 | 3.4 | 5.1 | 5.9 |
| Manufacturing Industry | 10.7 | 5.0 | 10.2 | 2.2 | 4.2 | 5.2 |
| Textiles | -1.3 | -15.6 | -4.9 | -8.2 | -23.6 | -13.5 |
| Petroleum product | -4.3 | -5.7 | -9.7 | -10.4 | 7.9 | -4.8 |
| Chemical products | 16.3 | 8.8 | 5.9 | 0.5 | 10.5 | 6.2 |
| Basic metal products | 11.7 | 7.0 | 8.8 | 5.0 | 3.8 | 6.1 |
| Food and beverages | -0.1 | 5.8 | 2.2 | 3.0 | -8.2 | 0.3 |
| Vehicles | 58.4 | 3.0 | 42.6 | 16.0 | 7.2 | 15.8 |

*Calculated from the 1997-based quarterly industrial production index, % change over a year ago




More recent data regarding industrial sub-sectors such as automobile and durable goods, as well as export data released by the State Institute of Statistics show that the production in those sectors continued to be robust in May. Another point worth to mention regarding the automotive sector is the considerable rise in the production and sales of commercial vehicles. We interpret this development as an indicator of vigorous commercial activity and production. Furthermore, Turkish Exporters' Assembly data for June show that exports amounted to USD 6 billion in June, at around the same levels of the previous two months. Thus, exports are still robust despite a slowdown in its growth rate in June (partly due to the high base effect), which is expected to continue to motivate strong industrial growth in the coming months.

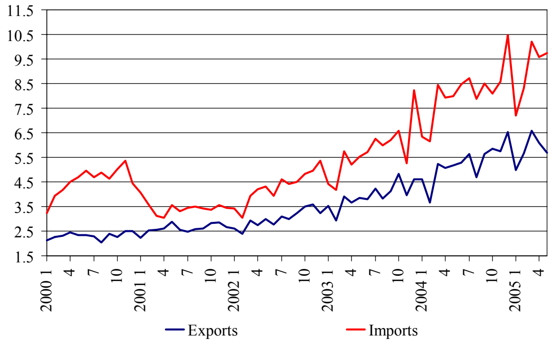
Apart from export-oriented sectors, substantial output increases in the non-metallic product manufacturing industry in the first four months of 2005 was quite noticeable. This sector includes manufacturing of construction-related mineral goods and is closely correlated with cement production data released by Turkish Cement Manufacturers' Association. Therefore, following strong output growth in the construction sector in the GDP data in the first quarter, developments in the non-metallic production can be interpreted as an indicator for continuing recovery in the construction sector. Besides, consumer loans for housing surged after March, which may also imply that output growth in the construction related sectors has continued in the second quarter. Consequently, we expect the contribution of the construction sector to the overall economic growth to be considerably higher this year compared to previous year.

However, some manufacturing industry sectors exhibited a poor performance in the first four months of 2005. These are food products and beverages, tobacco, textile and clothing industries. Output in the food and beverages sector almost kept its level with respect to the same period of 2004, while tobacco production rose only by 1.8%. Textile and clothing sectors, however, contracted by 13.5% and 5.4% in this period, mainly due to the increased international competition from China.

***A slowdown in the rate of growth of exports in May…***

In May, the trade deficit was recorded as USD 4.1 billion, the highest monthly deficit so far, mainly owing to the considerable slowdown in the rate of growth of exports. Exports grew by 9.9% in June, amounting to USD 5.7 billion, below our expectation of USD 6 billion. Imports, which grew by 22%, on the other hand, amounted to USD 9.8 billion, more or less within our expectation.

MONTHLY FOREIGN TRADE (USD BILLION)




It can be observed that the slowdown in exports growth in May emanated from the contraction in exports of some specific sectors, most significant being the 31% decline in the iron and steel sector. This is unusual, considering the continuously good performance of this sector in the first four months of 2005. Hence, it is early to comment that there are problems in this sector. The problems, however, are obvious in textile and clothing sectors. The rate of growth of some components of the textile exports was negative and clothing exports registered very limited growth in May, mainly due to the increased international competition from China. Apart from these features, trends in exports seem to have been maintained, automobiles and machinery-equipment being the best performers as usual.

