



REPUBLIC OF TURKEY
PRIME MINISTRY
UNDERSECRETARIAT OF TREASURY

PUBLIC DEBT
MANAGEMENT REPORT

2014



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INTRODUCTION





In 2013 global economy recorded a more moderate growth compared to the previous year. In the second half of the year, weaker growth was observed in emerging economies whereas developed economies exhibited relatively stronger growth. Although the risks to the global economy declined, they also persisted in 2013. As the downward pressures of accumulated fiscal problems on growth prevailed in developed economies, the normalization signal of monetary policies by the Federal Reserve created significant pressure on emerging markets. On the other hand, rebalancing process in China and geopolitical tensions experienced in certain areas emerged as other important risk factors in 2013.

Despite the adverse effects of developments in domestic and external markets since the second half of 2013, Turkey attained 4 percent GDP growth by the end of the year and sustained its uninterrupted growth process after the global crisis. 2014 growth forecast is 4 percent in our 2014-2016 Medium Term Program.

Fiscal discipline framework and the borrowing policy based on strategic benchmarks, continued to support the stability of the Turkish economy in 2013. Thanks to positive trend in budget balance and growth performance, the EU-defined debt to GDP ratio stood at 36.3 percent by the end of 2013. Moreover, the net public debt stock continued to decline both as a share of GDP and in nominal terms in 2013 similar to previous two years. In the meantime, the maturity and currency composition of debt improved significantly and strategic benchmarks based debt management policies are sustained decisively in order to reduce the sensitivity of debt stock to the fluctuations in variables such as foreign exchange, interest and growth rates.

Public debt management practices of the Treasury have played an important role in strengthening and maintaining the economic stability since 2002. In that regard, I would like to use this opportunity to thank all the Treasury staff for their dedicated work and achievements in the field of debt management.

Ali BABACAN
Deputy Prime Minister



We publish the seventh issue of the Public Debt Management Report in line with the transparency and accountability principles of public debt management. In this report, the general framework of the public debt management as well as the developments and assessments in the field of cash, receivables and risk management in the previous year are presented to the public.

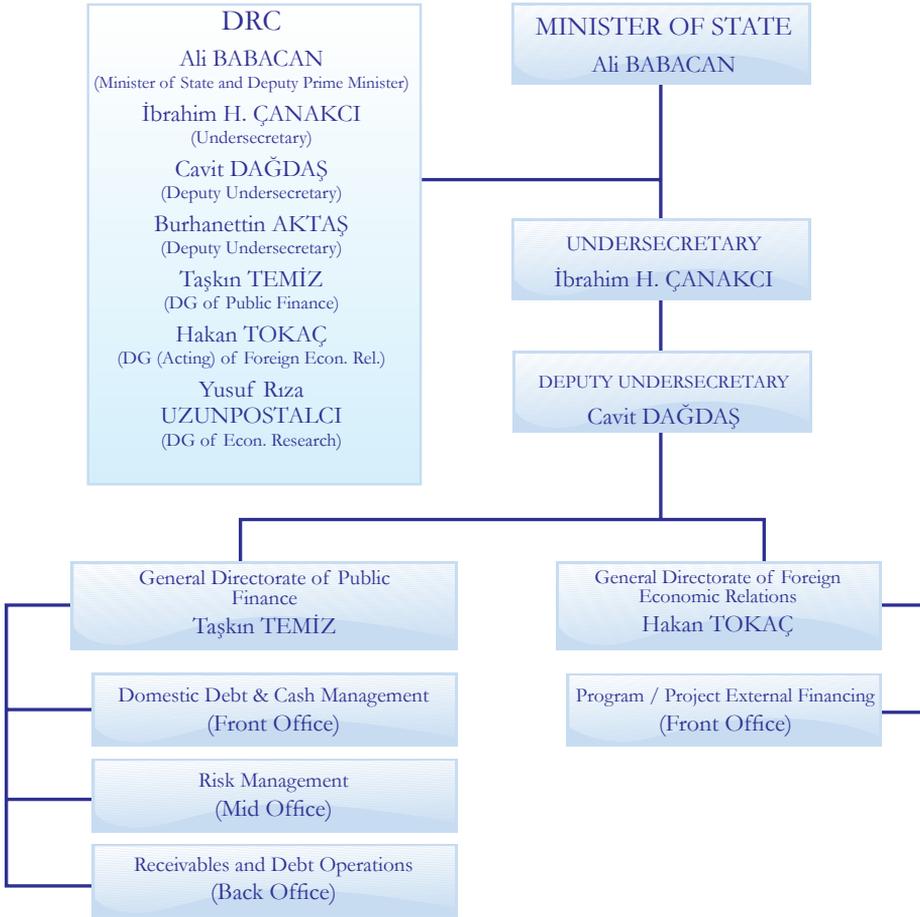
In a period where many countries experienced high public deficits, Turkey distinguish from these countries by preserving fiscal discipline, which plays a key role in maintaining confidence and functions as a reliable anchor. In this context, fiscal discipline has been maintained as in the previous years and the ratio of budget deficit to GDP declined to 1.2 percent. The ratio of the general government debt stock defined by EU standards to GDP continued to remain below the EU average and stood at 36.3 percent by the end of 2013. 2014-2016 Medium Term Program envisages this ratio to decline gradually and to reach 30 percent by the end of 2016. In addition to improvements regarding the level of the debt stock, sensitivity against exogenous shocks are also declined considerably. Thanks to efficient borrowing policy, the average time to maturity of central government debt stock continued to improve and reached to 46.9 months in 2013 from 33.6 months in 2012. Turkish Treasury aims to preserve those achievements in the debt dynamics by pursuing borrowing strategies in line with monetary and fiscal policies in the coming periods and will continue to share the implementation results of these strategies with the public in line with principles of transparency and accountability.

In addition to the efficient public debt management, increasing the efficiency of the primary and secondary markets is also one of the priorities of Turkish Treasury. To this end, improvement of investor base and development of new borrowing instruments have a great importance. Moreover, we continue to share our experience and knowledge in debt management with other countries' debt offices via Experience Sharing Program. In this context, several activities are conducted with Nigeria, Sudan, Indonesia, South Africa, Mongolia and Brazil in 2013.

While presenting the 2014 Public Debt Management Report, I would like to thank all my colleagues who contributed to preparation of this key document.

İbrahim H. ÇANAKCI
Treasury Undersecretary

ORGANIZATION STRUCTURE OF DEBT MANAGEMENT



Debt and Risk Management Committee (DRC)

Debt and Risk Management Committee (DRC) is the decision making authority within the Treasury, conducting the duty of designing main borrowing policies and providing coordination among units responsible for public debt management. The responsibilities of the DRC are set in Article 12 of the Law No. 4749 on Regulating Public Finance and Debt Management. Deputy Prime Minister responsible for Treasury chairs the DRC which comprises of Undersecretary of Treasury, Deputy Undersecretaries, Director General of Public Finance, Director General of Foreign Economic Relations and Director General of Economic Research, while the meetings held for monitoring the implementations or providing coordination are chaired by the Undersecretary.

MAIN PRINCIPLES AND PRACTICES IN DEBT MANAGEMENT

PRINCIPLES

The main principles of debt management are defined in the Regulation on the Principles and Procedures for Coordination and Implementation of Debt and Risk Management dated September 1, 2002 with No. 24863, as follows:

- Maintenance of a sustainable, transparent and accountable borrowing policy in consistency with monetary and fiscal policies, taking account of macroeconomic balances,
- Fulfillment of financing requirements at the lowest possible cost in the medium and long term in accordance with the levels of risk determined in consideration of domestic and external market conditions and cost factors.

PRACTICES

- Borrowing strategies are conducted based on the medium-long term programs while considering the trade-off between cost and risk.
- In order to ensure transparency and predictability financing program and auction calendar are publicized.
- Secondary market liquidity is increased and efficient yield curve is generated by implementing security benchmarking policy.
- Primary and the secondary markets are developed by implementing primary dealership system.
- Market risks are managed in medium and long term perspective through strategic benchmarks which are defined as indicators and criteria for general risk/cost targets of debt and risk management. In this regard, the following methods are used to reduce the sensitivity of the debt stock against shocks;
 - ♦ Liquidity risk management: Strong cash reserve is kept, redemption profile is smoothed out and maturity of borrowing is extended.
 - ♦ Interest rate risk management: Interest rate sensitivity of the debt stock is reduced by issuing mainly fixed rate instruments.
 - ♦ Exchange rate risk management: Borrowing operations are conducted by issuing mainly TL denominated instruments and the currency composition of debt stock is determined.
- Risk and cost indicators of the debt dynamics are evaluated through various scenario analyses.
- In order to control and mitigate the credit risk, tools such as risk account, external debt repayment account, guarantee fee, partial guarantee fee, debt assumption commitment and guarantee limits are being employed.
- Technical analyses and reports are conducted in order to control operational risks.
- Annual and monthly Public Debt Management Reports are prepared and presented to the Council of Ministers, the Parliament and the public.

DEVELOPMENTS
AND
PROSPECTS



MACROECONOMIC AND FINANCIAL FRAMEWORK

Global economy is in a gradual recovery process. While growth is led by advanced countries, a moderate growth is seen in emerging market economies. Risks in global economy have diminished but still remain. Public debt stock in advanced countries is still at historical high levels and unemployment rate is above pre-crisis levels. On the other hand, starting normalization process of monetary policies in advanced countries increases risks towards emerging countries.

Global economic growth was moderate in 2013 because of continuing fiscal consolidation, contraction in Euro Area economy and deceleration trend in emerging market economic growth. After a weak global growth in the first half of the year, global economic growth strengthened in the second half of the year led by advanced countries. Support of expansionary monetary policies, diminishing effect of fiscal consolidation and Euro Area economy recovering from recession have been effective in the recovery. On the other hand, after FED announcement in May that they can start tapering asset purchase program soon, volatility in financial markets increased and external financing conditions of emerging countries started to tighten. FED having started tapering asset purchase program in January 2014 as announced in December 2013 meeting points out that global liquidity will decline gradually. Therefore, policy makers in emerging countries should be more cautious and implement policies in this manner.

International institutions expect the global economy to recover gradually in the next few years. According to the most recent forecasts published in April 2014, IMF expects the global economy to grow 3.6 and 3.9 percent in 2014 and 2015, respectively, after growing 3 percent in 2013. World trade volume growth, slowing down considerably to 2.8 percent in 2012 and 3 percent in 2013, is expected to pick up in 2014 and 2015 and grow 4.3 percent and 5.3 percent respectively.

After the 2008-2009 contraction, United States economy has continued to grow for 4 years in a row between 2010 and 2013. In 2013, United States economy grew at a rate of 1.9 percent – especially with contributions of private consumption expenditures and investment. Although labor force participation rates are still the lowest of last thirty-five years, unemployment rate dropped below 7 percent by the end of 2013 and more than 2.3 million people were able to find jobs in non-agricultural sectors throughout 2013. Although extremely harsh winter conditions have hampered economic progress at the beginning of 2014 to a certain extent, it is expected that in 2014 United States economy will continue to grow with the help of the United States Central Bank's accommodating monetary policy and low interest rates.

The Eurozone economy has exited from recession in the second quarter of 2013. Economic recovery is expected to proceed at a slow pace. Global Financial Crisis and ensuing European Sovereign Debt Crisis are two main factors affecting



Eurozone economy. Bail out mechanisms which have been implemented after the term of crisis and the structural reform programs launched relating to financial sector are important steps to enhance sustainable, accountable and resilient structure of Eurozone economies. In the context of banking union, establishing common decision making and supervisory mechanisms are samples of concrete steps after the term of crisis.

On the other side, structural problems still exist in Eurozone. Labor market problems stand as an important matter. Historically high unemployment rates and specifically youth unemployment rates in the range of 50-60 percent in many economies have negative effect on Eurozone countries. Low inflation rates strengthen deflation risk in the region. Since the banking union has not been completed yet, financial system is reluctant to create credit. Thus, effects of policies, which have been implemented by European Central Bank, are restricted. After the completing of reforms, low inflation rates tend to be in upward trend through the effective functioning transmission mechanism.

In the Japanese economy, the policies called “Abenomics” have been implemented since the beginning of 2013. Considering the developments in the last year, Japan’s economy has responded positively to expansionary policies implemented with robust growth and rising inflation. However, the recovery process in Japan’s economy has lost some momentum during the last period. Consumption tax increase effective as of April 2014 and rising energy costs have become prominent as suppressing factors on the economy.

Developing economies showed a tendency to slowdown overall in 2013. The deceleration in the growth rate of these countries, which carried the world economy in the post-crisis period, has been evaluated as an important risk factor for global economy. Nevertheless, recently increasing foreign demand due to the recovery in developed economies is expected to provide positive contribution to developing economies. Conversely, some significant downside risks to developing economies still remain. The primary risk among those is normalization process in monetary policies of advanced countries. FED’s policy change leads to global financial tightening for developing economies. On the other hand, rebalancing process in China’s economy is also seen as a prominent risk factor. The Chinese government announced an aggressive reform plan in November 2013. If these reforms will be performed rapidly in 2014 and beyond, the growth in the country’s economy will likely to fall to more sustainable levels.

Turkish economy which recorded strong growth rates in the period of 2010-2011, slowed down and realized a growth rate of 2.1 percent in 2012. Beside the weak outlook in external demand conditions, geopolitical risks and high energy prices, macro-prudential measures taken in response to the deterioration of the current account balance in 2011 and providing a balance between domestic and external demand were decisive in the slowdown of the growth. Despite the unfavorable conditions affecting global growth, trade and finance, growth rate

reaccelerated and Turkish economy managed to grow by 4.0 percent in 2013 exceeding 3.6 percent MTP forecast for 2013. Private consumption expenditures were the main driver of this growth performance. While strong growth in public expenditures stood out in the first half of 2013, private sector investments has started to increase in the second half. Public consumption and investment expenditures contributed 1.6 points to growth throughout 2013 while private consumption and investment expenditures contributed 3.2 points. Additionally, private sector investments, which had a negative contribution to growth since the beginning of 2012, recovered significantly in the second half of 2013 and builds an important base for production capacity in the forthcoming period. Moreover, positive performance of private sector investments signals that the quality of growth composition is improving. On the other hand, despite the strong positive trend in exports, the contribution of net external demand to growth was realized negative in 2013 due to net gold-trade and accelerated domestic demand.

In the framework of 2014-2016 MTP, the growth rate is expected to be realized as 4 percent in 2014. High frequency data on economic activity shows that the growth still continues in 2014 despite the recent negative foreign and domestic developments. Additionally, domestic demand is expected to be slower than estimated while the positive contribution of external demand is expected to be stronger. In this framework, balancing between domestic and external demand in 2014 is expected to be stronger than the estimate of MTP.

As in all over the world during the crisis period, unemployment rate increased in Turkey. However, effects of the crisis on the labor market have been minimized in Turkey thanks to the measures taken during and after the crisis period. The strong economic recovery achieved in the post-crisis period brought along a strong trend in the employment and between April 2009 and December 2013 in seasonally adjusted terms additional 5 million and 64 thousands new jobs were created. Moreover, labor force participation rate maintained its upward trend in 2013 as it has been since 2008. The labor force participation rate which was 46.9 percent in 2008 was realized as 50.8 percent in 2013. Despite the strong trend in employment, the increase in participation rate led to the gradual increase in unemployment rate in 2013 and it was realized as 9.7 percent.

The MTP for the 2014-2016 period predicts that employment elasticity of growth would be around at historical levels and the increasing trend of participation rates would continue. As a result, the slight improvement in unemployment rates is forecasted throughout the period.

The moderate and steady upward trend in exports during recovery from global crisis has showed a stable outlook in 2013 due to the base effect stemming from the gold trade and realized as USD 151.8 billion. However, exports excluding gold has grown strongly in 2013 and the first two months of 2014. It is expected that upward trend in exports performance will continue throughout the year as a result of the relatively positive outlook in our trading partners and the gain in competitiveness in Turkish Lira.



After strong rebound in the wake of the global crisis imports declined in 2012 and contributed rebalancing in the economy. In 2013, imports exhibited a modest upward trend due to increasing domestic demand and production. In January-February 2014, with the impact of macro-prudential measures in the last quarter of 2013, the tax regulations in January 2014 and the exchange rate depreciation imports (exc. gold) has slowdown which is signaling the contribution of net external demand would be higher than MTP expectations for 2014.

Since the beginning of 2013 current account deficit has increased because of the rebound in domestic demand and gold trade, and realized as USD 64.9 billion, 7.9 percent of GDP. Although current account deficit widened and realized above MTP forecast level, current account deficit excluding gold has improved gradually since the beginning of 2013. Despite continued economic activity in January-February 2014, foreign trade deficit excluding gold has continued to improve and indicates that the decline in current account balance will be more pronounced in 2014 with the help of stable gold and energy balance.

In May 2013, with the emergence of expectations that FED would change its expansionary monetary policy that has been followed after the global crisis, Turkey has experienced capital outflows, mainly in portfolio outflows, similar to the other developing countries. However, Turkey has managed to conclude the year with USD 5 billion net portfolio inflows. Besides, Turkish banking sector and private sector managed to roll over its debt with over 100 percent; and banking and non-bank private sectors Eurobond issuances in international markets has continued in 2013 and 2014.

In 2013, exchange-rate pass-through effects and high unprocessed food prices were the main dynamics of inflation. On the other hand, moderating energy and import prices eased inflationary pressure last year. Thus, 2013 headline inflation realized as 7.4 percent. As of March 2014, monthly inflation was realized as 1.1 percent where yearly figure increased to 8.4 percent. In the upcoming period, modest domestic demand and base effect should ease inflationary pressure, but the lagged effects of the exchange rate pass-through and rising food prices (especially unprocessed food prices might be affected from probable drought) are expected to continue put some pressure on inflation. The CBRT raised its inflation forecasts for the end of 2014, hiking its mid-point forecast to 6.6 percent.

In 2013 central government budget performed well with the effects of the improvement in domestic economic activity and the one-off revenues; and budget deficit to GDP ratio realized at a level of 1.2 percent. While the budget deficit to GDP ratio improved prominently, the primary budget surplus to GDP ratio realized as 2.0 percent, well above the initial budget target. The improvement trend in the central government budget indicators is projected during the Medium Term Program period.

