

**T.C.  
IŐIK UNIVERSITY  
SOCIAL SCIENCES INSTITUTE  
MBA PROGRAMME**

**RELATIONS OF 1994 AND 2000 CRISES AND  
THEIR EFFECTS IN TURKISH CAPITAL  
MARKETS**

**MASTER THESIS**

**YEŐİM PINAR SOYKUT  
2001MBA0125**

**ADVISOR: ASSIST. PROF. DR. JAMES KURT DEW**

**İSTANBUL, 2002**

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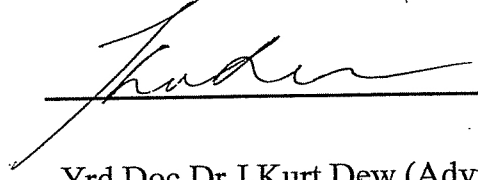
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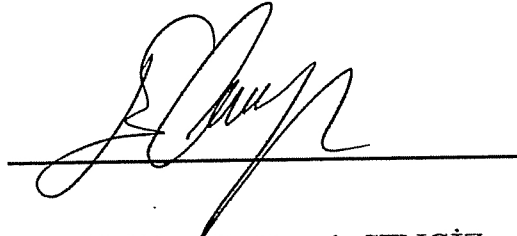
The thesis is submitted by Pınar Yeşim Soykut to the Institute of Social Sciences of Işık University in partial fulfillment of the MBA Degree approved by;



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## SUMMARY

Turkey, one of the most rapidly growing emerging market, is a heaven for investors with young population, dynamic private sector, and liberalised financial markets. In this respect, the question of “Why does the Turkish economy always face with either a crisis or a program for guiding her out of a crisis?”, comes to minds.

In the analysis period of this research, the Turkish economy has experienced with two major crisis in 1994 and 2000, which are called as “balance of payment crisis”. In the period, before 1994 crisis had happened, although the tight monetary and fiscal policies were supposed to be implemented, neither of them were successfully executed.

In the final crisis, Turkey launched a comprehensive and consistent disinflation program at the beginning of 2000 in order to stabilise the economy, which resulted as the abandonment of the crawling peg exchange rate regime- the anchor of the International Monetary Fund (IMF)- drawn back the economic reform program, brought instant and massive market devaluation, souring inflation, and tumbling financial markets.

Today, Turkish government aim is to keep the window of Turkey open to all investors and widen it enough to ensure that the government meets its borrowing requirements, banks make profit in subsidising the government while the rest of the economy continues to function with reasonable rates on loans and attractive interest on deposits in order to proper functioning of the economy.

This research makes a brief survey on the relationship between financial system, particularly in capital markets and economic crisis, in order to give a general background for the role of capital market in the case of Turkey by taking main macroeconomic indicators as the leading variables and their effects on ISE as the coincidental.

In the first part of the research, the emerging history of Turkish Republic is viewed for making clear the path, which Turkey followed as a developing country. In addition, the development of financial markets in Turkey is historically reviewed. After this introductory information, the effects of the deregulation and industrialisation are discussed. The discussion reflects the impacts of liberalisation upon the Turkish economy and financial markets.

In the second part of this research, 1994 crisis is explained, the most severe crisis ever lived in Turkey of all times. This part continues with the chronology of the 1994 crisis and is followed by economic indicators in terms of results of the economic crisis.

In the third part of this research, Turkey's problems remained the same including the high inflation rate. Turkish economy was launched a comprehensive and consistent disinflation program again. This part is followed by January 2000 and February 2001 crisis, which became as the most severe and destructive crisis ever lived in Republic of Turkey's history, worse than 1994 crisis, and resulted as another burden on Turkish economy.

In the fourth part of this research, Turkish Capital Markets' development is reviewed particularly and ISE is considered for the assessment of the role of the development of Turkish Capital Markets. Current part is followed by the condition of ISE during the period 1994 through 2000, including movements in the size and the volume of market with major events of daily market environment.

In the last part of this research, both crises are examined by using the financial instruments' returns in comparison with the ISE, the most efficient capital market of Turkey. Interest rates, T-Bill, foreign exchange market, money supply, and industrial production monthly returns are considered for plotting the analysis successfully on the ISE. In addition, for determining the relation between the ISE and other variables one-by-one, each of these

returns are graphed. According to the results of graphs, the relation between 1994 and 2000 crises are brought into open and the reasons for 2000 crisis' getting longer than 1994 crisis are tried to be achieved.

Relevant data and information have been obtained from several books and public sources such as company document press releases' annual reports, governments' statistics, databases, especially ProQuest, and finally state's official web-sites and organisations' web-sites for periodic data which has been cross checked and correlated with statistics issued by the several organisations.

Finally, it should be noted that, the capital markets is the most important arm of financial sector for Turkey. The future of capital markets in Turkey are highly interrelated with the stabilisation and the development in the entire economy. A better comprehension of the economic development and stabilisation package after the crisis helped public to understand the vital importance of entire capital markets.

## ÖZET

Türkiye genç nüfusu, dinamik özel sektör yatırımları ve liberalleşmiş finansal piyasalarıyla, hızla büyüyen ve gelişmekte olan pazarlardan biri olarak yatırımcılar açısından cazibesini korumaktadır. Bu bağlamda, “neden Türk ekonomisi sıklıkla finansal krizlere maruz kalarak krizle baş etme programlarıyla karşı karşıya geliyor? “sorusu akıllara geliyor.

Çalışmanın analiz dönemleri, 1994 ve 2000 yıllarında Türkiye'nin maruz kaldığı “ödemeler dengesi krizleri” olarak adlandırılan 2 büyük krizi kapsamaktadır, 1994 krizi öncesinde gerçekleşen krizlerde sıkı para ve mali politikaları uygulanmaya çalışıldı ancak başarılı sonuçlar alınmadı. Son yaşanan krizde, Türkiye ekonomiyi istikrara ulaştırabilmek için dalgalı kur rejimini bırakarak 2000 yılı başında kapsamlı ve tutarlı enflasyonla mücadele programı başlattı, Türkiye bant içinde dalgalanma rejimi uygulamaya başlamıştır. Ancak yaşanan 2001 kriziyle ekonomik reform programı geri çekilmiş devalüasyon yaşanmış ve finansal piyasalar dalgalanmıştır. Kriz sonrasında Türkiye dalgalı kur rejimine geçtiğini duyurmuştur.

Bugün, Türk hükümetinin amacı, Türkiye'nin penceresini tüm yatırımcılara açık tutmak ve olabildiğince genişletmek bu sayede hükümet borçlanma gereksinimlerini giderirken, bankalar devleti sübvansede ederek kazanacaklar, ekonominin geri kalanı makul kredi düzeyinden faydalanırken, mevduat faizi kazanmak cazip hale gelebilecektir.

Bu çalışma, finansal sistemle sermaye piyasaları arasında yaşanan mali krizlerin incelemesi üzerinedir, Türkiye'deki sermaye piyasasının rolünün incelenmesi başlıca makroekonomik göstergeleri kullanarak değişkenlerin İMKB üzerindeki tesadüfi etkileri gösterilmeye çalışılmıştır.

Çalışmanın birinci bölümünde, Türkiye Cumhuriyeti'nin gelişmekte olan bir ülke olarak izlediği yolu açıklamakla başlamak gerekiyor. Bu

duruma ek olarak, Türkiye'deki finansal piyasaların gelişimi de tarihsel olarak gözden geçirilmiştir. Başlangıç bilgilerden sonra, fiyat serbestisi ve sanayileşme etkileri tartışılmıştır. İnceleme Türk ekonomisi ve mali piyasalar üzerindeki küreselleşmenin etkilerini yansıtmaktadır.

Araştırmanın ikinci bölümünde ise, Türkiye'de yaşanan tüm zamanların en ağır krizi olan 1994 krizi açıklanmıştır. Bu bölüm 1994 krizinin kronolojisi ile devam ederken ekonomik krizin sonuçları açısından ekonomik göstergeler takip edilmektedir.

Bu araştırmanın üçüncü bölümünde, Türkiye'nin yüksek enflasyon dahil aynı kalan sorunları paylaşılmıştır. Bu dönemde Türk ekonomisine yeniden kapsamlı ve tutarlı bir enflasyon düşürme programı başlatıldı. İlgili bölümde, Türkiye tarihinin ve Cumhuriyeti'nin yaşamış olduğu en ağır ve yıkıcı krizlerden olan Ocak 2000 ve Şubat 2001 krizleri takip ediyor.

Çalışmanın dördüncü bölümünde ise, özellikle Türk Sermaye Piyasasındaki gelişmeler gözden geçirilmiştir ve İMKB'nin bu gelişmedeki rolü değerlendirilmiştir. İMKB'nin günlük piyasalarda gerçekleşen önemli olaylar sonucunda işlemlerinin büyüklüğü ve hacmi 1994 ten 2000 yılına kadar uzanan durumu incelenmiştir.

Son bölümde, her iki krizde finansal enstrümanların getirileri İMKB ile karşılaştırılarak incelenmiştir. Faiz oranları, hazine bonoları, döviz piyasası, para arzı ve sanayi üretimi aylık getirileri dikkate alınmıştır. Hazırlanan grafiklerin sonuçlarına göre, 1994 ve 2000 krizleri arasındaki ilişkiye bakılmıştır ve değerlendirme sonucunda 2000 krizinin 1994 krizinde daha uzun sürdüğü açıklanmıştır.

Son olarak, sermaye piyasaları Türkiye'de finansal sektörün en önemli kolu olarak dikkate alınmalıdır. Türkiye'de sermaye piyasalarının geleceği ekonominin tamamının gelişimi ve istikrarı ile ilişkilidir. Kriz sonrası ekonomik gelişmenin ve uygulanan istikrar paketinin daha iyi anlaşılması kamunun sermaye piyasalarının önemini anlamasına yardımcı olacaktır.



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## **ABBREVIATIONS**

<b>AMU-</b>	Asset Management Unit
<b>BAT-</b>	Banks Association of Turkey
<b>BRSA-</b>	Banking Regulation and Supervision Agency
<b>CBT-</b>	Central Bank of the Republic Turkey
<b>CMB-</b>	Capital Market Board
<b>CPI-</b>	Consumer Price Index
<b>EC-</b>	European Community
<b>ELIT-</b>	Electronic Trading System
<b>EU-</b>	European Union
<b>FX-</b>	Foreign Exchange
<b>GDI-</b>	Government Debt Instrument
<b>GDP-</b>	Gross Domestic Product
<b>GNP-</b>	Gross National Product
<b>IFC-</b>	International Finance Corporation
<b>IGE-</b>	Istanbul Gold Exchange
<b>IMF-</b>	International Monetary Fund
<b>IPO-</b>	Initial Public Offering
<b>ISE-</b>	Istanbul Stock Exchange
<b>P/E-</b>	Price Earning Ratio
<b>PSBR-</b>	Public Sector Borrowing Requirement
<b>SEC-</b>	Security Exchange Commission
<b>SEE-</b>	State Owned Economic Enterprises
<b>SDIF-</b>	Saving Deposit Insurance Fund
<b>STA-</b>	Short Term Cash Advance
<b>TL-</b>	Turkish Lira
<b>WPI-</b>	Wholesale Price Index

## **INTRODUCTION**

The aim of this research is to explore, if there is a connection, between 2000 and 1994 crises in Turkish Capital Markets for identifying clearly the relation among financial instruments, which of them are highly used in Turkey. As this reason, the Turkish Capital Market is modeled by using the most respected micro and macroeconomic indicators, which are used all over the world's most respected researches. Conducting library search of articles, books, thesis, journals and states' official web-site information sources about the subject performs this work.

The Republic of Turkey, which is located in an area where the Asian, European and African continents come very close to each other, is surrounded by Georgia, Armenian, Nakhichevan and Iran to the east, Bulgaria and Greece to the west and Syria and Iraq to the south. Turkey is a passageway for the old Asian Turkish cultures to reach Europe due to her location and is at the same time the window of the west opening to the east. Turkey has become the centre of the great trade and migration routes due to her place as a bridge between continents. Turkey is a NATO member country and at the same time plays an active role on the subject of developing multilateral economic cooperation among the European and Turkic countries.

Turkey has a dynamic economy that is a complex mix of modern industry and commerce along with traditional village agriculture and crafts. It has a strong and rapidly growing private sector, yet the state still plays a major role in basic industry, banking, transport, and communication. Its most important industry is textiles, which is almost entirely in private hands. The economic situation in recent years has been marked by erratic economic growth and serious imbalances. Potential investors concerned about economic and political stability. Prospects for the future, including prospects for foreign investment, are brighter because the government is implementing a major economic reform program, including a tighter budget, social security reform, banking reorganisation, and greatly accelerated privatization.



Because of being one of the most important emerging market all over the world, Turkey is taken into consideration as sample of this research because of its chronic economical problems which are explicitly explained by technocrats as “balance of payments” blindness and haven’t been solved since the last half century.

Turkish GNP and GDP changes, budget deficit movements, foreign exchange market’s fluctuations, deposit rate undulations, T-Bill monthly returns, debts and loans, change in money supply, structure and functioning of banks in the market are taken into account as primary data sources for plotting these data in comparison with ISE’s (Istanbul Stock Exchange) monthly stock price movements. Republic of Turkey’s official state web-sites was used for getting these primary data. IMF’s and WB’s reports, journals, articles, macroeconomic books, financial contents based well-known web-sites, and thesis are used as secondary data sources for this research. Computing the data is done by graphing the monthly returns of indicators stated above in comparison with ISE’s movements in Microsoft Windows Excel Program.

The main problem, which actually makes the solution of the chronic economic problems in Turkey even much harder, is the unsuccessful policies themselves. Since at the beginning of the transformation period, it was claimed that the public sector reforms, including privatization, rehabilitation of the social security system, tax reforms, trimming of agricultural and other subsidy programs were widely acknowledged as the key policies to resolve the economy’s problems. The trade regime and capital markets have been liberalised, but the government sector in the economy remained substantially large. Unfortunately, Turkey’s perennial economic problems, large public sector deficits and resulting high inflation, have continued to worsen even as the economy recorded impressive growth rates.

1980s have been a period of deregulation and integration of financial markets in Turkey. In a sharp break with past economic development policies that relied on various forms of financial repression, interest rates were lifted and entry barriers into the financial system were relaxed. There were comprehensive programs also for developing the equity and bond markets. In 1984, Turkish residents were permitted to have foreign currency deposits that formally established a link between Turkish and foreign interest rates. This process culminated in the opening of the capital account in 1989, which imposed significant constraints on monetary and exchange rate policies. As part of the whole liberalisation, deregulation, and internalisation process, the ISE, Istanbul Stock Exchange, was established in January 1986 as a “developing country’s emerging market”. By 1990, Turkey had minimal constraints on domestic and external financial intermediation with the exception of reserve and liquidity requirements. Capital markets were not developed and there was a very limited set of financial instruments. Banks were the dominant institutions in the financial markets and the corporate sector relied almost exclusively on bank credits.

It has been favour of the private sector to use currently inadequate savings to meet the budget deficit by the government. In addition, the high interest rate policy has deteriorated income distribution.

During 1990’s, the main problem of the economy has remained the same, including the inflation rate. In order to stabilise the economy; Turkey launched a comprehensive and consistent disinflation program between 1990 and 2000.

Fundamentals and the fiscal stance in the economy were deteriorating rapidly in those years. The public sector- borrowing requirement further deteriorated both 1993 and 2000. Government fundamental error of attempting to control interest rates triggered a major crisis in 1994 and 2000.

Turkish governments’ aim was attracting foreign investors to the country in order to generate cash. Thus some incentives should be given to

investors who will take active role in this program, because foreign investments in the local market will be a reliable signal for the future prospects of the country for speeding up a continuable growth. Besides, domestic investors who have currency will find an efficient market to invest.

Foreign investments in the local stocks played the most important role. Rumours about foreign activity triggered share trading in the ISE, meanwhile the foreigners' control over shares was about 12 percent, the ISE reports that foreign investors later owned about 40 percent of the stocks traded in 1996. As of 1999, they own slightly more than 60 percent of stocks in the Turkish Capital Markets.

However, in years 1994 and 2000, the most terrible economic crisis had happened. To the attention of economists', in 1993 and 1999 ISE realised a real return of 250% and 220% respectively. At this point, the question of "Is the year 2000 crises in Turkish Capital Markets an extension of the year 1994 crises in Turkish Capital Markets?" to the minds.

A financial crisis thus results in the inability of financial markets to function efficiently, which leads to sharp contraction in economic activity. Crises were like a large boulder on the top of a hill. Given enough pushes to get it started, the boulder will roll down the hill, accelerating as it goes. The consideration is why the market was such in a sensitive position and what factors acted to start its downward fall? There were many contributing factors leading up the crash. Basically, issued increase in interest rates, increase in uncertainty, asset market affects on balance sheets, and bank panics. Thus increase in uncertainty in Turkish financial markets precipitated the stock market decline.

This research makes a brief survey on the relationship between financial system, particularly capital market and economic crises in order to give a general background for the role of capital market in the case of 1994 and 2000 crisis of Turkey by explaining it, taking the ISE as the mainly affected indicator by comparing its relation with the industrial production

output level, sudden and destructive fluctuations of foreign exchange market, interest rate, and T- Bill movements, and change in money supply.

# **PART 1**

## **LIBERALIZATION AND INTERNALIZATION OF TURKISH FINANCIAL INSTITUTIONS**

Turkey's, the ex-closed economy, new liberal economic policy was put into effect in January 1980 aimed at integration with the world economy by establishing a free market economy. As a reflection of this policy, the 1980s were witnessing years to continuous legal, structural, institutional changes and developments in the Turkish financial system. During this period, a series of reforms were undertaken in order to promote financial market development. The aim of these reforms was to increase the efficiency of the financial system. The dominance of the state in key industries, as well as in pricing and resource allocation processes including foreign exchange rate and imports policy, was to be reduced and the economy was opened- up by the policy makers. Export oriented growth became the key objective. In addition to this key objective, Mc Kinnon's model points for accelerating the rate of economic growth and development depending on financial liberalisation.

### **1.1. FINANCIAL OPENING**

Up to 1980s, the overvalued Turkish Lira (TL) was devaluated in 1980 and Turkey maintained a commitment to a flexible exchange rate policy ever since. The exchange rate devalued more than the inflation for maintaining export competitiveness. Successful performance of the exports under the regime of aggressive real devaluation of the TL lasted until 1988. The second feature was the aggressive drive to promote exports by generous export promotion schemes. These included tax rebates, preferential export credits, and import duty exemptions for imported intermediary goods for exports. In 1984, Turkish residents were permitted to have foreign currency deposits that formally established a link between Turkish and foreign interest rates. The highly restrictive and complex import regime was gradually eased and duties were lowered. Another

important development was the further liberalisation of the capital account, which was fully liberalised the following year. The important point to note is, Turkey had a liberalised, open economy and a rapidly growing private sector by 1989. In the meantime, having an open economy increased the funding options abroad both for the financial system and corporations. Financial opening not only strengthened the links between domestic and foreign interest rates, also put in running order with the persistent lack of discipline, particularly on government papers and debt instruments.<sup>1</sup>

These reforms clearly represent major progress towards freeing the operation of financial markets. Widely accepted wisdom is that resource mobilisation and allocation would not be efficient without such policies. By their nature, reforms are also aimed to develop markets; institutions and instruments other than the banking market that traditionally dominated the financial sector under the state- led development policy period<sup>2</sup>.

Non- residents have been widely eased by the introduction of the concept of portfolio investment as distinct from foreign direct investment in the regulations governing capital mobility in Turkey in 1989.

### **1.1.1. Interest Rates**

Interest rates have been set by the state since the 1940s and were seldom changed. Because of rising inflation during the 1970s, real interest rates become increasingly negative; deposit rates were almost minus 40 percent in early 1980s. As a result, interest rate deregulation began in July 1980. Larger banks hoped that the rest of the system would follow the same interest rates on deposit rates. However, the smaller banks did not follow and entered a fierce competition with larger banks. The result was a financial crisis and the liabilities of five banks were taken over by the government. This situation, however, resulted as bankers' crises in 1982.

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<sup>1</sup> C.A. Denizler and N.B. Gültekin. "The Distorted Incentives and financial Development in Turkey", **World Bank**, 2000, p.4.

<sup>2</sup> **Ibid**, p.7.

The interest rates began to be regulated by the Government at 1982. The Central Bank moved into set the rates to prevent the leading banks to exploit their market power. This policy lasted until 1988. Hence, interest rate liberalisation was not an immediate success once the ceilings were abolished in Turkey. There was no regulatory structure to oversee the players in the market when reforms began and risky behaviour of banks could not be controlled. One major outcome of the crisis was the establishment of explicit deposit insurance for banks in 1993.<sup>3</sup>

It has been argued that interest rate ceilings distort the economy in three ways: First, low rate of interest on deposits leads to increase consumption and decrease in total investment and savings. Second, potential depositors may engage in relatively low – yielding direct investment instead of depositing money in a bank for subsequent lending for relatively much high – yielding investment. Third, investors will choose relatively capital intensive projects as they are able to borrow funds at low loan rates (Fry, 1993).<sup>4</sup>

### **1.1.2. Money and Foreign Exchange Markets**

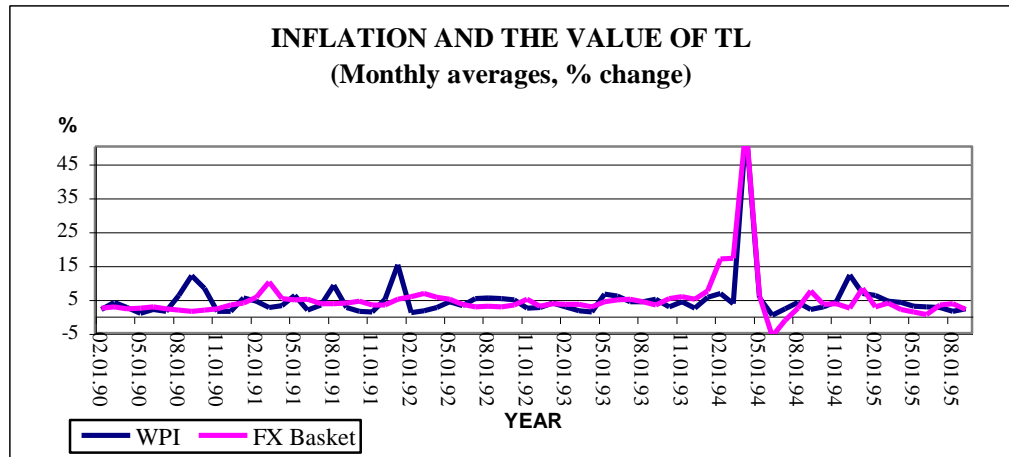
The Central Bank started setting daily exchange rates and allowed banks to fix their own rates within a band. In 1984, banks were allowed to accept foreign exchange deposits. The following year, they were free to set their own exchange rates. The consequences of liberalisation of exchange rate regime provided rapid currency substitution but change in banks asset and liability structure, weakened the stability of the system. TL became fully convertible on both current and capital accounts.

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<sup>3</sup> **Ibid.**, p.8.

<sup>4</sup> A. Esen and I. Seyrek, “The role of Capital Market in the Development Experience of Turkey”, **Cumhuriyet Üniversitesi Yayını**, 1998, p.6.

**Figure 1: Inflation and the Value of TL, monthly average**



The TL is managed against a basket of currencies, which is one third of US Dollars and two-thirds Deutschmarks. The index is computed as  $(1 \cdot \text{US\$}/\text{TL} + 1,5 \cdot \text{DM}/\text{TL})$  like in Figure 1 Inflation and the Value of TL, monthly. At the graph we see that foreign exchange basket continued to remain above the changes in the WPI like previous years. Such as the foreign exchange basket rose by 5% in real terms, in other words TL became overvalued by 5% against the FX Basket. The Central Bank follows a long-standing policy of maintaining a constant real exchange rate by depreciating the TL against the basket in line with inflation differentials.