On the imports side, it is observed that imports of intermediate goods for domestic production continued to be the main determinant of the total import growth. Meanwhile, imports of capital goods were quite strong, despite the high base effect of the previous year. Consequently, in the first five months of 2005, imports of intermediate and capital goods rose by 29% and 14%, respectively, implying a continuation in the strong industrial output growth. However, increasing international oil prices is reflected in the import bill as a 44% rise in mineral fuels and mineral oil imports during the first five months of the year.

To sum up, during the January-May period, total exports amounted to USD 29 billion and imports were recorded at USD 45 billion. The exports to imports ratio amounted to 64.3% in this period, just as much as the level in the same period last year.

*Regarding our end-year projections for exports and imports, we did not change our export projection of USD 74 billion, while we revised imports up from USD 113 billion to USD 114.5 billion due to the considerable increase in the international oil prices.*

***The primary surplus amounted to YTL 16.6 billion during the January-May period…***

The primary surplus in the consolidated budget amounted to YTL 5.9 billion in May, whereas the budget balance recorded a considerable surplus of YTL 1.7 billion. As a result, the primary surplus, which added up to YTL 16.6 billion during the first five months of the year, reached 61% of the amount targeted for the year as a whole. Meanwhile, the consolidated budget deficit remained at a significantly low level, namely YTL 3.8 billion, during the January-May period. This corresponds only to 13% of the amount projected in the 2005 budget. Although budget deficit is anticipated to be considerably higher in the last few months of the year, these figures suggest that the budget deficit by the year-end might remain below the target, thanks to the lower than expected interest expenditures.

A more detailed analysis of May data indicates that the considerably high non-tax revenues were effective in the substantial primary surplus. In May, the Savings Deposit Insurance Fund (SDIF) paid back YTL 1 billion to the Treasury, which was recorded as non-tax revenue. In addition to this, it has been announced that the Privatization Administration transferred around USD 1 billion of revenue to the Treasury during the first five months of the year, a large part of which, is thought to be transferred in May. This has also been recorded as non-tax revenue.

**SELECTED CONSOLIDATED BUDGET FIGURES**

| YTL million | Jan-May. 2004 | Jan-May. 2005 | % real increase | 2005 budget target | Jan-May. 2004 / year-end (%) | Jan-May. 2005 / year-end target (%) |
|---|---|---|---|---|---|---|
| **Revenues** | **42,555** | **51,064** | **9.5** | **126,490** | **38.7** | **40.4** |
| Tax revenues | 33,996 | 40,625 | 9.0 | 106,617 | 37.7 | 38.1 |
| Non-tax revenues | 8,559 | 10,438 | 11.3 | 17,238 | 43.2 | 60.6 |
| **Expenditures** | **53,986** | **54,855** | **-7.3** | **155,628** | **38.5** | **35.2** |
| **Non-interest expenditures** | **27,897** | **34,448** | **12.6** | **99,188** | **33.3** | **34.7** |
| Personnel | 12,263 | 13,367 | -0.6 | 31,904 | 42.4 | 41.9 |
| Investment | 727 | 1,654 | 107.5 | 10,071 | 9.1 | 16.4 |
| Transfers to social sec. inst. | 7,538 | 9,680 | 17.1 | 21,998 | 39.0 | 44.0 |
| Other | 7,368 | 9,747 | 20.7 | 35,215 | 26.8 | 27.7 |
| **Interest expenditures** | **26,089** | **20,406** | **-28.6** | **56,440** | **46.2** | **36.2** |
| **Primary balance** | **14,657** | **16,615** | **3.4** | **27,302** | **56.0** | **60.9** |
| **Budget balance** | **-11,432** | **-3,791** | **-69.7** | **-29,138** | **37.7** | **13.0** |

Among tax revenues, it is worth noting that direct tax revenues declined in real terms during this period, and that the increase in total tax revenues stemmed from the rise in indirect tax revenues. It is especially worth noting that corporate tax revenues declined by a real 5.1%. The 16.6% real increase in special consumption tax was effective in the surge in indirect tax revenues. Although the current outlook of the consolidated budget does not cause major concerns about the attainability of this year's targets, problems could arise in the longer term. In order to have a sustainable improvement in the consolidated budget, it is necessary that the share of direct taxes increases. However, the current data do not give any signals about an improvement in direct tax collections.