To reduce the sensitivity of debt stock to market volatilities, borrowing policy based on strategic benchmarks continued in 2013. However, the volatility occurred in exchange rates throughout the year limited the downward trend and European Union defined debt stock to GDP ratio realized as 36.3 percent at the end of the year. The downward trend of the debt stock to GDP ratio is expected in the Medium Term Program period.

Together with the successful outlook of public finance, the banking sector maintained its robust position during volatility in the global markets in 2013 and the sector continued to grow on the basis of credits and total assets to GDP ratio realized as 111 percent. In the banking sector with high quality structure, nonperforming loans to total loans ratio draw back to 2.7 percent as of 2013.

Capital adequacy ratio (CAR) realized as 15.3 percent as of 2013 and remained above the legal rate of 8 percent and targeted ratio of 12 percent. In addition, it is seen no significant currency risk in the banking sector that continued to be balanced in terms of net FX position.

Recently, a number of subsequent macro prudential measures have been put into practice to prevent excessive household's borrowing. Besides, in order to enable the channelization of funds to productive investments and support both production and exports, the costs of SME's and export credits were reduced. In this respect, in the upcoming period it is foreseen that commercial loans' growth will be dominant in total credit growth. It is also expected that in the mid- and long-term these measures will make a significant contribution to growth of banking sector in a stronger, stabilized and balanced way.

The main purpose of Medium Term Program, which is prepared in the perspective of the Tenth-Five Year Development Plan, determined by considering the developments in global economy in order to achieve strong, sustainable and balanced growth. In this framework, the priorities of medium-term policy have been determined as gradually reduce the current account deficit, decrease inflation rate and increase domestic savings rate. Recently observed external balance and credit developments demonstrate that the applied economic policies and the implementation of structural reforms are effective.

FISCAL POLICY AND CASH MANAGEMENT

1. FISCAL POLICY

Global economy showed a moderate recovery as well as continuing risk in 2013. Turkey's economy in 2013 showed a parallel performance in addition to the global economy and accelerated by comparison to the previous year especially with the contribution of public spending and consumption and grew by 4 percent on an annual basis, which grew under the expectations with a rebalancing policy in 2012. In this period, central government budget showed significant improvement as result of tax revenues, which increased by the contribution of domestic demand, and privatization revenues compared to the 2012. The central government budget deficit which was anticipated as 2.2 percent of GDP according to the 2013 Central Government Budget Law, was revised to 1.2 percent of GDP in the 2014-2016 MTP that was announced in October 2013 and realized 1.2 percent.

The central government budget (CGB) balance was realized as 1 point lower than the budget law deficit target in 2013, mainly because of increase in revenues. The main reason for this improvement was, as percentage of GDP, 1.5 point revenue increase compared to spending increase of 0.6 point. Central government revenues in detail, BOTAS and TEDAS payments related to their tax arrears were the main source of tax revenues increase, and one off revenues such as; Halkbank privatization, premium revenue on government bonds and 2B land sales were the main source of non-tax revenues increase. The main sources of increase in primary expenditure were capital expenditures and capital transfers. During this period, interest expenditures was realized TL 3 billion lower than Budget Law anticipation.

Table 1 - Central Government Budget 2013

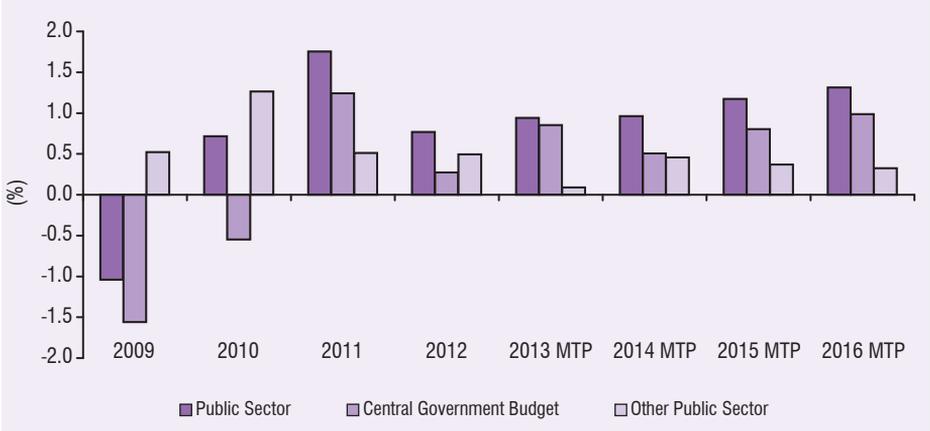
(Billion ₺)	Budget Law	MTP Est.	Realization
Budget Balance	-34.0	-19.4	-18.4
Primary Balance	19.0	31.1	31.5
Revenues	370.1	387.2	389.4
Tax Revenues	317.9	325.1	326.1
Other Revenues	52.1	62.0	63.3
Expenditures	404.0	406.6	407.9
Primary Expenditures	351.0	356.1	357.9
Interest Expenditures	53.0	50.5	50.0

Source: Ministry of Finance

The program defined primary balance of the public sector as a ratio of GDP in 2012 decreased by 1.0 point compared to the previous year and declined from 1.8 to 0.8. The main reason for this outcome was the central government budget, which was decreased 0.9 point. In the 2014-2016 MTP public sector primary balance to GDP ratio is estimated to be 0.9 percent surplus which leads moderate

recovery in 2013. Realizations of central government figures are the main reason of this improvement. However, due to negative effect of local government and extra budgetary funds compared to the previous year's performance, the positive impact of the central government is expected to remain limited to the program defined primary balance.

Figure 1 - Public Sector Primary Balance (% of GDP)



2. CASH MANAGEMENT

In 2013, cash-based revenue collection increased by 15.2 percent compared to 2012 and realized as TL 376.5 billion and previous year's deferred appropriations and cash based non-interest expenditure of the current year's budget appropriations increased by 14.8 percent with respect to 2012 and realized as TL 352.2 billion. Within this scope, cash-based primary surplus realized as TL 24.3 billion in 2013.

Table 2 - Treasury Cash Realizations

(Billion ₺)	2012	2013
1. Revenues	326,8	376,5
2. Expenditures	354,6	398,7
Non-interest expenditures	306,7	352,2
Interest payments	47,9	46,5
3. Primary Balance	20,1	24,3
4. Privatization and Funds Income ⁽²⁾	3,1	9,8
5. Cash Balance (1+4-2)	-24,7	-12,4
6. Financing (7+8+9+10+11)	24,7	12,4
7. Borrowing (Net)	19,2	18,0
Foreign Borrowing (Net)	1,7	4,9
Borrowing	13,6	13,5
Payment	11,9	8,6
Domestic Borrowing (Net)	17,5	13,1
Borrowing	101,5	141,2
Payment	84,0	128,1
8. Privatization ⁽³⁾	0,0	0,0
9. Transfers from SDIF	0,6	0,7
10. Receipts from On-lending	2,1	1,6
11. Change in Bank Accounts ⁽⁴⁾ -(5+7+8+9+10)	2,8	-7,9
12. Effect of Change in Exchange Rate ⁽⁵⁾	-0,5	1,9
13. Net Change in Bank Accounts ⁽⁴⁾ (11-12)	3,2	-9,8

(1) The amounts transferred from Privatization Fund and Unemployment Insurance Fund for South Eastern Anatolia Project that will be recorded as budget revenue in the Public Accounts Bulletin and revenue of 2B land sales are shown here.

(2) This row indicates the amount transferred from Turkish Privatization Administration for budget financing.

(3) A decrease / increase in bank accounts is denoted by + / - sign.

(4) This row indicates the change in the value of the items held in foreign exchange as a result of the exchange rate movements. Positive amount indicates the increase in the value of bank accounts and negative amount indicates the decrease in the value of bank accounts.

Furthermore, interest revenue of Unemployment Insurance Fund (UIF) amounted to TL 76 million, revenue of 2B land sales amounted to TL 1.4 billion, and cash surplus of Privatization Fund (PF) amounted to TL 8.3 billion were transferred to the Treasury accounts. The interest payments realized as TL 46.5 billion and Treasury cash deficit realized as TL 12.4 billion in 2013.

Box 1:

Public Resource Management (Public Treasurership)

The implementation of Public Treasurership aims to improve the effective use of public resources. In this context, detailed monitoring and reporting activities related to the regulations of General Communiqué on Public Treasurership for each public institution are carried out through usage of the data from banking sector based on the Tax Identification Numbers of the public institutions.

In order to ensure a more robust implementation, the Communiqué was amended in 11.09.2013 in line with the opinions and suggestions of the public institutions. With this amendment, the definitions of short term and long term public resources were determined. Within this framework, the regulation which intended that the short term resources of the public institutions under the scope of the Communiqué could be deposited with interest rate no less than the Turkish Central Bank's weekly repo rate and long term resources could be deposited with interest rate no less than the interest rate of Treasury Domestic Borrowing Bonds with similar maturity was made.



DEBT MANAGEMENT

Public debt management is primarily based on the principle of reducing costs to the most appropriate level by considering various risks that the debt stock is exposed to. Within this framework, borrowing policies are carried out in line with strategic benchmarks designed annually with a medium-term perspective. Conducted since 2003, this practice contributed significantly to the alleviation of debt burden and the reduction of debt stock's sensitivity to the external shocks.

In addition, macroeconomic balances and cyclical developments are considered during the all stages of debt management process starting with formulation of strategic benchmarks and proceeding with borrowing. In this context, debt management is carried out in coordination with institutions responsible for monetary and fiscal policies.

2013 Treasury Financing Program and its realization are shown in the following table.

Table 3 - Treasury Financing Program ⁽¹⁾

(Billion ₺)	2013	
	Program	Realization
I- TOTAL DEBT SERVICE	188.6	183.2
Domestic Debt Service	172.1	167.1
Principal	130.8	128.1
Interest	41.3	39.1
External Debt Service	16.5	16.1
Principal	8.8	8.6
Interest	7.7	7.4
II- FINANCING	188.6	183.2
Financing Other Than Borrowing ⁽²⁾	24.3	28.5
Total Borrowing	164.3	154.7
External Borrowing	13.7	13.5
Domestic Borrowing	150.6	141.2
TOTAL ROLL-OVER RATIO (%)	87.5	84.5
Memo (Billion TRY)		
NET BORROWING (Borrowing - Principal Payments)	24.7	18.0
Net Domestic Borrowing	19.8	13.1
Net External Borrowing	4.9	4.9

(1) Cash based.

(2) The cash primary balance, privatization revenues, the revenues from 2/B land sales, receipts from on lending and guaranteed debt, receipts from SDIF, use of cash account and FX changes are shown under other financing item.

As shown in Table 3, total amount of TL 183.2 billion debt was redeemed and TL 154.7 billion worth of borrowing was realized.

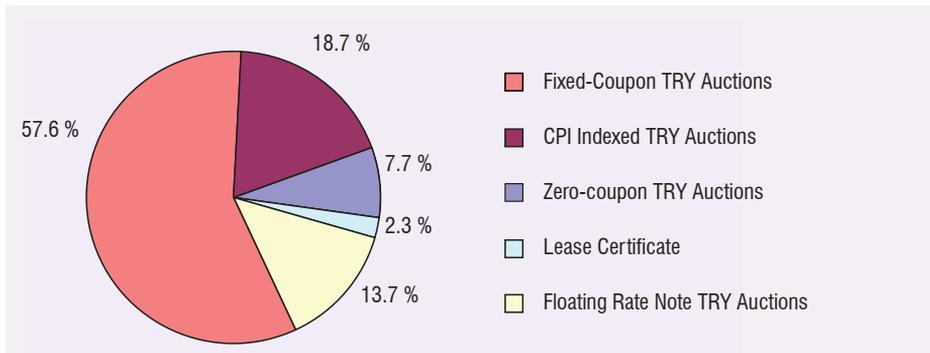
DOMESTIC BORROWING

During the year 2013 in which moderate recovery in the global economy has been continuing, policies in line with the medium and long term objectives of debt management were implemented by taking into account both foreign and domestic economic conditions and market developments. A significant decrease in interest rates was observed in domestic debt market within the increase expectations of receiving investment grade rating in the first half of the year. Nevertheless, in May 2013 interest rates in domestic market began to rise as a result of the announcement of FED's tapering plan and the developments in the local market. In the same period when the volatility in the domestic market has risen as in other emerging market economies, the effects of the experienced volatility in the domestic market were aimed to be minimized by implementing a financing program in coordination with monetary and fiscal policies. Besides, borrowing requirement has retreated due to the fact that non-borrowing resources have been realized better than the projections and also a better performance in the roll over ratio has been achieved compared to the projections. In this context, 2013 domestic roll over ratio was realized as 84.5 %, which was lower than the projection of 87.5 % at the beginning of the year.

Significant improvements in the maturity structure of Central Government Domestic Debt were achieved in 2013. In line with the medium and long term goals of the debt management, the borrowing maturity in the domestic market continued to increase gradually. In this context, the 10 years CPI Indexed and fixed rate domestic debt securities continued to be issued and the share of these securities in total borrowing was increased. On the other hand, liquidity enhancing has been tried out in a wide range of maturities on the yield curve by issuing TL denominated 2, 5 and 10 year fixed rate benchmark bonds on a regular basis.

To increase the domestic savings, to broaden the investor base and to diversify the borrowing instruments lease certificates (Sukuk bonds), which was firstly issued in 2012, were continued to be issued in 2013. Turkish Treasury raised TL 3.3 billion through the issuance in February and August 2013 in domestic markets.

Figure 2 - Domestic Borrowing by Instruments in 2013





In 2013, 57.6 percent of total domestic cash borrowing was conducted through TL denominated fixed rate coupon bonds; 18.7 percent through TL denominated CPI indexed bonds; 13.7 percent through TL denominated floating rate notes; 7.7 percent through TL denominated Zero-coupon bonds; 2.3 percent through TL denominated lease certificate.

In 2013, 97.7 percent of domestic borrowing was conducted through 64 auctions and the remaining 2.3 percent with direct sales. Due to higher demand for government securities from both domestic and foreign investors, cumulative average bid to cover ratio increased from last year's 2.4 to approximately 3.0. Following the announcement of FED's tapering plan in May 2013, risk perception of investors against emerging markets has been deteriorated. In this regard, an outflow of foreign inventors from the emerging markets has been observed in the second half of 2013 and share of foreign residents in domestic debt stock of Turkey decreased from 23.2 percent to 21.5 percent in the same period. The average maturity of cash-based domestic borrowing increased from 60.8 months to 74.5 months in 2013, relative to previous year. Moreover, the annual weighted average cost of TRY denominated fixed rate coupon bonds decreased from 8.8 percent to 7.9 percent in the same period.

EXTERNAL BORROWING

Program Finance

In 2013, an amount of TL 13.5 billion external borrowing was carried out in response to a total of TL 16.1 billion external debt services.

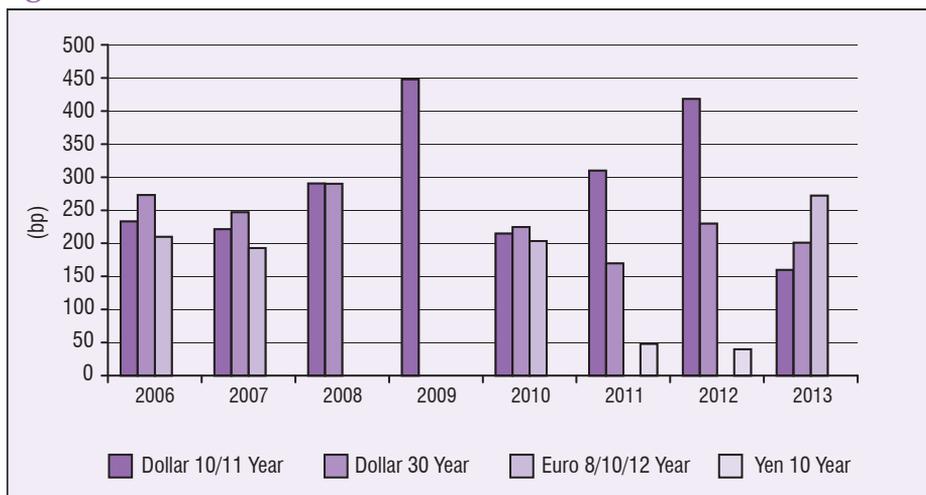
Financing from International Capital Markets

In 2013, USD 6.1 billion worth of funding was raised from international capital markets via 4 international bond and 1 lease certificate issuances. Treasury issued a bond in January 2013 with 10 year maturity and a yield of 3.25%. The maturity of the Yen transaction in Samurai private placement market on February 6, 2013, marks the longest ever achieved among Yen denominated bond issuances to date. The 30 year maturity bond that was issued in April 2013 with a yield of 4.875% marks the lowest cost among the issuances of the same maturity. Treasury issued a lease certificate, amounted to USD 1.25 billion, in October 2013. Additionally, following a 3-year absence from the EUR-denominated market, Treasury issued an EUR-denominated bond at an amount of USD 1.7 billion. Approximately USD 640 million of this issue was for pre-financing of the 2014 external borrowing program.

As part of the 2014 financing program, a total of USD 6.5 billion external financing is projected to be raised from international capital markets.

Table 4 - Eurobond Issuances in 2013

Issue Date	Maturity Date	Currency	Amount	Coupon (%)	Yield-To-Investor	
					(%)	Spread (bp)
01.15.2013	03.23.2023	USD	1,000,000,000	3.250	3.443	UST + 160
02.06.2013	02.07.2033	Yen	18,400,000,000	2.680	2.680	JPY 20 Y Swap + 89
04.16.2013	04.16.2043	USD	1,500,000,000	4.875	4.950	UST + 200.9
10.10.2013	10.10.2018	USD	1,250,000,000	4.557	4.557	MS + 300
11.12.2013	11.12.2021	EURO	1,250,000,000	4.350	4.450	MS + 272

Figure 3 - Risk Premiums for International Bond Issuances ⁽¹⁾

(1) The values are the weighted averages of the spreads and the nominal amounts of the bonds issued during the year corresponding to the given maturity.

Box 2:

Developments in the International Capital Markets

There has been volatility in emerging markets after FED Chairman Ben Bernanke signaled on May 22, 2013, the possible start of FED tapering of asset purchases by year-end. Capital inflows to EM have decreased to some extent and the central banks of Brazil, India, Indonesia, South Africa and Turkey increased interest rates to avoid currency depreciation. The increasing trend in advanced economies' growth rates has slowed down. In addition, the external and domestic political events have negatively affected the economy and financial markets.