### 1.1.3. Capital Markets

As part of the overall liberalization process, which has been in effect since in the beginning of the 1980s in the financial markets, liberalization and market orientation have been the dominant and leading factors shaping the system. Capital Board Market (CMB) was active to build the legal and the institutional infrastructure for the capital markets in the country. The present legal framework of the capital markets in Turkey is based on the Capital Market Law enacted in 1981 and amended in 1992. In the period of 1981 – 1983, a priority was given to the preservation of inflation and the promotion of exports.<sup>5</sup> CMB became responsible for the regulation and

<sup>5</sup> SPK, “ Türkiye’de Kaynak Aktarımı Sürecinde Sermaye Piyasalarının Rolü”, **Aylık Bülten Araştırma Dairesi**, Ankara, 1995, p. 35-39.



supervision of primary and secondary markets in Turkey. Until the amendment of the Capital Market Law in 1992, issuing of corporate sector securities was subject to the approval of the CMB. The previous merit system has been changed to disclosure, and the CMB started to decide only on the registration of the securities to be issued.<sup>6</sup> The Istanbul Stock Exchange opened in 1986. Once the interest rate restrictions on corporate bonds were eliminated in 1987 by the Central Bank, new financial instruments, such as commercial papers, were introduced. Mutual funds were allowed for the first time in 1987, but also commercial banks had the exclusive rights to establish them until 1992.<sup>7</sup>

There is also a bond market operating in ISE for fixed income securities trading. Besides, ISE was planning to introduce derivative products. The ISE, as Turkey's national centralised stock exchange, has performed promisingly well and also has attracted growing interest from foreign investors since it was established.

ISE was also officially recognised internationally. The U.S. Securities and Exchange Commission recognised ISE as a "Designated Offshore Securities Market". On May 9, 1995, the Japan Securities Dealers Association also designated ISE as an "appropriate foreign investment market for the private and institutional Japanese investors".<sup>8</sup>

The establishment of the Istanbul Gold Exchange Market (IGE) on 27<sup>th</sup> of July 1995, is a promising development for the Turkish Capital Market. The IGE has a spot gold market. In order to promote trading of gold internationally in Turkey.

Newly established financial institutions, investment companies started operating later in comparison to mutual funds. The first Investment

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<sup>6</sup> **Ibid**, p.35-36.

<sup>7</sup> Istanbul Stock Exchange, <http://www.imkb.gov.tr/history>, 2001.

<sup>8</sup> A. Demirgüç and R. Levine, "Stock Market, Corporate Finance and Economic Growth", **World Bank Economic Review**, V.10, 1996, P. 292.

Company was established in 1991. Their number reached 14 at the end of 1996 and 17 at the end of 1998.<sup>9</sup>

The first Real Estate Investment Company was established in 1995, but it started operating only in 1997. At the end of 1999 there were 8 real estate investment companies.<sup>10</sup>

The CMB also plans to follow with trading of cotton futures on İzmir International Futures and Options Exchange, which will be established subject to the approval of the draft code by the parliament. Chicago Board of Trade will be a partner to this exchange. Also there are plans for derivative contracts based on interest and foreign exchange rates as well as stock indices. Stock and bond markets are open to foreign investors without any restrictions.<sup>11</sup>

#### **1.1.4. Banking System**

During this period, a series of reforms were undertaken in order to promote financial market development. The main aim of these reforms was to increase the efficiency of the financial system by fostering competition among the banks. In this context interest and foreign exchange rates were freed, new entrants to the banking system were permitted, and foreign banks were encouraged to come to Turkey. Turkish banks took an interest in doing business abroad whether by purchasing banks in foreign countries or by opening branches and representative offices. The liberalization of foreign exchange regulations increased bank foreign exchange transactions. Special finance houses, doing business according to Islamic banking principles, also found a place in the Turkish financial system beginning in 1984. The Interbank Money Market was established in 1986 for the purpose of regulating liquidity in the banking system. Unified accounting principles and a standard reporting system were adopted in the same year. In 1987,

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<sup>9</sup> F. Özatay, "The 1994 Currency Crisis in Turkey", **World Bank Discussion Paper**, 1999, p. 4-9.

<sup>10</sup> **Ibid.**, p.10-11.

<sup>11</sup> **Ibid.**, p.13.

banks started to be audited by independent external auditors in accordance with internationally accepted principles of accounting.

As the end of September 1995, there were 69 banks operating in Turkey, including the Central Bank, 13 of which are investment and development banks, and the rest are commercial banks. Six of the commercial banks and three of the development and investment banks are state-owned by BAT. Turkey's banking network at the end of 2000 consisted of 79 banks with 7837 branches. In actuality, commercial banks both state owned and privately owned together accounted for only 40% of both state owned and privately owned together accounted for only 40 % of the total number of banks <sup>12</sup>

The total number of foreign banks operating in Turkey is 22. 11 were founded in Turkey with foreign capital as joint stock companies, while the remaining 11 are simply branches of foreign banks founded abroad.

Despite their small market share, foreign banks have an important place in the Turkish banking system because of the new concepts and practices they have introduced. Particularly in the last decade, foreign banks have brought new attitudes to the system toward competition and dynamism. Besides Turkish government persistent struggle to be a member of the European Union. But as is mentioned from the Table 1 Comparison the EU Countries and Turkey, Turkey needs to improve its banking sector. Column 1 denotes size of the asset per bank as billion, \$; column 2 denotes size of the assets per branch as million, \$; column 3 denotes total asset over national income as %, column 4 denotes population over number of banks take as 1000 people and the last column 5 denotes population over number of branch.

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<sup>12</sup> "Bank Association of Turkey", <http://tbb.org.tr/index/>, 2001.

**Table 1: Comparison of Turkish Banking System Relative to the E.U. Member Countries**

<b>COUNTRY</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Germany</b>	6,1	216	69	317	11,319
<b>England</b>	38,8	141	134	1336	4872
<b>France</b>	4,8	189	129	146	5701
<b>Netherland</b>	5,8	147	261	90	2275
<b>Belgium</b>	6	47	326	73	565
<b>Italy</b>	6,6	82	143	217	2677
<b>Españe</b>	3,6	34	106	238	2222
<b>Portugal</b>	5,6	58	212	253	2620
<b>Greece</b>	4,1	52	67	523	6573
<b>TURKEY</b>	1,2	10	48	1099	9587

Source: J. Hamington, **Emerging Turkey 2001-2002**, Oxford Business Group Hürriyet Yayınları, 2000, p.64.

Today handed over control of Ziraat Bank and Halk Bank, two loss making state owned banks, to a professional board which is now shrinking their staff and branches in preparation for eventual privatization. Emlak Bank is to lose its banking license. The government has also moved to take state owned banks out of money markets by covering their obligations with specially issued government bonds.

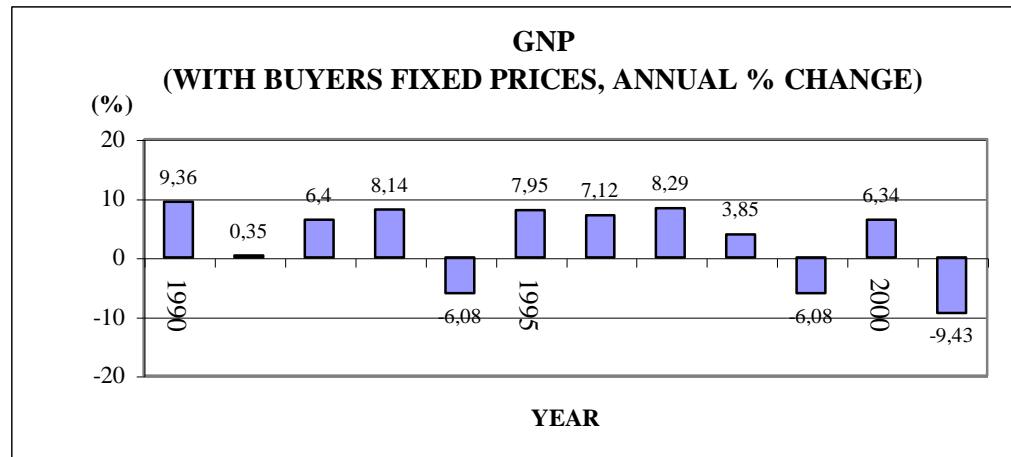
BAT began disposing of 13 failed private sector banks under state administration. Other ten banks have or are being bundled together in one of two transition institutions, which are to be sold or in the absence of buyers, liquidated by the end of the year.

## **1.2. EFFECTS OF LIBERALISATION AND INTERNALISATION ON TURKEY**

Financial crisis of 1982 is about the role of the bank intermediation process. This resulted in the bankers' crises in 1982. After the 1982 crisis, banks became the favoured institutions. The Central Bank took the leadership in the development of the money markets. The Central Bank was

a member of the BAT and the governor of the Central Bank was the president of the association until 1994.<sup>13</sup>

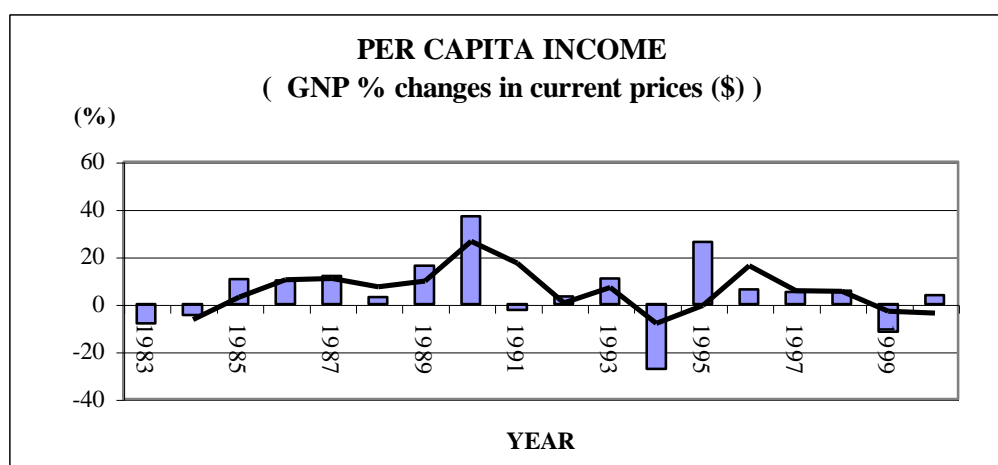
**Figure 2: GNP (With Buyers Fixed Prices, Annual Percentage Change)**



Since mid – 1989 Turkey is a financially open economy with a fully convertible currency. Financial liberalization and financial deepening would not result in a significant internalization of the markets. But Turkey’s GNP has grown significantly except the years of 1994 and 1999 in Figure 2 GNP, Annual Percentage Change). Between 1992 and 2000, Gross National Product (GNP) per capita increased from US\$2708 to \$3095, exports and imports of Turkey rose from \$3 billions and \$6 billions to \$27 billions and \$54 billions respectively. In Figure 3 Per Capita Income, GNP (percentage change in current prices) ) is shown also current account balance was not so much frustrating but the current account balance worsened so much that deficit increased by 11,7% and 12,5% in 1993 and 2000 respectively. On the other hand the Central Bank’s foreign exchange reserves have increased continuously from 6,1% to 19,6% (approximately US\$ 18 billions). Those indicators are the positive effects of the new policies.

<sup>13</sup> **Ibid**, p.6.

**Figure3: Per Capita Income (GNP, Percentage Changes in Current Prices (\$))**



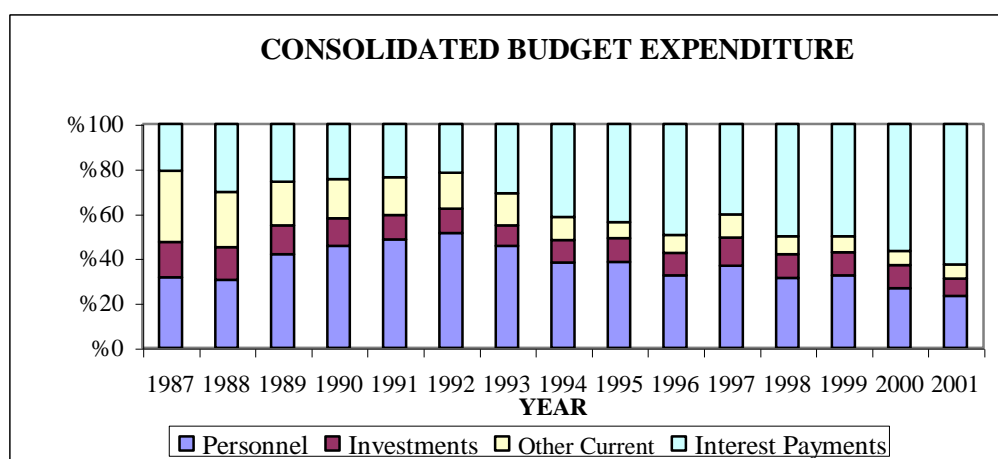
However, mirror has two faces, Turkey’s liberal financial markets have facing serious destabilising problems, capital account was opened untimely in 1989 under these unstable conditions while the officially declared objective was put as further integration with international markets. It appears that, easing of financing constraints on increasing public expenditures may have been an important consideration. <sup>14</sup>Thus problems high public sector borrowing requirements, unsustainable domestic debt financing caused problems which was resulted as high inflation, change in exchange rate policy, growing foreign debt and unemployment.

### 1.3. FINANCIAL IMBALANCES BETWEEN 1990 AND 1993

Turkey has suffered from high and persistent inflation, which is sustained by high budget deficit. Turkey’s inefficient financing methods led to further increase in inflation. Because expenditures mostly exceeded the revenues at the years 1992 and 2000, as it is shown in Figure 4 Consolidated Budget Expenditure and deficit mostly rise from 47 trillion TL to 27847 trillion TL.

<sup>14</sup> O. Celasun, “The 1994 Currency Crisis in Turkey, Macroeconomics and Growth”, Group Development Research Department , [www:// http: econ.worldbank.org/doc/606.pdf](http://econ.worldbank.org/doc/606.pdf), 1996, p.6.

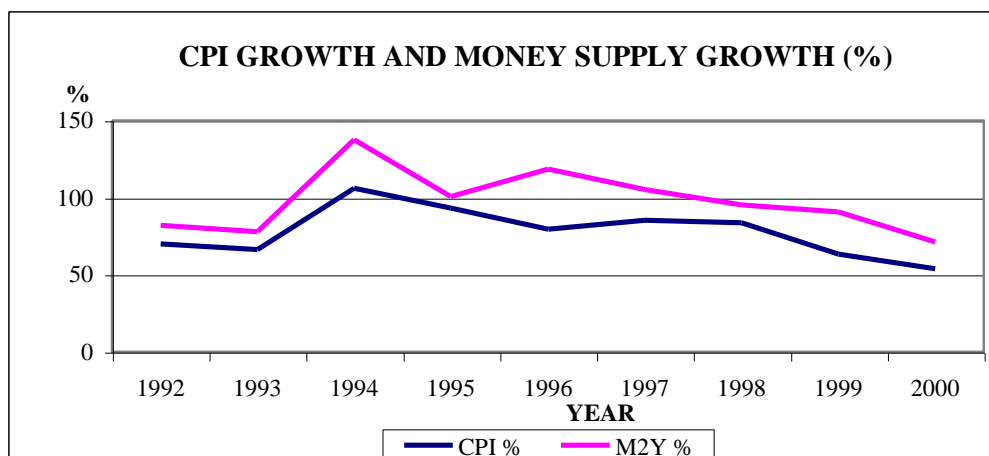
**Figure 4: Consolidated Budget Expenditures**



In this respect, the inefficient taxing system is the reason for insufficient government revenues. Inefficient taxing system sustained by unregistered economy. State owned enterprises, agricultural subsidies, huge amount of money transfers to social security institutions were loaded considerable burden to government, then triggered budget deficit.

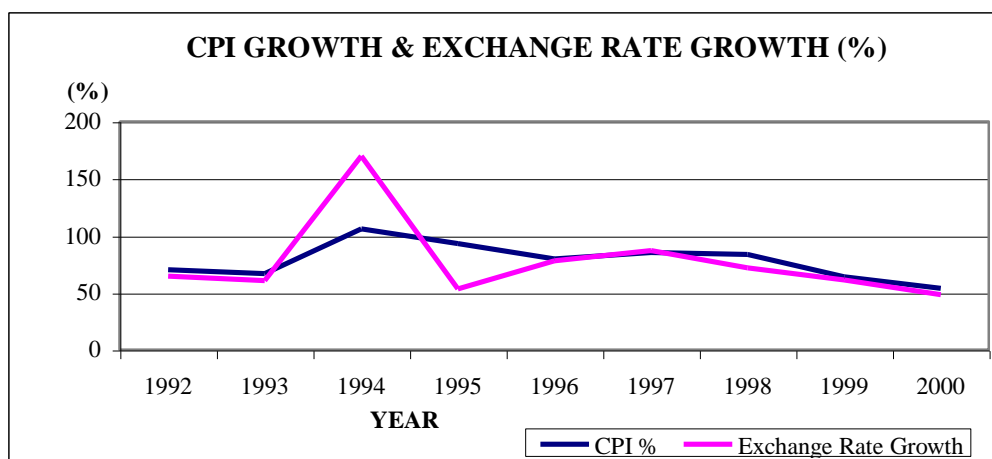
In addition, Turkish government needed to finance its deficit through domestic and foreign borrowings. Finance of the deficit has led to increase in money supply in the economy. Due to the increase in money supply, the level of aggregate demand will increase (As it is shown in Graph 5/ CPI and Money Supply Growth), which will effect CPI and depreciate the TL in foreign exchange market where is shown in Figure 6 CPI and Exchange Rate Growth, this resulted as high nominal interest rates.

**Figure 5: CPI Growth and Money Supply Growth**



Because of not producing the technology, the industry is largely dependent on imports. The depreciation of the TL leads to increase in the prices of imported goods. Because of not obtaining the intermediate goods used in the production, export decreases and current account balance deteriorates.

**Figure 6: CPI Growth and Money Supply Growth (%)**



On the other hand, the export-oriented policy adopted the producers to start importing their raw materials from relatively cheaper countries. Total imports increased enormously as compared to increase in exports. It became very disruptive in the pre- crises periods as it was in



1993 and 2000. Due to the establishment of the Customs Union with the European Union (EU) in 1996, the tariffs on industrial products were abolished between Turkey and EU which caused trade deficit even worse.

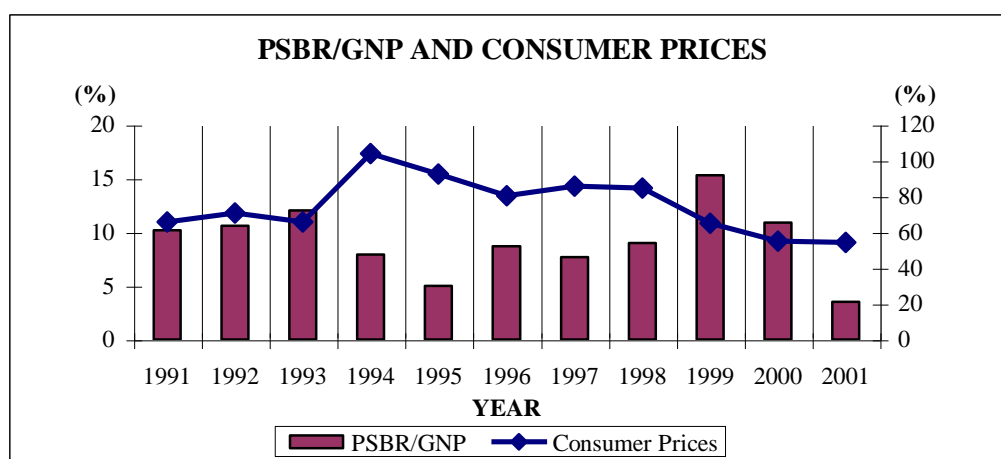
These are the chronic economic problems in Turkey. They are consolidated with the unsuccessful policies. At the beginning of transformation period, the trade regime and capital markets have been liberalised, but the government sector and their expenditures in the economy remained large.

### **1.3.1. Government Deficit**

The deficit in Turkey's consolidated government budget has been one of the most serious threats for the stability of its economy throughout the 1990s. The budget deficit deteriorated to especially dangerous levels in the late 1990s, approximately from 3% of GNP in 1990 to 11,6% of GNP in 1999.

Turkey has suffered from high and persistent inflation for more than two decades. Sustained fiscal deficits and their financing methods explain this chronic inflation. Even though these circumstances did not result in a hyper- inflationary environment, the inflation rate couldn't be decreased by the government policies. Turkey has high level of public sector borrowing requirement, this liability due to the reason of high government deficit. Public sector financing requirements created severe distortions in the financial system. One of the significant levels of government expenditures is inefficient tax revenue. As it is shown in Figure 7, deficit of the state owned enterprises contributed the huge ratio of government deficit.

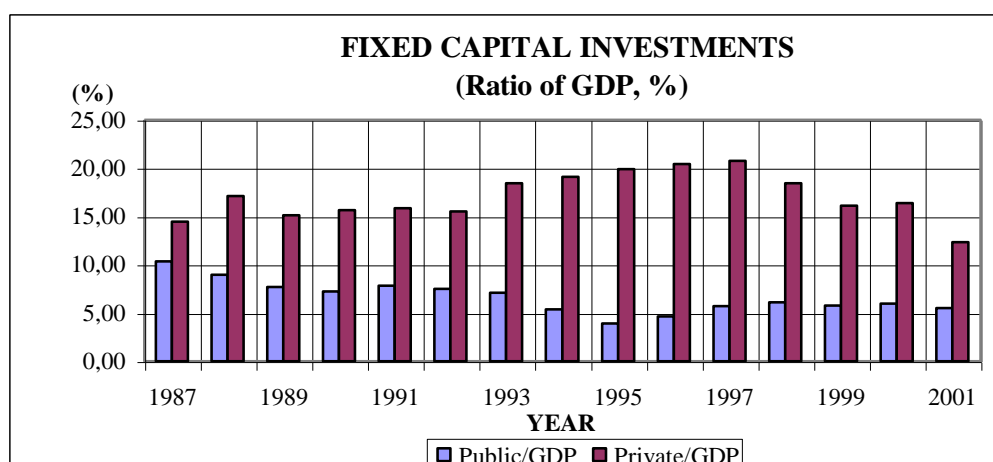
**Figure 7: PSBR/GNP and Consumer Price Index**



The reason for this condition is the relatively low returns of public sectors' compared to private sectors. Fixed capital investment chart is shown in Figure 8 between 1989 and 1997 public sector borrowing never fell below 5% of GDP<sup>15</sup>. Thus the Turkish government has financed its deficit through the domestic and foreign borrowing. The financial system channeled the significant part of the funds available for the Turkish economy to the Treasury. Tax treatment of treasury securities with high rates offered made them difficult to complete with showing the yields and rates of return on a set of instruments available for Turkish citizens.

<sup>15</sup> Includes the consolidated government local authorities, extra budgetary funds, social security funds and state enterprises.

**Figure 8: Fixed Capital Investments (Ratio of GDP, %)**



Investors mostly preferred public sector securities rather than private sector in Table 2. Between the years 1990 and 1993 they prefer to invest long - term maturity papers like government bonds. In the year 1994, they had to change their investment strategy to treasury bills. Government was also at the same mind. They preferred to offer treasury bills because in year 1994 interest rates jumped up thus government not to pay high yield securities for long period of time.

