GLOBAL COMMENTARY

Equity Research

June 20, 2001

David Malpass
212 272-4293
dmalpass@bear.com

Tim Kearney
212 272-5981
tkearney@bear.com

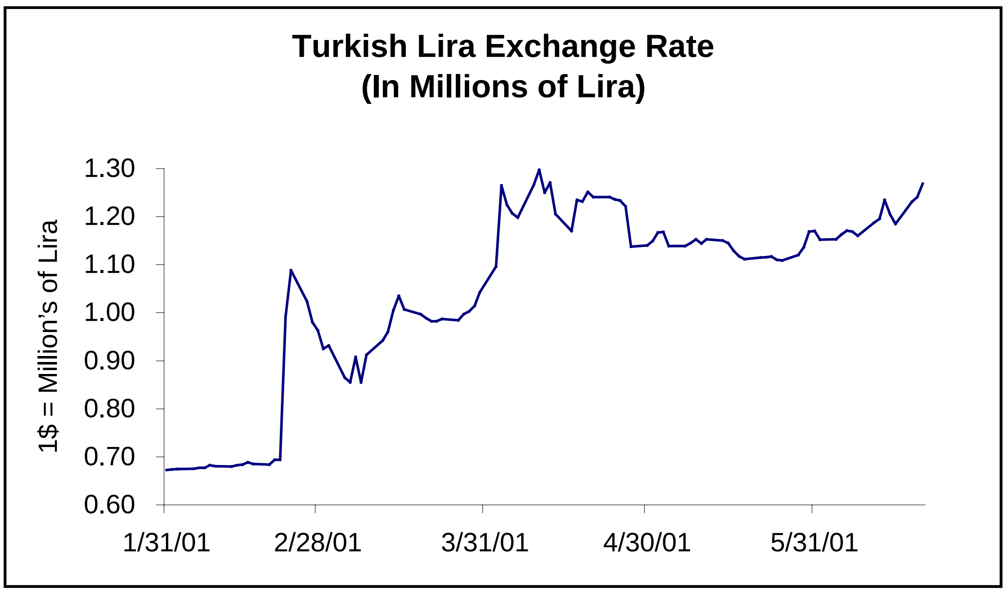
Emy Shayo
212 272-7587
eshayo@bear.com

Crunch Point: Turkey's Massive Debt

Turkey's economy continues to sink following the February devaluation. Its Treasury swapped $7.1 billion of short-term debt for longer maturities on June 15 but, like Argentina, it had to promise high interest rates and U.S. dollar payments to attract interest in the deal. Over the next six months, Turkey faces $32 billion in domestic debt maturities alone. Due to the devaluation and ongoing explosion of debt, the debt/GDP ratio has ballooned to 80% of GDP, dwarfing the debt challenges in Argentina and Brazil. On top of domestic difficulties, the global slowdown, dollar strength, and Argentine crisis are weighing on Turkey.

Turkey is laboring to fulfill the detailed structural conditions in its latest IMF austerity program, adding to political strains. Interior Minister Sadettin Tantan, who was leading the fight against corruption, left the government due to difficulties in pursuing his investigations. There are rumors of another cabinet reshuffling. The chief opposition party may be banned for its Islamic orientation. The governing coalition is losing popularity. Though faltering on some of the IMF commitments – the closure of a state-owned lender and steps toward privatizing the telecommunications monopoly – Turkey is likely to receive its next IMF disbursement.