With the implications of the negative sentiment in global markets, the yield level of our bond due in 2023 increased to 5.22% at the end of February 2014, from 3.632% at the end of February 2013. The 5 year CDS spread of Turkey increased to 245 bps at the end of 2013, from 127 bps at the end of 2012. The maximum and the minimum levels of 5 year CDS of Turkey were respectively 248 bps and 111 bps in 2013. 5 year CDS spread is 230 bps, as of end of February 2014.

JP Morgan Emerging Markets Bond Index (EMBI+), which comprises all major emerging market sovereigns and is widely used as a benchmark for the performance of the market as a whole, and the EMBI+ Turkey sub-index increased by approximately 72 bps and 95 bps respectively to 348 bps and 297 bps in February 2014, compared to at the end of February 2013.

Program Financing from the International Monetary Fund (IMF)

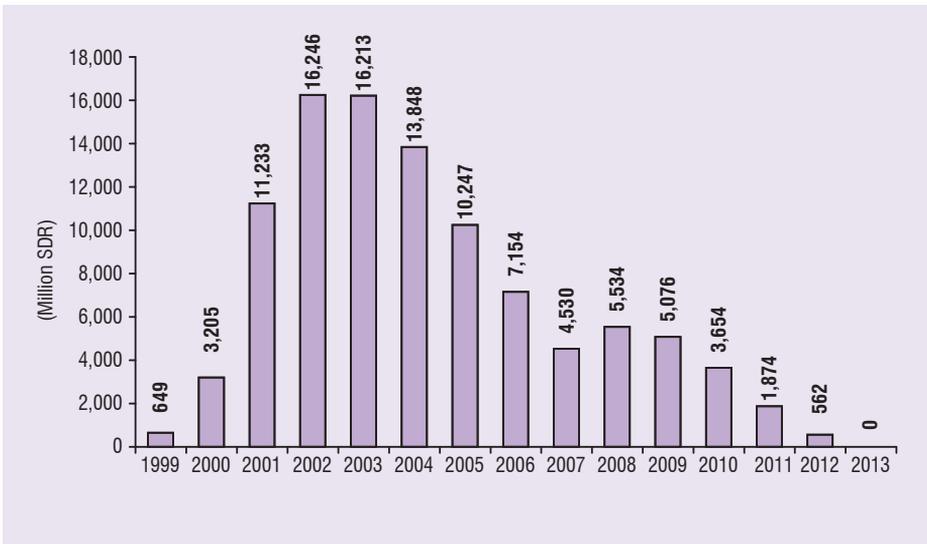
In 2013, total repayment to the International Monetary Fund (IMF) has been SDR 565 million (of which SDR 562 million was principal and SDR 3 million was interest). Following the last principal repayment amounted to SDR 281,054,809 due on May 14, 2013, Turkey's debt to the IMF resulting from the disbursements under the Stand-By Arrangements was completely paid off.

Table 5 - Net Financing From International Monetary Fund ⁽¹⁾⁽²⁾

(Million SDR)	2000-2008	2009	2010	2011	2012	2013	TOTAL
I. Disbursement	30,093	0	0	0	0	0	30,093
II. Debt Service	29,313	582	1,508	1,826	1,328	565	35,121
Principal	25,208	458	1,423	1,780	1,312	562	30,742
Interest	4,105	124	85	46	16	3	4,379
III. Net Financing (I-II)	780	-582	-1,508	-1,826	-1,328	-565	-5,028
IV. Net Financing Excluding Interest	4,886	-458	-1,423	-1,780	-1,312	-562	-649
V. IMF Debt Stock (end of period)	5,534	5,076	3,654	1,874	562	0	..

- (1) The Undersecretariat of Treasury and the Central Bank combined. The Central Bank made its last disbursement in 2001 and completed its repayment obligations in 2005.
(2) End-Dec 2013 \$/SDR exchange rate is 1.54.

Figure 4 - Debt Stock to IMF





Program Financing from European Investment Bank (EIB)

A program loan of EUR 150 million was secured from the European Investment Bank on December 2, 2013. The loan will be utilized to support the ongoing activities regarding forest rehabilitation, erosion control and afforestation by the Ministry of Forestry and Water Affairs.

Program Financing from French Development Agency (AFD)

Similar to the program loan with the EIB, a program loan of EUR 150 million was secured from the French Development Agency (AFD / Agence Française de Développement) on January 27, 2014 for the forest rehabilitation, erosion control, and afforestation activities of the Ministry of Forestry and Water Affairs.

Program Financing from the World Bank

A Competitiveness and Savings Development Policy Loan (CSDPL), in the amount of EUR 624.1 million has been secured from the World Bank to support Turkey's reform efforts in fostering business environment and competitiveness, boosting domestic savings and deepening the financial sector. The Loan Agreement was signed on June 7, 2013 and the loan amount disbursed on July 25, 2013.

DEBT STOCK

The ratio of central government debt stock to GDP was 37.5 percent in 2013 while it was 37.6 percent in 2012. 68.8 percent of the total stock is domestic debt stock, while foreign debt stock forms 31.2 percent of the total stock in 2013.

Furthermore, the share of the fixed rate debt within the central government debt stock, which was 59.8 percent at the end of 2012, increased to 61.5 at the end of 2013. Therefore, declining trend in the sensitivity of the debt stock to interest rate changes has been continued (Table 8).

Table 8 - Interest Composition of Central Government Debt Stock

(%)	2006	2007	2008	2009	2010	2011	2012	2013
Fixed	54.0	55.8	57.0	53.4	56.0	59.2	59.8	61.5
Floating	40.8	37.5	37.3	38.0	32.8	28.4	25.9	22.1
CPI Indexed	5.2	6.7	5.7	8.5	11.2	12.4	14.3	16.4

A gain of confidence has been built in the markets for a while by means of strong borrowing strategies that have been steadily implemented and enhanced by medium-long term programs by the Undersecretariat of Treasury and sharing of the debt management results in a transparent way with the public. Thus, the control of liquidity, interest and foreign exchange rate risks with the help of strategic benchmarks has been maintained and the sensitivity of the domestic debt stock to these risks has declined.

In this context, the currency risk of the domestic debt stock was reduced to zero through the redemption of the foreign exchange denominated and indexed securities in debt stock and the new borrowings realized in domestic currency during 2012.

Additionally, to reduce the interest rate sensitivity on debt under the framework of debt management, mainly fixed rate securities were issued during the year. Thus, the balance of debt has changed in the direction of fixed rate securities such that the ratio of fixed rate securities in total debt is 52.6 percent and the GDP ratio of fixed rate debt is 13.6 percent by the end of 2013.

The share of CPI Indexed securities in total floating rate securities has gradually increased since 2008. The share of CPI Indexed securities in floating rate debt has reached 50 percent at the end of the 2013 from 16 percent as of 2008.

On the other hand, in line with the completion of the redemption of previously issued non-cash securities in 2013 and no more non cash bond issuances the share of non-cash securities in domestic debt stock has decreased to 0.31 percent as of end 2013.

Besides, owing to the ongoing issuance of long term domestic debt securities, there has been improvement both in average maturity and time to maturity of domestic debt stock. Time to maturity of debt, which has showed an upward trend since 2008, has increased by 40 percent last year; from 33.6 months at the end of 2012 to 46.9 months at the end of 2013, thanks to the intensive issuance of 10 year bonds in 2013.

The investor composition of the domestic debt stock has shifted toward local investors during last year. In this context, the ratio of domestic debt stock held by local investors has increased by 1.7 pp and realized as 78.5 percent while the ratio of domestic debt stock held by foreign investors has decreased to 21.5 percent.

Table 9 - Central Government Domestic Debt Stock by Instrument, Currency and Interest Type

(Billion ₺)	2006	2007	2008	2009	2010	2011	2012	2013
Interest								
Fixed	121.1	128.1	140.6	155.1	175.7	192.4	201.9	212.0
Floating	130.4	127.2	134.2	174.9	177.1	176.4	184.7	191.0
<i>CPI Indexed</i>	23.7	22.6	21.7	37.7	53.0	64.3	76.3	96.2
Currency								
TL	216.8	229.2	251.8	312.8	347.3	365.0	386.5	403.0
FX	34.7	26.1	23.0	17.2	5.5	3.7	0.0	0.0
Cash / Non-Cash								
Cash	208.4	220.6	248.7	313.2	350.4	366.4	384.7	401.8
Non-Cash	43.1	34.7	26.1	16.8	2.5	2.4	1.9	1.3
Central Government Domestic Debt Stock	251.5	255.3	274.8	330.0	352.8	368.8	386.5	403.0

On the other hand, the general government debt stock of Turkey (Maastricht debt) within the context of Excessive Deficit Procedure (EDP) has been compiled and announced by the Undersecretariat of Treasury since 2003 for the purpose of comparison and analysis of Turkey's general government debt with the level of other EU members' debt. With the scope of EDP, 60 percent threshold is determined for member countries as an indicator of sustainability of debt stock. In this context, in Turkey, the ratio of general government debt stock to GDP has exhibited a downward trend since 2001 except for the 2009 which is the year after global financial crisis. The ratio has realized 36.3 percent at the end of 2013, which is well below the sustainability limit of 60 percent. So, in the last ten years, the debt to GDP ratio in Turkey has followed negative pattern compared to EU average; while the average ratio was 61.1 percent for EU and 77.9 percent for Turkey at the end of 2001, the average ratio of the Union has increased to 85.9 percent and Turkey's ratio has decreased to 36.2 percent as of 2012. It is expected that this downward trend will continue during 2014-2016 period and the ratio is projected as 30 percent by the end of 2016.



The public sector net debt stock has shown an improvement parallel to the progress achieved in both central government and general government debt liabilities during 2013. By the end of 2013, public net debt stock to GDP ratio has declined to 12.7 percent, a reduction of 4.3 pp compared to the end of 2012. The main reason of the reduction is that public sector financial assets has increased by 32.1 percent whereas, liabilities has increased 10.8 percent. In addition to this, the increase in the level of GDP has also contributed into this result. A significant effect of the structural improvement in the public sector net debt has been observed in FX denominated public net liabilities. As of the end of 2013, FX denominated public net debt stock to GDP ratio realized as -4.8 percent which points to a significant improvement in the net foreign currency public asset – liability position.

Table 10 - Debt Stock Indicators

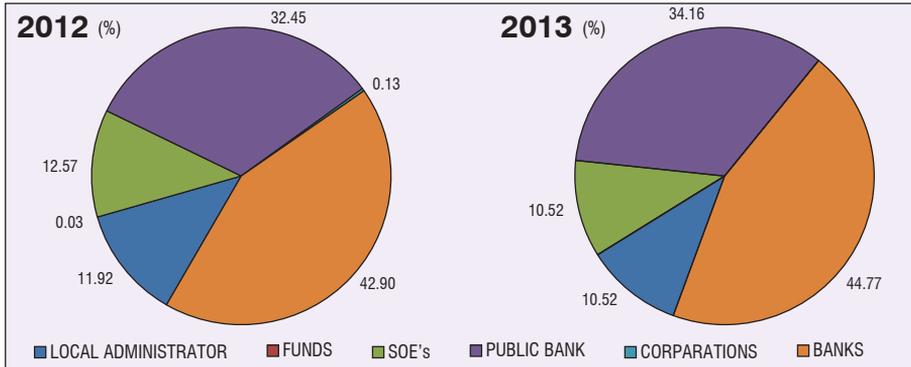
	2008	2009	2010	2011	2012	2013
Central Government Gross Debt Stock (Million ₺)	380,321	441,508	473,561	518,350	532,199	585,835
Central Government Gross Debt Stock / GDP (%)	40.0	46.3	43.1	39.9	37.6	37.5
General Government Nominal Debt Stock Defined by EU Standards (Million ₺)	380,058	438,423	464,604	507,887	512,187	566,288
General Government Nominal Debt Stock Defined by EU Standards / GDP (%)	40.0	46.0	42.3	39.1	36.2	36.3
Public Sector Net Debt Stock (Million ₺)	267,992	309,886	317,783	289,997	240,562	198,278
Public Sector Net Debt Stock / GDP (%)	28.2	32.5	28.9	22.3	17.0	12.7

Note: Figures may vary due to revision of external debt data.

CONTINGENT LIABILITIES AND MANAGEMENT OF TREASURY RECEIVABLES TREASURY GUARANTEES

Treasury guaranteed foreign debt stock has increased in 2013 from its level of USD 9.7 billion in 2012 to USD 10.5 billion. The increase of USD 880 million in the stock is due to Treasury guaranteed credits provided for the public and private banks. The guarantees provided for banks are mostly for financing of the Renewable Energy and Energy Efficiency projects and financing of Small and Medium Sized Enterprises in 2013.

Figure 5 - Treasury Guaranteed External Debt Stock By Borrower



The financial burden of Treasury guaranteed credits by means of Treasury Undertakings has decreased to 4.3percent in 2013 from 5.4percent in 2012. The decline in undertakings from municipalities and lack of undertakings from other enterprises are the main reasons behind this decrease.

In 2013, Treasury has undertaken TL 60.2 million due to the repayment guarantees provided and TL 173.2 million due to investment guarantees provided totaling TL 233.3 million. In 2013, institutions paid 1.38 billion TL from their guaranteed debt stock without any undertakings by the Treasury.

In 2013, no budget allocation has been used for The Risk Account from which the Treasury guaranteed credits undertakings has been paid. The balance of the account carried forward in 2012 and the collections of the account are the main reasons for the surplus of the account in 2013. There hasn't been any need for transfer from the budget allocations because of the sufficient balances of the account since 2009.

Table 11 - Repayments of Treasury Guaranteed Credits

(Million ₺)	2012			2013		
	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %
Local Administrations	74	158	31.8	60	169	26.2
Funds	..	27	..	..	5	..
Financial Institutions	..	119	..	..	128	..
Non-Financial Institutions	..	308	..	..	362	..
Private Sector Financial Institutions	..	648	..	..	694	..
Private Sector Non-Financial Institutions	..	48	..	..	17	..
Total	74	1,307	5.4	60	1,376	4.3

TREASURY RECEIVABLES

As of end of 2013, Treasury Receivables amount has been realized as TL 19.9 billion of which the overdue receivables¹ stock is TL 5 billion and the remaining TL 14.9 billion is undue receivables².

In 2013, overdue receivables stock decreased around TL 2.9 billion with respect to previous year. The transactions of reconciliation with Municipality of Ankara Greater City and privatization revenues of BAŞKENTGAZ are the main reasons for this decrease. Overdue receivables from local administrations accounts forms the biggest part of the stock. The overdue outstanding debt of SOEs and the other central government administrations followed the local administrations respectively.

Table 12 - Treasury Receivables Stock⁽¹⁾

(Million ₺)	2012			2013		
	Outstanding Overdue Receivables	Projected Receivables Stock	Total	Outstanding Overdue Receivables	Projected Receivable Stock	Total
Local Administrations	7,480	7,039	14,519	4,832	8,204	13,036
SOE's ⁽²⁾	304	2,978	3,282	93	3,076	3,168
Banks	0	712	712	0	639	639
Social Security Institution	0	9	9	0	11	11
Public Banks	0	524	524	0	503	503
Other Public Enterprises	0	962	962	0	806	806
Central Administrations	80	1,631	1,711	86	1,706	1,793
Organizations ⁽³⁾	0	10	10	0	5	5
Insurance Institutions	0	22	22	0	13	13
Private Institutions ⁽⁴⁾	0	4	4	0	4	4
Foundations ⁽⁵⁾	0	16	16	0	14	14
TOTAL	7,864	13,907	21,771	5,012	14,982	19,994

(1) Provisional. Indicates the total amount of outstanding overdue and projected receivables.

(2) Due to the prepayment made by Turkish Grain Board, 843.3 million TL was offsetted against the Board's Duty Loss in November 2012.

(3) Represents Industrial Zones, Trade Unions and Istanbul Olympic Games Preparation & Organizing Board.

(4) Represents privatized SOE's and corporations governed by foundations.

(5) Represents universities subordinated by foundations and Foundation of Technological Improvements in Turkey.

1 This shows the unpaid portion of the receivables which is followed under a redemption plan. It consists of receivables arising from the on-lent loans, undertaken amounts of the Treasury guarantees and non-cash domestic debt securities that are not paid on the due date by the borrower

2 This is the projected principles of the receivables followed under a redemption plan.

Compared to 2012, in 2013 undue receivables stock has increased approximately TL 1 billion. This increase is due to the increase of exchange rates observed throughout the year. The Local Administrations and SOE's have the major amount in the undue receivables stock.

In 2013, total collections from Treasury receivables amounted to TL 2.4 billion. With respect to borrowers, the collections realized from Local Administrations have the majority with TL 1.3 billion which is followed by SOE's with TL 0.42 billion and Public Enterprises with TL 0.22 billion.

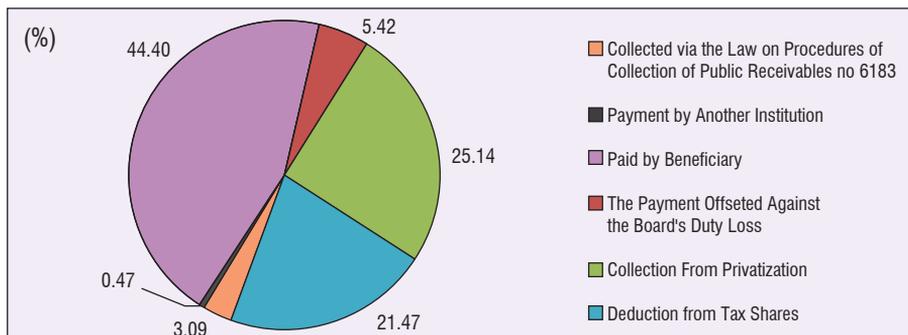
Table 13 - Collections from Treasury Receivables

	2012		2013	
	Million ₺	(%)	Million ₺	(%)
Local Administrations	779	29.0	1,356	55.4
SOE's ⁽¹⁾	1,297	48.2	422	17.2
Banks	164	6.1	214	8.8
Social Security Institution	1	0.1	1	0.0
Public Banks	88	3.3	131	5.3
Public Enterprises	260	9.7	227	9.3
Central Administrations	75	2.8	71	2.9
Organizations	7	0.3	11	0.4
Insurance Institutions	14	0.5	13	0.5
Private Institutions	1	0.0	1	0.0
Foundations	4	0.2	0	0.0
TOTAL	2,689	100	2,446	100

(1) Prepayment made by Turkish Grain Board with the amount of TL 843.3 million was offsetted against the Board's duty loss in November 2012.