**Table 2: Outstanding Securities (US \$ Million)**

	1990	1991	1992	1993	1994
<b>Private Sector Securities</b>					
Shares	4.946	6.366	5.743	4.931	2.843
Corporate Bonds	475	322	195	115	37
Commercial Papers	71	108	88	83	5
Asset Backed Securities			1.056	2.530	519
Others	35	101	13	91	3
<b>TOTAL</b>	<b>5.527</b>	<b>6.897</b>	<b>7.095</b>	<b>7.750</b>	<b>3.407</b>
<b>PERCENT OF TOTAL</b>	<b>%39</b>	<b>%44</b>	<b>%31</b>	<b>%29</b>	<b>%18</b>
<b>Public Sector Securities</b>					
Government Bonds	6.423	4.863	10.097	13.122	6.060
T- Bills	1.868	3.598	4.938	4.460	7.919
Revenue Sharing Certificates	273	20			530
F/X Indexed Bills	102	328	729	1.099	1.053
Privatization Bond					

<b>TOTAL</b>	<b>8.666</b>	<b>8.809</b>	<b>15764</b>	<b>18.681</b>	<b>15.562</b>
<b>PERCENT OF TOTAL</b>	<b>%61</b>	<b>%56</b>	<b>%69</b>	<b>%71</b>	<b>%82</b>
<b>TOTAL OUTSTANDING</b>	<b>14.193</b>	<b>15.706</b>	<b>22.859</b>	<b>26.431</b>	<b>18.969</b>

Source: Capital Market Board”, <http://spk.gov.tr>, 2000.

Also Turkish government has a persistent struggle to be a member of the European Union. Therefore they have tried to decrease the inflation rate in order to satisfy the required criteria for being a candidate country for EU. For this reason, the governments have attempted several times to decrease the high level of inflation via the stabilisation program.

The important point is to note that the real appreciation of the currency provided both by the commercial banks and other institutions that could borrow abroad large incentives to do so. These are reflected in banks’ balance sheets. The Turkish banks’ liabilities to non residents have grown being negligible in the early 1980s to 13% of total liabilities by 1993.<sup>16</sup>

Even though Turkey has been influencing the current account balance via the changes, it has been facing with a significant level of trade deficit since it liberalised its foreign trade in the beginning of the 1980’s. And by 1994, fundamentals and the fiscal stance in the economy were deteriorating rapidly.

### **1.3.2. Monetary Expansion**

M1 % changes over the end of the previous year, a financial deepening measure used for developing countries came from 73.1% to 89.3%. M2 rose modestly from 71.9% to 84.1%. M2Y, where the money supply measure include foreign exchange deposits, rose from 49.4% to 125.4%, which is a sign for the currency substitution took place after the resident and non-residents were allowed to have foreign exchange deposits. The results clearly indicate the impact of rising and volatile inflation throughout the period on the demand for national currency.

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<sup>16</sup> O. Celasun, **op.cit**, p.10.

Main indicators surrounding monetary aggregate M1, M2 and, and M2Y as far as narrowing the definition of money is concerned, the Central Bank achieved an overall on contractionary policy. This is especially true for the following 1994 crisis. This is the exception mostly provided from the economists.

The real expansion in M1 reached to 19,3% in 1996. Given the overall trend towards real contraction, however the velocity of M1 with respect to the GNP followed a secular-increasing path.

Money stocks of M2 and M2Y, were expansionary instances in real terms. M2 was almost constant over the 10-year episode, which accommodates the expansion of real GNP. M2Y was on a continued downward trend indicating that the demand for M2Y has increased at a far faster rate than the rate of increase of real national product. Against the rising path of M1, this tendency disclosed the culminating pressures of currency substitution (dollarization) of the domestic markets with increased demand toward foreign denominated assets as it is shown in Table 3.

**Table 3: Monetary Aggregates**

Monetary Aggregates (% Change)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Money in circulation	67,0	73,1	89,3	86,0	68,5	94,2	81,2	58,3	68,6	55,5
M1	66,8	71,9	84,1	75,7	104	79,1	73,6	69,6	84,4	57,4
M2	61,4	49,6	125	101	118	97,8	100	102	58,6	57,6
M2Y	81,9	77,9	137	100	118	105	95,3	90,8	71,1	76,1

Source: “Central Bank of Turkey”, <http://tcmb.gov.tr>, 2001

After the crisis, key financial indicators showed a moderate expansion. Banknotes circulation increased by 22% from the year end 1995 to June 7 1996. On a year on year basis, bank notes in circulation increased by 60%, compared to an increase of 91% during 1995. Money supply (M1) expanded during the January 1996 – June 1996 period by 16%, with M2 up 33%. On year on year basis, M1 rose by 61%. For 1995, the same indicators were up by 90% and 113% respectively. The expansion experienced in 1995 stemmed mainly from the increase in reserves, and

was reflected in domestic demand. The increase of M2 during the first six months of the year was held below the rate of inflation, indicating that the authorities maintained a tight money policy.<sup>17</sup>

### **1.3.3. Overvaluation of TL**

The exchange rate is being used as a policy tool to improve the current account balance and also to offset the negative effects of the high inflation rate on the current account, however it also creates an increase in inflation rate in the economy. Because the Turkish industry is significantly dependent on imports This causes the increase in the prices of the final goods in the economy, thereby weaken the competitiveness of the Turkish products Thus, exports decrease and current account balance deteriorates.

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<sup>17</sup> R. Yolaalan, C.V. Rijekeghem and M. Ucer, “Leading Indicators of Currency Crises: The Case of Turkey”, **Discussion Paper Series of Yapı Kredi**, 1998, p.11.

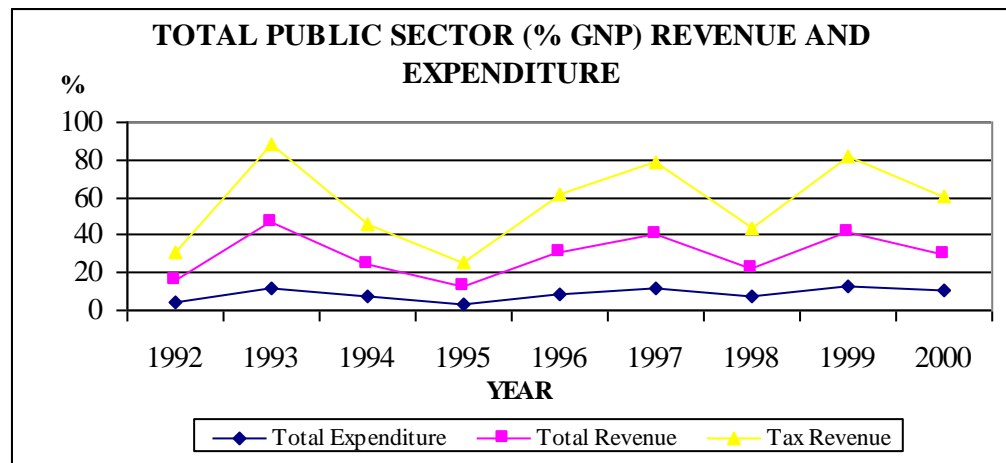
## PART 2

### THE CRISE OF 1994

In the analysis period (1990-2000), the Turkish economy has experienced two major economic crisis in 1994 and 2000, called as “balance of payment crises”.

Starting from 1988, the process capital account liberalisation completed. This reversed the major exchange rate trends which prevailed till then, the cumulative appreciation of the real exchange rate amounted to no less than 20% during 1989 –90. Tariff reductions combined with currency appreciation led to an import boom.<sup>18</sup>

Figure 9: Total Public Sector (% GNP) Revenue and Expenditure



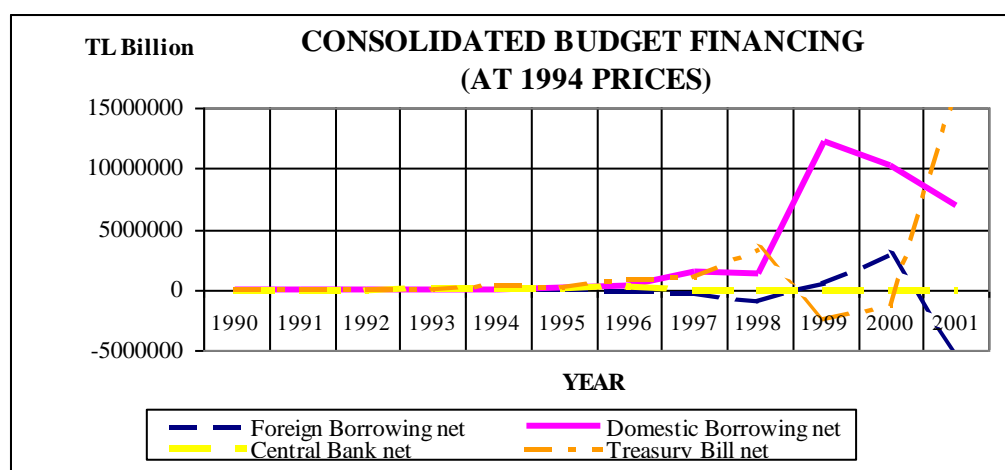
As it is shown in Figure 9 Total Public Sector Revenue and Expenditure, the gaps between public sector revenue expenditures is widening between 1989 and 1993. In 1987, public sector deficits resumed its secular climb until 1993 when PSBR reached an all time high of 12% of GDP. The PSBR is increasing along with the primary deficit<sup>19</sup>.

<sup>18</sup> Celasun, *op.cit*, p.11.

<sup>19</sup> Significant reason public expenditures of late 1993 and early 1994 was local elections to be held on March 27, 1994. Prices of goods were not increased on time and changes in those were lagging well behind the inflation rate.

In 1989, the financing of public sector deficits were shifted to domestic borrowing, and the share of external borrowing was to be reduced. External borrowing was delegated to private financial institutions, mainly to commercial banks, which were the main source of demand for domestic debt instruments. In 1991 Gulf war took place and led to uncertainties and minor panics in the financial markets. This resulted in increases in interest rates, shortening of debt maturity and also put constraints on foreign financing. As it is shown in Consolidated Budget Finance Figure 10, short-term borrowing was the main source of financing, and the finance scheme was relied mainly on domestic borrowing as a consequence of longer maturities. Net foreign borrowing repayments persisted with the even higher amounts. Nearly half of the internal debt is shorter than one year. Thus, debts in Turkey are paid off by debts.<sup>20</sup>

**Figure 10: Consolidated Budget Financing (at Prices 1994)**



Reasons for this growth in public expenditures were increased in the total wage bill of government, generous agricultural support policies, worsening performance of the state owned economic enterprises (SEE), the increase in military cost south eastern region of the country and increase in interest payments after 1992.<sup>21</sup>

Turkey's fundamental economic problem is permanent increase in budget deficits, which led high annual inflation rate. In the period before

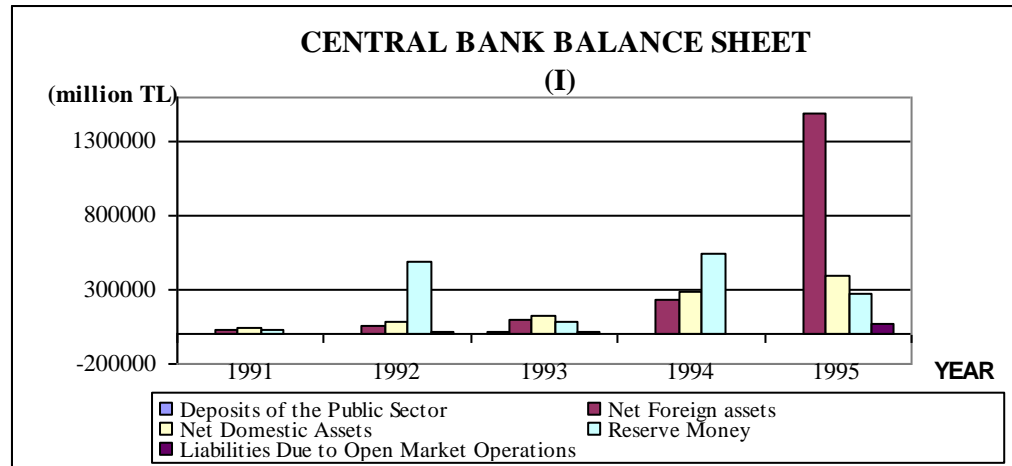
<sup>20</sup> **Ibid.** p.14.

<sup>21</sup> **Ibid.** p.15.



the 1994 crises, although the tight monetary and fiscal policies are implemented, neither one of them were successfully executed<sup>22</sup>.

**Figure 11: Central Bank Balance Sheet (1)**



The new government announced a program aiming at lowering inflation, through reducing the public deficit. In 1992 facing high levels of domestic debt services payments, the government increased the share of money financing in Figure 11. It use almost all of its short - term advances from the Central Bank up to its legal limit. Treasury restated the goal of lowering the interest payments and lengthening the maturity of domestic borrowing in the Figure 4 Consolidated Budget Expenditure. Lengthening the maturities of domestic borrowing over one year curtailed the interest expenditure. Examining the expenditure side items in the detail, they indicate the continuing upward movements in personnel and other transfer expenditures. Interest expenditures, on the other hand, tended to increase in trend since 1994 to 1997 respectively. The investment expenditure kept its small fraction in total expenditures while registering a slight rise in 1997.

Then it has followed the quasi-fixed exchange rate, which purposed to reduce inflation rate by decreasing, increasing disruptive effect of domestic prices. During the second half of 1993, the Treasury continued

<sup>22</sup> L. Rittenberg, *The Political Economy of Turkey in the Post Soviet Era*, Greenwood, 1998, p.34.

to finance the growing deficit. The average maturity of domestic debt stock was on a steadily declining<sup>23</sup>.

In the last quarter of 1993, the Treasury started to cancel all auctions. In December 1993, no bills with maturities shorter than a year were auctioned. They gave on interest rates and to increase maturity in Table 4.

**Table. 4: Auctions of Treasury Bills and Bonds in 1993 (Billion TL)**

TERM	1993.09	1993.10	1993.11	1993.12
<b>Maturity: 12 Months</b>				
Amount Offered	18730	28866	14942	9743
% Accepted	33,6	90,6	44,1	81,7
Max Interest Rate	87,5	87,5	88,5	90,0
<b>Maturity: 9 Months</b>				
Amount Offered	20263	10699	1433	828
% Accepted	18,7	32,7	48,9	0,0
Max Interest Rate	82,6	79,5	81,6	93,0
<b>Maturity: 6 Months</b>				
Amount Offered	16566	10007	2917	1577
% Accepted	11,7	19,5	0,0	0,0
Max Interest Rate	72,5	70,0	75,8	82,5
<b>Maturity: 3 Months</b>				
Amount Offered	4521	6174	2287	1453
% Accepted	21,5	16,2	0,0	0,0
Max Interest Rate	65,1	63,4	73,3	72,7

Source: O. Celasun, The 1994 Currency Crisis in Turkey, World Bank, 1996, p. 25

The “% accepted” entry refers to the percentage of these offers that were accepted by the Treasury. The amount of borrowing from 3 and 6

<sup>23</sup> Against that background the rates on 3 month bills were suppressed down 4 - 5% points, while 6 – 12 monthly borrowing increased with increased rates of 2 – 3%.

month paper was zero, and for the 9 and 12 month bills, both the offered amounts and rates accepted were low.

The Treasury cancelled the auctions in November 1993 would return to the domestic borrowing market in January 1994. During that period, while increasing real money supply, this created upward pressure and increased the aggregate demand. Increasing aggregate demand affected the consumer price index and this caused the depreciation of Turkish Lira. On the other hand, policy makers applied new fiscal policy as downward pressure on the exchange rate and appreciate TL against foreign currency. Meantime fixed maximum interest rate was at 94 % in annual terms.

**Table. 5: Monetary Aggregates (TL Billion End of the Period)**

<b>Monetary Aggregates</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>
<b>M1</b>	67.677	116.366	162.786
<b>Currency in Circulation</b>	31.373	53.933	85.280
<b>Sight Deposits</b>	36.230	62.307	77.505
<b>M2</b>	179.161	268.063	450.319
<b>Time Deposits</b>	111.484	151.697	287.533
<b>M2Y</b>	284.830	506.637	890.282
<b>Foreign Exchange Deposits</b>	105.669	238.574	439.964

Source: **OECD Economic Survey on Turkey**, 1995, p23.

The announced budget for 1994 contained no measure for the price increases on SEE goods but change in price would take place after the local municipal elections of April 1994, thus among people inflationary expectations were high and residents were starting to abound TL denominated assets. Currency substitution, M2Y to M2 increase as it is shown in Table 5 , the share of domestic currency deposits in M2Y fell from 53% to 42 % between December 1993 and to April 1994.

This development actually requires depreciation of TL in the market but the government did not let the exchange rate to depreciate as much as it should be. As a result the exchange rate depreciated less than the inflation rate, which made the TL overvalued against the foreign currency. Thus we

see that Turkey managed to improve its fiscal balances but these were never credible.

The liquidity pumped into the system at a time when the demand for TL was low led to several runs against the TL. The Central Bank, prior to the official devaluations, was heavily intervening in the overnight market to defend the parity by selling foreign currency at rates below the market rate. As a result Central Bank lost half of its reserve while the commercial banks closed their short positions and overnight rates did jump to compound annual interest rates exceeding 1000%.

The percentage depreciation of the TL was about 16, 6, 18 and 35 during the dropped to 39900 TL/US \$ on April 7, but received to 33,400 TL/US\$ at the end of the month.<sup>24</sup>

1994 corresponds to the period of large withdrawals and then the return to TL denominated assets in May 1994. Treasury borrowed at compounded annual rates around 400 %. Rates on 3, 6, 9 months bills is as shown in the Table 6/ Maturity Composition of the Domestic Borrowing, billion TL.

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<sup>24</sup> O. Celasun, **op.cit**, p.17.

**Table 6: Maturity Composition of the Domestic Borrowing (TL Billion)**

<b>Maturity</b>	<b>1993</b>	<b>1994</b>
<b>Bonds Total</b>	64.820	21.107
1-month	-	38.222
3-months	46.433	329.809
6-months	54.197	80.247
9-months	25.099	21.304
Public Offering (3-months)	10.377	1.240.007
Public Offering (6-months)	32.568	10.370
Public Offering (9-months)	-	234
Irregular Maturity	2.476	6.580
Consignment	-	12.577
<b>T-Bills Total</b>	171.151	623.349
<b>General Total</b>	235.971	644.457

Source: "Turkish Treasury", <http://www.treasury.gov.tr/publications>,

1995.

In May 1994 the Turkish authorities signed a stand by agreement by the IMF. The financial crises ended only after the Treasury was able to re borrow from the domestic debt market with very high interest rates. Because of the high devaluation, the firms couldn't afford their foreign currency denominated loans; there were lots of bankruptcies and then the output decreased severely. Three small commercial banks were placed into receivership in April 1994. The currency depreciated by almost 50 percent, and three small banks were closed who had extremely large foreign exchange positions. A financial system wide instability was contained, when the coverage of deposit insurance was increased to 100 percent.<sup>25</sup>

Due to the devaluation, the trade balance improved and currency account balance turned to surplus in 1994. Moreover Turkey was accepted into the Customs Union at the start of 1996, and the trade balance started to deteriorate again<sup>26</sup>. Foreign Exchange position of commercial banks was

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<sup>25</sup> R. Yolalan, *op.cit.*, p.5.

<sup>26</sup> O. Celasun, *op.cit.*, p.12. Many commercial banks held short positions in foreign exchange, and lent domestically at high rates, including to the Treasury

US\$ 4,9 billion in December 1993 and declined to US\$ 1,1 billion in June.  
27

Moody's and Standard & Poor's downgraded Turkey's long term credit rating twice in 1994, first in January and then in June. (Moody's downgraded Turkey Ba3 from Baa3 and Standard and Poor's B+ from BBB) The first downgrading, which was attributed to the deterioration of public finances and expectation of continued budget deficits, was one of immediate triggers of the currency crisis. It is added to the pressure on the exchange rate arising from the substantial growth in the balance of payments, current trade deficits, and contributed to the steep devaluations as it is shown in Table 7.

In 2000 May, S& P revised its outlook for Turkey from positive to stable. In February 23, 2001 announcement in terms of sovereign ratings had downgraded by Moody's while S&P and IBCA have placed Turkey's credit standing on Negative Watch. Recent rating changes have featured four sovereign ratings shifts by S&P. The agency has moved to downgrade Turkey.

S&P has downgraded Turkey from a single 'B' rating to a single-'B'-minus' rating. Notwithstanding the announcement of a new International Monetary Fund (IMF)-supported fiscal program, S&P has expressed concern with Turkey's ability to secure budget financing, and to stabilize the public debt stock, inflation, and the exchange rate. Note that on the April 2nd Fitch IBCA had already lowered Turkey's rating. Taken together, these changes have caused Turkey to lose five positions in their Ratings Ladder. Today at the world average goes up to 64.84 from 64.80 but Turkey is at 37.19.

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<sup>27</sup> Özatay **op.cit.** p.27.

**Table.7: Sovereign Ratings of Turkey**

Türkiye'ye verilen notlar		
1991	S&P	BBB
May.93	S&P	BB
Oca.94	Moody's	BA1
Oca.94	JCR	BBB
Mar.94	S&P	BB
Nis.94	S&P	B+
Haz.94	Moody's	BA3
Ağu.94	IBCA	B
Ağu.94	S&P	B+
Ağu.94	JCR	BB+
Tem.95	D&P	BB
Tem.95	S&P	B+
Eyl.95	IBCA	BB
Eki.95	S&P	B+
Kas.96	JCR	BB+
Ara.96	S&P	B
Ara.96	IBCA	B+
Mar.97	D&P	BB
Mar.97	Moody's	B1
Ağu.98	S&P	B
Ağu.98	D&P	BB+
Oca.99	S&P	B
Ağu.99	IBCA	B+
Şub.00	JCR	BB+
Nis.00	S&P	B+
Nis.00	IBCA	BB-

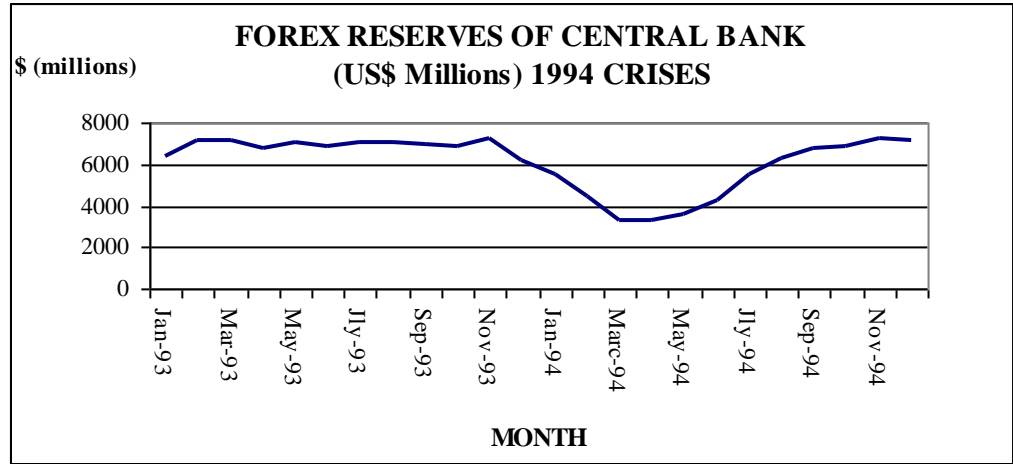
NTVMSNBC

Source: NTCMSNBC, <http://www.ntvmsnbc.com.tr/2001>.