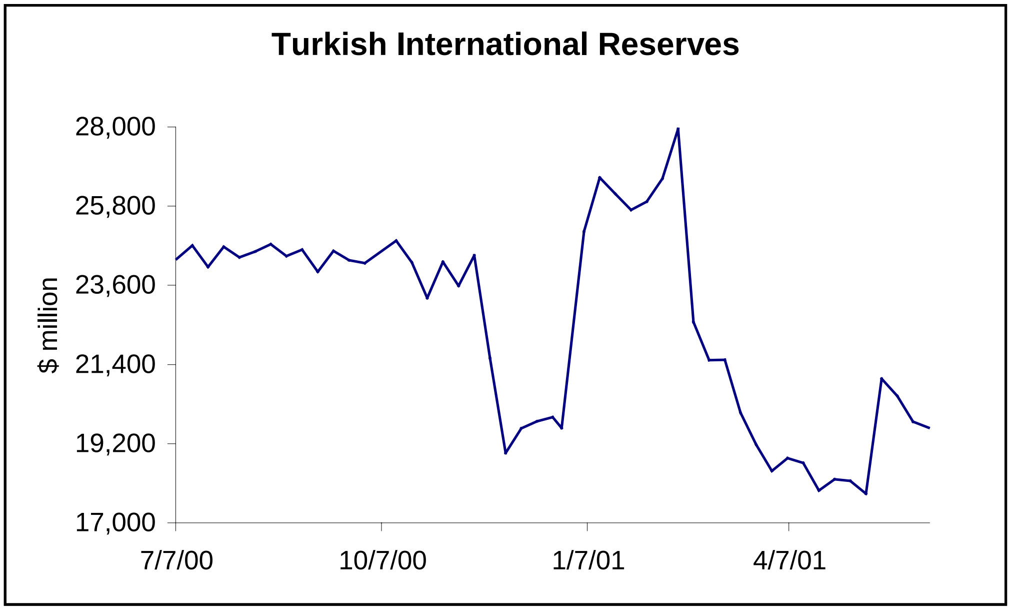
The IMF program doesn't provide a process to stabilize the currency or contain inflation (see *Turkey: Wrong Track* on 4/3/2001.) It calls on Turkey to limit the money supply growth. But this is done without taking into account the fluctuations in the demand for money. The result is a growing supply of lira despite a shrinking demand for lira. Thus, the lira sinks and inflation rises well beyond the targets. This keeps interest rates sky-high, compounding the debt problem.



Source: Bloomberg

Turkey's markets are reflecting the tough political and economic situation:

- The Treasury auctioned $692 million of three-month lira bills on June 19 at a still very high 79.5%.
- The stock market has fallen by 28% in dollar terms over the past four weeks.
- The yield on the Turkish 2009 bond has risen to 14.1% from 13% one month ago.
- The lira, now at 1.27 million, has fallen by 7.2% in June and by 46% since February.
- International reserves are down from $21 billion on May 18 to $19.645 on June 8, the latest report. During this period, the lira fell 5%, suggesting further drains on international reserves to come.



Source: Central Bank of Turkey

The June 15 debt swap is a measure of Turkey's uneasy position. The debt/GDP ratio is around 80%, one of the highest in the world. An estimated $37 billion of domestic government debt was coming due by end 2001. The swap pushed $5 billion of this from 2001 into later years, mostly into 2004.