The amount of TL 1.09 billion of total collections was paid directly by beneficiaries and TL 0.61 billion were collected from the privatization revenues. In addition TL 0.52 billion were collected via deductions from tax shares.

Figure 6 - The Distribution of the Collections from Treasury Receivables According to Collection Types in 2013



Box 3:

The Sources of Treasury Receivables

The source of Treasury receivables are legislated by the 3rd article of Law No 4749 as follows:

- Undertaking of Treasury Guarantees provided for financing facilities obtained from any foreign financing source
- On-lending of foreign facilities
- Undertaking of other payments which are stemming from relevant legislation by the Treasury
- The State Domestic Borrowing Notes (SDBN) issued by the Treasury for on-lending.

Types of Collections from Treasury Receivables

Cash Payments

- Payment by beneficiary; calculated by adding the principal, interest and expense payments which are directly made by the beneficiary institution.
- Payment by another institution; payments which are made by another institution on behalf of the main borrower.

Deductions from Tax Shares

It covers the deductions from the institutions' general budget tax revenues and İller Bank shares. For metropolitan municipalities, those deductions are made by the Ministry of Finance and for municipalities it is made by İller Bank. The deduction ratio is set to be 25% of the general budget tax revenues share of local administrations if the indebted institution doesn't have any overdue debt after 3/1/2010, otherwise deduction ratio is 40%.

Other Collections

- Payment via the Law on Procedures of Collection of Public Receivables No 6183: It is the forced payment via the Law on Procedures of Collection of Public Receivables No 6183 for which the unpaid amount when a Treasury receivables are not paid by the borrowers.
- Offsetting Payments: They are the offsetting against unpaid capital of the institutions, offsetting against institutions' duty losses, the offsetting payments made by debtor institutions and other institutions on behalf of the main debtors.

RISK MANAGEMENT

Within the framework of the Law on Regulating Public Finance and Debt Management numbered 4749 and the secondary regulation, “Debt and Risk Management Committee” (DRC) is responsible for determining general strategies concerning the management of public assets and liabilities. Major risks arising from the public debt and receivable portfolios, namely market risk, credit risk, and operational risk, are managed in line with the principles and policies set by and regularly reported to the DRC.

MARKET RISK MANAGEMENT

“Market risk” is defined as the exposure of public debt dynamics to market variables such as exchange rates, interest rates and inflation. Delineated as experiencing difficulties in accessing funds required for Treasury operations, “liquidity risk” also raises refinancing (roll-over) risk for Treasury. Public debt management is based on the principle of reducing costs to the most appropriate level considering these risks in medium to long term. Faced with a trade-off between cost and risk, public debt managers try to balance cost and risk effects of changes in macroeconomic indicators on debt dynamics.

By considering risk factors that Treasury portfolio is exposed to, targets are set for current year and following two years via strategic benchmarking approach started in 2003 by Undersecretariat of Treasury. Thus, a medium-term perspective is brought in borrowing policies. In this context, strategic benchmarks determined for the period 2014-2016 are stated below:

- **Exchange Rate Risk:**
 - To borrow mainly in TL.
- **Interest Rate Risk:**
 - To use fixed rate instruments as the major source of TL borrowing and to decrease share of TL debt stock with interest rate re-fixing period of less than 12 months.
- **Liquidity Risk:**
 - To increase average maturity taking market conditions into consideration and to decrease share of domestic debt maturing within 12 months.
 - To keep a certain level of cash reserve in order to reduce liquidity risk associated with cash and debt management.

Figure 7 - Share of Domestic Debt Maturing within 12 Months

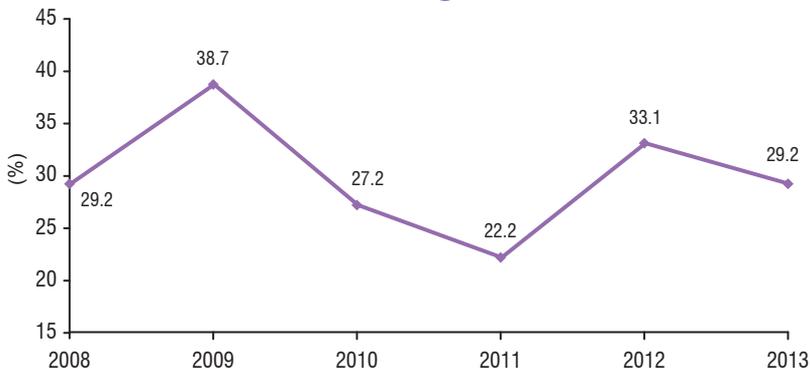


Figure 8 - Interest Composition of Central Government TL Denominated Debt Stock

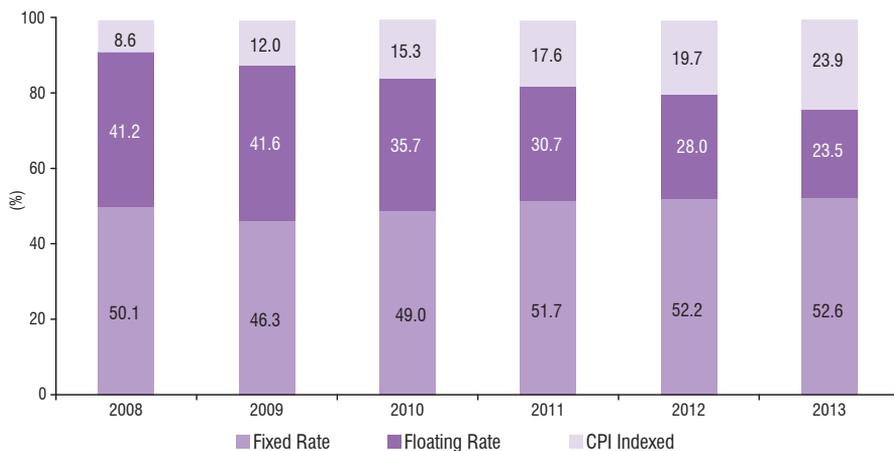
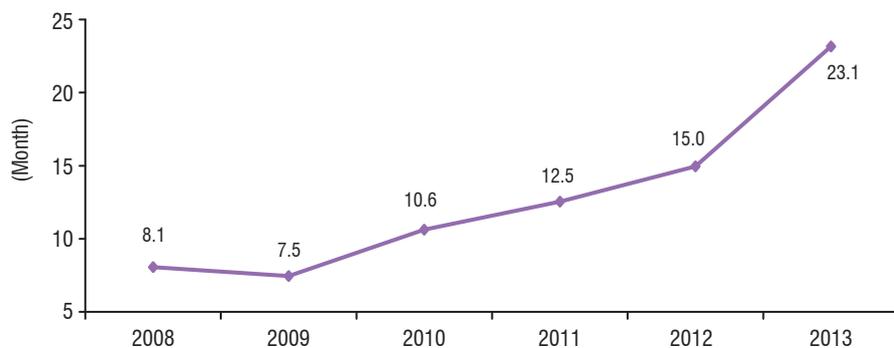
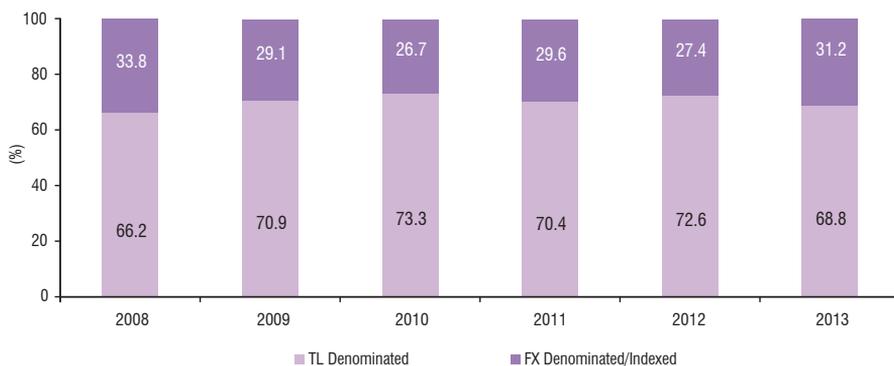


Figure 9 - Duration of TL Denominated Domestic Debt Stock ⁽¹⁾



(1) Non-cash and CPI Indexed bonds are excluded.

Figure 10 - TL/FX Composition of Central Government Debt Stock



Sensitivity Analyses Related to the General Government Debt Burden

Based on “Accounting Approach”, sensitivity analyses related to the debt stock-to-GDP ratio are performed through the sustainability formula stated below. In sensitivity analyses, annual deviations of the general government debt stock-to-GDP level from the baseline scenario are computed under real interest rate, growth rate, exchange rate and primary balance shocks. Therefore, sensitivity of debt burden to changes in these macroeconomic variables is identified.

$$b_t = -ps_t - pri_t + \left[\frac{(1+r_t^d)}{(1+g_t)} \right] b_{t-1}^d + \left[\frac{(1+r_t^f)}{(1+g_t)} \right] (1+\Delta rer) b_{t-1}^f$$

b_t	Total Debt Stock / GDP	r_t^d	TL Real Interest Rate
b_{t-1}^d	TL Denominated Debt Stock of Previous Period / GDP	r_t^f	FX Real Interest Rate
b_{t-1}^f	FX Denominated Debt Stock of Previous Period / GDP	g_t	Growth Rate
ps_t	Primary Surplus / GDP	Δ_{rer}	Change in Real Exchange Rate (TL/\$)
		pri_t	Privatization Revenues/GDP

The results of sensitivity analysis for the general government debt burden by the end of 2013 are stated in the table below together with the ones for 2001 and 2012.

Table 14 - Sensitivity of the EU Defined General Government Debt Burden ⁽¹⁾

	2001	2012	2013
Change in real exchange rate app/dep by 5 percent	+/- 2,2	+/- 0,5	+/- 0,6
Change in TL interest rate by			
10 percent	+/- 2,1	+/- 0,2	+/- 0,3
25 percent	+/- 5,2	+/- 0,5	+/- 0,6
Change in GDP growth rate by 2 percentage points	+/- 1,6	+/- 0,7	+/- 0,7
Change in primary surplus/GDP ratio by 1 percentage point	+/- 1,0	+/- 1,0	+/- 1,0

(1) Reflects the result of analyses carried out by taking into account the adjustment items defined in European System of Accounts 95 (ESA 95) methodology.

In general, sensitivity of the general government debt burden to macroeconomic shocks has a downward trend since 2001. Tight fiscal policies and debt management policies based on strategic benchmarks have contributed significantly to this change. As results of these policies, reduction in borrowing requirement and improvement of debt stock's structure provided a substantial decline in the sensitivity of general government debt burden. On the other hand, fluctuations in interest rates and exchange rates since May 2013 led a limited increase in the sensitivity of general government debt burden to these macroeconomic variables at the end of 2013 compared to 2012.

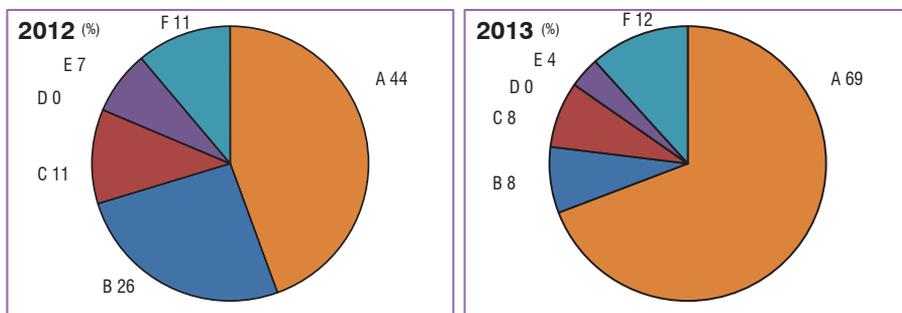
CREDIT RISK MANAGEMENT

Credit risk is defined as the probability that the beneficiary institutions will not be able to fulfil their obligations on time, under the terms of guaranteed or on-lent loan agreements. The realization of credit risk will result in an unanticipated cash need, which may have negative impacts on the borrowing programs. Credit risk management policies aim to assess such risks and to take necessary measures to mitigate them.

In order to effectively manage the credit risk exposure of Treasury, a credit rating model is used to assign ratings to the beneficiary institutions.

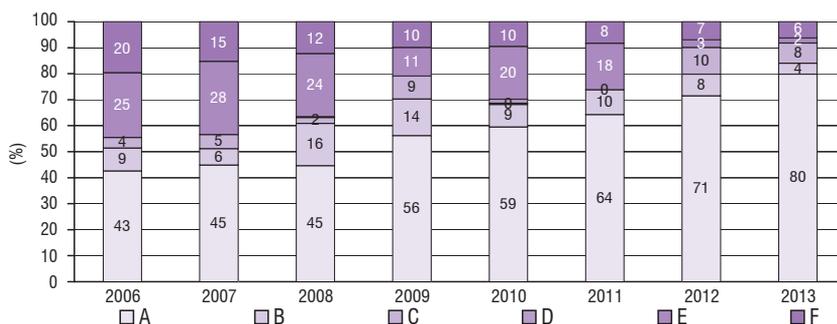
As a result of the measures introduced³ in the area of credit risk management, the share of institutions with “A” credit rating within the overall portfolio of Treasury guaranteed credit and receivable portfolio increased to 69% in 2013 compared to 44% in 2012 (Figure 11).

Figure 11 - Distribution of Treasury Guaranteed Credit and Receivable Portfolio by Credit Rating



By the end of 2013, 80% of the institutions in the Treasury guaranteed and on-lent stock have A credit ratings, whereas only 6% have F credit ratings (Figure 12).

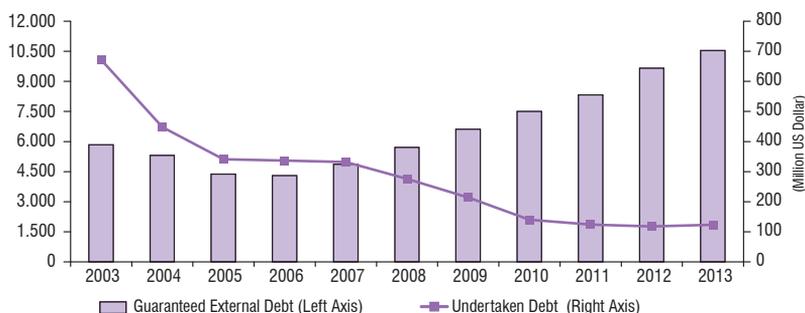
Figure 12 - The Distribution of Treasury Guaranteed Credit and On-lent Stock by Credit Rating



³ For the measures taken under credit risk management, Credit Rating Model and detailed information about the calculation of credit ratings see Public Debt Management Report 2011 pg. 39- 42

Despite the continuous increase in Treasury guaranteed external debt stock since 2007, undertakings from Treasury guaranteed debt stock decreased significantly, as a result of constant implementation of effective credit risk management measures. Consequently, USD 123 million was undertaken in 2013 compared to USD 672 million undertaken in 2003 (Figure 13).

Figure 13 - Treasury Guaranteed External Debt Stock and Undertakings from Treasury Guarantees



On the other hand, the revenues of the Risk Account, which was established to enhance fiscal discipline, has reached a level sufficient to cover the undertaken amounts beginning from 2009. As a result, no budgetary appropriations were allocated to the Risk account since 2009.

Concerning the developments under Treasury supported credit guarantee scheme⁴, between July 2009 and December 2013 a loan volume of TL 2,3 billion was reached, which was supported by guarantees provided by the Credit Guarantee Fund (CGF) amounting TL 1,6 billion. In 2013, a total loan of TL 710 million was provided to the SMEs and TL 53 million was allocated to the maritime companies. In the same year, the amount of guarantee provided by CGF was realized as TL 550 million (Table 15).

Table 15 - Guarantees Provided by the CGF Under Treasury Supported Scheme

(Million ₺)	Loan Size			Corresponding Guarantee Amount		
	SMEs	Maritime	TOTAL	SMEs	Maritime	TOTAL
2010	218	17	234	140	11	151
2011	482	201	683	318	128	445
2012	592	18	610	428	13	441
2013	710	53	763	516	35	550
Toplam	2,002	289	2,291	1,401	187	1,587

Under Treasury supported credit guarantee scheme, the ratio of amounts undertaken by CGF to the total guarantees provided was 2,4% as of the end of 2013. The amount of payments made to CGF by Treasury as a result of non-performing credits was realized at TL 12,2 million in 2013.

4 See Public Debt Management Report 2010 pg. 63-71 for detailed information on credit guarantee applications in Turkey



Box 5:

Debt Assumption Commitment Procedure in Public Private Partnership (PPP) Projects

Debt assumption principally means, within the framework of PPPs, in case of early termination of the contract concluded between the institution owning the project (administration) and the company carrying out the project (company), the assumption by the public sector regarding the liabilities outstanding under the financing provided for the project as of the date of termination of the contract.

In this context, in order to determine the framework of the debt assumption commitment made by Treasury, Article 8/A was added to the Law No. 4749 with the Law No. 6428 dated 21/02/2013. Afterwards, the regulation which defines the principals and procedures for Treasury's debt assumption commitments in the context of this article, has been published in the Official Gazette dated 19/04/2014 with no 28977.

The purpose of the legislation that sets the base for the debt assumption mechanism is to facilitate the financing of the projects by changing the risk allocation between the administration and the company. The debt assumption commitment to be given in one year is capped by a limit which is determined within the central government budget law of the relevant year. The limit was set to be USD 3 billion for 2014, whereas the Council of Ministers is authorized to increase this amount by one fold.

Against this backdrop, Treasury's debt assumption commitment process is presented below.

Schema 1 – Debt Assumption Commitment Process in PPPs



In order to get a debt assumption commitment from Treasury the general and special budget administrations must send a written request with the draft implementation contract to Treasury before publishing the specifications of the tender for the project authorized by the High Planning Council. After the written request, Treasury assesses the clauses directly related with the debt assumption commitment in the draft implementation contract and gives its consent if it deems appropriate. As the next step, a council of ministers decree that authorizes Treasury as the responsible body to provide debt assumption commitments and to negotiate the scope, principles and payment conditions of the financial obligations under the commitment is issued.