Finally, the overvaluation of TL from 1989 to 1993 has become the most significant factor in the 1994 crisis. The trade deficit significantly increased which led to increase in expectations that the government could not keep the interest at prevailing level. Therefore the Central Bank did not want to loose its control over exchange rate and increased the interest rate in order to keep exchange rate at previous level. Depreciation expectations caused a rise in interest rate differentials. At the end of 1993, government changed its deficit financing policy and started to use Central Bank resources heavily in order to reduce the interest rate in domestic borrowing. This caused an increase in money supply, which led to decrease interest rates. By this action, the government directed the excess money in economy to go to stock market. But it has gone to foreign exchange market, which in turn resulted as depletion of the Central Bank's foreign exchange reserves. In order to benefit from significant depreciation, action triggered a sudden attack to get rid of TL to prevent excessive losses. Those actions followed by a large capital outflow from the country. International reserves

consisting of gold, foreign exchange reserves of the Central Bank and commercial banks recorded.

**Figure 12: For Ex Reserves of Central Bank (US \$ Millions) 1994 Crisis**



The Figure 12 is for exhibiting foreign exchange reserves of the Central Bank. Besides international reserves consisting of gold, foreign exchange reserves of the Central Bank and the commercial banks recorded.

## **2.1. SIGNIFICANT NEWS AND DATES IN THE YEAR OF 1994**

### **2. 1.1. January, 1994**

The burden created by inefficient public sector enterprises constitutes the fundamental cause that sets in motion series intermediate causes. Those are the significant dates in 1994.<sup>28</sup>

<sup>28</sup> Ş. Yüksel, "1994 Krizin in Kronolojisi" **Ekonomik Forum**, Nisan 2001, p.16-19.



**Table. 8: Free Market Exchange Prices, January 1994**

	<b>Buying Prices</b>	<b>Selling Prices</b>
<b>U.S. Dollar, \$</b>	14.900	14.950
<b>Deutsch Mark, DM</b>	8.840	8.575

Source: "Republic of Turkish Central Bank", <http://www.tcmb.gov.tr>

**January 18<sup>th</sup>, 1994:** Foreign exchange prices unexpectedly started to increase. Large masses sold all their belongings and invested to foreign exchange. Dollar was increased 16.420 TL to 17.050 TL. On the other hand DM was increased 9.320 TL to 9.750 TL. Then Stock exchange was declined 27563point to 25907 point in one day.

**January 19<sup>th</sup>, 1994:** Movement of the dollar was reached to 22,000 TL. On the late hours there was some news came from the outside that Central Bank brought foreign exchange from abroad. Closing of price of dollar was 18.650 TL and DM was 10.550 TL.

**January 20<sup>th</sup>, 1994:** Central Bank entered with TL to the market and put a barrier of increasing the foreign exchange. Central Bank made an explanation about being ready to borrow from banks for 100% interest for 4 days and for 110% interest payment for 1 week. This explanation started to increase interest. Moreover during February 2<sup>nd</sup>, 1994 deposit payment Central Bank explained to borrow 120% interest.

**January 26<sup>th</sup>, 1994:** Turkish Lira was devalued 13.6%. Government put several precautions in order to avoid increase in dollar. Central Bank determined dollar balance parity as 17,250 TL.

### **2.1.2. February, 1994**

**February 1<sup>st</sup>, 1994:** Bülent Gültekin, governor of the Central Bank criticize the government because of the devaluation decision and resigned from the Central Bank.

### **2.1.3. March, 1994**

**March 27<sup>th</sup>, 1994:** Due to the election left parties lost. On the other hand, conservative parties gained most of the votes. Wealth Party gained 27 cities' municipality presidency, which also included İstanbul and Ankara. Wealth Party's votes ratio raised 9.8% to 17.8%.

### **2.1.4. April, 1994**

**April 5<sup>th</sup>, 1994:** Existing government took several harsh economic decision in order to remove the bottleneck situation economy inside. Turkish Lira's value devalued at a rate of %38.8. Those "April 5<sup>th</sup> Decisions- Austerity Package" which was entered to the history of the Turkish economy, was ordered as follows:

#### **The AUSTERITY PACKAGE**

- Central Bank changed its system for determining the parity. Parities will be determined according to the information from the 10 Banks, which were elected by the Central Bank. From this point of view, US Dollar selling parity was determined as 32.053 TL. (One day before dollar selling rate was 23.078 TL. Devaluation rate was 38.8 %.)
- Civil servant's and workmen's salary payments were limited by budget allowances.
- Workmen's work overtime payments were cut down by %50.
- The new employment of the public civil servants were cancelled.
- There were certain obligations had to be done by employees in order to gain rights for the retirement. For insured women workers, they had to pay premium for 7200 working days; for insured men workers, they had to pay premium for 9000 working days.

In addition to the Austerity Package;

- ✓ Social Insurance Institution decided to change retirement pays coefficient.
- ✓ Saving Deposit's upper limit, which comprised by insurance, increased to 100 million Turkish Lira.
- ✓ Stock and Bond market was not allowed to operate A typed fund and wealth were depended on stocks.
- ✓ VAT Ratio was declined 15% to 23% for tourism and advertising sector.
- ✓ Government had already passed annual VAT application since May 1<sup>st</sup>.
- ✓ Corporation and Income Tax Payers had to pay extra tax according to their declared taxes.
- ✓ Till the end of 1994, Erdemir, TÜPRAŞ, Petrol Ofisi, Petkim, THY-Turban, Havas and Ditas would be partly or wholly privatized. Government targeted to save 38 trillion TL by the help of these precautions. In addition to the precautions, Government raised the prices for certain goods, those were between %45.9 to 90% for fuel oil. Super gasoline price increased from 9473 TL to 17.083 TL per litter in İstanbul, normal gasoline increased from 8.562 TL to 15,432 TL per litter. 12 kilogram tube gas increased from 85 thousand TL to 124 thousand TL.
- ✓ Liquor products were increased in price between 77% to 110%.

**April 6<sup>th</sup>, 1994:** After the explanation of the economic package everybody was predicting a recession in the market however decreasing interest rates forced the people to get their money from Repo transferred to dollar. Dollar increased from 7.000 TL and shoot 40.000 TL. Moreover Central Bank devalued the TL approximately 24.8% then dollar became 39.933 TL. Thus on two days for real devaluation of TL reached 73%.

**April 24<sup>th</sup>, 1994:** Council of ministers determined to take away the Impexbank. Impexbank was composed of 5 branches, and 3 departments, which are, finance, investment banking, and security exchange. Banking Commission cancelled the authority of banking operations and accepted deposits of Impexbank like TYT and Marmara Bank.

**April 29<sup>th</sup>, 1994:** Standard and Poor downgraded our long- term credit rating B+ from BB.

#### **2.1.5. May, 1994:**

**May 4<sup>th</sup>, 1994:** State Institute of Statistics (SIS) announced April's Consumer Price Index (CPI) raised as 24.7%. Thus yearly inflation firstly reached to 3 digit numbers after 14 years. CPI increased 10.74%, Wholesale Price Index (WPI) increased 32.8% at April. Those were the numbers all-time high.

**May 16<sup>th</sup>, 1994:** Meeting with IMF had already concluded after 2 weeks at Ankara. President Thomas Reichman turned two years standby agreement into one year. President Reichman said that applied economic program was bold and assertive.

#### **2.1.6. June, 1994:**

**June 1<sup>st</sup>, 1994:** Tofas Auto factory changed its work schedule 3 shifts to 2 shifts and dismissed 2404 workmen and civil servants at 14<sup>th</sup> July.

**June 8<sup>th</sup>, 1994:** Oyak Renault Factory decided to stop production because of increased number of stocks.

#### **2.1.7. July, 1994:**

**July 8<sup>th</sup>, 1994:** International Monetary Fund (IMF) and Turkey got into engagement to make stand by agreement. This agreement caused Turkey to borrow \$713 million from IMF.

### **2.1.8. August, 1994:**

**August 5<sup>th</sup>, 1994:** Minimum Wage Fixing Commission set minimum wage for employees according to the wants of present government and employers but Turkish Labor Union Representatives did not attend the meetings. Minimum wage was raised 67.12% for the workers more than 16 years old, and they would take 2 million 759 TL. For the workers less than 16 years old would take 2 million 330 TL.

### **2.1.9. October, 1994:**

**October 18<sup>th</sup>, 1994:** First time in Turkish economy quadrillion is heard in Republic era at the budget meetings. Prediction of 1995 budget was 1.4 quadrillion TL.

### **2.1.10. December, 1994:**

**December 20<sup>th</sup>, 1994:** Civil servants held a mass meeting about wage progress at Istanbul.

**December 31, 1994:** WPI announced 149.6 %. Consumer price index was announced 125.5% at 1994. Those numbers were the highest inflation rates during the Republic era.

### **2.1.11 January, 1995:**

**January 2<sup>nd</sup>, 1995:**

**Table. 9 : Free Market Exchange Prices, January 1995**

	<b>Buying Prices</b>	<b>Selling Prices</b>
<b>U.S. Dollar, \$</b>	40.400	40.700
<b>Deutch Mark, DM</b>	25.900	26.150

Source: "Republic of Turkish Central Bank", <http://www.tcmb.gov.tr>

**January 4<sup>th</sup>, 1995:** SIS announced December 1994 monthly inflation rate for WPI as 8% and consumer price index as 6.3%.

## **2.2. TURKISH POLITICS IN 1990s**

After following an inconclusive general election in October 1991, Mr. Demirel formed a coalition government with the support of the Social Democratic Populist Party.

President Turgut Özal had died from a sudden heart attack in April, 1993. Mr. Demirel was elected as the president of Republic of Turkey in May and Mrs. Tansu Çiller was voted as the leader of the True Path Party (DYP) and became Turkey's first female prime minister.

In an attempt to boost the economy, the TL was devalued in January, 1994. Alienation was the major theme in the March 27 Turkish municipal elections. The campaign's true winner, the pro Islamic Welfare Party won the mayoral elections in two major cities Istanbul and Ankara. A growing malaise with the overall system was a primary reason for its success. The good news, last year's seven percent economic growth rate, is overshadowed by a spiralling fiscal deficit that presently equals 17 % of total GNP. Expanding imports were a major factor in Turkey's \$ billion deficit the largest in history. Since January, 1994, Standard & Poor's has downgraded Turkey's international credit rating twice, triggered 12 percent devaluation of TL.<sup>29</sup>

Businessmen chide Mrs. Çiller for the management style that caused two Central Bank governors to resign over policy differences. In addition to this scenario, an inflation rate hovering around 70 percent, and the commercial outlook is rife with problems. The economy was destroyed by a professor of economics that was the real irony.

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<sup>29</sup> O. Ulugay, **Krize Adım Adım**, Milliyet yayımları, İstanbul, 1994.

Prime Minister Ciller too declared victory, but then announced a 3-month austerity package and further devalued the TL by 28 percent. State controlled consumer price promptly doubled, furthering fears of hyperinflation. Mr. Yılmaz criticised these measures calling them a “bad copy” of earlier stabilisation programs where workers become the big losers.<sup>30</sup>

Following a rise in annual inflation is more than 10 % the government announced measures designed to stabilise the nation’s economy but by the end of 1994 the annual inflation rate had risen to 149%. During 1994, Turkey borrowed \$742 million from the IMF.

### **2.3. AFTER THE CRISE PERIOD THROUGH 1995-1999**

The economy has strongly bounced back and the output has grown significantly since 1995 except the earthquake year 1999. Although the previous year because of the burden of domestic debt and the eventual shift towards Central Bank financing of the Treasury lead to the crisis of 1994. In the financial markets, the yields offered on the Government Debt Instruments (GDI) dominated with real rates of return reaching almost 35% after the 1994 crisis. The rates of return on 1 year time deposits versus that of the GDI is contrasted. The annual compounded rate of yield on the GDI is observed to be at par initially until 1991. After the gap between the 2 instruments widens continuously, reaching a plateau of 30% especially in the aftermath of the 1994 crisis.

In 1995, the economic revival was reflected across the economy, figures released by the state institute of statistics show that the Turkish economy is maintaining its momentum. GNP, which expanded by 8,1% in 1995 following a contraction of 6,1% in 1994, grew at a rate of 9,9% during the period. So that the Turkish economy achieved high growth rates in three successive years after the deepest crisis in 1994. Growth rates in 1995 and

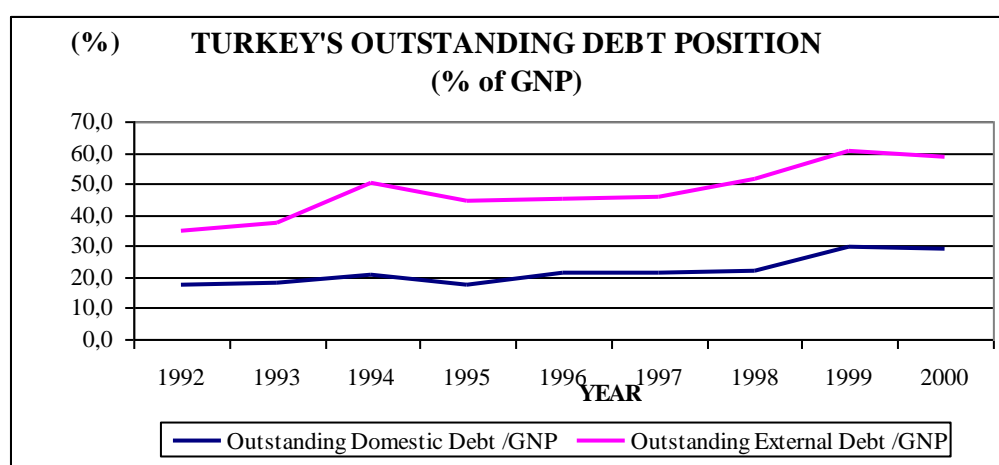
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<sup>30</sup> Özatay, op.cit., p. 21-23.

1996 reached 8% and 7,1% respectively (As it is mentioned in the Graph 2/ GNP, Annual % Change). Nevertheless, per capita income could not be pulled up to the level of 1993, mainly because of real depreciation of the TL in 1994.

Both the budget deficit and PSBR decreased in 1994 and 1995, have risen considerably since 1996. To finance budget deficit, the government was again forced to offer very high interest rates on short-term domestic bonds. As a result, Turkey's domestic debt stock has increased significantly and interest payments have become a large burden on budget in Figure 13 is exhibited.

**Figure 13: Turkey's Outstanding Debt Position (% of GNP)**

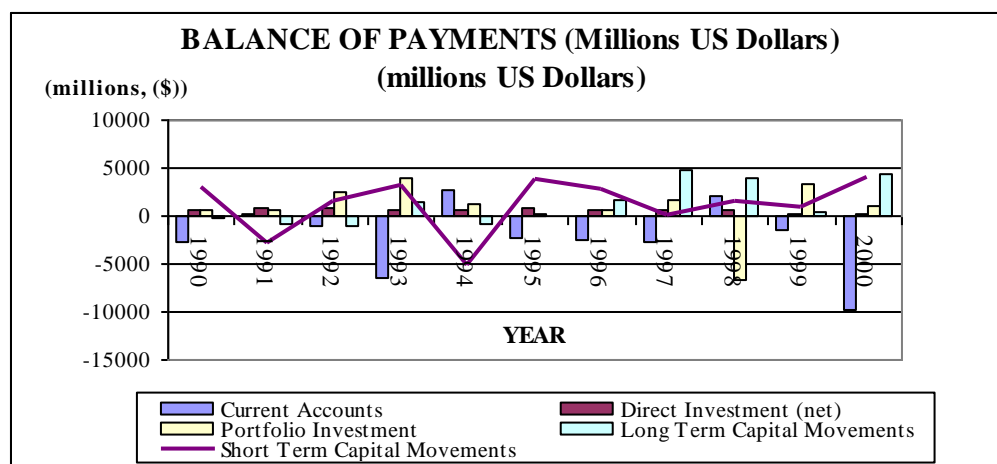


It is obvious that the decrease of the inflation rate has been the first target to stabilise the economy. Therefore the Turkish government aimed to decrease the high inflation rate to abolish its disruptive effects on the Turkish economy. According to the SIS the rate of inflation had continued at a high level during the first quarter in 1995 but began to fall from April on to below 1994 levels because of seasonal factors in the middle of the year and the postponement of public sector price increases towards the end of the year due to general elections. The size of public deficits kept the



inflation high. WPI rose by 64,9% and CPI increased by 78,9% as it is mentioned in the Table 9/ WPI, % Change and CPI, % Change, in 1994.<sup>31</sup>

**Figure 14: Balance of Payments**



In 1995, Turkey's current account registered a deficit of \$2,3 billion in contrast to a surplus of \$2,6 billion the previous year. The deterioration in the current account was primarily caused by significant increases in the foreign trade deficit, but was kept at reasonable levels by the increase in other foreign currency revenues, capital movements and tourism as it is shown in Figure 14.

Official estimates put the 1996 current account deficit at \$3,8 billion. Invisibles such as tourism, expected between \$6-7 billion, worker's remittances of \$3 billion and undeclared exports of about \$6 billion should keep this figure manageable. If the embargo with Iraq is lifted, Turkey will receive rental payments amounting to \$750 million for its two pipelines.<sup>32</sup>

<sup>31</sup> Z. Oniş, Globalization and Financial Blow-up in the Semi-periphery, **Perspectives on Turkey's Financial Crisis of 1994**, 1996, p. 1-24.

<sup>32</sup> N. Yentürk, "Türkiye Ekonomisinin Son 20 Yılı", **Foreign Policy**, p. 28-39.

**Table 10: WPI, % Change and CPI, % Change, in 1994**

<b>WPI (% Change)</b>	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>	<b>AVR.</b>
Monthly	5,3	10,1	8,5	32,8	9,0	1,9	0,9	2,7	5,4	6,9	6,4	8,3	8,2
12 Months	60,6	68,0	74,0	125	138	137	128	126	129	136	137	149	117
<b>CPI (% Change)</b>	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>	<b>AVR.</b>
Monthly	4,4	6,0	5,2	24,7	10,0	0,9	1,7	2,0	7,2	9,5	8,1	6,3	7,2
12 Months	69,6	73,0	73,6	107	117	115	109	108	111	116	119	125	103,9

Source: "State Planning organizations", <http://www.dpt.gov.tr/>, 2001.

Year 1997 was the increase in the long-term capital inflows coupled with reduction in short-term capital inflows. Short-term capital inflow was declined by reductions in the commercial banks reserves and deposits. FDI decreased because of unstable political and macroeconomic environment, high inflation rate, public deficits and the failure of acceptance to EU<sup>33</sup>. Tax on government bonds was raised to 10% in 1994. There are tax advantages for banks as well. Taxes due to interest income from government bonds are payable during the next tax year, allowing banks to postpone tax payments for a year. In a high inflationary environment the effective tax rate is much lower.

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<sup>33</sup>Özatay, **op.cit.**, p. 26-28. .

## **PART 3**

### **THE CRISIS OF 2000**

Rooted in years of economic mismanagement, and chronic corruption, financial upheaval was triggered on February 19<sup>th</sup> 2001 by row between Prime Minister and President.

#### **3.1. SIGNIFICANT NEWS AND DATES IN THE YEARS BETWEEN 1999 AND 2000**

**3.1.1. May 1999:** Three parties' coalition government formed in May 1999. Left wing party (DSP) and the Right wing parties (MHP & ANAP) were work together with harmony.

**3.1.2. August 1999:** The great Marmara earthquake was occurred.

**3.1.3. December 1999:** The stabilisation program launched with the IMF attached particular importance to budget deficit of Turkey. Outlined a series of revenue generating and cost cutting measures. The program was planning to reduce consumer price inflation by 32,3 percentage points, from 69,7 % to 33,4%, while decreasing the wholesale price inflation by 41 points from 67.5% to 26.5%. Turkey signed agreement with the IMF. Confirmation of the EU's official announcement on Turkey at the Helsinki summit.

**3.1.4. January 2000:** Interest rates in domestic borrowing having already taken a giant dive from 93,3% to 37%.

**3.1.5. May 2000:** Ahmet Necdet Sezer, head of the Constitutional Court, was officially sworn in as 10<sup>th</sup> president of Republic of Turkey.

**3.1.6. July 2000:** The first sign that not all was well between the government, and president. Sezer refused to sign the document of removing

obstacles to sacking civil servants suspected of Islamist, or separatist sympathies.

**3.1.7. September 2000:** Sezer thwarted government plus again, when he refused to sign the decree on the privatisation of the three public banks, Ziraat, Halk, and Emlak Bank.

**3.1.8. October 2000:** The opposition Virtue Party asked for cancellation of 17 decrees, many of, which had been introduced as part of economic program agreed with IMF.

**3.1.9. November 2000:** Public confidence had been shaken by financial turmoil, after an investigation into ailing banks seized by the state revealed evidence of fraud and arrested of several prominent figures such as nephew of the former president, Murat Demirel. Financial markets fell victim to a liquidity squeeze as nervous international funds pulled out of Turkey. Banks stepped up the competition to tap a diminishing money supply to meet their daily obligations. Overnight rates up to nearly 2000%. IMF pledged an extra injection of \$7.5 billion.

**3.1.10. February 2001:** In February 19, 2001, financial upheaval was triggered by a row between Prime Minister Bülent Ecevit and President Ahmet Necdet Sezer. Again the immediate problem was a liquidity crunch. Foreign institutional investors withdrew their liquid funds, while panic stricken banks rushed to reverse open positions in exchange rates in fear of official devaluation. Overnight interest rates reached 7500%.

In February 22, 2001, Turkish Lira was far beyond expectations. The US Dollar appreciated by 39.8% against the Lira on the first day of the float and by a cumulative 56.6% at the end of the second day.

This time neither the IMF nor other international organisations are willing to sponsor the Turkish banking sector's financial deterioration.

**3.1.11. March 2001:** Dr. Kemal Derviş was sworn in on March 13<sup>th</sup> 2001 as Minister of the State in charge of the Economy.

**3.1.12. April 2001:** The new economic program was announced on April 14<sup>th</sup>. During the semi annual meeting between the IMF, and the World Bank in Washington on April 27<sup>th</sup>, Kemal Derviş announced he had secured a \$10 billion funding pledge from the IMF including \$1.5 billion from the World Bank to assist Turkey's implementation of the new economic program.

Markets reacted immediately. The ISE –100 Index rose 13.5% on the good news from multiple sources. It had already risen 7.7% the previous day in anticipation of favourable results from the Derviş road show.

**3.1.13. May 2001:** The IMF's approval of aid on May 15<sup>th</sup> and the governments' disclosure of the letter intent the same day had only a minor effect on the stock market.

## **3.2. OVERCONFIDENCE IN 2000 PROGRAM**

During the period 2000, the greatest concern of the banks was the threat inherent in the possibility of exchange rate movements exceeding rises in domestic price levels. The crawling peg introduced as the cornerstone of the official exchange rate regime in the economic program was launched in January, 2000 provided even greater assurance in this respect. As IMF records, some countries have chosen to peg their currency to a stable currency like the US Dollar, because they are seeking a nominal anchor that will promote price stability. However, it is dangerous a pegged exchange rate regime can be for an emerging country, like Turkey. If it has a fragile banking system, short duration of debt contracts, and substantial amount of debt denominated in foreign currencies.<sup>34</sup>

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<sup>34</sup> S. Rehman, **Financial Crisis Management in Regional Blocs**, Massachusetts, Klawer Academic Publisher, 1998, p. 67-83.

Banks fell victim to their confidence in the program, and maintained just as vulnerable positions, terms of exposure to risk in liquidity, maturity and exchange rates.

Their 37% nominal interest rate attached to the first Treasury auction of 2000 was down from 93.3% in the last auction of 1999 was substantially lower than the 62.9% wholesale inflation rate.<sup>35</sup>

Yet the danger this time was in the possibility, that inflation might not fall to levels envisaged in the program. As usual bank's receivables were in TL with relatively longer maturities, their payables were in foreign currency with due dates striking with greater frequency. Denominating debts in foreign currencies is a very tempting for firms, banks, and governments. Because of stability, in the value of domestic currency makes it harder to attract capital if the debt is denominated in the domestic currency.