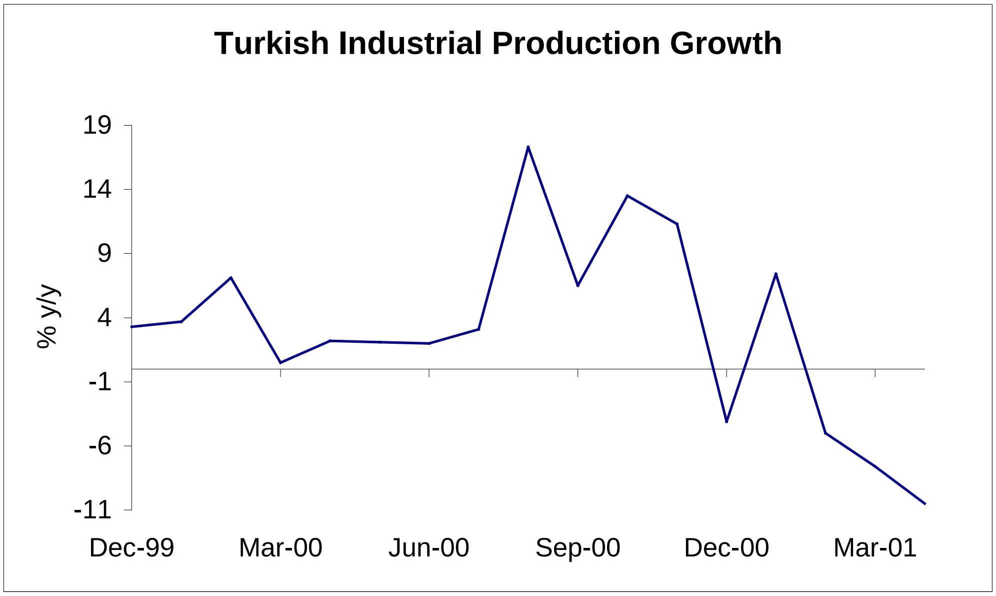
- A total of $7.1 billion of short-dated lira debt was swapped on June 15. This was more than the $5.7 billion that the government had expected to swap.
- The government had to pay a hefty premium to do the deal. Of the $7.1 billion total, $4.8 billion was swapped into dollar-linked paper paying around 14.7%.
- The rest, $2.3 billion of lira-denominated debt, is floating at high local market rates.
- On June 18, the authorities swapped another $717 million. It placed the dollar paper around 14.4%.

Turkey's Domestic Debt Amortization Schedule
($ billions, translated at June 15 exchange Rate)

	Pre Swap	**Post Swap**
June	7.3	6.5
July	4.8	4.3
August	7.3	6.8
September	4.5	4.1
October	6.3	5.0
November	3.5	2.7
December	3.2	3.1
	37.1	32.4

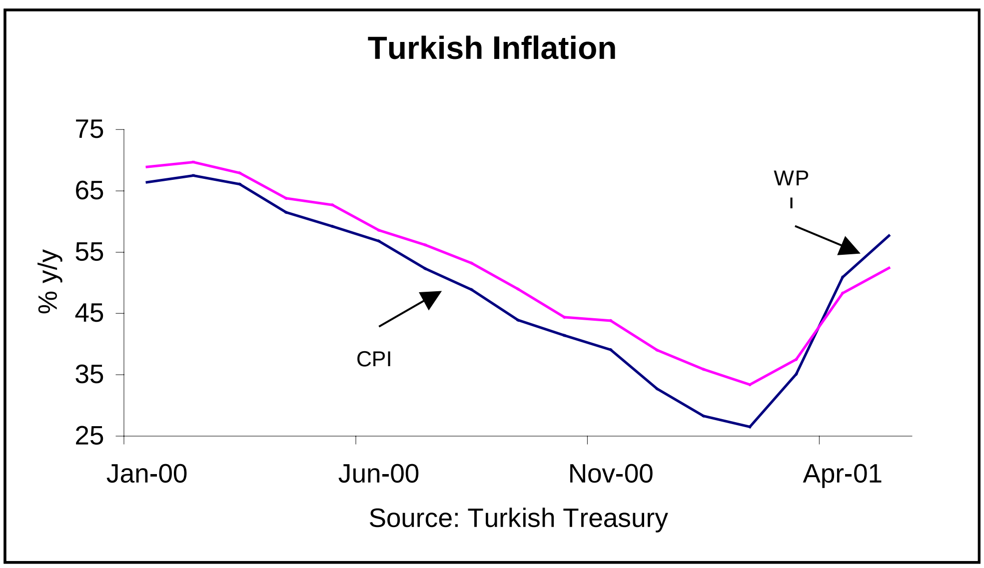
The economy remains in a weak state:

- April industrial production fell by 10.5% on a year/year basis, and there are no signs of a rebound yet. The government/IMF forecast for a 3% decline in real GDP in 2001 seems unrealistic.



Source: State Institute for Statistics

- The inflation rate is still rising, and we believe that the government/IMF expectation for a 52% CPI inflation rate by year-end is highly unlikely.



Source: State Institute for Statistics