Budget expenditures in May do not exhibit major changes compared to the first four months of the year. Non-interest expenditures rose by 12.6% in real terms during January-May period with respect to the same period of 2004. This increase stemmed mainly from the surge in transfers to social security institutions and from agricultural transfers.

*We revised our year-end estimations based on the developments in the first five months of the year. As a result, we revised our primary surplus / GDP projection to 5% from the previous 5.2%, while our budget deficit / GDP forecast has been revised to 4.5% from 5.1%.*

***Outstanding external debt declined in the first quarter of 2005…***

Total external debt, which was USD 161.8 billion at the end of 2004, declined to USD 160 billion in the first quarter of 2005. The reduction in the debt stock originated from the USD 2.2 billion of decline in the long-term debt stock. Meanwhile, the short-term debt, which is mainly owed by banks and corporate sector, rose by a mere USD 385 million. The most notable development in the long-term debt stock is the decline in the loans borrowed by the Central Bank, due to payments to the IMF in return for previous stand-by arrangement credits. Furthermore, a USD 761 million reduction in the FX deposits of non-residents, the so-called Dresdner accounts of the CB is also worth of notice, which was the other major factor behind the decline in the long-term foreign debt stock.

Consequently, in the first quarter of 2005, the outstanding short-term foreign debt rose to USD 32.3 billion, whereas long-term debt stock amounted to USD 127.7 billion, of which USD 73.3 billion is owed by the public sector, including the CB.

***The domestic debt stock declined by YTL 1.1 billion in May…***

The domestic debt stock, which was YTL 225 billion at the end of 2004, rose to YTL 236 billion in April and declined to YTL 235 billion in May. This decline in the debt stock stemmed mainly from the payments of the debt owed by the SDIF and redemption of the GDIs (government debt instruments) held in the CB's portfolio. The USD value of the stock, however, rose by USD 1.5 billion in May and reached USD 172 billion, mainly due to the appreciation of the domestic currency.

| | **Dec.04** | **Apr.05** | **May.05** |
|---|---|---|---|
| **Domestic Debt Stock** | **224,483** | **236,185** | **235,064** |
| **Public** | 83,335 | 81,684 | 80,614 |
| Central Bank | 22,119 | 20,774 | 20,137 |
| Public Banks (1) | 27,451 | 27,294 | 27,249 |
| SDIF | 8,317 | 7,611 | 6,964 |
| Other Public (2) | 25,449 | 26,004 | 26,265 |
| **Market** | **141,148** | **154,501** | **154,450** |

(1) This figure contains only non-cash sales to the public banks and cash sales for the interest payments of the noncash securities issued to the public banks.
(2) Non- comp. sales are included.

Examining the debt stock with respect to the end of 2004, it is observed that there are some improvements in terms of instrument composition. The share of FX-linked instruments has been reduced from 17.6% at 2004-end to 16.2% in May, while fixed rate instruments remained around 42.5% in this period. The floating rate GDI stock, on the other hand, rose from 40.1% to 41.4%. These figures show that, although the vulnerability of the total debt stock to the foreign exchange rate fluctuations declined moderately, the substantial share of floating rate bonds still generates susceptibility to the interest rate fluctuations.