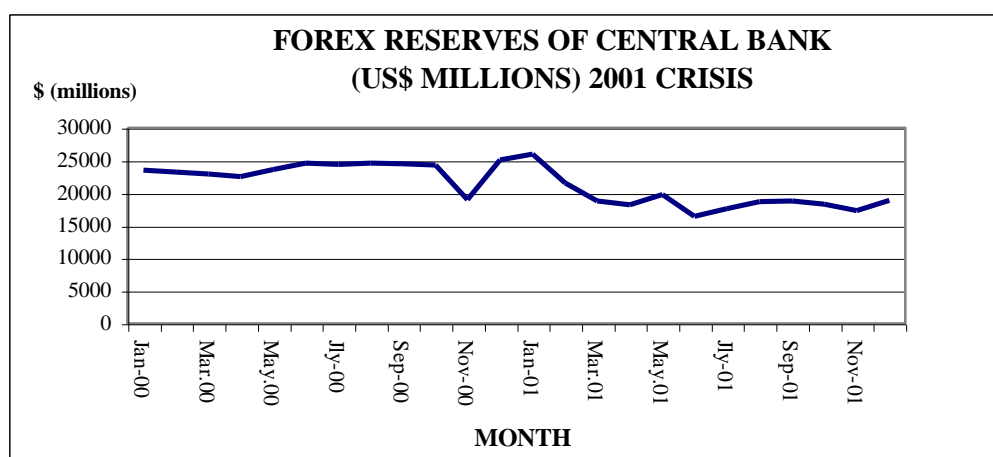
By November, inflation of 39.1% stood at nearly twice at the end year target. On the other hand nominal interest rates in the two auctions in November were 40.1% and 38.3%. As it became clear that nothing was left to do anxieties grew among international investors, and overnight rates rose to 100% in order to meet banks daily obligations.<sup>36</sup>

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<sup>35</sup> Yentürk, **op. cit.**, p. 34.

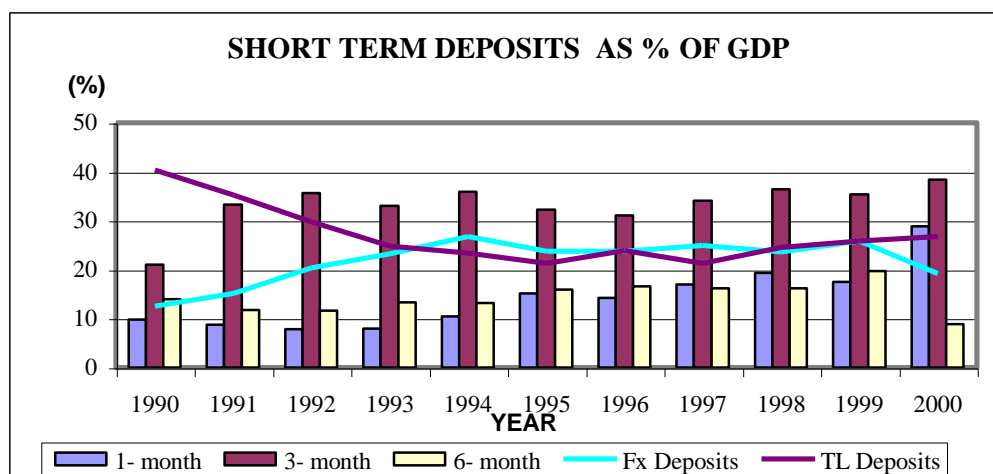
<sup>36</sup> E. Gerçek, "Kamu Bankaları ve Krizler", **Küresel Politika, Ekonomi ve Fikirler**, Türkiye Baskısı, Ocak-Şubat 2001, p. 16.

**Figure 15: Foreign Exchange Reserves of Central Bank, 2001**



As a result international investors took more than \$6 billion worth of foreign currency out of the financial system within the span of the week as it is shown in Figure 15/ For-Ex Reserves of Central Bank, 2001. The consequent liquidity squeeze exacerbated the efforts of banks to obtain inter-bank funds to satisfy daily payment requirements.

**Figure 16: Short Term Deposits As % of GDP**



This sudden spike is said to have led to a mismatch between liabilities, and assets, leading to crisis, Lira denominated real interest rates were fallen. Both 1993/94 and 2000/01 –have triggered a banking crisis. During both periods, real interest rates had fallen sharply, and turned negative period then as a result the banking sector had been making losses.

The habit of Turkey's banking system, dollar denominated liabilities and TL denominated assets, was incompatible with the needs of its real economy and stable public finance. When TL interest rates fell sharply in both 1993 and 2000, as it is shown in Figure 16, Short Term Deposits as % of GDP, the real economy grew rapidly and Turkey's public finances benefited so gain on real economy based on loss of banks. Therefore any stabilisation program designed to bring down real interest rates rapidly was likely to create pressures on the banking system.

**Table.11: Possible Devaluation Effect On Total Assets**

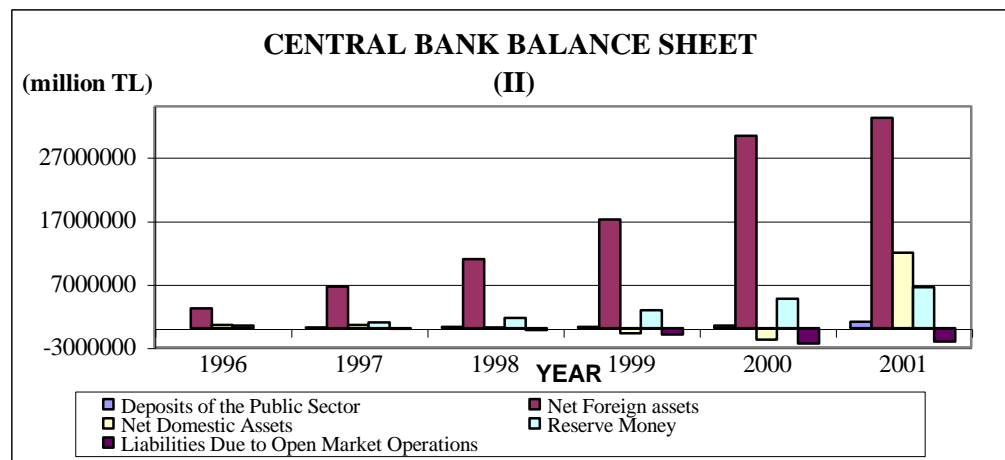
	Official Results			June 01	Devaluation Simulation	
	Dec 99	Dec 00	Change 99		Change 99	Change 00
<b>Banking Sector</b>	133.533	155.237	16,3	113.440	-15,0	-26,9
<i>Commercial Banks</i>	127.165	148.335	16,6	108.000	-15,1	-27,2
<b>State Banks</b>	46.625	53.151	14,0	35.141	-24,6	-33,9
<b>Private Banks</b>	66.060	73.588	11,4	56.685	-14,2	-23,0
<b>Under Receivership</b>	7.506	13.192	75,8	9.580	27,6	-27,4
<b>Foreign Banks</b>	6.973	8.403	20,5	6.594	-5,4	-21,5
<i>Investment Banks</i>	6.368	6.902	8,4	5.440	-14,6	-21,2
<i>Note: Central Bank buying rates for the dollar was 671.765 TL in Dec. 99 and 1.151.000 in June 01.</i>						
Source: "Bank Association of Turkey, <a href="http://www.tbb.org.tr/english/asp/2001">http://www.tbb.org.tr/english/asp/2001</a>						

Although the Central Bank faced several options in order to meet the banks liquidity demands, this meant violating the ceiling on its net domestic assets and also risking the depletion of its reserves. The intervention in December 2000 had helped build up the Central Bank's reserves and bring interest rates down from meaningless levels. Banks still have significant borrowing needs. Such a system was widely open for a second crisis, which was soon triggered by public sector banks attempting to fund their duty losses through the overnight borrowing market. Yet the choice was between giving up the Central Bank's reserves and announcing an official devaluation of the Turkish Lira. Then government introduced crawling peg exchange rate regime to a free float regime. The Lira was left to float on February 22<sup>nd</sup>,



2001. However lira seemed to have settled for a 40% loss against the US Dollar. If a flexible exchange rate regime was first introduced to the Turkish market, the movements in the exchange rate are much less non-linear than the pegged exchange rate regime. Indeed, as it is shown in the Figure 17, Central Bank Balance Sheet, the daily fluctuations in the exchange rate may provide an early warning signal to policy makers that their policies may have to be adjusted in order to limit the potential for a financial crisis.

**Figure 17: Central Bank Balance Sheet (II)**



### 3.3. TURKISH BANKING SECTOR

Banks play particularly important role in emerging markets' financial system. There is an important need for a government safety. Although the safe guard of deposits is important, it increases moral hazard incentives for excessive risk taking in the financial system. But the insurance system requires corrective action by banks' supervisors to stop undesirable bank activities. And close down institutions that do not generate sufficient net worth. It creates incentives for banks not to take on too much risk in the first place.

Although, firms in every sector of Turkey's economy were hard hit by the multiple crises; the banking sector was unique. Not only did it sustain the greatest damage, but it was also seen to be one of the causes.

Turkish enterprises are dominated by family owned corporations, and they have organic relationships with the banking sectors.

The determination of interest rates for short term affected the stock market. As a result, a severe liquidity crunch in November 2000, and a worse one in February 2001, latter combined with steep market devaluation. For these reasons reform of the banking sector at the forefront of the government's efforts toward economic reconstruction.

Banks earn higher yield on assets than liabilities, they absorb the risk assumed in making individual credit decisions, and the difference between yield on loan and cost of deposit is the risk premium. The crisis in the banking system is linked to both macroeconomic conditions especially disinflation policies leading the banks to lose risk premium, decrease in the intermediary role and for the problems inherent in banks operating such as undercapitalisation, bad management, short positions in foreign exchange, liquidity bottlenecks and other deficiencies. Banks misjudge the real return their own loan. So they are overestimating, risk premium and no way to hedge with dollar yield on dollar denominated loans. Banks problems' have two sides. One side is the government actions such as risk premium and the other side is bank's internal decision making mistakes such as long the dollar short the lira.

Many countries, well over 100, have experienced banking system problems since 1980's. These problems are often linked to macroeconomic conditions and policies. They are very much expensive to resolve, costly to taxpayers, need prompt and timely action, involve a heavy fiscal burden. To make sure the banking system is operating efficiently and the restructure the banks taken over under SDIF, careful and correct design and implementation of a bank structuring strategy is an important government policy concern.<sup>37</sup> ”. Banks are guilty of a serious mismatch between funds,

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<sup>37</sup> A. Kenneth, “Restructuring of Banking Sector in Emerging Countries”, **Turkey Investor**, November 2000-2001, p. 27.

and sources; the government was guilty of a substantial mismatch between targeted inflation, and actual inflation.

Banks operating in Turkey collectively registered a net loss of \$4 billion in 2000. The net loss reported on the sectoral income statement was attributable to a \$4,9 billion loss generated by the 11 banks under state receivership and a \$264 million loss by the state banks, while the 28 privately owned commercial banks managed to put together a modest net income of \$787 million.

**Table 12: IMF Expectations of Duty Losses of Turkish State Banks (Million US Dollar)**

	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
<b>Ziraat Bank</b>	4500	7550	9950	13600	18500
<b>Halkbank</b>	2900	4400	5650	7650	10300
<b>Total</b>	7400	11950	15600	21250	28800

Source: Cladudia Dizobek and Ceyda Pazarbaşıoğlu, “Lessons from Systematic Bank Restructuring: A Survey of 24 Countries”, **IMF Working Paper**, 1997, p.161

At the end of 2000, the Central Bank’s buying rate for the US dollar was TL 671,765. Following the February 2001 devaluations, this rate seemed to have settled around TL 1,150,000 in early May. In between the Turkish Lira had depreciated by more than 40% against the US dollar by creating a liquidity crunch in November 2000, and another one in February 2001. Many banks had maintained a mismatch between their assets, and liabilities in terms of liquidity, maturity and currency denomination. In addition they left themselves fully exposed to risks in interest rates as well as exchange rates.

Some of the economists answer to the question of “Did the banking sector produce the economic crisis in 2001, or did it suffer from a crisis created by less than perfect management of an economic stabilisation program?” Their answer is “Yes.

### **3.3.1. The Reasons for the Banking Problem in Turkey**

Banking Sector problems in Turkey have never been single cause. Recurrent banking problems seen to be both restructuring and macroeconomic policies are required implemented together. The reasons for the crises have so far been as follows in Turkey.

#### **3.3.1.1.1. External Bank Problems that Government Induced**

- State Banks (duty loss)
- Disinflation Policy
- Adverse effects of deposit insurance which creates adverse selection and moral hazard
- High Tax Burden on Banking Transactions (Banking Transaction Tax, Resource Utilisation Fund, Civil Defence Fund, Stamp Duty Tax, Income Tax etc.)
- Lending Premium Loss Recently due to Disinflation Policy
- Absence of hedging mechanisms inside the economy
- Political Intervention to Public Banks (Interest /Income seeking lobbying efforts by politicians)
- Protective Regulatory Measures

#### **3.3.1.1.2. External Bank Problems that Economic Forces Outside Turkey**

- Global crises
- Earthquake 1999
- Uncertainty due to Coalition Government
- Higher Cost of Branch Intensive Banking

#### **3.3.1.2. Internal Bank Problems**

- Deficient Bank Management
- Undercapitalization of Banks
- Non- Performing Loans

- Worst Banking Practices (connected loans, open repo crises in 1994)<sup>38</sup>

### **3.3.2. The Objectives of Restructuring Operations**

- To restore the financial viability of the banking system, these are solvency and sustainable profitability.
- To restore the system's intermediation capacity and appropriate level of banking services relative to aggregate economic activity.
- In short the aim of the policy is to restore the bank performance.

Restructuring always involves cost to taxpayers. In many cases, the fiscal cost of bank restructuring are very high relative to GDP. The total cost to citizens in Turkey has been calculated as 13-14 billion dollars, which represents 7% of GDP.<sup>39</sup>

### **3.3.3. The Rehabilitation of the Banking Sector**

The program's, for rehabilitating the banking sector, introduction is related to the state banks. State banks' liabilities to the system is for their incomparable need for overnight borrowing in order to fund their huge duty losses. (As it mentioned in Table12/ IMF Expectations of Duty Losses of Turkish State Banks)

This was especially problematic in the case of Ziraat Bank and Halk Bank, as they were offering highest interest rates for deposits, while granting the cheapest loans, and tapping the interbank market to cover cash deficit. Politics affected the privately run banks ability to make loans at profitable level.

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<sup>38</sup> "Restructuring Banks in Turkey", **Journal of International Business and Finance Investor Turkey** 2000-2001, No.15, p. 29.

<sup>39</sup> C. Dizobek and C. Pazarbaşıoğlu, "Lessons from the Systematic Bank Restructuring: A Survey of 24 countries", **IMF Working Paper**, 1997, p. 61.

The new economic program included several measures towards structural change. These were plans for a merger between Ziraat Bank, and Halk Bank and the transfer of central authority over all state banks to a joint board of directors. Operating efficiency maximised through downsizing the combined branch network, and work force by closing down unproductive branches, and reducing number of employees through retirement incentives.

Once there is an evolutionary process, economies develop bank based finance emerges first, then the emergence of equity markets comes as an additional institution for raising external funds in an economy.<sup>40</sup>

This view asserts that development processes require first a banking system, and a capital market in a sequential form.<sup>41</sup>

Bank based system is superior because it is easy to gather information about investors scale economies, but checking is done only once by the bank during the credit evaluation for firms. However, in the stock market case, there has been a strong control on firm management because checking is continuous through the capital markets. In addition, stock market prices tend to reflect the true value of the firm given current management policies.<sup>42</sup>

It is expected that all flow ratios are likely to improve in restructuring the banks in Turkey. The improvement after restructuring also depends on the disinflation policy. The disinflation policy, accessed for Turkey, can be seen in the following table 13.

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<sup>40</sup> F. Allen, **Stock Market and Resource Allocation**, Colombia, 1993, p. 217.

<sup>41</sup> A. Demirgüç and R. Levine, "Determinants of Banking Crisis", **IMF Staff Paper**, 1996, p. 291

<sup>42</sup> Allen, **op. cit.**, p. 217.

**Table 13: Variables in Disinflation Program in Turkey**

<b>Variables in Disinflation Program in Turkey</b>	
<b>Variables</b>	<b>Comment</b>
1. Current account	High Level of Deficit
2. Growth	6% after recession
3. Central Bank Reserves	18,8 billion dollar lost after the speculative attack to the reserve at the year end due to the banks closing short positions and hot money leaving for abroad.
4. Inflation Rate	Slowly Decreasing
5. Interest Rate	Slowly Decreasing, but fluctuating in time and recently out of control
6. Devaluation	26% annually within the band preset by central Bank
7. Budget Balance/Tax Policy	Having deficit thanks to cost of restructuring, duty loss of the public banks and failing tax collection
8. Monetary Policy	Lately failures due to Reserve money of 8 billion dollars escaped from the country and led to shortage in TL thanks to CBRT behaviour of the stickiness to IMF targets during the crises. IMF induced shortage of TL resulting from CBRT in action.
9. Foreign Debt	100 billion dollars
10. Foreign Investment Attraction	No Improvement
11. Stock Exchange	Went Down
12. Crises in Banking Sector	Recurrent and Systematic

Source: Neptün Ltd., Turkey – **Journal of International Business and Finance**, Nov. 2001, p.36

The final crisis in the banking sector is due to liquidity shortage in TL, rush by banks on fx to close their short positions at year end so that they can publish profit in the balance sheets, wrong perceptions of foreign investors about the economy and of course the problems inherent in the banks.

### 3.3.4. Banks in State Receivership

Banks under state receivership are given damage to the entire banking system as well. SDIF, the principal banking authority in charge of the Turkish banking sector is the Banking Regulation and Supervision Agency (BRSA). The agency assumed the authority and responsibility of the banking supervision departments at the treasury and the Central Bank, as well as transferring the entire staff of these departments. The transfer power also included the Saving Deposit Insurance Fund (SDIF), which is legal entity managed by the BRSA. The transfer of regulatory and supervisory powers to the BRSA was completed by the creation of an Asset Management Unit (AMU), serving under the agency to restore the value of assets taken over by the SDIF. SDIF is responsible for resolving problems with banks under state receivership either through liquidation or through re – capitalisation.

The government's efforts to sell the banks under receivership began on November 17<sup>th</sup> 2000, with the BRSA's announcement of an action plan to privatise eight banks owned by the SDIF prior to October, including Sümerbank, Bank Ekspres, Egebank, Yaşarbank, Yurtbank, Esbank, Interbank and Türkbank. There were two other banks, which were placed under BRSA control, Etibank and Bank Kapital.

**Table 14: Banks Under State Receivership**

<b>BANKS UNDER STATE RECEIVERSHIP</b>	
<b>Banks owned by the SDIF</b>	
<b>Bank</b>	<b>Date of Transfer</b>
<b>Bank Ekspres</b>	26 <sup>th</sup> of Oct., 1998
<b>Demirbank</b>	6 <sup>th</sup> Dec., 2000
<b>Esbank</b>	22 <sup>nd</sup> Dec., 1999
<b>Etibank</b>	27 <sup>th</sup> Oct., 2000
<b>Interbank</b>	7 <sup>th</sup> Jan., 1999
<b>İktisat Bankası</b>	15 <sup>th</sup> March, 2001
<b>Sümerbank</b>	22 <sup>nd</sup> Dec., 1999
<b>Türk Ticaret Bankası</b>	6 <sup>th</sup> Nov., 1997

Source: BRSA , <http://www.tbb.org.tr>, 2001



**Table 15. SDIF banks merged under Sümerbank**

<b>Bank</b>	<b>Date of Transfer</b>
<b>Sümerbank</b>	22 <sup>nd</sup> Dec., 1999
<b>Bank Kapital</b>	27 <sup>th</sup> Oct., 2000
<b>Egebank</b>	22 <sup>nd</sup> Dec., 1999
<b>Yaşarbank</b>	22 <sup>nd</sup> Dec., 1999
<b>Yurtbank</b>	22 <sup>nd</sup> Dec., 1999
<b>Ulusal Bank</b>	28 <sup>th</sup> Feb., 2001

Source: “BRS A”, <http://www.tbb.org.tr>, 2001

- Six had been merged into a single bank.
- Etibank had neither been up for sale among the original eight nor was merged with the group six, but was later put up for sale with the tender proceedings expected to be finalised on May 15<sup>th</sup> 2001.
- Demirbank was taken over after the sale process was launched for the group of eight, and was put up for sale separately with the deadline for submitting final bids set for June 18<sup>th</sup> 2001.
- İktisat Bank was the last one to join the SDIF portfolio and had not yet been put up for sale.
- No sales had been concluded as of mid- May 2001.

### **3.4. PACE OF STRUCTURAL REFORMS**

As previously mentioned, inefficient public sector enterprises constitute the fundamental cause of the crises. Nowadays last few months of the structural reforms have been much more rapid than any time. However, Turkey had a relatively early start in privatisation compared to other emerging markets. Yet privatisation presents a significant potential for both the expansion and diversification. Turkey’s privatisation program is always looking forward to the fulfilments of certain contingencies, but never actually getting around to produce the results that justify expectations.

IMF supported new economic program outlines the privatisation of small and medium sized companies and the divesture of majority stakes in key state owned enterprises in banking, telecommunications (Turk

Telekom), petroleum refineries (Tüpraş), transport (Turk Airlines), steel (Erdemir), tobacco and spirits (Tekel), sugar (Şeker), electricity generation (Teaş), and electricity distribution (Tedaş) (Privatisation Administration).

**Table 16: Privatization Administration Portfolio**

<b>Privatisation 1986 - 2000 (US \$)</b>			
	<b>1986 – 99</b>	<b>1986 - 00</b>	<b>2000</b>
<b>Block Sale</b>	4.619.965.565	7.332.472.239	2.712.506.675
<b>Asset Sale</b>	2.031.702.613	3.511.174.478	1.479.471.865
<b>Public Offering</b>	661.457.521	789.971.667	128.514.416
<b>ISE Sale</b>	526.587.764	526.587.764	0
<b>International Offering</b>	721.949.083	987.441.068	265.491.985
<b>Incomplete Asset Sale</b>	4.368.792	4.368.792	0
<b>Other (GSM Lines License Transfer)</b>	1.000.000.000	3.525.000.000	2.525.000.000
<b>Total Privatisation Revenue</b>	5.619.965.564	10.857.472.239	5.237.506.675

Source: “Republic of Turkey, Privatisation Administration”, <http://www.oib.gov.tr/2000program.htm>, 2001

Although every year is supposed to be a breakthrough in privatisation sales revenues in 2000 finally reflected this goal, as implementations carried out by the Privatisation Administration amounted to a record \$2.7 billion which represents more revenues from its entire portfolio between 1986-1999.

### **3.5. THE REASONS OF SO MANY CRISES**

The proper functioning of the economy depends on striking and maintaining an optimum balance between interest rates, inflation, and exchange rates. Continuing inefficiencies in the public sector, and the systematic preservation of policies are the indirect causes of all economical problems. Without decreasing inflation rate to appropriate level, it is not a good policy for the monetary authority to decrease the rate of interest below the inflation rate since it is best that they move together. We see another

problem, that there is a big difference between inflation and foreign exchange rate with the gap of 20% since they moved together as well. Moreover, the interest rate is moving sharply up but getting slowly down, and does not seem it is under control. Yet the Turkish economy always seems to either in a crisis or in a program guiding it out of crisis. In Turkey achieving an optimum balance between the statements, which I mentioned at the beginning means keeping domestic interest rates higher than inflation while controlling exchange rates so that they match movements in consumer and wholesale prices. This provides a window of opportunity for a real return on investments and savings in TL.