After the above stated decree is issued, the public entity finalizes the tender. After the tender, the draft implementation contract is again sent to Treasury. Treasury reviews the provisions related with the Treasury's debt assumption commitment and gives its affirmative opinion. In the meanwhile, Treasury negotiates the debt assumption agreement with the creditors. The scope, principles and payment conditions of the financial obligations arising from debt assumption commitment agreed after the negotiations are presented to the Council of Ministers. Following the issuance of the decree, the debt assumption agreement is signed and the procedure for debt assumption commitment is finalized.

OPERATIONAL RISK MANAGEMENT

Operational Risk Management is a process that provides assessment and measurement of all the risks to which Undersecretariat of Treasury, General Directorate of Public Finance is exposed within the context of corporate goals and objectives effectively. In this context, operational risks in debt management refers to the potential losses that may occur at every stage of the borrowing processes. Operational risks can arise from the extreme events that are not a natural part of everyday life as well as the events driving from personnel, information systems and legislation. In this context, the purpose of operational risk management is the creation of a working plan which can provide minimum errors in the business process as a result of reducing likelihood of the emergence of operational risks by controlling them.

Management of Operational Risks

5018 Public Financial Management and Control Law that reorganizing public financial management and control system in Turkey and the related secondary legislation (Public Internal Control Standards Notification dated 26.12.2007 and published in the Official Gazette No. 26,738 of the internal control standards) aim the establishment of an internal control system based on the COSO model.

Therefore, applied methodology for the management of operational risk management in the asset and liability management in Treasury is based on the COSO⁵ that approaching the establishment of internal control system.

Management of operational risks while conducting of debt, receivables and cash operations is a cycle of the process starting with the definition of risks and continuing with the measurement of risks, production of new control mechanisms and reporting regularly aims to reduce the likelihood of risks.

Cycle of the process mentioned is located in Schema 2.

Schema 2 - Cycle of the Operational Risk Management Process



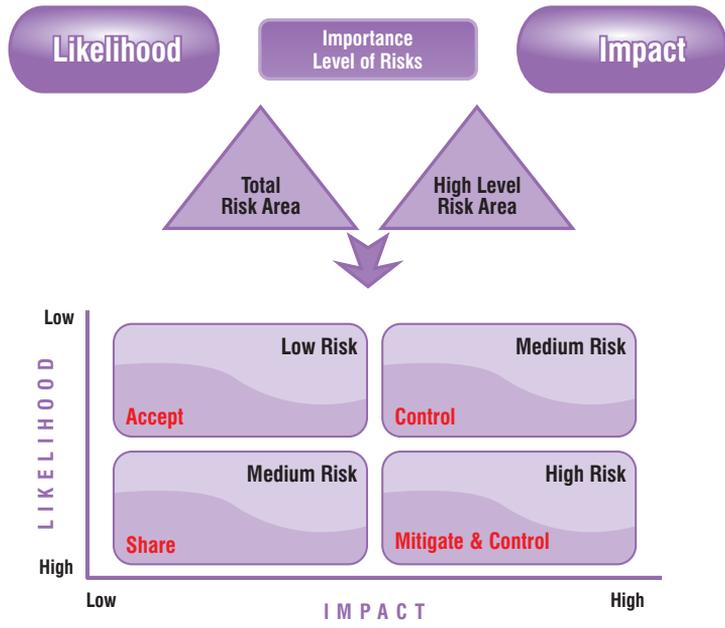
5 Committee of Sponsoring Organizations: COSO provides a guidance based on the principles in order to devise and carry out effective internal controls. For this purpose, it improves effective techniques such as controlling and reporting which enabling the top management to make assessments in an effort to provide institutions to achieve their objectives.

As measuring and analyzing risks, the activities taking place in the work processes, opening at the work processes, threats and countermeasures are taken as input values whereby risk value is projected (calculated) using mathematical and logical methods. However, expression of the cost of operational risk as a numerical is not always possible. Therefore, Undersecretariat of Treasury uses various kind of techniques different from other financial risk measurement methods when it measures operational risks that can be occur at the process of the asset and liability management. Consequently, risk measurement techniques called “Qualitative Approach” and allowing to analyzing of the circumstances in which numerical costs cannot be determined in the context of COSO standards at all times, were improved.

- Likelihood of Risk Level, represents the realization of the level of risks which are defined by the institution.
- Impact Level of Risk, refers to the impact on the completion of the activities in case of each of the risks happened.

After likelihood and the impact level of the risks are identified at the quantitative level, priority risks have been determined and strategies have been developed for eliminating the risks. In this context, risk improvement strategies that each institution can implement at different risk levels are shown in Chart 2.

Schema 3 - Risk Matrix



In order to control of the likelihood of the risk, various kinds of tools such as management of work process, arranging training programs to workers, technical controls in the information systems are used at the General Directorate of Public Finance.



GDPF Risk Profile Table

In the process of risk identification, GDPF Risk Profile Table was created consisting of likelihood, impact and significance level of possible risks to be encountered with the activities belonging to whole work processes of the General Directorate of Public Finance.

In this context, employees match the risks in the Risk Profile Table with the negative operations by entering them to the Incident Notification Table when they fulfill their work within the framework of the asset and liability management. Thus, the input of status notifications are both an indicative of the probability of risks and a tool used for monitoring and controlling of the risk by comparing the activity with the number of annual transaction.

Incident notifications are recorded through employees by Operational Risk Management Information System (ORMIS). Incident notifications entered by employees are reported monthly and quarterly in detail including some indicators such as the number of the notifications, the number of correction of the notifications, the number of correction on the basis of the source of risk etc.

Business Continuity Plan

Institution needs Business Continuity Plan that includes actions and strategies needed in the event of unforeseen extraordinary events in order to perform the first intervention for ensuring the continuity of critical business functions. "Emergency and Business Continuity Plan" which is created in order to ensure effective management of receivables, debt and cash and to take control of the effects of risk, updated when necessary and critical processes through drills at regular intervals sustainability is ensured.

In the process of the practice conducted in 2013, accounting and accrual operations relating to the Turkey's foreign debt payments transactions were tested.

INTERNATIONAL ACTIVITIES IN THE FIELD OF DEBT MANAGEMENT

Since 2002, Treasury has developed its legal and organizational infrastructure and technical capacity in the field of public debt, cash and risk management in line with the best practices at the international level. By the Experience Sharing Program⁶, experience and knowledge acquired over the years are shared with debt management authorities of other countries as well as international institutions via training programs, consultancy, technical support, and workshops.

In 2013, information and training programs on debt, cash and risk management were organized for Nigeria, South Africa, Mongolia, Brazil, and the Commonwealth Secretariat officials. In addition, consultancy on cash management and Single Treasury Account is provided to the Ministry of Finance and Economy of Sudan. Foreign debt managers were informed on debt and risk management methods and activities in training seminars held by institutions like “IMF Middle East Center for Economics and Finance”, “Central Banking Publications”, and “International Consortium on Governmental Financial Management”.

On the other hand, Turkish experience was shared with representatives from various Middle Eastern, African and Asian countries in meetings organized by international organizations, especially OECD, World Bank, IMF and UNCTAD. In addition, within the scope of the Indonesia Public Debt and Risk Management Program organized by the World Bank, information sharing and technical support were provided on management of state guarantees and cost-at-risk modeling.

As in previous years, in 2013 active participation in the activities of the “Debt Management Working Group” and the “Steering Committee” operating within the OECD was continued. Among these activities, preparation and submission of the reports titled “Transparency of Statistics, Operations and Policies” and “Structural Changes in the Investor Base” can be stated.

6 2014 Experience Sharing Program catalog is available at: <http://www.treasury.gov.tr>



RESEARCH
AND ANALYSES



METHODOLOGIES OF CREDIT RATING AGENCIES AND CHANGES IN THESE METHODOLOGIES AFTER THE GLOBAL FINANCIAL CRISIS*

INTRODUCTION

Credit rating agencies (CRAs), with ratings they give, play a role in the assessment of creditworthiness of corporates and countries. However, global crises have caused the credibility of credit ratings to be questioned. The bankruptcies of high grade corporates and funds brought about criticisms on credit rating methodologies and several regulations have been put into force to control the actions of CRAs in a global scale.

This study aims to explain the indicators that CRAs base their qualitative and quantitative evaluations on, and provide information about the changes in the CRAs' methodologies after the crisis. In this context, in the first section of the study, sovereign credit rating will be defined. In the second section, criticisms that are directed to CRAs during the crisis and EU regulations for CRAs after the crisis will be discussed. In the third section, rating methodologies of Fitch, Moody's and Standard & Poor's (S&P), as well as the changes in those methodologies after the crisis, will be explained. Finally, a general assessment regarding the study will be given.

1. THE DEFINITION OF THE SOVEREIGN CREDIT RATING

Sovereign credit rating is an indicator that assesses a country's capacity and willingness to pay back its debt, from a forward looking perspective. Sovereign credit ratings ease interpretation of credit risk, are used in pricing of assets in international capital markets, serve as criteria for regulations in financial system and facilitate comparison of similar asset classes by representing several parameters in a single indicator (Öztürk 2011).

There is an inverse relationship between credit rating and probability of default. CRAs show credit ratings with letters, with AAA/Aaa representing the highest rating and D representing the lowest rating (Table 16). Moreover, BBB-/Baa3 and above ratings indicate that the sovereign is in investment grade category, while below BBB-/Baa3 levels indicate that the sovereign is in speculative category.

Sovereign credit ratings are assigned separately for local currency and foreign currency denominated liabilities. The reason that sovereign credit ratings reflect a country's willingness to pay, in addition to its capacity, is that especially in international context, creditors have limited enforcement if the particular sovereign is not willing to pay back its debt. Local currency credit ratings are generally one notch or two notches above the foreign currency credit ratings due to relative easiness in accessing country's own local currency.

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Table 16 - Credit ratings of S&P, Moody's and Fitch

	Standard & Poor's	Moody's	Fitch
Investment Grade	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
	A+	A1	A+
	A	A2	A
	A-	A3	A-
	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
BBB-	Baa3	BBB-	
Speculative Grade	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-
	CCC+	Caa1	CCC+
	CCC	Caa2	CCC
	CCC-	Caa3	CCC-
	CC	Ca	CC
	C	C	C
D	DDD		
	DD		
		D	

Source: S&P, Fitch, Moody's

2. CRITICISMS TO CRAs DURING THE CRISIS AND EU REGULATIONS ON CRAs

After the 2008 global crisis, CRAs have been criticized for both their methodological errors and conflict of interests, resulting in market participants' trust to CRAs getting seriously shaken. The crisis proved that the early warning mechanisms of CRAs failed, and the markets further deteriorated after rating downgrades (Öztürk 2011). In this context, CRAs have been exposed to serious criticisms for;

- creating conflict of interest, as they receive funds from institutions that they rate and provide consulting services to these institutions at the same time,
- not being able to adapt to the changing environment, and using the same methodologies for years,
- inadequacy of their methodology reports, since the reports are not able to fully explain the intricacies of the rating process. (Rafailov 2011, Öztürk 2011).

Since market trust in CRAs has been seriously shaken due to reasons listed above, some regulations have been made for CRAs. EU regulations are worth mentioning within these regulations, since they are also closely related to Turkey.

The G20 Summit in Washington (2008) aimed to ensure that no institution, product or market was left unregulated in EU and at an international level. The EU Regulation on Credit Rating Agencies (Regulation 1060/2009), which has been in force since December 2010, was part of Europe's response to these commitments. The Regulation was amended in May 2011 (Regulation 513/2011) in order to adapt to the establishment of the European Securities and Markets Authority (ESMA). Finally, with the belief that there are still deficiencies regarding the regulation of CRAs in CRA II, regulation 1060/2009 was amended again with the regulation 462/2013 (CRA III Regulation), and the new regulation became effective on June 20, 2013. The new regulation aims to reduce investors' over-reliance on credit ratings, avoid risks that may arise from conflict of interests, and increase transparency and competitiveness in the sector. The prominent issues in the regulation are as follows:

- CRAs will publish annual calendars each December, setting out the dates for publication of sovereign rating reviews for affected issuers for the forthcoming year, and they will inform ESMA about their calendars. Derogations remain possible in exceptional circumstances and subject to appropriate explanations.
- CRAs will formally review each issuer at least every six months, not at least every 12 months as in the former regulation.
- The ratings or outlook changes will only be published on Fridays after close of business and at least one hour before the opening of trading venues in the EU.
- CRAs will notify the issuers of the rating decision and related rationale a full working day before publication.
- A CRA can be held liable in case it infringes intentionally or with gross negligence the CRA Regulation, thereby causing damage to an investor or an issuer.

The rating of a sovereign is subject to EU regulations if the analyst of that sovereign is located in one of the EU countries. Since the Turkey analysts of Fitch, Moody's and S&P are located in London, these CRAs assign Turkey's credit ratings according to the EU regulations.

3. SOVEREIGN CREDIT RATING METHODOLOGIES

3.1. Fitch

When assigning a credit rating to a sovereign, in addition to the sovereign's financial strength, Fitch considers the following factors:

- Macroeconomic performance and prospects,
- Structural features of the economy,
- Public finances and sustainability of public debt,
- External finances (international trade balances, capital flows, level and structure of external debt etc.)

The sovereign is compared with other sovereigns that are in the same category (e.g., the BBB category would consist of 'BBB-', 'BBB' and 'BBB+') based on each of the factors above and is assessed as strong, weak, or neutral relative to its peers.



The model that Fitch uses in its sovereign rating process is a multiple regression model that employs quantitative and qualitative variables that are shown in Table 17. Although Fitch considers this model as an important analytical tool, it states that none of the models can reflect the country's sovereign rating precisely. For this reason, the final rating that is given by the credit rating committee may differ from the model's results.

Table 17 - Variables that are used by Fitch for sovereign credit rating assessment

Category	Variables
1. Macroeconomic	Consumer price inflation, real GDP growth, real GDP growth volatility.
2. Public Finances (General Government)	Budget balance, gross debt, interest payments, public foreign currency debt.
3. External Finances	Commodity dependence, current account balance plus net foreign direct investment, gross sovereign external debt, external interest service, official international reserves.
4. Structural	Money supply, GDP per capita, composite governance indicator (Average percentile rank of World Bank Governance Indicators: 'rule of law'; 'government effectiveness'; 'control of corruption'; 'voice & accountability'), reserve currency status, years since default.

Source: Fitch

Differences from the Pre-crisis Methodology

When Fitch's current rating methodology is compared with the pre-crisis methodology, following discrepancies arise:

- The pre-crisis methodology was a comparative scoring and peer comparison framework, and this analysis was not based on an empirical model. The new methodology includes a multiple regression model as well as comparative analysis.
- In the current methodology, the variables are listed in a more explicit manner. In this regard, current methodology is more transparent than the pre-crisis one.

3.2. MOODY'S

When assigning bond ratings to sovereigns, Moody's uses 4 key factors which can be seen in Table 18. The values regarding these 4 factors are being provided from the World Bank, OECD, IMF, European Commission and the BIS. However, especially for general government and foreign debt statistics, Moody's uses its own estimates and statistical data which are provided by its analysts.

Table 18 - Credit Rating Factors of Moody's

Broad Rating Factors	Rating Sub-Factor	Sub-factor Weighting (towards factor)	Sub-Factor Indicator
Factor 1: Economic Strength	Growth Dynamics	50%	Average Real GDP Growth
			Volatility in Real GDP Growth
	Scale of the Economy National Income	25%	WEF Global Competitiveness Index
			Nominal GDP (US\$)
Adjustment Factors	1-6 scores	GDP per capita (PPP, \$US)	
		Diversification	
Factor 2: Institutional Strength	Institutional Framework and Effectiveness	75%	Credit Boom
			World Bank Government Effectiveness Index
	Policy Credibility and Effectiveness	25%	World Bank Rule of Law Index
			World Bank Control of Corruption Index
Adjustment Factor	1-6 scores	Inflation Level	
		Inflation Volatility	
Factor 3: Fiscal Strength	Debt Burden	50%	Track Record of Default
			General Government Debt/GDP
	Debt Affordability	50%	General Government Debt/Revenues
			General Government Interest Payments/Revenue
Adjustment Factors	1-6 scores	General Government Interest Payments/GDP	
		Debt Trend	
Factor 4: Susceptibility to Event Risk	Political Risk	Max. Function*	General Government Foreign Currency Debt/General Government Debt
			Geopolitical Risk
	Government Liquidity Risk	Max. Function*	Other Public Sector Debt/GDP
			Fundamental Metrics
Banking Sector Risk	Max. Function*	Public Sector Financial Assets or Sovereign Wealth Funds/GDP	
		Market Funding Stress	
External Vulnerability Risk	Max. Function*	Strength of Banking System	
		Size of Banking System	
			Funding Vulnerabilities
			(Current Account Balance + FDI)/GDP
			External Vulnerability Indicator (EVI)
			Net International Investment Position/GDP

* The aggregation of Political Risk, Government Liquidity Risk, Banking Sector Risk, and External Vulnerability Risk follows a maximum function, i.e. as soon as one area of risk warrants an assessment of elevated risk, the country's overall Susceptibility to Event Risk is scored at that specific, elevated level.

Source: Moody's

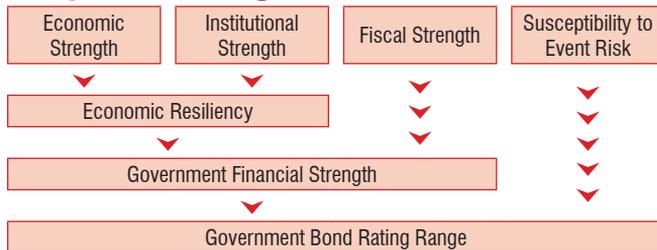
After assigning each sub-factors to a sovereign, these sub-factors are scaled from Very High+ (VH+) to Very Low- (VL-), which are 15 different levels in total.

Schema 4 - Rating Scale of Moody's

VH+	VH	VH-	H+	H	H-	M+	M	M-	L+	L	L-	VL+	VL	VL-
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Schema 4 shows how these 4 main factors result in a sovereign credit rating.