*Our projection of the domestic debt stock/GDP ratio for 2005 stands at 50%.*

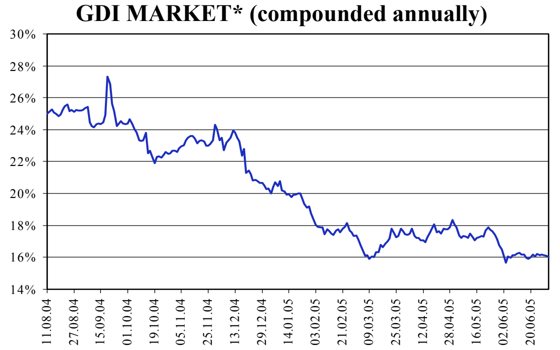
## FINANCIAL MARKETS

***The CB lowered the ON rates in June, for the sixth consecutive month…***

Following the meeting of the Monetary Policy Committee, the CB announced that it reduced its ON borrowing and lending rates by 0.25 percentage points on June 9th. As a result, the CB's ON borrowing rate was cut to 14.25% from the previous 14.5%, while the ON lending rate has been reduced to 18.25% from 18.5%. The ON borrowing rate was 18% in 2004 year-end, which indicates that the total rate cut so far in 205 reached 3.75 percentage points.

***The secondary GDI market has been quite calm in June following the rally at the beginning of the month…***

**INTEREST RATES IN THE SECONDARY GDI MARKET* (compounded annually)**




* Interest rate of the most active bond: Feb.22, 2006 bond during Aug.11–Sept.21, 2004; Apr.4, 2006 bond during Sept.12–Nov.9, 2004; May 24, 2006 bond during Nov.10–Dec.15, 2004; Jul.5, 2006 bond during Dec.15, 2004–Jan.25, 2005; Aug.9, 2006 bond during Jan.25-Feb.8,2005; Sept.27,2006 bond during Feb.9-Apr. 19, 2005; Nov.8, 2006 bond during Apr.20-May 24, 2005; and Jan.24, 2007 bond afterwards.

The tension in the financial markets eased at the beginning of June after the French and Dutch referendums. Although, the EU Constitution was rejected in both countries, the financial markets in Turkey did not react negatively to this outcome since it has already been priced in GDI and FX rates. Various declarations by senior EU officials indicating that this outcome would not affect the start of Turkey's negotiations on October 3rd, helped to relieve the tension in the markets. As a result, the rally took place during the first few days of the month and interest rate of the most actively traded bond in the secondary GDI market, namely January 24th, 2007 paper, which was 17.4% on the last trading day before the French referendum, declined to 17.1% the day following the referendum and further to 15.7% on June 3rd. This has been the lowest level to which the interest rates have ever declined. Meanwhile, the YTL appreciated considerably against the dollar, despite the strengthening of the dollar in international markets. In more detail, the YTL/USD rate which was over 1.37 level before the referendum declined towards the 1.34 level as of June 3rd. As a result, the CB intervened directly in the FX market, pointing out to increased volatility. The CB is estimated to have bought around USD 2.4 billion through this intervention.

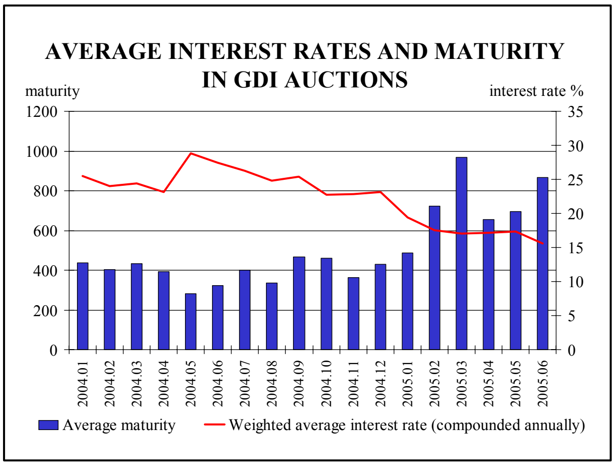
During the rest of the month, financial markets remained quite calm. Although the mood in the markets in June can be described as positive, GDI rates remained above the CB's ON rate, which is currently 15.3% in annually compounded terms. Interest rate of January 24th, 2007 bond traded in the 15.9%-16.3% band after the first few days of June, ending the month at 16%.