For the latest crises, Turkey's crawling peg was a bold but a risky attempt to eliminate inflation. Because, inflation remained above the rate nominal exchange rate, depreciation, and current account deficit widened to unprecedented, mainly due to booming consumption. Reason; Turkey relied heavily on preannounce exchange rate regime in reducing inflation. Then program followed by Central Bank lost 20% of its foreign currency reserves during a first round of attack on the currency November 2000.<sup>43</sup>

The aim is to ensure, that the government meets its borrowing requirements, and that banks make a profit in financing the government while the rest of the economy continues to function with reasonable rates on loans, and attractive interest on deposits. And also government should try successive to achieve more complete in the collection of taxes. State total expenditures base on structure exceed the saving that cause chronic current deficit. This deficit compensates by short - term debt than longer - term.

The burden created by inefficient public sector enterprises constitutes the fundamental cause of the crises. The government continually subsidises heavy losses incurred by public sector enterprises.

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<sup>43</sup> C. Akyürek, , "Emerging Markets Take Wing", **Oxford Business Group**, 2002.

As long as the window of opportunity for arbitrage remains open the financial sector's hoarding of both government securities, and also stock market, because there are times interest rates are high and turn gain in interest denominated assets, the international business community's injection of short term foreign capital into financial system are not damaging to the economy.

When the window appears to be closing, banks become anxious to liquidate the government securities in their portfolio, and to switch quickly to hard currencies, while foreign investors withdraw their liquid assets. Those problems emerge as both domestic and international arbitragers. Real role of the banking sector in economy is to extent the excess saving to the investors who have in shortages, and sectors, which have been high returns. As mentioned above, state is the segment to show the biggest demand, and offer the highest return in order to fund the budget deficit. On the other hand if the domestic sources are insufficient to compensate the demand, state will apply the foreign debt as natural. During this circuit we must tolerate certain amount of risk. Wrong part is the position, when the banks are taking the risk more than their capital.

The consolidated government budget stays in a steady state of deficit, where there won't be much problem. However, the permanent undertaking keeps government expenditures high, and budget deficit wide. Financing the budget deficit through domestic borrowing in an inflationary environment drives interest rates up, and sustains inflation. Domestic debt stock increases steadily due to a mounting interest burden in payments on debt.

Such was the fate to avoid private sectors crow out from the effective investment opportunities, in order to extract the limited resources of the public sector. Banking system's late structural disposition is another reason for this deficit situation. Some banks carried high risks relative to their capitals in order to gravitate the profit maximisation. Along the way those factors created the inflationary environment. So it is known that inflation is

not the factor, it is the result of these factors. While Turkey may have lost the battle, priority became as increasing the growth rate sufficiently to absorb unemployment.<sup>44</sup>

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<sup>44</sup> K. Dervis, "Why are There so Many Crises in Turkey" **Emerging Turkey 2001-2002**, Oxford Business Group, p. 69.

## PART 4

### BASIC FACTS OF TURKISH CAPITAL MARKET

Overall, the ongoing crises and the reforms under the agreements signed with the IMF affect the capital markets. According to the policy makers, reform measures related to banking sector will help strengthen Turkey's capital institutions.

#### 4.1. PROBLEMS OF TURKISH CAPITAL MARKET

In 1980 structural changes and models were adopted such as liberalisation of foreign exchange, and foreign trade without increasing productivity in industry, liberalisation of money, and exchange market with foreign debts without providing stability, and domestic borrowing instead of encouraging internal savings in order to balance fiscal deficit, and a tax-spending arrangement is able to not disturb income distribution.<sup>45</sup>

The reasons for, which the developments in capital market in Turkey, is not as much as the Western countries is the concentration on only bond and share selling. There is an inadequacy of secondary market, and inadequate savings.

For Turkey one of the problem is inadequate domestic saving. For this reason investment could not be realised, or available savings could not be channelled into investment. In addition to that, low national income, and unequal income distribution are important reasons for inadequate saving. In Turkey number of savers about 26.65 % of public.<sup>46</sup>

An additional important institutional feature of financial systems in many emerging market countries, have the short duration of debt contracts,

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<sup>45</sup> M. Toprak, "Finansal Sistemin Ekonomik Kalkınmadaki Yeri: Türk Finansal Sistemi Örneği", **Yayınlanmış Doktor a Tezi**, İstanbul Üniversitesi, 1992, p. 67.

<sup>46</sup> O. Şener, **Effects of Capital Markets on Industrialization in Turkey**, İMKB Yayınları, 1988, p. 14- 15.

both domestic, and those issued to foreigners, as seen in Turkey. These leads to increased cash flow and liquidity problems for non-financial firms, and banks when interest rates rise, or when the domestic currency depreciates. In order to promote financial stability in emerging market countries, need to encourage the development of longer- term debt markets. However, the resulting interest rates can be substantial and a sharp rise in interest rates, which decreases the value of the long term liabilities can cause a sharp deterioration in bank net worth. Indeed, the problem suggests that regulatory requirements or bank supervisory procedures to limit market risk.

**Table 17: Saving Instruments in Turkish Society**

<b>Investment Types</b>	<b>Percent (%)</b>
Gold	23,8
<b>Bank deposits</b>	21,4
<b>Real Estate</b>	17,6
<b>Foreign Exchange</b>	9,4
Private Corporate Sec. Bond	5,1
Government Bond & Treasury Bill	5,1
<b>Revenue Sharing Bond</b>	4,0
<b>Private Firm Security</b>	3,5
<b>Mutual Fund</b>	3,2
<b>Other Places</b>	5,6
<b>No answer</b>	1,3

Source: O. Sener, **Effects of Capital Markets on Industrialisation in Turkey**, İMKB Yayınları, 1988, p.18.

Majority of people still keep their savings in form of gold, real estate, and bank deposits very small part of the savings goes to the instruments of capital markets such as stocks and bonds. Real estate is one of the most important investments in Turkish society. Most of the investments are made in unproductive instruments in Turkey, because speculation opportunity of high-level income groups is significantly high in

Turkish market. On the other hand, foreign currency has also entered one of the favoured investment instrument both individual, and institutional investors. Besides that income out of interest payment has gained revenues to the income groups. The effects of increase in the rate have been realised on financial savings rather than on domestic savings.<sup>47</sup>

Investors in Turkey prefer short-term investment tools such as gaining income out of interest payments. Providing long- term fund does not mean more than a claim in Turkey. Because, in Turkey there is high inflation, instability, and affect both security importers and investors.

Rise in interest rates also led to the further deterioration of bank balance sheets. Banks were purchasing long- term government bonds, and financing these purchases by borrowing in the repo market. When interest rates rose, the value of the long- term bonds declined, causing substantial losses in banks' trading accounts. Increases in uncertainty in Turkish financial markets caused stock market decline precipitated the full blown financial crisis.

#### **4.1.1. Factors Inhibiting the Development**

Capital markets were not developed, and there was a very limited set of financial instruments. Banks were the dominant institutions in the financial markets and the corporate sector relied almost exclusively on bank credits. Approximately the largest three banks of Turkey owned 25% shares of the ISE.

Banking sector has a large share of total operations in the ISE. Banks have an aggressive superiority among financial institutions. It can be said, that Turkish banking sector has the control over very large funds after 1980.

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<sup>47</sup> Serek and Esen, **op. cit.**, p. 18.



As it mentioned in the Table 1 in the Appendix, while the share of the public sector increased in the last years compared the beginning years, the share of the private sector falls below 10%. The government turned towards internal resources as a result of decline in the tax revenue in the last years. It has been favour of the private sector to use currently inadequate savings to meet the budget deficit by the government. In addition, the high interest rate policy has deteriorated income distribution.<sup>48</sup>

As it is shown in Table 18/ The Share of Financial Sector- as a share of GNP- (%), the share of the financial sector as a share of GNP has increased from year to year while the share of financial asset to GNP was 43,9% in 1991. The value of traded capital market assets as a share of GNP also increased. Political, social and economic development at the end of 1992 increased the debts of the public sector. High rates of interest encouraged depositors in favour of banks and government papers, and this development affected equities negatively.

**Table 18: The Share of Financial Sector- As a Share of GNP- (%)**

Years	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
<b>Private Sector</b>	23,2	28,3	31,1	34,2	38,9	43,9	31,0	29,3	18,0	19,7
<b>Public Sector</b>	76,8	71,7	68,9	65,8	61,1	56,1	69,0	70,7	82,0	80,3
<b>Total</b>	100	100	100	100	100	100	100	100	100	100

Source: Capital Market Board Monthly Bulletin, March, 1996, p. 17

#### **4.2. AN OVERVIEW OF THE TURKISH CAPITAL MARKET THROUGHOUT THE PERIOD 1995-1999**

<sup>48</sup> **Ibid.**, p. 25.

The crisis in 1994 and the high devaluation expectation caused by the low exchange rate policy resulted as the foreign currency crisis, and the stock market was affected from this inversely.

When, the Turkish Capital Markets are examined throughout this period, the total volume of issues of securities registered with the CMB increased substantially between 1996 -1998. The volume of issues of securities registered with the CMB rise from 161.9 trillion TL (US \$ 1.9 billion) in 1996 with a 419% increase to 841.7 trillion TL (US \$ 3.2 billion) in 1998. The share of equities in the total volume increased from 29.4% in 1995 to 63.1% in 1996. In 1997 and 1998 equity issues increased their share in total volume further reaching 80.8 and 82.8% respectively. As the end of September 1999, the total volume of the issues of securities registered with the CMB was 514 trillion TL (US \$ 1.3 billion).

Rises in the stock market remain temporary, unless there is a positive stable development in main economic indicators. In order to get desired performance from the capital market and the stock market, it is necessary to stabilise correct basic economic indicators by getting down inflation, interest rates, and decreasing budget deficits.

In 1997, all emerging markets began to perceive as more risky than before by the international investors, because of the crisis started in East Asia in May 1997, which also affected the Turkish economy. From the first half period, due to Turkey's relatively rapid growth among emerging markets, and declining of interest rates to around 60% both domestic and foreign investors showed strong interest to the ISE. Although Turkish financial markets seemed not affected by the crisis but the economic crisis in Russia resulted as a capital flight from Turkey during August. The official reserves of the Central Bank decreased by 5.2 billion US dollars to 21.5 billion US dollars. This capital outflow caused to a liquidity squeeze and a rise in interest rates. The Central Bank took necessary actions in order to create liquidity to the market using open market operations, and tried to sustain exchange rate stability. The index began to recover to

around 2,200 following the announcement of a government support program for capital markets, and indicators that the real economic situation was not as bleak as market levels would imply.<sup>49</sup>

ISE was also affected from the crisis, the ISE National 100 Index dropped by 39% in one month due to capital flight and increased uncertainties in the markets. The foreign investors withdrew 418,4 million US dollars in 1998, which concentrated in May, August and September. At the end of 1997 the value of stock holdings of the international investors was 6 billion dollars whereas in 1998 it decreased to 3.7 billion dollars.<sup>50</sup>

The coming April elections presented uncertainties at the beginning of 1999. However the ISE National 100 Index increased by 51% in February and 17% in March. On the other hand the strong earthquake in the Marmara region on August 17<sup>th</sup> has been the major event of 1999. The ISE remained closed for 7 working days following the earthquake, from August 17 through 26. On the first trading day after the natural disaster, ISE index showed a sharp decline.

During the records in 1987, 1989, 1993 and 1999, annual rises in index were exceptionally large. The ISE's performance appears less unstable, while the ISE has only four annual declines in its trading between 1986 and 2000.

#### **4. 3. MOVEMENTS IN ISE INDEX IN 2000**

The ISE 100 Index fell by 37,9% in 2000, declining from a closing value of 15209 points at the end of 1999 to 9437 points on the last day of trading December 2000.

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<sup>49</sup> E. Alper, **Business Cycles, Excess Volatility and Capital Flows Evidence From: Mexico and Turkey**, 1999, p. 13-17.

<sup>50</sup> **Ibid.**, p. 22.

The ISE's fall in 2000 was a gradual one. At the end of April 2000, the ISE 100 Index was 26.3 % higher than its end 1999 level.

By May 2000, the fuel of market confidence borrowed from 1999 ran out. Several favourable developments such as final touches on a promising economic program focused on reducing inflation, Stand-By Arrangement with the IMF and Turkey's official recognition as a candidate for EU membership. This combination raised 79.8 % in the ISE 100 Index in December 1999 alone.

An expected reduction in inflation was instrumental in the gains through April 2000. Lower inflation meant lower interest rates, and thus, lower returns on government borrowing instruments. Indeed nominal interest rates in Treasury auctions fell immediately, and dramatically from 93,3% in December 1999 to 37% in January 2000, leaving the ISE as the best option for channelling liquid funds.

Expectations were revised with actual developments. The disinflation program started with 2 consecutive months of rises. Program's pace was too slow to achieve inflation targets. Confidence fell in May 2000, and continued to fall. It was overturned the following month by severe liquidity crisis in the banking sector, which fell the ISE 100 Index down 35,4% in November. The annual fall was reflected in varying, but salient degrees across all sectoral indexes.

The ISE Financial Index continued to cast above the ISE 100 Index, but registered a slightly higher year on year decline. The ISE Industrial Index remained below the ISE 100 Index, and its end year decline was 7,8 percentage points less than that of the primary index. The ISE services index dipped below the ISE 100 index in 2000.

Daily average trading volume in 2000 amounted to \$740 million in traded value, 132000 transactions in the number of contracts, and 45 billion shares in the number of stocks traded. The number of shares traded continued to grow faster than the number of contracts as the average

transaction size increased from 225863 shares per contract in 1999 to 241544 shares per contract in 2000. In terms of traded value the average contract size grew from \$3259 in 1999 to \$5611 in 2000.<sup>51</sup>

The ISE experienced a major crash during the three-day period between February 19<sup>th</sup>, when a political spat between the president and the prime- minister made headlines throughout the world, and February 22<sup>nd</sup>, when the government decided to float the Turkish Lira. The primary index fell by 14,6% from 10170 points to 8683 points. The next day was followed by the greatest daily decline in the exchange's history. February 21 ISE – 100 Index dove 18,1% from 8769 points to 7181 points. However ISE was not alone in its misery in 2000. Stock markets were down across the world, and the gloomy global outlook was not limited to emerging markets. The NASDAQ Composite Index was down also.

#### **4.4. RESCUE OF IMF**

While the indexes showed little sign of recovery in the first quarter of 2001, the ISE began to move in mid- April following the announcement of a new economic program designed to pull Turkey out of crisis. It was only when the new program was announced on April 14<sup>th</sup> that the stocks market showed any sign of life. The program announcement was followed by the US Federal Reserve Bank's decision on April 18<sup>th</sup> to cut the interest rates by half of a percentage point. The ISE 100 Index responded to the announcement of the domestic program with a 4.9% rise. While meeting between the IMF and World Bank in Washington on April 27<sup>th</sup> Economy Minister Kemal Dervis announced to secure \$10 billion funding pledge from the IMF-including \$1.5 billion from the World Bank to assist Turkey's implementation of the new economic program. When combined with the \$4.3 billion still due from previous agreements, the proposed package brought to total to \$14.3 billion. The good news reacted market immediately ISE 100 rose 13.5 %. But this new and the last stand-by

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<sup>51</sup> "İstanbul Stock Exchange", <http://www.imkb.gov.tr/annualbulletin> , 2002.

agreement signed with IMF has hard conditions which can cause new shocks in the economy.<sup>52</sup>

The measure outlined in the country's new economic program, introduced on April 14<sup>th</sup>, 2001, have a revolutionary character. They collectively amount to a complete restructuring of the financial system unlike previous efforts that had proposed adjustments in certain operational units and regulatory issues in the financial services sector.

The index has already digested the stream of favourable developments through May, including news of fresh international aid. Future gains will require more developments primarily in the form of a visible and determined effort by the government to carry out the new economic program.

Yet the disagreements between the state ministers about the privatisation, which IMF states as main conditions for the future of coming credits, started to dip the primary index in late May. On June 5<sup>th</sup>, the ISE 100 Index was at 11296 points down.

#### **4.5. EMERGING MARKETS AND THEIR EFFICIENCY CONDITION**

In practice, a financial system consists of mainly banking sector, and the capital market in a country. In the banking sector accumulation of funds, and their uses take place through commercial banks, central bank, development, and investment banks. On the other hand, the capital market is a market, where the supply and the demand of long term funds meet each other. Financial institutions and stock markets are generally complements, and they grow simultaneously as the economy develops.<sup>53</sup>

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<sup>52</sup> C. Akyürek, "Turkey's Last Chance", **Business Week**, May 2001, p. 32-37.

<sup>53</sup> Esen and Seyrek, **op. cit.**, p. 5.

In ISE the number of companies whose stocks have been traded increased from 80 in January 1986 to 176 by the end of 1994 and 315, when the time comes to 2000. Total market capitalisation was U.S. \$ 938 million at the end 1986. It increased to U.S. \$21.8 billion by the end of 1994. The highest capitalisation, U.S. \$37.8 billion was observed in December 1993. In 1994, total trading volume was U.S. \$ 23.2 billion. For the period 1986 –94, average price – earning ratio 12.4. As it is mentioned in the Appendix III, further descriptive detailed information can be analysed concerning the ISE.<sup>54</sup>

Foreign speculators are mostly accused who were claimed out to destroy emerging market economies for the sake of making money. However, it is real that emerging markets try to attract capital flows for realising substantial improvement regulatory framework, and contributing to development of stock market. But, certain macroeconomic imbalances increased the volatility of the stock then easily reverse equity flows out from the country. On the other hand, some analysts argue that the stock markets in developing countries are defined as ‘casinos’ that have little positive impact on economic growth.<sup>55</sup>

**Table 19: Istanbul Stock Exchange (ISE): Descriptive Data**

	1986	1987	1988	1989	1990	1991	1992	1993
<b>Market Capitalisation (million, US \$)</b>	938	3125	1128	6756	18737	15564	9922	37824
<b>Total Trading Volume (million, US \$)</b>	13	118	115	773	5854	8502	8567	21770
<b>Year end P/E ratio</b>	5,07	15,86	4,97	15,74	23,97	15,88	11,39	25,75
	1994	1995	1996	1997	1998	1999	2000	2001
<b>Market Capitalisation (million, US \$)</b>	21785	20782	30797	61879	33975	114271	69507	47689

<sup>54</sup> <http://www.imkb.gov.tr/monthlybulletin/>, June, 2000.

<sup>55</sup> Demirgüç and Levine, *op. cit.*, p. 24-25.

<b>Total Trading Volume (million, US \$)</b>	23203	52357	37737	58104	70396	84034	18193 4	80400
<b>Year end P/E ratio</b>	24,83	9,23	12,15	24,39	8,84	37,52	16,82	108,33

Source: “ **Istanbul Stock Exchange** ” ,  
<http://www.imkb.gov.tr>

Rapid increase portfolio equity flows to emerging markets, the World Bank defines developing countries to have per capita GNP below US \$ 7620 in 1990 prices, meantime Turkey was highly correlated with the rapid development of emerging stock markets both interns of capitalisation, and liquidity.<sup>56</sup>

As the market size liquidity increase, and regulatory and laws evolve to operate more efficiently, the systematic divergence of stock prices will tend to diminish.<sup>57</sup>

Elevating domestic accounting and supervision standards to international levels increase the quality of the financial system. Those reforms definitely help an increase in public confidence, and attract more investors in order to fund their capital. However, the fiscal indicators of Turkey, only financial liberalisation is not a sufficient condition for rapid development of stock market. This is just the first step to attract investors, especially foreigners, with huge funds diffuse into the capital market then it may have a chance to become a developed market. Although the ISE has not reached the enough size among world stock markets, it showed an adequate performance in 1993. The most important structural problem is its high volatility compared to other stock markets. By this way, risk adverse small investors escape from the market, and the manner speculative becomes effective.

<sup>56</sup> **World Bank Annual Bulletin**, 1997 .

<sup>57</sup> Yolalan, **op. cit**, p. 34-37.



Overall development of market will definitely increase the trust, and confidence, attracting more investors to purchase stocks. Attracting more and more investors to rise long term financing through the stock market, increasing private investment expenditures, and the rate of long run economic growth. Gain is for both sides; investors from industrial countries will earn higher return to their capital in emerging markets. Emerging market economies gain to enhance investment in longer-term projects, and increase the long run growth.

More investors with sizeable investment funds will establish the market, and will become easier to find buyers and sellers. Increased market liquidity leads to decline in transaction costs attracting more domestic investors to the market. As the size and liquidity of the market increases over time, the ability of a few large domestic investors to manipulate stock prices would diminish. This in turn will lead to an increase public confidence in the stock market.<sup>58</sup>

Rapid development of emerging stock markets helped these markets to become as efficient markets. Three different forms of informational efficiency in stock market; weak form, semi strong form, and strong form. Semi strong form, all public information is reflected in stock prices. This information set includes that of the weak form plus all other public information. Under this form, all publicly available information is quickly incorporated to stock prices to prevent investors trading on this piece of information from extra profits in a stock market. Strong form of market, stock prices immediately reflect all relevant information including information available only to corporate insiders<sup>59</sup>.

It becomes more difficult to predict future returns using publicly available information, and markets move closer to weak form of efficiency. For being known as an efficient capital market, current prices should reflect available information, and adjust quickly to new price of information.

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<sup>58</sup> **Ibid.** p. 45.

<sup>59</sup> H. Bierman, **The Causes of Stock Market Crash**, Greenwood Press, London, 1998, p. 15.

Competition is the driving force in the market efficiency. If there is any relevant piece of information, like earnings announcements, resignation of the chairman, investors will have an incentive to spend time and resources. Analysts believe markets are not efficient otherwise they would stop doing security analysis. So that the market would no longer efficient.<sup>60</sup>

Foreign investors, who have large portfolios carry the risk of the currency, as a result, they are eager than other investors to learn more about corporations and the government. However, losses resulting from inadequate information can be quite high for them. The demand for information at emerging markets increases. Brokerage firms are responsible for gathering and processing intensive information. These movements in an economy will increase information about stocks. Market will move closer to efficiency.

To be more precise, stock price behaviours would approach towards random walk behaviour as the emerging stock market evolves through time from a small and segmented speculative market into a sizeable and liquid stock market integrated to the world financial system. New information is unpredictable. Stock or security prices change only with new information. Therefore, price changes are unpredictable. This is what a random walk means. Random walk happens if changes in price from day to day or percentage changes are independent of each other.  
$$\text{Cov}(R_{\text{Migrost}}, R_{\text{Migrost-1}}) = 0$$
<sup>61</sup>

First studies of market efficiency are focused on the relationship between price changes over time. Any unpredictable pattern in asset returns may be exploitable and judged as evidence against efficiency of asset markets. The essence of testing rests on the random walk theory of price movements. Stock returns are serially uncorrelated at all leads, and lags. The close link between market development, and international portfolio

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<sup>60</sup> M. Hirscey, **Managerial Economics**, Revised Edition, Orlando, 2000, p. 264- 266.

<sup>61</sup> P. Kennedy, **A Guide to Econometrics**, Fifth Edition, MIT Press, 1990, p. 235.

equity flows, as an emerging market, are affected by equity flows in Turkey and fail to reject random walk behaviour. So the stock market development led to greater weak form of efficiency in Turkey where stock prices reflect all past trading data, such as historic prices, trading volume, and short term interests. Certain implication is looking at market – trading data such as price trends, trading volume, or short-term interest. Therefore, it rules out technical analysis as a profitable endeavour.

A study, Dew, 2001, is concerned in whether excess return of Turkish common stock is dependent on excess return of world common stocks. Finally in Turkey’s equities and T-Bill excess returns are independent of World market risk, and Turkish real risks are dependent on Turkish financial risk.