Schema 5 - Moody's Credit Rating Mechanism



When reaching a sovereign credit rating, first step is to weigh economic and institutional strength scores equally and get the economic resiliency outlook. Second step is combining economic resiliency outlook with the fiscal strength



score and reaching government financial strength level. In contrast to the first step, economic resiliency outlook and financial strength score are not weighed equally. If a sovereign's economic resiliency level is within the mid-range, the weights of the economic resiliency and fiscal strength are relatively close to each other. Otherwise, economic resiliency level weighs more. Finally, combining the sovereign's government financial strength and susceptibility to event risk levels determines the government's bond rating range.

Table 19 - Credit Rating Scale Table of Moody's

		Government Financial Strength														
		VH+	VH	VH-	H+	H	H-	M+	M	M-	L+	L	L-	VL+	VL	VL-
Susceptibility to Event Risk	VL	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3
	VL	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3
	VL+	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3
Susceptibility to Event Risk	L+	Aa1	Aa2	Aa3	A1	A2	A3	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3	Caa1
	L	Aa1	Aa2	Aa3	A1	A2	A3	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3	Caa1
	L+	Aa1	Aa2	Aa3	A1	A2	A3	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3	Caa1
	M-	Aa2	Aa3	A1	A2	A3	Baa1	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3
	M	Aa2	Aa3	A1	A2	A3	Baa1	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3
	M+	Aa3	A1	A2	A3	Baa1	Baa2	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	
	H-	Aa3	A1	A2	A3	Baa1	Baa2	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	
	H	A1	A2	A3	Baa1	Baa2	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	
	H+	A1	A2	A3	Baa1	Baa2	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	
	VH-	A2	A3	Baa1	Baa2	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	Caa3	Caa3
	VH	A2	A3	Baa1	Baa2	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	Caa3	Caa3
	VH+	A3	Baa1	Baa2	Baa3	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	Caa3	Caa3	Caa3

Source: Moody's

Adjustment Factors

In addition to the broad rating factors, Moody's also uses some adjustment factors in its credit assessment. These adjustment factors can impact the level of associated factors by 1 to 6 notches to the upside or downside. Adjustment factors can be categorized as follows:

- ✓ **Credit boom:** This adjustment factor is located under the broad rating factor of economic strength. If a country's credit growth exceeds the economic growth, then the risk level in the economy increases and the economic strength factor is affected negatively.
- ✓ **Diversification:** This is another adjustment factor located under the broad rating factor of economic strength. If an economy is depending heavily on a single sector or a single commodity, then the risk level increases.
- ✓ **Track record of default:** This adjustment factor is located under the broad rating factor of institutional strength. Final score of this adjustment factor depends on the default possibility that Moody's assigns to a country, how long it has been since the latest default and the calculated loss of the investors in case of a default.
- ✓ **Debt trend:** This adjustment factor is located under the broad rating factor of fiscal strength. For instance, despite the fact that countries such as Turkey, Indonesia and Philippines have relatively higher debt burdens recently, their credit ratings were upgraded because of the positive developments in their historical and expected debt trends.
- ✓ **General Government Foreign Currency Debt/General Government Debt:** This adjustment factor is located under the broad rating factor of fiscal strength. A country which borrows significantly in foreign currency can be subject to greater financing and exchange rate risks when the markets deteriorate, even if the overall debt burden is not so significant.

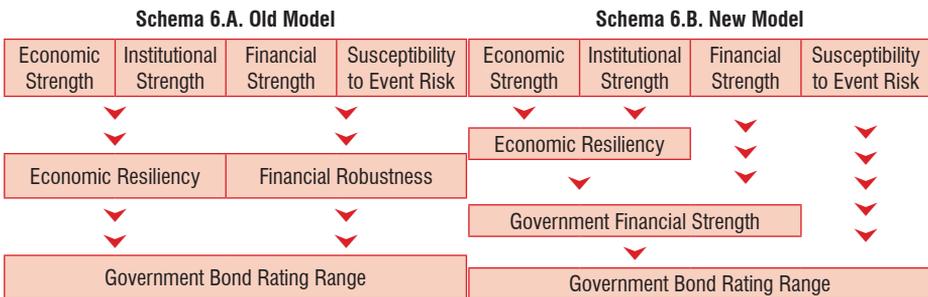
- ✓ **Other Public Sector Debt/GDP:** This adjustment factor is located under the broad rating factor of fiscal strength. This factor is employed based on the fact that financially weak public companies bring additional burden on the budget.
- ✓ **Public Sector Financial Assets/GDP:** This is another adjustment factor that is located under the broad rating factor of fiscal strength. When public sector faces financial distress, existing financial assets act as a positive adjustment factor.

Differences from the Pre-crisis Methodology

When we compare the current credit rating methodology of Moody’s with that of the pre-crisis period, the following discrepancies arise:

- The use and total weight of the quantitative sub-factors were increased within the overall analysis. 10 sub-factors were added under the 4th broad rating factor and inflation measures were added under the 2nd broad rating factor.
- The ‘credit boom’ was added under the 1st broad rating factor, and the ‘debt trend’ under the 3rd broad rating factor.
- Weights of the sub-factors within the broad rating factors are now more explanatory.
- Weights of the growth performance and potential growth were increased in the assessment of the economic strength of a country,
- In addition to the World Bank indicators, inflation measures which reflect the flexibility of the central bank were also included in the institutional strength factor, While the weight of the susceptibility to event risk rating factor was increased, the ‘government liquidity risk’ and ‘external vulnerability risk’ factors, which used to be under the fiscal strength category, were moved to the ‘susceptibility to event risk’ factor.
- By adding “positive”, “neutral” and “negative” outlook levels to the previously only five factor scores (“very low”, “low”, “medium”, “high”, “very high”), the scale of the analytical differentiation between sovereign credit ratings was increased.
- The left-hand side diagram below of the pre-crisis credit rating methodology has evolved into the diagram on the right-hand side:

Schema 6 - Comparison Between New and Old Methodologies (Moody’s)



3.3. STANDARD & POOR'S (S&P)

S&P uses five key areas in its sovereign credit rating assessments:

- Institutional and governance effectiveness and security risks are reflected in the institutional and governance effectiveness score.
- Economic structure and growth prospects are reflected in the economic score.
- External liquidity and international investment position are reflected in the external score.
- Fiscal performance, fiscal flexibility and debt burden are reflected in the fiscal score.
- Monetary policy flexibility is reflected in the monetary score.

Table 20 - Credit Rating Factors of S&P

Area	Main Variables
1. Institutional and Governance Effectiveness Score	<ul style="list-style-type: none"> • The effectiveness, stability, and predictability of the sovereign's policymaking and political institutions • The transparency and accountability of institutions, data, and processes, as well as the coverage and reliability of statistical information • The sovereign's debt payment culture • External security risks
2. Economic Score	<ul style="list-style-type: none"> • Income levels • Growth prospects • Economic diversity and volatility
3. External Score	<ul style="list-style-type: none"> • The status of a sovereign's currency in international transactions • The country's external liquidity • The country's external position
4. Fiscal Score	<ul style="list-style-type: none"> • Fiscal flexibility • Long-term fiscal trends and vulnerabilities • Debt structure and funding access • Potential risks arising from contingent liabilities
5. Monetary Score	<ul style="list-style-type: none"> • The sovereign's ability to coordinate monetary policy with fiscal and other economic policies to support sustainable economic growth • The credibility of monetary policy • Market-oriented monetary mechanisms' impact on the real economy

Source: S&P

Based on the five key rating factors, S&P's credit rating analysis requires a few steps. (See Schema 7).

Schema 7 - S&P's Sovereign Issuer Credit Rating Framework



The first step is to assign a score to each of the five key factors on a six-point numerical scale from '1' (the strongest) to '6' (the weakest). Each score is based on a series of quantitative factors and qualitative considerations. The criteria then combine the institutional and governance effectiveness and economic scores to form a sovereign's "institutional and governance effectiveness and economic profile" and the external, fiscal and monetary scores to form its "flexibility and performance profile." Finally, those two profiles are combined to determine the sovereign foreign-currency rating (after factoring in supplemental adjustments, when applicable and after considering trends and other factors, which can raise or lower the indicative rating by one notch).

A sovereign local-currency rating can be determined by applying zero to two notches of uplift from the foreign-currency rating.

Differences from the Pre-crisis Methodology

When we compare the current credit rating methodology of S&P with that of the pre-crisis period, the following discrepancies arise:

- ✓ With the changes in the methodology that was introduced in 2008, the method to use the five key rating areas became more clear in determining the sovereign ratings. For instance, while there was also a six-point numerical scale from '1' (the strongest) to '6' (the weakest) for the rating factors in the 2008 methodology, the way to combine these scores into a rating was not clear. The multi-step methodology published in the 2013 report contains a more detailed framework to determine sovereign ratings (See Schema 7).
- ✓ The contents of the five key rating areas were also changed compared to the 2008 report. The scopes of the economic, external and fiscal scores were expanded and the adjustment factors became more clear.
- ✓ As the importance of the financial markets has increased especially after the global financial crisis in 2008, some updates have been made in the criteria regarding financial market analysis:
 - The evaluation of contingent liabilities within the financial markets became more comprehensive and the measurement of credit risk, market risk and operational risk became more functional.
 - The impact of the financing provided from other countries or international organizations such as the IMF, World Bank became more significant in credit ratings.
 - The impact of the exchange rate regime in monetary score was decreased and the advancement level of the financial system and the capital market structure began to be reviewed in depth.
 - The weight of the monetary flexibility was increased in the criteria which is needed to put local currency rating at a higher level than the foreign currency rating.



CONCLUSION

Credit rating agencies play an important role in the global financial system as they combine numerous parameters into a single letter, which makes the interpretation of credit risk easier, is used for asset pricing in capital markets, provides criteria for regulations within the financial system and facilitates comparison among similar asset classes.

However, especially after global financial crisis in 2008, credit rating agencies faced some serious criticism and their credibility diminished. Among the criticisms towards the credit rating agencies during this period was that their methodologies were not clear enough.

In this study, credit rating methodologies of three major credit rating agencies (Fitch, Moody's and S&P) were examined and the changes in those methodologies after the 2008 global financial crisis were analyzed. As a result of the analysis, it is observed that the credit rating methodologies have become more transparent compared to the pre-crisis period.

Nevertheless, the fact that the announced credit rating of a country may be different than what the methodology suggests, the confidentiality of the minutes of rating committee meetings and the existence of qualitative elements in the methodologies make the credit rating process more ambiguous.

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PUBLIC FOREIGN FINANCING INSTRUMENTS IN TURKEY*

1. INTRODUCTION

Legal basis for public foreign financing operations in Turkey is defined in the “Law on Regulating Public Finance and Debt Management (Law No. 4749)”. According to the 4th article of the law, the Minister who is in charge of Treasury is authorized to execute all types of foreign state debt operations on behalf of Republic of Turkey⁷. All kinds of preparations, contacts and negotiations related with foreign State debt are implemented and finalized by the Undersecretariat of Treasury⁸.

In this study, foreign financing instruments are analyzed under two sections: “Foreign Financing Instruments for Budget Financing” and “Foreign Financing Instruments for Project Finance”. In the “Budget Financing” section, bond and lease certificate issuances and program loans provided through international financial institutions will be analyzed. In the “Project Finance” section, allocated loans, on-lent loans, Treasury guarantees and grants will be analyzed. In the last section, an overall assessment of foreign financing instruments will be provided.

2. FOREIGN FINANCING INSTRUMENTS FOR BUDGET FINANCING

Foreign financing for budget financing is provided through bond and lease certificate issuances and program loans.

Bond Issuances

Financing through bond issuances in international capital markets is considered to be an important source of funding for emerging market countries. Underdeveloped domestic financial markets, insufficient saving ratios and structural macro-economic problems are the main factors that make international capital markets more appealing for emerging economies. In 2013, a record level of \$480 billion worth of bonds were issued by emerging market economies in international capital markets and \$98 billion of this total amount was issued by emerging market sovereigns. In 2013, despite serious volatility in emerging market economies mainly stemming from US FED’s intention to reduce monthly

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7 Law On Regulating Public Finance And Debt Management (Law No. 4749) - Article 4 – In the name of the Republic of Turkey, the Minister is authorized to obtain Domestic and Foreign State Debt, to provide Treasury Reimbursement Guarantee, Treasury Counter – Guarantee and to make amendments in conditions of such guarantees, grant permission for obtaining foreign financing, to receive grants, to make available the foreign financing facility used through Transfer of Foreign Debt, Onlending of Foreign Debt and Allocation of Foreign Debt complying with the financial terms of the agreement and to create new financial liabilities, to manage these debts and liabilities and to manage the Treasury Claims stemming from these.

8 The Minister is authorized to provide foreign financing from any foreign financing source, to determine the conditions of the mentioned foreign financing facility including financial conditions in the name of the Republic of Turkey, and to bear the responsibility within the framework of the stated conditions. All kinds of preparations, contacts and negotiations related with foreign State debt are implemented and finalized by the Undersecretariat (of Treasury).

bond purchase program, high level of bond issuances gives a strong signal that international bond markets will continue to be a major source of funding for emerging economies in the medium term.

When we look at Turkey, first bond issuance in international capital markets on behalf of Republic of Turkey was executed by Central Bank of the Republic of Turkey in 1987. Tenor of this bond was 5 year, amount was 125 million Deutsche Mark and the coupon rate was fixed coupon rate of 6.875%. First bond issuance executed by Treasury is dated May 10, 1988. Tenor of this issuance was 7 year, amount was 500 million Deutsche Mark and the coupon rate was 6.5%.

After the first issuance in 1988, \$102.4 billion worth of foreign financing has been provided through 161 international bond issuances to date. While the majority of these issuances have been executed in USD and Euro (Deutsche Mark prior to January 1st, 1999), there have also been Japanese Yen denominated issuances between 1992-2000 and 2011-2013. Besides hard currency issuances, there were issuances in alternative markets such as Italian Lira as well. Up until now, the longest maturity bond issued in international markets by Turkey is the 31-year USD denominated bond issued in February 12th, 2014. Size of this bond was \$1.5 billion and the coupon rate was 6.625%.

Lease Certificate Issuances

Lease certificate (Sukuk) is a security which is issued by an asset leasing company in order to enable its holders to get a proportionate share from the revenues derived out of underlying assets and rights. Main difference between lease certificates and bonds is that lease certificates are interest-free borrowing instruments.

On September 18th, 2012, Treasury issued its debut lease certificate in international capital markets. Tenor of this lease certificate was 5.5 years, amount was \$1.5 billion and the lease rate was 2.803%. As of April 2014, a total of \$2.75 billion foreign financing has been provided through 2 lease certificate issuances in international capital markets. And the average maturity of these issuances is 5.27 years.

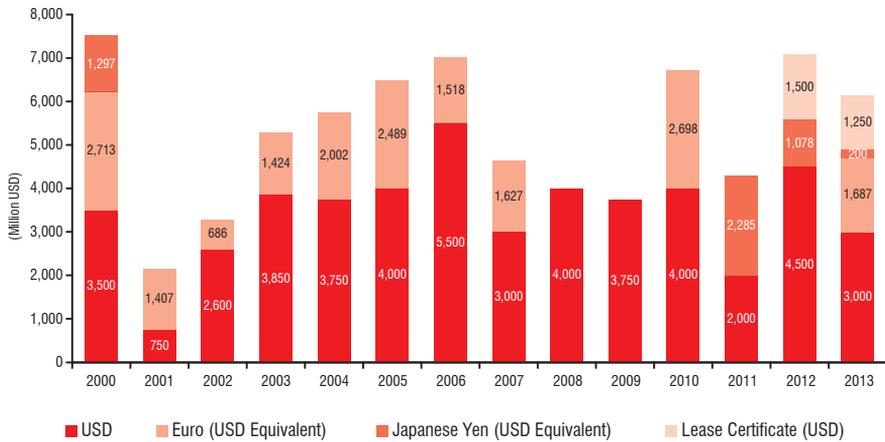
As a new financial instrument, lease certificates have an important role in the diversification strategy embraced by Treasury. Lease certificate issuances helped Treasury to gain access to new group of investors in Middle East and Asia, where Treasury couldn't reach before. Treasury lease certificate issuances have also helped to improve private sector interest-free financial market by establishing benchmarks for corporate sector issuers.

Bond and lease certificate issuances have an important role in borrowing operations in terms of providing foreign financing. One of the main reasons why these instruments are more commonly used recently is the noticeable improvement in investor perception originating from consistent improvement in macroeconomic indicators, strong public finance and banking sector after 2001. This improvement in the investor perception has had a positive effect on borrowing costs and enabled Treasury to borrow from international capital

markets with more favorable conditions. Moreover, improvements in credit ratings that have been assigned by international credit rating agencies to Turkey have also had an important role in terms of improving the investor perception. In this sense, investment grade credit ratings assigned by both Moody's and Fitch in recent years are considered to be significant. Fitch upgraded Turkey's credit rating to investment grade in November 2012 and Moody's upgraded our rating to investment grade in May 2013 (Current Credit Notes: Moody's: Baa3, Fitch: BBB-). Having investment grade credit rating from at least 2 out of 3 major credit rating agencies (Moody's, Fitch and S&P) means having a "full investment grade" status. And being a full investment grade country has been a significant development in terms of extending the investor base.

During the period 2000-2013, \$74 billion worth of bond and lease certificate issuances were executed. Below is a figure for distribution of these issuances on a yearly basis:

Figure 14 : Bond and Lease Certificate Issuances in International Capital Markets Between 2000-2013



Program Loans

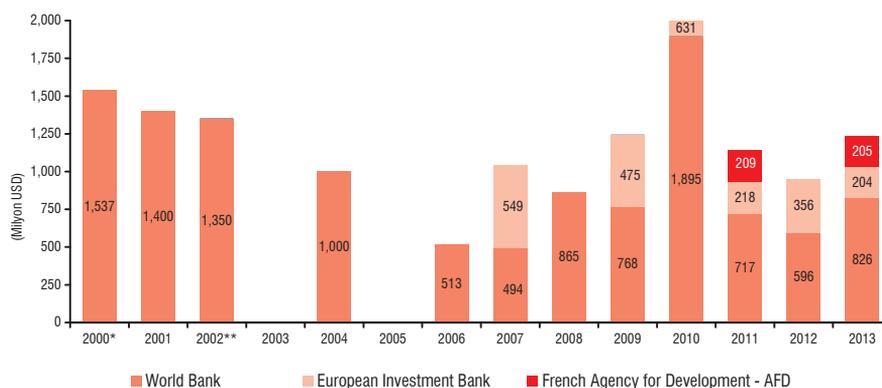
Program loan is a financing facility obtained from any foreign financing source by the Treasury, either directly or under its guarantee, in order to meet the public finance requirement within the framework of macroeconomic programs of the country.