After the CB's intervention in the FX market at the beginning of the month, the YTL/USD rate rose to the 1.36-1.37 range, before declining around 1.35 level during the second half of the month. The YTL/USD rate ended the month at around 1.34 level, thanks to the positive mood in the financial markets related to the release of the EU Commission's draft framework for accession negotiations with Turkey. In sum, the YTL/USD rate declined by 1.6% in June when compared to the end of May, whereas the fall in the YTL/euro rate reached 3.8% due to the depreciation of the euro against major currencies in the international markets.

| FOREIGN EXCHANGE RATES | | | | | | | |
|---|---|---|---|---|---|---|---|
| | (1) 31.12.04 | (2) 31.5.05 | (3) 30.6.05 | (3)/(2) % change | (3)/(2) real % change *** | (3)/(1) % change | (3)/(1) real % change *** |
| YTL / USD* | 1.3427 | 1.3615 | 1.3401 | -1.6 | -1.1 | -0.2 | -4.3 |
| YTL / Euro * | 1.8321 | 1.6823 | 1.6178 | -3.8 | -3.4 | -11.7 | -15.3 |
| FX basket ** | 2.7534 | 2.6569 | 2.5858 | -2.7 | -2.2 | -6.1 | -9.9 |
| Euro/USD rate | 1.3645 | 1.2356 | 1.2072 | -2.3 | - | -11.5 | - |

* Central Bank's selling rate; ** 1 USD + 0.77 euro; *** The real change has been calculated using the Producer Price Index.

***The Treasury borrowed below its redemptions in June…***




The Treasury had to redeem YTL 13.4 billion of domestic debt in June, including the payments to the Compulsory Saving Fund. Of this total amount, YTL 5.9 billion consisted of repayments of FX-denominated and FX-linked instruments, while YTL 7.4 billion was the servicing of YTL-denominated GDIs. In order to rollover these redemptions, the Treasury held 2 FX-denominated and 3 YTL-denominated GDI auctions. In fact, in June, the Treasury issued twice the May 28th, 2008 bond, a three-year USD-denominated FRN with coupon payments every 6 months and borrowed USD 4.5 billion (YTL 6.2 billion) via these auctions. Moreover, the Treasury borrowed YTL 5.1 billion of funds through the YTL-denominated auctions. As a result, the Treasury's total borrowing in June amounted to YTL 11.3 billion, which indicates a rollover ratio of 86%. Meanwhile, the average rollover ratio during the first half of the year was 89%, the same ratio recorded in 2004.

| TREASURY'S DOMESTIC BORROWING IN JUNE 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Date | Redemption Date | Maturity (days) | Interest rate (ca, %) | Total Bids (Nominal) | Borrowing (Nominal) [1] | Borrowing (Net) [1] | Total Net Borrowing [2] |
| 31.05.05 | 28.05.08 [3] | 1092 | 5.47 | USD 1.4 bn | USD 0.9 bn | USD bn | USD bn |
| 14.06.05 | 14.09.05 | 91 | 14.89 | YTL 2.3 bn | YTL bn | YTL bn | YTL bn |
| 21.06.05 | 28.05.08 [3] | 1071 | 5.51 | USD 1.2 bn | USD bn | USD bn | USD bn |
| 28.06.05 | 05.04.06 | 280 | 16.21 | YTL 1.6 bn | YTL bn | YTL bn | YTL bn |
| 28.06.05 | 17.02.10 [4] | 1694 | 20.93 | YTL 1.5 bn | YTL bn | YTL bn | YTL bn |

[1] Sales in the auctions, excluding the sales to public institutions and primary dealers at uncompetitive bids and option sales.
[2] Total sales including the sales to public institutions and primary dealers at uncompetitive bids and option sales.
[3] USD denominated FRN auction, with coupon payments every 6 months.
[4] FRN auction, with coupon payments every 6 months.

The Treasury's borrowing rate in discounted YTL-denominated auctions declined considerably in June. Besides the decline in the interest rates registered in both the primary and secondary GDI markets, the mathematical effect coming from the fact that the Treasury held only two discounted YTL-denominated GDI auctions in June, one of them being a 3-month auction carrying lower interest rates as usual, was also effective in lowering the average borrowing cost. As a result, the average borrowing cost of the Treasury declined to 15.6% in June from 17.3% in May. The average maturity, on the other hand, rose to 867 days in June, from 697 days in May.