As an emerging market, Turkey is lagged behind developed stock markets’ both interns of market size and liquidity. Foreign investors become actively involved in the domestic stock market, stock prices would increase, thus domestic firms to raise funds through initial public offerings in the stock market. The size of the stock market will increase both interns of total market value of stocks, and interns of the number of companies, whose shares are traded in the market.

In order to test whether the ISE is a continuous market, it is necessary to look at frequency in operations, the number of firms make the significant part of the operation, while market concentration was 17% in 1992, this ratio increased to 40% in 1993.<sup>62</sup>

**Table 20: Net Portfolio Investment by Foreign Investments (Million US\$)**

<b>Years</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>
Share	346	572	858
<b>State’s Internal Borrowing</b>	13	181	20

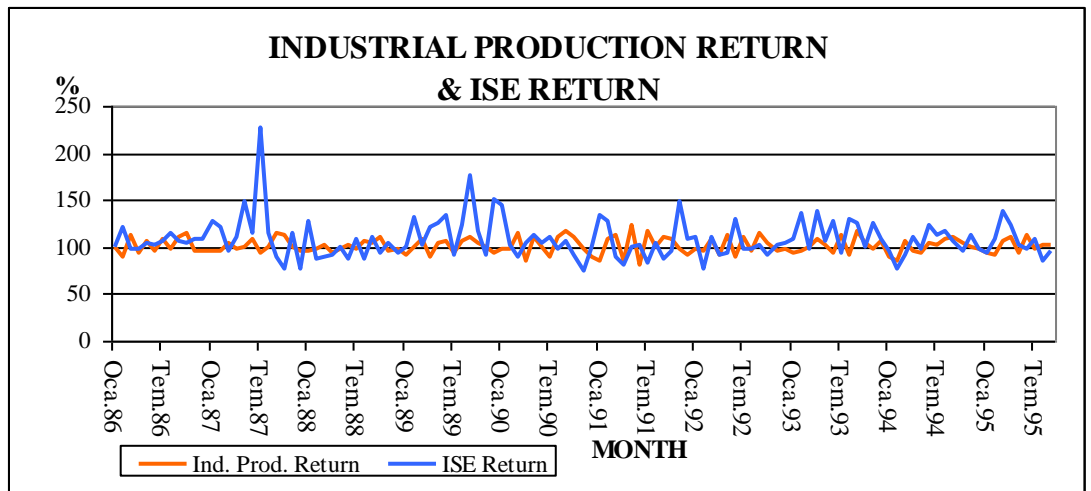
<sup>62</sup> Esen and Seyrek, op. cit., p. 48.

<b>Certificate</b>			
<b>Total</b>	359	753	878

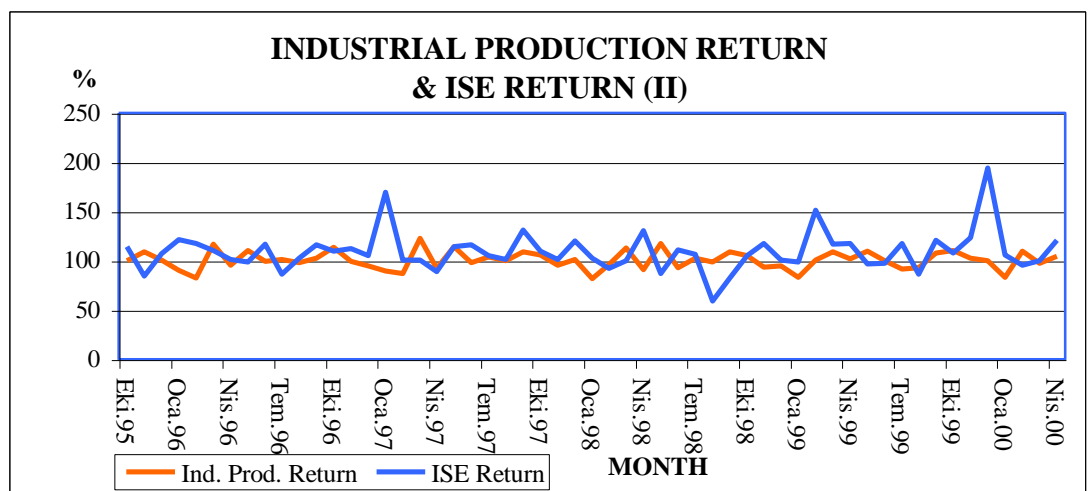
Source: "Central Bank Republic of Turkey", <http://www.tcmb.gov.tr>, 2001

Foreign investment has been showing continuous increase in 1993, it continued to increase in 1994. But net portfolio investment varies year to year in Turkey.

**Figure 18. 1: Industrial Production Return and the ISE Return**



**Figure 18. 2: Industrial Production Return and the ISE Return (II)**



The relationship between the monthly industrial production return of the SSI and the ISE return is weak. This shows that ISE Market does not reflect developments in real sector. The demand, which developed in Turkey, has been directed by demand oriented incentives. As shown in the Figure 18 because, of low supply oriented incentives instant explosions take place in ISE from time to time.

**PART 5**  
**THE COMPERATIVE RELATION OF 1994 AND 2000**  
**CRISIS WITH THE ISE**

Rooated in years economic mismanagement and chronic corruption, financial upheavel was triggred crises first on April 1994 and the latest one is the february 19t, 2001. Unlike previous bailouts, international, Lenders this time demanded a series of deep reforms. As a result; governments, political and social infrastructure, method of working and way of thinking changes.

In Turkey, the situation is a little bit different from the statement given above. Leaders of Turkey did not change since a half century, when one of them loses the election, the other substitute comes to power. As a result of governing the public by old and accompolished leaders, public started to identify its economic destiny by themselves and in majority of some groups.

As a result of liberalization and internalisation process in the economy, conditions started to change in country by 1990's. After the 1994 crisis the confidence to the government was lost, and the period for caring for the publics' flu future had started. Citizens who have money to save, started to learn more about economy and started using new financial instruments. Foreigners, who have money to invest also started to invest more in the Turkish economy. One of these highly used financial instrument is the Istanbul Stock Exchange, ISE, where is defined as "casino" by some economists. Some analyst defined as stock market develops economic growth.

As mentioned in previous chapters, the chronology of events for the 1994 and 2000 crises are stated by using the graphs drawn by the micro and macroeconomic variables. In this section, by using the ISE as the main

rapidly affected indicator of Turkish economy, the relation between these chronological events and data will be examined. Some economists explain the relation between two crises as “perfect”, some explain the crises 2000 as a result of wrong political directions and disregard the problems in the crisis in 1994. The economic problems which are passed over in the crisis 1994 had appeared as a giant in front of the Turkish economy in 2000 as another crisis. A tiny part of economists, who have political connections, differ two crises from each other and blame the policy makers for the periods when crises occurred. They consider economy as money injection to their sides.

The relation between the 2 crises is shown by plotting data on ISE. Because of the importance of general outlook: interest rate, treasury bill, foreign exchange market, money supply, industrial production, export-import and budget deficit fronts have to be considered carefully for plotting the analysis successfully on the ISE.

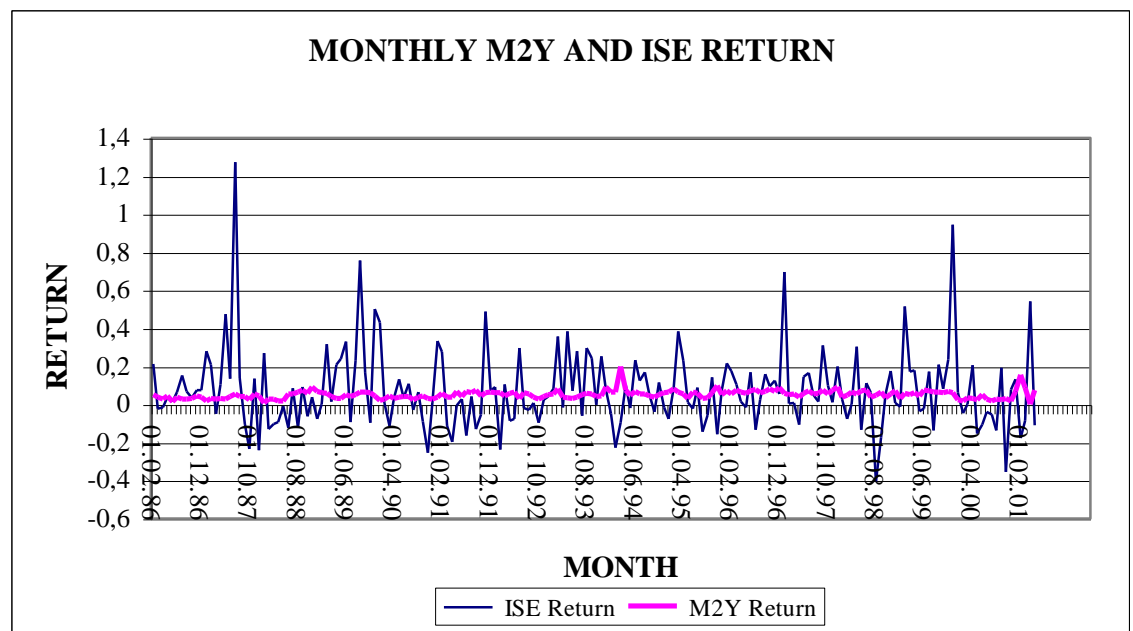
For forecasting the crises of 1994 and 2000 clearly, it is important to state the conditions starting from two years earlier for each crises to analyse the acceleration of the crises.

## **5.1 COMPARISON OF MONTHLY M2Y AND ISE RETURN**

As shown in the Figure 19, in crisis terms, money markets react rapidly and turn the way of the capital market by sharp and aggressive movements. M2Y, which is the most important indicator for the money existing in the market, is an indicator for an economy in crisis terms for predicting the next movement of the market by analyzing the type of money injected to the markets and taken back from the markets. In 1994 crisis, money injection to capital markets was in a rank of 6% monthly starting from 1992. Year 1993 return for the ISE was 210%, which made investors’ expectations get bigger. But in March and April, 1994; money injection to capital markets stopped, after this unexpected figure, the crisis had occurred,

the government started to inject money around 7% to capital markets which shows the governments' attacks on again taking back the control of the monetary field. This situation can be easily seen in the figure 19 in year 1994. Before analyzing the year 2000 crisis, it is important to note that government was not allowed to inject money to the capital markets, which can not be covered by the funds in the account, which it has been guaranteed, because the new stand-by agreement with the IMF hinders the government to inject money for moving the public's trust in state backwards, which will make the public spend their savings.

**Figure 19. Comparison of M2Y and ISE Return**



Monthly increase in the capital markets was again around 6% for 1999 and again stock investors had realised a return of 255% in ISE. Starting from the first month of the year 2000, increase in M2Y started to fall to the levels of 2-3% monthly but now government was not able to attack on capital markets because of the new agreement with the IMF. In November, 2000 first signals for a possible crisis had seen and foreign exchange basket perforated. In February, 2001 new stand-by agreement had been taken active and floating exchange rate regime took the place of fixed exchange rate regime which caused sudden expansion of the year 2000 crisis in the means of “trust” in policy makers. In the graph, for year 2000

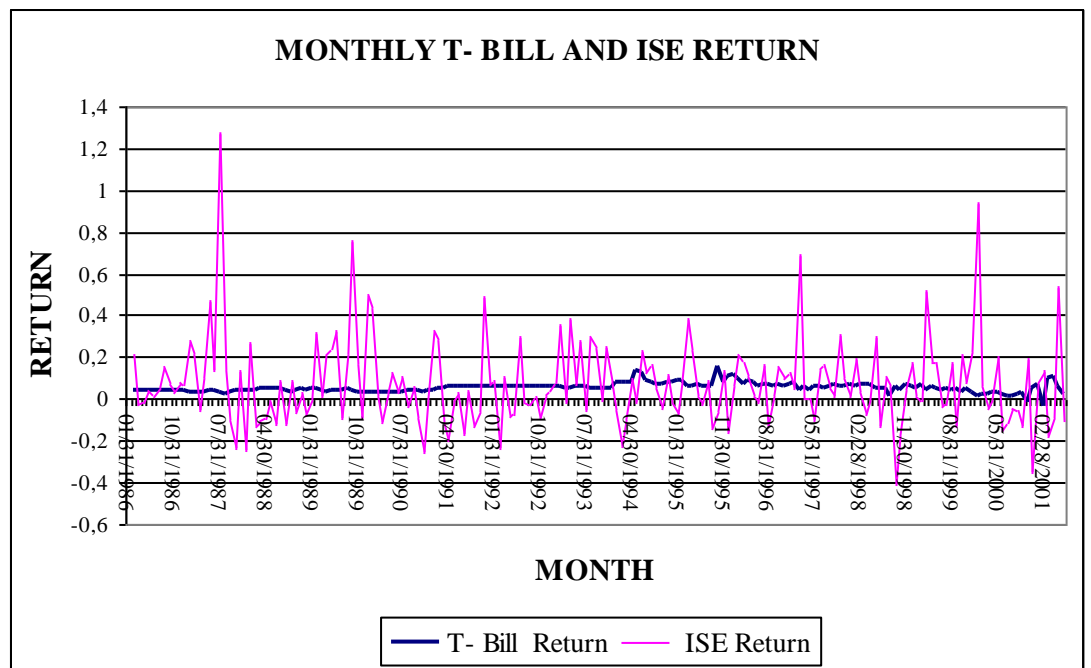


and 2001 the monthly M2Y can be easily seen in comparison with year 1994.

## 5.2 COMPARISON OF MONTHLY T-BILL AND ISE RETURN

In Figure 20, the relation of ISE with Turkish T-Bill return is analyzed. In general, an increase in the trend of T-Bill returns is expected when stock market has a better alternative or the micro and macro economic indicators tend to show investors to be careful on their movements in the market. In the case of Turkey, stock market was the leader in return against other financial instruments for the years of 1993 and 1999. T-Bill return was in a trend of increase starting from the year 1993, meantime 1994 crisis had occurred and the need of money appeared in markets, T-Bill had shown a great performance in 1994. In 1995, a possible crisis was infinitesimally missed, an increase in trend of T-Bill returns can be seen also for this period. Like in after crisis periods in Turkey, T-Bill had only a return of near or below inflation rate.

**Figure 20. Comparison of monthly T-Bill and ISE Return**

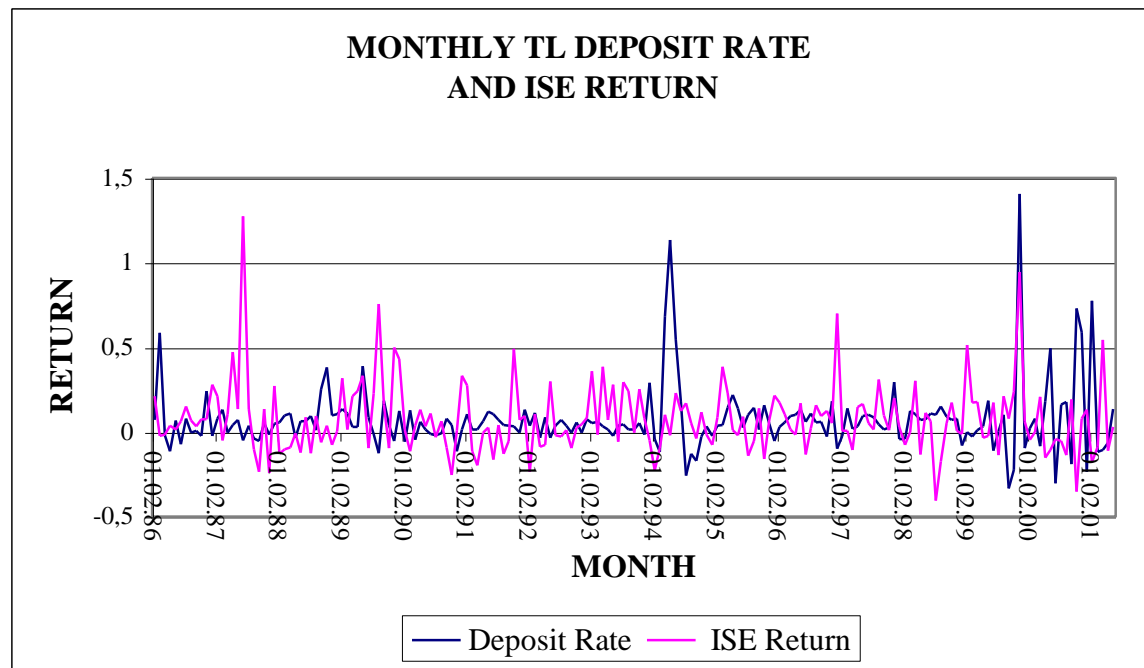


In 1999, by the effect of new stand-by with the IMF, T-Bill market seemed uninspired, when November, 2000 fixed exchange rate regime perforated, T-Bill market was completely forgotten, after the rescue of IMF in April, 2001 with the new stand-by, T-Bill market again showed a high performance because of crisis' destructive result. As seen in all crisis periods, according to the need of money and structure of the money market, T-Bill is taking active role in order to stabilise the market in the limit of the agreements' and conditions' permission set by the IMF. During crisis periods, volume of T-Bill in Turkey increased 500% in 1994 and 700% in 2001.

### 5.3 COMPARISON OF MONTHLY TL DEPOSIT RATE AND ISE RETURN

In Figure 21, monthly TL deposits' change is seen as expected in crisis periods of emerging countries which Turkey had shown the same characteristics with others.

**Figure 21. Comparison of monthly TL Deposit Interest Rate and ISE Return**

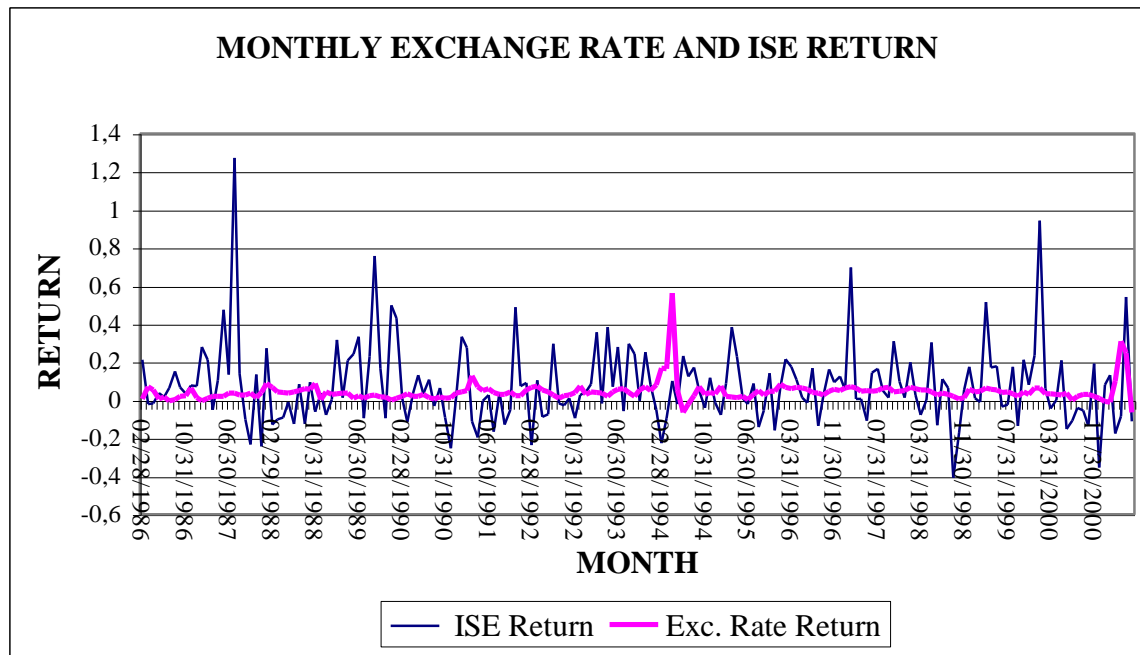


During crisis periods, investors of Turkish Capital Market wanted to invest their money as deposits in banks and as foreign exchange currency. In crisis periods, for the years 1994 and 2000, deposit rate became as definite peaks in the graph. After crisis periods, deposit rates fall as expected and in the near period of crisis, deposit rates tend to fall more which shows sharp and aggressive increase in a short period at the beginning of the crisis. Year 2000 crisis continued longer than 1994 and its effects caused pressure on other financial instruments and made money not to move from the position where the money is invested in.

#### **5.4 COMPARISON OF MONTHLY EXCHANGE RATE AND ISE RETURN**

In emerging countries, one of the main problem is the devaluation of the domestic currency for export, and import traders, which causes great current account deficits in balance sheets. Because almost all goods are related with foreign raw or semi finished materials, enterprises have to conserve themselves against the pressure on exchange rate differences. As a result, Turkish enterprises also suffered from exchange rate differences. Year 1994, and 2000 were the clear evidences for this situations. As seen in the Figure 22, sharp increases in foreign exchange currency occurred during these crisis periods. As happened in all crisis terms in turkey, exchange rates increased first, and allowed the crisis got started. Floating exchange rate regime prevented sudden devaluations in the economy to production but it was never able to stop the devaluation of the domestic currency. Fixed exchange rate regimes caused great problems socially, people who believed in the new economic program lost huge part of their savings against sudden foreign exchange rate fluctuations. As a result, in countries like Turkey, the exchange market is let floating due to changes in economy for keeping the market in a rank, the domestic currency floats and in some periods it devaluates and policy makers let people to conserve themselves against these movements which causes a high interest in foreign exchange currencies, called as “dollarization” in Turkey.

**Figure 22. Comparison of monthly Exchange Rate and ISE Return**



Year 1994 and 2000 were the clear evidences for this situation. As seen in the Figure 22, sharp increases in foreign exchange currency occurred during these crisis periods. As happened in all crisis terms in Turkey, exchange rates increased first, and then crisis get started.

### **5.5 MOVEMENTS OF ISE ACCORDING TO CHANGES IN THE MARKET**

The stock market indicators presented in the Table 20, includes measures of size and liquidity. Market capitalisation shows the overall size of the stock market in Turkey.

**Table 20 Movements of ISE according to changes in the market**

Year	Trading Value	Market Capitalisation	1-Year Change in Index- Real %	Volatility- Standard Deviation of Monthly Change
1992	56,339,092	84,809,001	-46.19	565.76
1993	255,221,681	546,316,000	210.32	1460.52
1994	650,864,146	836,118,000	-36.09	2648.78
1995	2,374,055,290	1,264,998,000	-21.88	5113.19
1998	18,029,966,636	10,863,002,000	-59.23	608.18
1999	36,877,334,600	61,137,073,000	255.09	1860.63
2000	110,089,800,329	46,692,373,000	-59.94	2144.64
2001	93,118,834,000	68,603,041,000	1.81	1933.04

**Table 20 Movements of ISE according to changes in the market**

Year	Liquidity, Value*100/ Avg. Mkt. Cap.	% =Trading % = Dom.	Avg. Price Per Share, US \$	Price- Economy % = Dom. Mkt. Cap.*100/ GDP	Price/Earnings
1992	51.37		0.71	11.71	11.39
1993	74.25		0.56	16.67	25.75
1994	66.33		0.25	25.37	24.83
1995	167.38		0.16	18.27	10.23
1998	105.36		0.03	33.15	8.84
1999	93.31		0.01	104.47	37.52
2000	155.72		0.01	63.80	16.82
2001	137.35		0.01	-	108.83

**Table 20 Movements of ISE according to changes in the market**

Year	Price/ Book Value Ratio	Dividend Yield, %	Total (Dom+For) Mkt. Cap., US \$ Million	Average Company Size, US \$ Million	% Share of Top 10 Companies in Mkt. Cap. Conc.
1992	1.67	6.43	14,239	76	-
1993	6.78	1.65	26,813	266	-
1994	5.9	2.78	37,123	180	-
1995	3.7	3.56	28,544	124	42.54
1998	3.21	3.37	55,684	128	56.46
1999	7.7	0.72	64,765	330	59.96
2000	3.2	1.29	72,959	164	55.20
2001	-	0.95	50,131		-

Source: “Meridian Securities”, <http://www.meridiansecurities.com/login>, 2002

Liquidity is an important attribute of stock market development because in theory liquid markets improve the allocation of capital enhance prospects for long term economic growth.