In this context, program loans were obtained and are being obtained from the International Monetary Fund (IMF), the World Bank, The European Investment Bank (EIB) and French Development Agency (AFD):

- ✓ **Program Loans Obtained from IMF:** Turkey's relations with the IMF regarding financing were mainly based on Stand-By arrangements. Since 1961, there have been 19 Stand-by arrangements between Turkey and the IMF. Under these arrangements, 37.7 billion SDR worth of funding were projected to be used and 32.8 billion SDR of the projected amount was used.
- ✓ 19th and the last Stand-By arrangement was completed in May 2008 and since then there has been no funding program with the IMF. Principal payments stemming from 19th Stand-By arrangement were redeemed in May 2013.
- ✓ While Turkey-IMF relations during the 47 years of period between 1961-2008 were mainly based on financing function of the IMF, with the completion of 19th Stand-By Arrangement, relations between Turkey and the IMF shifted to fields of management of global economic system.
- ✓ **Program (Development Policy) Loans obtained from the World Bank:** Within the scope of budget financing, another source of funding is the World Bank. Development Policy Loans (DPL) raised via World Bank are the loans that support budget financing by promoting institutional reforms and comprehensive policy steps in predetermined sectors. Including revenue enhancing policies and institutional precautions these loans target sustainable growth and efficient allocation of resources by stimulating growth and prosperity. In addition, they encourage reforms implemented in different sectors. These loans can be secured through lump sum operations or through a programmatic approach. For non-programmatic loans, secured through lump sum operation, actions and reforms should be completed before the approval of the loan. On the other hand, for programmatic loans succeeding actions and reforms should be implemented on a serial basis with time intervals.
- ✓ **Program Loans obtained from EIB:** As an institution of European Union (EU), EIB provides long term financing to EU member and pre-accession countries in order to foster integration, and economic and social partnership among member countries. In this context, since 2007 program loans in education, R&D, afforestation and erosion control are obtained.
- ✓ **Program Loans obtained from AFD:** In the context of the development and partnership strategies of the French government, the AFD provides loans to public and private sectors. In 2011 and 2014, program loans in afforestation and erosion control field have been provided by the AFD.

Between the years 2000 and 2013, program loans in the amount of \$15 billion has been provided from the World Bank, EIB, and AFD; below is the distribution of the program loans among the international financial institutions:

Figure 15 - Program Loans Provided from International Financial Institutions between 2000-2013



*: In 2000, \$385 million of the \$1.54 billion loan obtained from World Bank was cancelled.

** : In 2002, \$900 million of the \$1.35 billion loan obtained from World Bank was cancelled.

Source: Undersecretariat of Treasury

Although program financing process is very similar to project financing process, there are a few differences between the two. Program loans support the budget financing directly and transferred to the related institution's budget. The operations related to the disbursements from the effective program loans are conducted within the Undersecretariat of Treasury, not by the related institutions as in the case of project financing.

3. FOREIGN FINANCING OPERATIONS WITHIN THE CONTEXT OF PROJECT FINANCING

In the context of development plans; borrowing to finance important public projects like defense, real sector or disaster projects, included in investment plan or not by its nature, is called project finance loans.

Public projects can be financed by both domestic financing sources and foreign financing sources. The expenses related to the public investment projects (how much to expend to which project and from which financing source) are regulated by the annual investment programs, which are prepared according to development plans. Financing operations of the projects that are included in the Annual Investment Program and envisaged to be financed by foreign financing sources, are conducted by the Undersecretariat of Treasury in accordance with the Law no 4749 Law on Regulating Public Finance and Debt Management.

In accordance with the Law no 4749, foreign financing, in other words state foreign debt, guaranteed loans and grant, are provided by various foreign financing sources by the Undersecretariat of Treasury to finance the projects of the state institutions and organizations covered by the Law. The foreign finance provided is utilized to institutions through onlending of foreign debt, allocation of foreign debt or Treasury reimbursement guarantee mechanisms. Moreover, in order to provide foreign loans to projects of state institutions and organizations, these institutions should obtain permit from the Undersecretariat of Treasury.

Allocated Loans

Allocation of foreign debt means a foreign financing facility obtained by the Undersecretariat from any foreign financing source and disbursed to public administrations under the general government budget, Higher Education Council, universities and higher institutes of technology; and organizations under the special budget that execute the project where the end user is one of the public administrations covered under the general government budget limited to defense and security services sector in accordance with the purpose of the related agreement in order to promote development in various sectors of the economy or/and to meet the financial requirement.

On-lent Loans

On-lending of foreign debt means foreign financing obtained by the Undersecretariat from any foreign financing source and on-lent to the public agencies and establishments other than public administrations under the general government budget, Higher Education Council, universities and higher institutes of technology and to investment and development banks without being bound by the terms and conditions of the related agreement when necessary, in order to promote development in various sectors of the economy and/or to meet the financial requirement. The Undersecretariat of Treasury is the borrower of the on-lent loan agreements. Although the Undersecretariat of Treasury is the borrower of the on-lent loan agreements, the Undersecretariat transfers its financial obligations to the executing agency with the on-lent agreements.

Treasury Guarantee

Treasury guarantees include Treasury reimbursement guarantee, Treasury counter-guarantees, Treasury investment guarantees and Treasury country guarantees, currently only Treasury reimbursement guarantee is being used actively⁹.

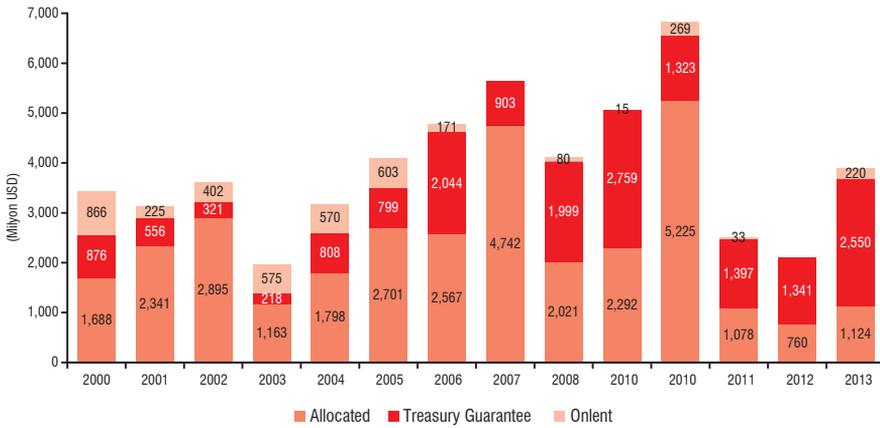
Treasury reimbursement guarantee means guarantees provided for reimbursement of foreign debts taken from foreign financing facility by state economic enterprises, establishments subject to provisions of private law with more than 50% their capital belonging to the state, funds, state banks, investment and development banks, metropolitan municipalities, municipalities and establishments affiliated to municipalities, and other local government agencies.

In accordance with the Law no 4749, the limit to the Treasury guarantee and allocation of foreign debt provided in a fiscal year is determined by that year's budgetary law.

Between the years 2000 and 2013, project loans in the amount of \$54 billion has been provided, below is the distribution of the project loans among utilization mechanisms:

⁹ Treasury investment guarantee has been provided to the Public-Private-Partnership projects, so far Treasury investment guarantee has been provided to almost \$8 billion worth project portfolio. The final Treasury investment guarantee has been provided in 1999.

Figure 16 - Distribution of Project Loans Among Utilization Mechanisms Between 2000-2013



Source: Undersecretariat of Treasury

When the project loans provided in recent years is examined, it is observed that the share of the loans obtained from the international financial institutions has increased and reached over 80% of the total project loans provided. The increase of the international financial institutions' share is considered as a positive development since these institutions provide financing at more favorable conditions (low cost and long maturity) than the market. Another positive development is the share of the loans utilized under Treasury reimbursement guarantee. In recent years, more than 50% of the project loans provided is utilized under Treasury reimbursement guarantee. The financial obligations related to the loans under Treasury reimbursement guarantee are undertaken by the Undersecretariat of Treasury only if the obligations are not fulfilled by the related executing agency; hence, the increase in the share of these loans decreases Treasury's direct burden. Moreover, in the context of diversification of foreign financing strategy, work is under way to both provide guarantees other than the Treasury reimbursement guarantee such as Treasury counter-guarantees and finance projects by issuing lease certificates.

Grants

Grant means real and/or cash aid obtained from any foreign financing source by the Republic of Turkey without an obligation to repay, and real and/or cash aid given by the Republic of Turkey to foreign countries, organizations of foreign countries, international organizations and international aid consortia to be established. Between the years 2000 and 2013, grant in the amount of almost \$0.6 billion has been provided.

4. CONCLUSION

Every public foreign financing instrument has its own unique process and area of use, and with these instruments it is targeted to lower the foreign financing costs and lengthen the maturities. Accordingly, bond and lease certificate issuances and program credits provide budget financing, while project loans provide low-cost and long-term financing to specific public projects. In this context, foreign financing instruments and total financing amounts for 2000-2013 period and 2013 are shown in the below table:

Table 21 - Instrumental Breakdown of Public Foreign Financing Instrument for the Period 2000-2013 and 2013

(Billion USD)	2000-2013	2013
Budget Finance	88.9	7.4
Bond Issuances	71.3	4.9
Lease Certificate Issuances	2.8	1.3
Program Credits	14.8	1.2
Project Finance	54.9	5.3
Allocated Loans	32.4	1.1
On-lent Loans	4.0	0.2
Treasury Guarantees	17.9	2.5
Grants	0.6	1.5

Source: Undersecretariat of Treasury

As a part of an active diversification strategy, international capital markets transactions such as Japanese yen denominated issuances with the guarantee of Japan Bank for International Cooperation beginning 2011 and lease certificate issuances which are interest free financing instruments are considered to be significantly important. Along with the conventional markets like USD and Euro markets, executing regular transactions in these alternative markets and thus extending the investor base is a strategic objective for Treasury.

In the context of foreign loans provided for project finance in recent years, among foreign financing sources the international financial institutions and among utilization mechanisms the Treasury reimbursement guarantees have the biggest share. The high share of loans provided by the international financial institutions has been decreasing the average cost and increasing the average maturity, since these institutions offer more favorable terms than the market conditions. The high share of the loans under Treasury reimbursement guarantee has been decreasing Treasury's direct burden, since the financial obligations related to these loans are undertaken by the Undersecretariat of Treasury only if these obligations are not fulfilled by the related executing agency. Moreover, in the context of diversification of foreign finance strategy, it is aimed to use both Treasury guarantees other than Treasury reimbursement guarantee (Treasury counter-guarantee) and lease agreement issuance to finance project.

INFORMATION
FOR INVESTORS



GOVERNMENT DEBT SECURITIES

1. Government Domestic Borrowing Securities and Lease Certificates

Government Domestic Borrowing Securities (GDBS) are the common name of government bonds and treasury bills issued by Republic of Turkey Prime Ministry Undersecretariat of Treasury. Information regarding types of securities, issuing process and frequently asked questions can be reached through Undersecretariat's web page by following the link "Public Finance > Information for Investors".

Lease certificates are the securities designed by the asset leasing companies in their own name and own behalf and for the account of and the benefit of certificate holders to provide the financing of assets that are taken over by special purpose vehicles through sale or lease agreements and to give the holders of the security the entitlement to the revenues generated from these assets in proportion to the holders' share. Investor guide takes place on the following link: www.treasury.gov.tr.

2. International Bonds

These bonds have been issued by Treasury in the international capital markets in the purpose of budget financing since 1988. Information about to issuance of such bonds made via press release on Undersecretariat's web site.

PRINCIPLES OF PARTICIPATION IN THE AUCTIONS OF GDBS

These participation principles comprise regulations related to the operations of Government Domestic Borrowing Securities (GDBS) issuance; switching and buy-back auctions performed by Republic of Turkey Prime Ministry Undersecretariat of Treasury (Undersecretariat) and also includes the auction participation form. These principles can be reached through Undersecretariat's web page by following the link "Public Finance > Information for Investors".

TAXATION OF DOMESTIC BORROWING NOTES¹⁰

According to the provisional Article 67 of the Personal Income Tax Act, withholding rate of the interest incomes and purchase and sale incomes of the domestic borrowing notes which are issued after 01.01.2006 is:

- 0% for capital stock companies (Including investment funds),
- 10% for other taxpayers (Real persons and other institutions).

Provisional Article 67 is not applied for interest incomes and purchase and sale incomes of Eurobonds regardless of their issuing date. Interest income is declared by resident taxpayers when the declaration limit of the preceding year is surpassed while purchase and sale income is declared for the remaining amount over the cost value indexing and exemptions. For non-resident taxpayers, income of the Eurobonds is not declared.

¹⁰ Information about taxation of state domestic borrowing notes are based on from "Taxation Guide For Real Persons 2011" which is published by Revenue Administration.

PRIMARY DEALERSHIP SYSTEM:

Primary Dealership System can be described as a system which is designed with the purpose of reducing roll-over risk, broadening investor base, constituting transparent, competitive and more organized market and also increasing liquidity and reducing volatility in the secondary market by giving certain official rights and obligations related to primary and secondary market of government debt securities to a group of professional intermediaries. 2014 period Primary Dealership Agreement which includes the rights and obligations for Primary Dealers can be reached under the Public Finance section at www.treasury.gov.tr.

The 13 Primary Dealers for the year 2014 are listed below:

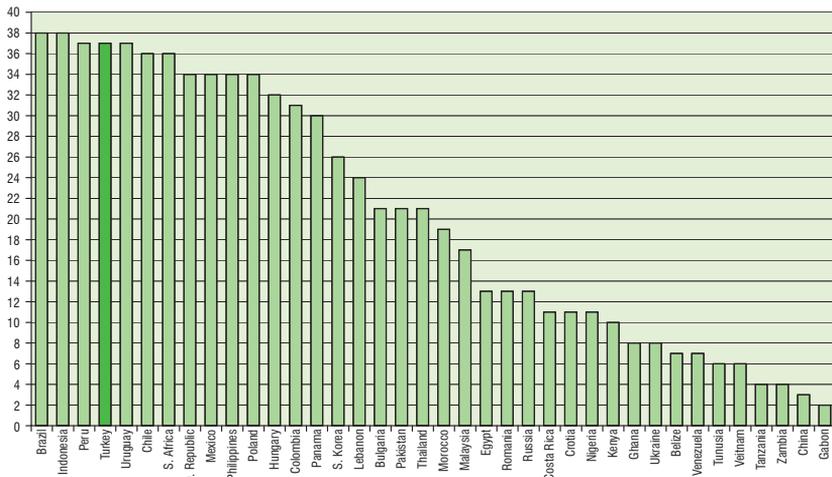
1. Akbank T.A.Ş
2. Denizbank A.Ş.
3. Deutsche Bank A.Ş.
4. Finansbank A.Ş.
5. HSBC Bank A.Ş.
6. ING Bank A.Ş.
7. T. Ekonomi Bank A.Ş.
8. T. Garanti Bank A.Ş.
9. T. İş Bank A.Ş.
10. T. Vakıflar Bank T.A.O.
11. T. Halk Bank A.Ş.
12. T.C. Ziraat Bank A.Ş.
13. Yapı ve Kredi Bank A.Ş.

INVESTOR RELATIONS OFFICE

The Investor Relations Office (IRO) was established in August 2005 as part of the efforts to foster and improve Turkey’s relations with international investors and can be accessed through <http://www.treasury.gov.tr/iro.htm>.

In its annual report, the International Institute of Finance (IIF) evaluates investor relations activities of 38 prominent emerging market countries. In the latest IIF report dated October 2013, Turkey’s IRO score was announced as 37 (out of 38) for fulfilling all of the 20 criteria, placing Turkey 4th in ranking.

Figure 17 - Data Transparency and Investor Relations Ranking



Source : IIF - October 2013

Not: The number of criteria fulfilled by the Turkish IRO increased to 19 in 2008, from 17 in 2006.