***The Treasury has a financing need of YTL 16.8 billion in July…***

The Treasury's domestic debt servicing amounts to YTL 15.7 billion in July, whereas the foreign debt servicing has been announced as YTL 1 billion. Of this total amount of domestic debt redemption, YTL 1.5 billion consists of repayments of FX-denominated and FX-linked GDIs.

| TREASURY'S DOMESTIC DEBT REDEMPTIONS IN JULY 2005 (YTL million) | | | | |
|---|---|---|---|---|
| **Date** | **Payments to the market** | **Payments to state enterprises (1)** | **Payments to the CBRT** | **Total** |
| 06.07.2005 | 4,451 | 1,209 | - | 5,660 |
| 10.07.2005 | - | - | 178 | 178 |
| 12.07.2005 | 4 | - | - | 4 |
| 13.07.2005 | 1,276 | 71 | - | 1,347 |
| 16.07.2005 | - | - | 165 | 165 |
| 17.07.2005 | 16 | - | - | 16 |
| 18.07.2005 | 915 | - | - | 915 |
| 20.07.2005 | 2,840 | 28 | - | 2,868 |
| 26.07.2005 | 5 | - | - | 5 |
| 27.07.2005 | 4,241 | 306 | - | 4,546 |
| **Total** | **13,748** | **1,614** | **342** | **15,705** |

(1) Sales to the public institutions through uncompetitive bids at the price formed in the auction.

| TREASURY'S BORROWING REQUIREMENT IN JULY 2005 (YTL billion) | |
|---|---|
| **Payments** | **16.8** |
| **Domestic Debt Service** | **15.7** |
| Principal | 12.5 |
| Interest | 3.2 |
| **Foreign Debt Service** | **1.0** |
| Principal | 0.5 |
| Interest | 0.5 |
| **Financing** | **16.8** |
| **Borrowing requirement from the markets** | **10.8** |
| Reference bond auction | 2.3 |
| Borrowing via auctions | 8.5 |
| **Other financing** | **6.0** |
| Primary Surplus | 2.2 |
| Sales to public institutions | 1.6 |
| Foreign Borrowing (*) | 2.2 |
| Treasury's Cash Balance | 3.0 |

(*) The receipts from the latest eurobond issue in the amount of euro 650 will be received in July. The foreign borrowing estimate for July includes this eurobond issue and the second credit tranche from the IMF.

The Treasury announced that it plans to finance YTL 10.8 billion of its financing need in July through domestic borrowing. The other major financing items in July are estimated to be YTL 2.2 billion of primary surplus and YTL 2.2 billion of foreign borrowing. This estimate of foreign borrowing for July includes the proceeds from the eurobond issued at the end of June, amounting to EUR 650 million, which will be received in July and the second credit tranche from the IMF.

***Financial markets are expected to remain relatively calm in July…***

Financial markets, being quite stable in June following the rally at the beginning of the month, were once again in a positive mood at the beginning of July. The announcement of the EU Commission's draft negotiation framework, and the outcome of the Turk Telekom privatization tender were effective in this positive mood in financial markets. As a result, interest rates in the secondary GDI market fell to 15.8% as of July 4th, and the YTL/USD rate declined to the 1.34 level.

July is expected to be a relatively calm month for the financial markets. The Parliament went into recess before passing the social security law required for the completion of the first review with the IMF. However, markets did not react negatively to this event, since the law is expected to be passed as soon as the Parliament convenes again, either at the official date in beginning of October, or before on a extraordinary meeting. Hence, there will be no expectations regarding the enactment of laws in July, which means that there will be no tension coming from this issue.

A key issue that is expected to be important for the markets, is the ratification of the customs union agreement by Turkey, expanding the agreement to the 10 new members of the European Union, including Cyprus. Markets are expected to react positively if Turkey signs the agreement in July. However, any developments regarding the relations with Cyprus can affect the path of interest rates in the future, especially as the beginning date of accession negotiations of Turkey with the EU, namely October 3rd, approaches. A possible tension regarding Cyprus could influence the financial markets negatively.