As a result of being mainly and rapidly affected from the movements in money market, ISE had data given below. For forecasting the crises of

1994 and 2000 clearly, I found it important to state the conditions starting from two years earlier for each crises to analyse the acceleration of the crises.

For 1994 crisis; trading value, market capitalisation, and volatility had changed 4000%, 1500%, and 900% respectively between 1992 and 1996. Only in 1993, the ISE had a return of 210% in 1993 and had made its investors lost -46%, -36%, and -21% for the years 1992, 1994, and 1995 respectively. Liquidity had changed 300% between 1992 and 1996. After 1994 crisis had happened, the money injection of government can be easily seen for data of 1995 which records 250% increase on the liquidity of 1994. Average price per share declined 65% from 0,71 US \$ to 0,16 US \$ per share and dividend yield declined 50% between 1992 and 1996. Total market capitalisation increased 100% from 14,2 billion US \$ to 28,5 billion US \$, according to this change in the market capitalisation the average company size increased from 76 million US \$ to 124 million US \$ between 1992 and 1996. Price/Earnings ratio increased about 100% in 1993 and 1994 which declined to same ratio in 1996 as 1992.

After the devaluation in 1994, liquidity of ISE increased and the money in the market had difficulties to find its way and place in the market. This liquidity, which government also helped it to increase by printing money, caused Turkish economy to suffer more under interest returns' payment.

For 2000 crisis; trading value, market capitalisation, and and volatility had changed 500%, 650%, and 300% respectively between 1998 and 2002. Only in 1999, ISE had a return of 255% in 1999 and had made investors lost -60% for the years 1998 and 2000. There was no change in index in 2001. Liquidity had increased 35% between 1998 and 2002 which is completely different than the period between 1992 and 1996 when the 1994 crisis had occurred. The main reason is the new stand-by agreement which hinders the government to supply the amount of currency which can not be covered by the funds in the account. As a result of efforts for keeping the market

structure same by not keeping the capital markets standing with the state's back, the ISE had suffered loss the most in 2000 crisis. Average price per share declined to 0,01 US \$, dividend yield declined from 3,37% to 0,95% between 1998 and 2002, investors who couldn't be able to get out of ISE while crisis, started to change their shares in increasing days of ISE and started to buy from shares of top 10 companies in the ISE.

After the devaluation of 2000 and 2001, in contrast with 1994 crisis, liquidity of market declined, price/earnings ratio increased to 108,83 and total market capitalization declined 10%, which can be defined as Us \$ 23 billion to depart only from ISE. Insecurity, and instability caused ISE's foreign investors to go away.

## CONCLUSION

As mentioned in the title of this research, the answer for the question, “Relations of 1994 and 2000 Crises and Their Effects in Turkish Capital Markets” revealed in this section.

When crisis of 1994 and 2000 are held one-by-one, they seem to be the same type of financial crisis, the only difference is between governments’ range of vision and their working methods after the term of the crisis. Also, when the crisis’ chronology is followed to determine the possible relationship between crises, the same mentality in Turkey in identifying reasons and preventive measures for each crisis is easily seen.

Countries, especially those that shelter different cultures and infrastructures in, like Turkey, have always had difficulties in finding the right type of economic management. To prevent possible crisis in a country’s economical management, leaders should have the enough knowledge, and experience in their public’s needs, wants, and resources, which to prevent these crises. Without this leadership crisis can not be prevented as Turkey experienced in 1994 and 2000. Recurring crises are inevitable.

Recovering from a financial crisis is difficult to achieve. Expansionary monetary policy is not an option for stimulating recovery from a financial crisis. Monetary policy must be restricted to promote low inflation, and restore confidence in the domestic currency. Therefore, this only can not be used to meet an additional objective of stimulating recovery from a financial crisis. In the case of Turkey, monetary policy caused the expected inflation to rise and the domestic currency to depreciate sharply. The depreciation of the domestic currency led to a deterioration in firms’ and banks’ balance sheets, because much of their debt was denominated in foreign currency. Upward jump on expected inflation caused interest rates to rise because lenders needed to be protected from the loss of purchasing



power, when they lend. Also, because of the short terms in date of maturities in debt contracts, the rise in the price level did not affect the value of households' and firms' debts.

In both pre-crises periods, rapid disinflation aimed programs led to high real interest rates, and adverse cash flow consequences for financial institutions. Because, the financial system was very fragile with already weakened balance sheets, the disinflation programs resulted as financial crises with the resulting depressing effect on the economy. Before engaging in an anti-inflation stabilisation program, policy makers need to first pay attention to the health of the financial system. Sure that, the regulatory, and supervisory process has been effective in promoting strong economy.

Before starting to analyse the results of this research on ISE, it is important to state the differences and similarities between 1994, and 2000 crises to bring out the subject into open. As this reason, these data among crises are revealed clearly below.

Similarities between 1994 and 2000 crises;

- Both crises occurred during disinflation aimed, economical reform, programs
- TL overvalued in both crises
- In the previous years of crises years, ISE realised a return of approximately 3 times, than interest rates
- In both crises, market players rapidly moved from the ISE and those players who prefer to stay in Turkish market moved directly especially to foreign exchange market, or the deposit market
- State fastened its domestic borrowings with increase in volume, interest rate, and in shorter maturities
- Overnight and repo are started to be used highly as a financial instruments and investors started to think more recovering, or conserving themselves instead of thinking on year based developing programs

- Real sectors had faced with great problems, imports incredibly increased, exports decreased, and their deficits showed first signals of a possible crisis
- In both crises, coalition governments were in power
- In both crises, market conditions were set by the IMF which of these conditions were also killed by the IMF with heavier conditions, than before
- Budget deficits were so high that debt interest payments rose to 40% of budget in 1994 crisis, which rose to 100% in 2000 crisis. It proves, that debts' interest payments grew rapidly and preventive measures are not taken into account for the coming years, which could come to a point of a possible consolidation

Differences between 1994 and 2000 crises;

- In 1994 crisis, government immediately printed money, and started to conserve financial instruments artificially, but in 2000 crisis government was not allowed to inject money, which can not be covered by the funds in the account on which it has been needed
- In 1994 crisis, government was not as determined as 2000 crisis' government
- Before the 1994 crisis, foreign direct investors were highly interested in Turkish market, but after the 1994 crisis and customs union with EU, 1996, foreign direct investors' annual entrance came to a point of less than US \$ 1 billion and number of hot money players increased. In the 2000 crisis, foreign direct investments came to a point of nearly stop
- Before the 1994 crisis, privatisation was desired by the government, but politics made the government unable to move, the 2000 government had found no difficulties on privatisation management but prices offered for state enterprises declined to 40% of 1994 prices
- The number of banks held by the SDIF increased enormously in 2000 crisis, which banks were supported by the government in 1994 crisis

As a conclusion for the research, these crises' effects and the extension between these crises in the front of ISE are examined. Main

leading indicators of economy, such as money supply- deposit rate of TL- changes in foreign exchange market- T-Bill returns, are in a strong correlation, when outcomes of 2000 crisis is compared with crisis in 1994. ISE's reaction against money market's movements is in the same way with ex-crisis periods. But 2 different movements of ISE for these 2 crises have to be explained basing on 2000 crisis for clearing the possible misunderstandings. First point is the government's no chance for printing money caused market players to take care of themselves without any state encouragement. Second point is the 2 devaluations, which happened during the 2000 crisis caused as the devaluation of TL and rise in interest rates twice. Between November 2000 and April 2001, ISE had realised difficulties to find its way and made its investors lost more than ever before. Before the crisis of 2000, ISE-100 Index was US \$ 1,5, but in April 2001 the Index was US \$ 0,6 which means as losing 50% of its real value in TL for investors, who couldn't leave from the stock exchange market.

It also has to be mentioned, that foreign investors' share in ISE had increased to 60% in 2001, which was 30% during 1994 crisis. % Share of Top-10 companies in ISE increased to 60%. It can be easily considered, that the other companies, who are in ISE had no chance to have cash flows from ISE, these firms devalued more sharply than ever before, because of their requirements for hot money, they asked for credits to banks, because banks were also in a deep financial crisis, no institution is found to give these companies credits, and they couldn't be able to cycle their financial needs, then the over devaluation period started for these firms in ISE. These firms became very cheap in the market, when they were compared with their book values, the situation is same also now.

As a result of this research, it can be easily predicted that, the next movement of this more destructive crisis in the front of ISE will continue with realizing the best return among other financial instruments. Foreign investors will again welcome to Turkish Capital Markets, especially ISE, but for this time the government will try to conserve money markets more effectively by putting new laws or penalties for hot money players. Cheaper

or financial support needing companies will be forced to emerge. Nearly all companies in ISE will start realising better, and continueing cash flows, liquidity and trading volume of market will increase sharply. It's always been this, way and it always will be for ISE.

But the most important outstanding obligation comes at this point; if the government can't be able to show a tangible improvement in Turkish economy, and problems still remain the same, IMF, and the other financial institutions point the situation of Turkey as its economically last chance for new encouragements, and credits.

## **RECCOMENDATIONS FOR FURTHER STUDIES**

This study aims to identify aims to investigate causes and effects of the latest financial crises in Turkey and investigate the coincidental effects on the Turkish Stock Market by using financial market variables. It provides a base for further studies in the financial crises and stock market reactions' in Turkey. It is organized on two logic levels as follows.

One of the levels describes the financial crises, in general, may be attributed to the need for sudden and sharp changes.

Further studies on the first level might include a more detailed analysis of the causes of crises are different for each country, early warning systems may be helpful by looking different countries crisis experience and their comparison to Turkey.

The other level analyzes the stock market for Turkey by investigating the current and crisis periods' pictures of Turkish Capital Market, the comparison of financial market variables and giving a profile of the effects of crises to the Turkish Stock market.

Further studies on the second level might include an analysis of the stock market reactions by using econometric models. These efforts are found to be helpful in predicting economic fluctuations, the leading indicators approach might useful in constituting an early warning system.

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to depart only from ISE. Insecurity and instability caused ISE’s foreign investors to go away.

## DEFINITIONS

**Balance of Payments Crisis:** It is gradual depletion of reserves, which eventually leads an economy to currency crises.

**Cash/Bank:** Ratio of bank liquid reserves to bank assets

**Custody:** The safe keeping and administration of securities and financial instruments on behalf of others.

**Domestic Borrowing:** Not only blurs the correlation between inflation rate and public deficit but also masks foreign exchange losses

**Gradual Depletion** of reserves is the special way by which public deficits are financed; that is by domestic credit expansion.

**Growth:** Rate of growth of GDP per capita

**IFC Investable Index Price Change** is the U.S. dollar price change in the stock markets covered by the IFCI country index, supplemented by the IFICG country index.

**Incentives and International Recognition:** Tax incentives will promote investment by Turkish institutions, while Turkey's increased coefficient in the IFC's Emerging Markets index, should generate investment by foreign investors.

**Inflation:** Rate of change of the GDP deflator

**Listed Domestic Companies:** refer to the number of domestically incorporated companies listed on the country's stock exchanges at the end of the year. This indicator does not include investment companies, mutual funds, or other collective investment vehicles.

**M2/ Reserves Ratio:** M2 to foreign exchange reserves of the Central Bank

**Market Capitalisation:** (also known as market value) is the share price times the number of shares out – standing.

**Market Liquidity:** the ability to easily buy and sell securities, is measured by dividing the total value traded by GDP. This indicator complements the market capitalisation ratio by showing whether market size is matched by trading.

**Modernisation Program:** The ISE is being modernised with relocation to a new and larger building and the installation of an automated electronic trading system.

**Private/GDP:** Ratio of domestic credit to the private sector to GDP

**Privatization Program and New Forms of Equity Investments:** The government's Privatization of state owned enterprises and the introduction of new equity investments should continue to attract investors. In this connection CMB recently approved the listing of equity based mutual funds.

**Real Interest Rate:** Nominal interest rate minus rate of inflation

**Spill over Effects from European Economies:** The linkages between Turkey and the major European economies suggest that the spill- over effects will be strong as Europe emerges from recession.

**Surplus/GDP Ratio:** Central Government budget surplus to GDP

**Excess Supply of Base Money Increases Demand for Foreign Currency:** The gradual depletion of reserves. You can prevent by changing financing mechanism.

**Turnover Ratio:** The value of shares traded as a percentage of market capitalisation, is also a measure of transaction costs. The turnover ratio complements the ratio of value traded to GDP, because turnover is related to the size of the market and the value traded ratio to the size of the economy.

**Value Traded:** refers to the total value of shares traded during the period.

## APPENDIX I

### MAIN ECONOMIC INDICATORS I

	Units	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>GNP Growth (at 1987 prices)</b>	%	6,4	8,1	-6,1	8,0	7,2	8,3	3,9	-6,4	6,1	-8,5
Agriculture		4,3	-1,3	-0,7	2,0	4,4	-2,3	8,4	-4,6	4,1	-5,8
Industry		5,9	8,2	-5,7	12,1	7,1	10,4	20,0	-5,0	5,6	-5,7
Services		6,5	10,7	-6,6	6,3	7,6	8,6	2,4	-5,1	8,7	-6,5
<b>Population</b>	1000 people	58.401	59.491	60.576	61.644	62.697	62.685	63.451	65.107	65.293	66.275
<b>GNP Per Capita</b>	USD	2.708	3.093	2.184	2.759	2.928	3.080	3.213	2.878	3.095	2.261
<b>Gross Fixed Capital Investment (at 1987 prices)</b>	%	4,3	24,9	-18,9	9,1	14,1	14,6	-3,9	-16,0	14,2	-27,7
Public		6,1	5,6	-34,8	-18,8	24,4	28,4	13,9	-4,1	20,6	-27,8
Private		3,1	26,8	-9,1	16,9	12,1	11,7	-8,3	-19,6	11,5	-27,7
<b>Final Consumption Growth (at 1987 prices)</b>	%										
Public		9,4	3,7	-3,5	6,8	8,6	4,1	7,8	6,5	4,5	-6,0
Private		5,7	8,1	-5,4	4,8	8,5	8,0	0,6	-3,1	7,1	-7,1
<b>GNP Deflator</b>	%	62,6	61,1	107,9	81,9	78,6	83,0	95,3	60,0	51,6	60,3
<b>Unemployment Rate</b>	%										
General		8,0	8,0	7,9	6,6	5,8	6,9	6,4	7,3	6,6	8,0
Urban		12,0	12,0	11,1	10,0	9,3	9,7	9,9	11,7	8,9	11,6
Rural		4,9	4,5	5,1	39,0	2,9	4,2	3,2	3,4	3,7	3,9
<b>Inflation (Average)</b>	%										
Wholesale Price Index		62,1	58,4	120,6	86	75,9	81,8	71,8	53,1	51,4	61,6
Consumer Price Index		70,1	66,1	106,3	89,1	80,4	85,7	84,6	64,9	54,9	54,4
<b>Public Sector Balance/ GNP</b>	%										
Public Sector Deficit		10,1	11,7	7,9	5,4	9,0	9,6	9,2	14,3	12,5	15,4
Cons. Budget		4,3	6,7	3,9	4,0	8,3	9,0	7,0	11,8	10,9	15,1

Deficit											
SEE		3,3	2,5	1,4	-0,2	-0,5	-0,6	1,3	1,2	2,2	0,6
Other		3,0	2,5	2,6	1,6	1,2	1,2	6,9	1,3	-0,6	-0,3
<b>Consolidated Budget</b>	Trillion TL										
Revenue		174	351	753	1.404	2.728	5.854	11.888	18.973	33.245	50.151
Expenditure		222	485	899	1.721	3.956	8.035	15.585	28.018	46.970	77.998
Deficit		47	134	146	317	1.218	2.181	3.698	9.044	13.725	27.847
<b>Outstanding Domestic Debt</b>	Trillion TL										
Government Bonds		86	191	239	512	1.250	3.751	5.772	19.683	34.363	102.873
Treasury Bills		42	64	304	631	1.528	2.375	5.841	3.237	2.058	14.372
Government Debt Securities		129	255	544	1.143	2.778	6.126	11.613	22.920	36.421	117.245
CB Advances		31	70	122	192	371	338	0	0	0	0
Parity Differences		35	32	133	26	40	0	0	0	0	0
Total		194	357	799	1.361	3.189	6.463	11.613	22.920	36.421	117.245
Sources: SPO, CB, SIS											

## APPENDIX II

### MAIN ECONOMIC INDICATORS II

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Interest Rates (simple annual) %</b>										
12 month	74,2	74,8	95,6	92,3	93,8	96,6	115,2	46,7	45,6	62,5
3 month	69,1	64,0	77,3	83,9	79,7	83,2	82,8	59,5	105,5	61,2
<b>Foreign Exchange Rates (% change of average exchange rate)</b>										
USD	64,7	69,5	170,6	54,0	77,5	86,6	71,6	60,5	49,4	96,4
DM	76,0	50,0	178,8	72,7	69,1	61,9	69,8	52,7	29,4	90,5
<b>Monetary Aggregates (% change over the end of previous year)</b>										
Money in circulation	67,0	73,1	89,3	86,0	68,5	94,2	81,2	58,3	68,6	55,5
M1	66,8	71,9	84,1	75,7	104,6	79,1	73,6	69,6	84,4	57,4
M2	61,4	49,6	125,4	101,3	118,9	97,8	100,0	102,0	58,6	57,6
M2Y	81,9	77,9	137,6	100,6	118,6	105,3	95,3	90,8	71,1	76,1
Total TL deposits	60,1	47,4	128,6	98,4	150,5	92,9	102,8	107,8	57,6	57,9
Deposit- bank credits	83,3	86,0	73,7	127,3	127,6	131,4	103,4	41,8	60	42,4
<b>Foreign Trade (USD Billion)</b>										
Export	14,7	15,3	18,1	21,6	23,2	26,2	26,9	26,6	28,3	30,8
Import	22,9	29,4	23,3	35,7	43,6	48,6	45,9	40,7	46	43,6
Trade Deficit	8,2	14,1	5,2	14,1	20,4	22,4	19	14,1	17,7	12,8
<b>Balance of Payments (USD Billion)</b>										
Foreign Trade Balance	-8,2	-14,2	-4,2	-13,2	-10,6	-15,4	-14,3	-10,4	-22,4	-5,5
Invisible Balance	7,2	7,7	6,8	10,9	8,2	12,7	16,2	9,1	12,6	8,6
Current Account Balance	-1,0	-6,4	2,6	-2,3	-2,4	-2,7	1,9	-1,4	-9,8	2,9
<b>Current Account Balance/GNP %</b>	-0,6	-3,5	2,0	-1,4	-1,3	-1,4	0,9	-0,7	-4,1	2,3
<b>Capital Account (Excluding Reserves) USD Billion</b>	3,6	9,0	-4,2	4,7	8,8	8,6	0,8	4,6	11,6	-17
Direct Investment	0,8	0,6	0,6	0,8	0,6	0,6	0,6	0,1	0,1	3,3
Portfolio Investment	2,4	3,9	1,2	1,7	0,6	1,6	-6,4	3,4	7,5	-4,8

Other long term capital	-0,9	1,4	-0,8	-0,1	1,6	4,7	4	0,3	1,4	-1,8
Other short term capital	1,4	3,1	-5,1	2,3	5,9	1,8	2,6	0,8	2,6	13,7
<b>International Reserves (USD Billion)</b>										
CB Reserves	6,1	6,2	7,1	12,4	16,5	18,4	19,7	23,2	19,6	18,7
Commercial Bank Reserves	7,6	10,1	8,0	10,2	7,4	7,6	10,9	14,3	16,1	13,4
Gold	1,5	1,5	1,4	1,4	1,4	1,1	1,1	1,0	1	1
Total	15,3	17,8	16,5	24,0	25,2	27,2	31,7	38,5	36,8	33,1
<b>Outstanding External Debt (USD Billion)</b>	42,9	48,8	54,3	57,6	62,5	69,6	78,8	81,9	90,7	98
Medium Long Term	12,7	18,5	11,3	15,7	20,5	20,5	27,2	29,2	28,9	20,8
Short Term	55,6	67,4	65,6	73,3	83,0	90,1	106,0	11,2	119,6	118,8
Total										
Medium Long Term	27,0	27,0	41,6	34,8	34,1	35,4	37,8	44,3	44,2	52,4
Short Term	7,9	10,3	8,7	9,5	11,2	10,4	13,5	15,8	14,4	134
Total	34,9	37,3	50,3	44,3	45,2	45,9	51,5	60,1	58,6	65,7
Source: SPO, CB, SIS										

## APPENDIX III

### TURKISH CAPITAL MARKETS' TRADING VOLUME (US \$ Million)

Years	Shares	Private Sector Securities			Government Bonds	Public Sector Securities			TOTAL
		Asset Backed Securities	Others **	TOTAL		T-Bills	Others ***	TOTAL	
1986	13		-	13	-	-	-	-	13
1987	118		-	118	-	-	-	-	118
1988	115		-	115	-	-	-	-	115
1989	773		-	773	-	-	-	-	773
1990	6.195		1.487	7.682	23.712	12.295	1.042	37.049	44.731
1991	8.583		3.140	11.723	34.114	31.627	1.146	66.887	78.610
1992	8.217	432	1.875	10.524	30.405	54.772	3.641	88.818	99.342
1993	23.315	2.908	818	27.041	59.974	93.706	4.462	158.142	185.183
1994	21.968	3.496	1.451	26.915	56.581	117.240	6.975	180.796	207.711
1995	51.990	3.615	2.933	58.538	100.269	324.685	3.557	428.511	487.049
1996	37.510	2.947	2.196	42.653	159.063	705.777	5.442	870.282	912.935
1997	60.074		1.317	61.391	565.639	600.697	746	1.167.082	1.228.473
1998	69.647		296	69.943	423.114	655.825	234	1.079.173	1.149.116
1999*	44.415		73	44.488	798.291	422.892		1.221.183	1.265.671

Source: CMB

\* As of August end

\*\* Consist of Corporate Bonds, Commercial Papers and Bank Bills & Bank Guaranteed Bills

\*\*\* Consist of Revenue Sharing Certificates, Housing Certificates and Foreign Exchange Indexed Bonds



## APPENDIX IV

### MAIN INDICATORS OF THE STOCK MARKET ON THE ISTANBUL STOCK EXCHANGE

Years	Trading Volume (\$ Billion)	Market Capitalisation (\$ billion)	Number of shares traded (\$ billion)	Average Daily Trading Volume (\$ billion)	Average daily Number of Shares Traded (\$ billion)	Number of Contracts traded (\$ billion)	ISE Index (\$ based) (1986=100)
1990	5,9	18,7	1.534,9	24	6,2	746,7	642,6
1991	8,5	15,6	4.539,0	34	18,4	1.446,5	501,5
1992	8,6	9,9	10.296,4	34	41,0	1.681,9	272,6
1993	21,8	37,8	35.291,9	88	143,5	2.815,5	833,3
1994	23,2	21,8	100.087,7	92	395,6	5.290,0	413,3
1995	52,4	20,8	306.253,0	209	1.220,1	11.666,0	382,6
1996	37,7	30,8	390.917,0	153	1.582,7	12.447,0	534,0
1997	58,1	61,8	918.555,0	231	3.645,1	17.059,0	982*
1998	70,4	33,9	2.242.532,0	284	9.042,5	215.777,0	484,0
1999**							

Source: CMB

\*In the beginning of the year, the index has changed and has been called as 'National-100 Index'

\*\* As of September end

Composite Index has been used since 1991.