**SELECTED
STATISTICS**



CENTRAL GOVERNMENT DEBT STOCK - CURRENCY AND INTEREST COMPOSITION⁽¹⁾

73

	2010			2011			2012			2013			
	Billion ₺	Billion USD	%	Billion ₺	Billion USD	%	Billion ₺	Billion USD	%	Billion ₺	Billion USD	%	
INTEREST COMPOSITION	TOTAL DEBT STOCK	473.6	306.3	100.0	518.4	274.4	100.0	532.2	298.6	100.0	585.8	274.5	100.0
	Fixed	265.3	171.6	56.0	307.0	162.5	59.2	318.1	178.4	59.8	360.2	168.8	61.5
	Floating	155.3	100.4	32.8	147.1	77.9	28.4	137.8	77.3	25.9	129.4	60.6	22.1
	Indexed to CPI	53.0	34.3	11.2	64.3	34.0	12.4	76.3	42.8	14.3	96.2	45.1	16.4
	TL	347.3	224.7	73.3	365.0	193.3	70.4	386.5	216.8	72.6	403.0	188.8	100.0
	Fixed	170.3	110.2	36.0	188.7	99.9	36.4	201.9	113.2	37.9	212.0	99.3	52.6
	Floating	124.0	80.2	26.2	112.0	59.3	21.6	108.4	60.8	20.4	94.8	44.4	23.5
	Indexed to CPI	53.0	34.3	11.2	64.3	34.0	12.4	76.3	42.8	14.3	96.2	45.1	23.9
	FX	126.2	81.6	26.7	153.3	81.2	29.6	145.7	81.7	27.4	182.8	85.7	100.0
	Fixed	94.9	61.4	20.0	118.3	62.6	22.8	116.2	65.2	21.8	148.2	69.4	81.0
	Floating	31.3	20.2	6.6	35.0	18.6	6.8	29.5	16.5	5.5	34.6	16.2	19.0
	DOMESTIC DEBT STOCK	352.8	228.2	100.0	368.8	195.2	100.0	386.5	216.8	100.0	403.0	188.8	100.0
	Fixed	175.7	113.7	49.8	192.4	101.8	52.2	201.9	113.2	52.2	212.0	99.3	52.6
	Floating	124.1	80.3	35.2	112.1	59.4	30.4	108.4	60.8	28.0	94.8	44.4	23.5
	Indexed to CPI	53.0	34.3	15.0	64.3	34.0	17.4	76.3	42.8	19.7	96.2	45.1	23.9
	TL	347.3	224.7	98.4	365.0	193.3	99.0	386.5	216.8	100.0	403.0	188.8	100.0
	Fixed	170.3	110.2	48.3	188.7	99.9	51.2	201.9	113.2	52.2	212.0	99.3	52.6
	Floating	124.0	80.2	35.1	112.0	59.3	30.4	108.4	60.8	28.0	94.8	44.4	23.5
	Indexed to CPI	53.0	34.3	15.0	64.3	34.0	17.4	76.3	42.8	19.7	96.2	45.1	23.9
	FX	5.5	3.6	1.6	3.7	2.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Fixed	5.4	3.5	1.5	3.7	1.9	1.0	0.0	0.0	0.0	0.0	0.0	0.0	
Floating	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FOREIGN DEBT STOCK	120.7	78.1	100.0	149.6	79.2	100.0	145.7	81.7	100.0	182.8	85.7	100.0	
Fixed	89.5	57.9	74.1	114.6	60.7	76.6	116.2	65.2	79.8	148.2	69.4	81.0	
Floating	31.2	20.2	25.9	35.0	18.5	23.4	29.5	16.5	20.2	34.6	16.2	19.0	
CURRENCY COMPOSITION	TOTAL DEBT STOCK	473.6	306.3	100.0	518.4	274.4	100.0	532.2	298.6	100.0	585.8	274.5	100.0
	TL	347.3	224.7	73.3	365.0	193.3	70.4	386.5	216.8	72.6	403.0	188.8	68.8
	USD	71.7	46.4	15.1	86.0	45.5	16.6	85.1	47.8	16.0	105.6	49.5	18.0
	EUR	36.2	23.4	7.6	45.4	24.0	8.8	42.9	24.1	8.1	60.4	28.3	10.3
	SDR	11.0	7.1	2.3	8.3	4.4	1.6	4.2	2.4	0.8	3.2	1.5	0.5
	JPY	6.4	4.1	1.4	12.5	6.6	2.4	12.3	6.9	2.3	12.2	5.7	2.1
	Other	0.9	0.6	0.2	1.1	0.6	0.2	1.0	0.6	0.2	1.4	0.6	0.2
	DOMESTIC DEBT STOCK	352.8	228.2	74.5	368.8	195.2	71.1	386.5	216.8	72.6	403.0	188.8	68.8
	TL	347.3	224.7	73.3	365.0	193.3	70.4	386.5	216.8	72.6	403.0	188.8	68.8
	USD	5.5	3.6	1.2	3.7	2.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
	EUR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	FOREIGN DEBT STOCK ⁽²⁾	120.7	78.1	25.5	149.6	79.2	28.9	145.7	81.7	27.4	182.8	85.7	31.2
	USD	66.2	42.8	14.0	82.3	43.6	15.9	85.1	47.8	16.0	105.6	49.5	18.0
	EUR	36.2	23.4	7.6	45.4	24.0	8.8	42.9	24.1	8.1	12.2	5.7	2.1
	JPY	6.4	4.1	1.4	12.5	6.6	2.4	12.3	6.9	2.3	60.4	28.3	10.3
	SDR	11.0	7.1	2.3	8.3	4.4	1.6	4.2	2.4	0.8	3.2	1.5	0.5
	Other	0.9	0.6	0.2	1.1	0.6	0.2	1.0	0.6	0.2	1.4	0.6	0.2
\$ Buying Rate		1.5460		1.8889			1.7826			2.1343			
USD/EURO		1.3254		1.2938			1.3192			1.3759			
USD/SDR		1.54071		1.53952			1.53729			1.53989			

(1) Provisional

(2) TL equivalents of external debt figures are calculated by end of relevant period US \$ buying rates.

GENERAL GOVERNMENT DEBT STOCK⁽¹⁾ DEFINED BY EUROPEAN UNION STANDARDS

Million €	2006	2007	2008	2009	2010	2011	2012	2013
A- GENERAL GOVERNMENT DEBT STOCK⁽²⁾	352,007	340,797	391,735	454,837	487,561	534,551	549,146	606,946
Central Government	345,050	333,485	380,321	441,508	473,561	518,350	532,199	585,835
Other Public Institutions	6,957	7,312	11,413	13,329	14,000	16,201	16,947	21,111
B- DOMESTIC DEBT STOCK	256,631	260,651	282,302	338,690	361,220	377,870	396,841	416,399
Central Government	251,470	255,310	274,827	330,005	352,841	368,778	386,542	403,007
Other Public Institutions	5,161	5,341	7,475	8,685	8,379	9,091	10,299	13,392
C- EXTERNAL DEBT STOCK	95,376	80,146	109,433	116,148	126,340	156,682	152,305	190,547
Central Government	93,580	78,175	105,494	111,504	120,720	149,572	145,657	182,828
Other Public Institutions	1,796	1,971	3,939	4,644	5,621	7,110	6,648	7,719
D- ADJUSTMENT ITEMS⁽³⁾	868	-4,325	-11,676	-16,414	-22,957	-26,665	-36,959	-40,658
Central Government	24,333	27,778	26,409	23,674	20,696	24,361	21,312	22,398
Other Public Institutions	-23,465	-32,103	-38,085	-40,088	-43,653	-51,025	-58,271	-63,056
ESA DEFINED GENERAL GOVERNMENT DEBT STOCK								
GENERAL GOVERNMENT DEBT STOCK (A+D)	352,875	336,472	380,058	438,423	464,604	507,887	512,187	566,288
GDP	758,391	843,178	950,534	952,559	1,098,799	1,297,713	1,416,798	1,561,510
GENERAL GOVERNMENT DEBT STOCK / GDP (%)	46.5	39.9	40.0	46.0	42.3	39.1	36.2	36.3

1) Consolidated nominal debt stock defined in European System of Accounts 95 (ESA 95) deficit and debt manual.

(2) Unconsolidated gross debt of General Government

(3) Adjustment items:

For Central Government:

- nominal adjustment of zero coupon securities and valuation of inflation indexed bonds
- the stock of circulating coins issued by Treasury
- securities held by central government institutions

For Other Public Institutions:

- securities held by other public institutions

PUBLIC NET DEBT STOCK

Million ₺	2006	2007	2008	2009	2010	2011	2012	2013
Total Public Sector Net Debt (I-II-III-IV)	258,202	248,441	267,992	309,886	317,783	289,997	240,562	198,278
I- Total Public Sector Debt Stock (Gross)	365,891	355,519	408,232	465,690	497,103	546,442	562,836	623,850
A-Domestic Debt	268,286	273,262	295,787	347,378	368,934	387,566	408,367	430,884
Central Government	251,470	255,310	274,827	330,005	352,841	368,778	386,542	403,007
Rest of the Public Sector	16,816	17,952	20,960	17,374	16,093	18,788	21,826	27,877
B- External Debt	97,605	82,257	112,445	118,311	128,169	158,876	154,469	192,966
Central Government	93,580	78,175	105,494	111,504	120,720	149,572	145,657	182,828
Rest of the Public Sector	4,024	4,082	6,951	6,807	7,450	9,304	8,812	10,138
II- Central Bank Net Assets	45,685	41,769	60,371	65,995	86,216	143,162	189,502	271,110
Net Foreign Assets	67,136	70,977	92,835	92,497	114,572	150,634	198,965	267,400
Other Asset and Obligations (Net)	-21,451	-29,208	-32,464	-26,502	-28,356	-7,471	-9,464	3,710
III- Public Sector Deposits	38,256	34,603	41,516	47,713	47,166	59,762	71,610	84,110
Central Government	24,745	20,712	19,621	27,974	25,537	31,096	33,535	45,691
Rest of the Public Sector	13,511	13,892	21,895	19,739	21,629	28,666	38,075	38,419
IV-Unemployment Insurance Fund Net Assets	23,748	30,705	38,352	42,095	45,939	53,521	61,162	70,352
Memo								
Net External Debt Stock	30,468	11,280	19,610	25,814	13,597	8,242	-44,496	-74,434
Net Domestic Debt Stock	227,734	237,161	248,382	284,072	304,186	281,755	285,059	272,712
Public Net Debt Stock/GDP (%)	34.0%	29.5%	28.2%	32.5%	28.9%	22.3%	17.0%	12.7%
GDP	758,391	843,178	950,534	952,559	1,098,799	1,297,713	1,416,798	1,561,510

GROSS EXTERNAL DEBT of TURKEY - by BORROWER

	2007	2008	2009	2010	2011	2012	2013
SHORT TERM	43,145	52,519	48,990	77,294	81,841	100,540	129,107
PUBLIC SECTOR	2,163	3,248	3,598	4,290	7,013	11,040	17,605
GENERAL GOVERNMENT	0	0	0	0	0	0	0
Central Government	0	0	0	0	0	0	0
Local Administrations	0	0	0	0	0	0	0
Funds	0	0	0	0	0	0	0
FINANCIAL INSTITUTIONS	2,163	3,148	3,598	4,290	7,013	11,040	17,605
Banks	2,163	3,148	3,598	4,290	7,013	11,040	17,605
NON-FINANCIAL INSTITUTIONS	0	100	0	0	0	0	0
SOE's	0	100	0	0	0	0	0
Other	0	0	0	0	0	0	0
CBRT	2,282	1,874	1,764	1,553	1,239	1,036	833
PRIVATE SECTOR	38,700	47,397	43,628	71,451	73,589	88,464	110,669
FINANCIAL INSTITUTIONS	16,656	24,088	21,858	47,630	46,555	59,214	74,553
Banks	16,184	23,692	21,587	46,576	45,228	57,145	72,048
Non-Banking Institutions	472	396	271	1,054	1,327	2,069	2,505
NON-FINANCIAL INSTITUTIONS	22,044	23,309	21,770	23,821	27,034	29,250	36,116
LONG TERM	207,158	228,644	220,140	214,516	222,043	237,769	259,136
PUBLIC SECTOR	71,362	75,058	79,884	84,791	87,268	92,983	98,371
GENERAL GOVERNMENT	68,813	72,362	77,139	81,721	82,949	85,440	89,279
Central Government	67,121	69,757	74,054	78,085	79,185	81,710	85,662
Local Administrations	1,505	2,466	2,993	3,589	3,748	3,727	3,616
Funds	187	138	91	47	17	3	0
FINANCIAL INSTITUTIONS	620	592	1,118	1,745	3,018	6,211	7,863
Banks	620	592	1,118	1,745	3,018	6,211	7,863
NON-FINANCIAL INSTITUTIONS	1,929	2,104	1,627	1,324	1,301	1,333	1,229
SOE's	1,812	1,892	1,437	1,183	1,162	1,214	1,108
Other	117	212	190	141	140	119	121
CBRT	13,519	12,192	11,398	10,012	8,095	6,052	4,401
PRIVATE SECTOR	122,276	141,394	128,858	119,714	126,681	138,734	156,364
FINANCIAL INSTITUTIONS	51,994	51,266	44,655	40,416	47,113	54,722	70,769
Banks	31,418	30,540	28,446	28,961	35,109	41,131	55,263
Non-Banking Institutions	20,575	20,726	16,208	11,455	12,004	13,591	15,507
NON-FINANCIAL INSTITUTIONS	70,283	90,128	84,204	79,298	79,569	84,012	85,594
GROSS EXTERNAL DEBT of TURKEY	250,303	281,163	269,130	291,810	303,884	338,309	388,243
PUBLIC SECTOR	73,525	78,306	83,482	89,081	94,281	104,023	115,976
GENERAL GOVERNMENT	68,813	72,362	77,139	81,721	82,949	85,440	89,279
Central Government	67,121	69,757	74,054	78,085	79,185	81,710	85,662
Local Administrations	1,505	2,466	2,993	3,589	3,748	3,727	3,616
Funds	187	138	91	47	17	3	0
FINANCIAL INSTITUTIONS	2,783	3,740	4,716	6,035	10,031	17,251	25,468
Banks	2,783	3,740	4,716	6,035	10,031	17,251	25,468
NON-FINANCIAL INSTITUTIONS	1,929	2,204	1,627	1,324	1,301	1,333	1,229
SOE's	1,812	1,992	1,437	1,183	1,162	1,214	1,108
Other	117	212	190	141	140	119	121
CBRT	15,801	14,066	13,162	11,565	9,334	7,088	5,234
PRIVATE SECTOR	160,976	188,791	172,486	191,165	200,270	227,198	267,033
FINANCIAL INSTITUTIONS	68,650	75,354	66,513	88,046	93,668	113,936	145,322
Banks	47,602	54,232	50,033	75,537	80,337	98,276	127,311
Non-Banking Institutions	21,047	21,122	16,479	12,509	13,331	15,660	18,012
NON-FINANCIAL INSTITUTIONS	92,327	113,437	105,974	103,119	106,603	113,262	121,710

NET EXTERNAL DEBT STOCK of TURKEY (Million USD)

	Gross External Debt Stock	CBRT (-)	Banks (-)	Gross External Debt Stock, Excluding Banking Sector (1)	Monetary Authorities and Deposit Money Banks (1)	Investment and Development Banks & Participation Banks	Banking Sector / Monetary Sector Net Foreign Assets (1) (2)	Net External Debt Stock (I-II)	Net External Debt Stock/GDP (%)
2007	250,303	15,801	50,386	184,116	53,106	-3,092	50,014	134,101	20.7
2008	281,163	14,066	57,972	209,124	60,933	-3,692	57,241	151,883	20.5
2009	269,130	13,162	54,750	201,219	57,609	-2,887	54,723	146,496	23.8
2010	291,810	11,565	81,572	198,673	31,630	-5,589	26,041	172,633	23.6
2011	303,884	9,334	90,368	204,183	30,834	-9,158	21,676	182,507	23.6
2012	338,309	7,088	115,527	215,695	38,541	-12,240	26,301	189,394	24.1
2013	388,243	5,234	152,779	230,230	15,224	-15,554	-331	230,560	28.1

(1) As the Treasury's obligations to the IMF is included in the liability side of the Monetary Survey table and Gross External Debt Stock, this amount is subtracted from CBRT's liabilities in order to avoid double counting.

(2) Central Bank's Banking Survey data, that is not published anymore, is used for the period before 2005. After 2005, Monetary Survey data is used as a net foreign assets of monetary sector.

PUBLIC SECTOR PRIMARY BALANCE (PROGRAM DEFINITION)

(Percent of GDP)	2005	2006	2007	2008	2009	2010	2011	2012 ⁽¹⁾	2013 ⁽²⁾	2014 ⁽²⁾	2015 ⁽²⁾	2016 ⁽²⁾
Public Sector Primary Balance	4.8	4.5	3.1	1.6	-1.0	0.7	1.8	0.7	0.9	1.0	1.2	1.3
Central Government Budget	4.1	4.3	2.6	1.8	-1.6	-0.5	1.2	0.3	0.9	0.5	0.8	1.0
Other Public Sector	0.7	0.2	0.6	-0.2	0.5	1.3	0.5	0.4	0.1	0.5	0.4	0.3

(1) 2014-2016 Medium Term Program targets

REPAYMENTS OF TREASURY GUARANTEED CREDITS																		
Million ₺	2008			2009			2010			2011			2012			2013		
	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %	Paid by Treasury	Paid by Institution	Undertaken Ratio %
Local Administrations	113	134	45.7	70	122	36.4	77	167	31.6	85	176	32.64	74	158	31.8	60	169	26.2
Funds	-	99		-	80		-	85		-	76		-	27		-	5	
Financial Institutions	-	58		-	28		-	44		-	317		-	119		-	128	
Non-Financial Institutions	152	176	46.3	110	213	34.1	190	144	56.9	9	268	5.71	-	308		-	362	
Private Sector Financial Institutions	-	152		-	285		-	326		-	317		-	648		-	694	
Private Sector Non-Financial Institutions	-	199		-	167		-	176		-	141		-	48		-	17	
Total	265	818	24.4	180	894	16.7	267	943	22.1	94	1,054	8.16	74	1,307	5.4	60	1,376	4.3

(1) Provisional.



	TREASURY RECEIVABLES STOCK ⁽¹⁾								
	2011			2012			2013		
	Outstanding Overdue Receivables	Projected Receivables Stock	Total	Outstanding Overdue Receivables	Projected Receivables Stock	Total	Outstanding Overdue Receivables	Projected Receivables Stock	Total
Local Administrations	7,903	7,179	15,082	7,480	7,039	14,519	7,448	6,981	14,429
SOE's ⁽²⁾	630	4,212	4,842	304	2,978	3,282	105	2,855	2,959
Banks	0	909	909	0	712	712	0	681	681
Social Security Institution	0	11	11	0	9	9	0	9	9
Public Banks	0	628	628	0	524	524	0	531	531
Public Enterprises	0	1,129	1,129	0	962	962	0	921	921
Central Administrations	73	1,721	1,794	80	1,631	1,711	81	1,619	1,700
Organizations ⁽³⁾	0	17	17	0	10	10	0	9	9
Insurance Institutions	0	36	36	0	22	22	0	23	23
Private Institutions ⁽⁴⁾	0	4	4	0	4	4	0	4	4
Foundations ⁽⁵⁾	0	21	21	0	16	16	0	14	14
TOTAL	8,606	15,868	24,474	7,864	13,907	21,771	7,634	13,646	21,280

(1) Provisional. Indicates the total amount of outstanding overdue and projected receivables.

(2) Due to the prepayment made by Turkish Grain Board, 843.3 million TL was offsetted against the Board's Duty Loss in November 2012.

(3) Represents Industrial Zones, Trade Unions and Istanbul Olympic Games Preparation & Organizing Board.

(4) Represents privatized SOE's and corporations governed by foundations.

(5) Represents universities subordinated by foundations and Foundation of Technological Improvements in Turkey.



REPUBLIC OF TURKEY
PRIME MINISTRY
UNDERSECRETARIAT OF TREASURY