Besides the ratification of the customs union, another issue that could influence the markets positively is thought to be the developments regarding the foreign direct investments to the country. Since foreign investors' interest in Turkey's privatizations and Turkish private companies increased considerably during the last few months, any concrete development in this area is expected strengthen the positive mood in financial markets. Even in the absence of the FDI, the YTL appreciated considerably in the recent period, and could appreciate further in the coming months with increased tourism activity. In this case, the CB could intervene in the FX market to prevent sudden appreciation of the YTL, which in turn, is expected to lead to a decline in interest rates.

A final issue that is expected to influence the GDI rates is the CB's interest rate decision. A large part of market players anticipate another rate cut of 25 basis points in July. Since this expectation has already been priced in the GDI rates, its realization is not expected to lead to a considerable decline in interest rates. However, the possibility that the CB does not change the ON rates, exists as well. We think that the CB could decide not to cut the ON rates, taking into account the fact that some risks that were cited in the latest inflation report, namely domestic demand pressures and increasing international oil prices, did not alleviate as of June. Hence, in case the CB decides not to change the ON rates, we think that the GDI rates could increase temporarily, however not to a great extent.

In sum, considering all these factors mentioned above, GDI rates are expected to remain in the 15.5%-16.5% band in July, the probability of interest rates reaching the lower limit of this range seeming to be higher.

# MAIN ECONOMIC INDICATORS (July 5, 2005)

| | | |
|---|---|---|
| **GROWTH:** | | |
| GNP | 2005 – 1st Quarter | 5.3% |
| GDP | 2005 – 1st Quarter | 4.8% |
| GNP | 2004 | 9.9% |
| GDP | 2004 | 8.9% |
| **PRICES:** | | |
| Consumer Prices | June 2005, Annual | 8.95% |
| Consumer Prices | June 2005, Monthly | 0.10% |
| Producer Prices | June 2005, Annual | 4.25% |
| Producer Prices | June 2005, Monthly | -0.48% |
| **EXTERNAL BALANCE:** | | |
| Exports (Shuttle trade excluded) | June 2004 – May 2005 | USD 68.4 billion |
| Imports | June 2004 –May 2005 | USD 105.8 billion |
| Trade Balance | June 2004 –May 2005 | USD - 37.4 billion |
| Current Account Balance | January – April 2005 | USD –8.9 billion |
| Foreign Debt Stock | 2005 – 1st Quarter | USD 160 billion |
| **CENTRAL BANK AND MONETARY AGGREGATES:** | | |
| CBRT Foreign Exchange Reserves | 24.06.2005 | USD 39.2 billion |
| Total Gross Reserves | 10.06.2005 | USD 56.7 billion |
| Total YTL Deposits | 31.12.2004 – 17.06.2005, % change | 12.2% |
| Deposit Money Banks Domestic Credit Stock | 31.12.2004 – 17.06.2005, % change | 19.7% |
| M1 | 31.12.2004 – 17.06.2005, % change | 11.7% |
| M2 | 31.12.2004 – 17.06.2005, % change | 13.6% |
| M2Y | 31.12.2004 – 17.06.2005, % change | 5.9% |
| **PUBLIC FINANCE:** | | |
| Consolidated Budget Balance | January – May 2005 | YTL - 3.8 billion |
| Primary Balance | January – May 2005 | YTL 16.6 billion |
| Domestic Debt Stock | May 2005 | YTL 235.1 billion |
| **FOREIGN EXCHANGE:** | | |
| Devaluation Rate (TL/$) | June 2005 (Monthly) | -1.6% |
| | June 2005 (Over year-end) | -0.2% |
| Devaluation Rate (TL/EURO) | June 2005 (Monthly) | -3.8% |
| | June 2005 (Over year-end) | -11.7% |
| **ISE:** | | |
| ISE Composite Index | 29.12.2004-30.06.2005, % Change | 8% |
| | | |



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