THE CAUSES AND EFFECTS OF DOMESTIC DEBT SWAP IN TURKEY

Turkey signed a Stand-By Agreement with the IMF and initiated a disinflation program at the end of 1999. Although the program worked well and had a considerable public support until the third quarter of 2000, Turkey experienced a liquidity crisis in November 2000 and another one in February 2001 after which, the fixed exchange rate system was replaced with a floating exchange rate system.

The most important reasons for the crises were the unsustainable domestic debt structure and the structural problems of the banking sector. To overcome the domestic debt problem, the Treasury carried-out a domestic debt swap auction on June 15, 2001, in which the Treasury swapped short term Treasury bills with long term government bonds in the amount of 9.3 quadrillion Turkish lira.

This domestic debt swap helped the Treasury to decrease the domestic debt to be paid in the second half of 2001. The swap operation also improved the maturity structure of the domestic debt stock as well as helping banks to decrease their foreign exchange short positions and hence their foreign exchange risk. However, this operation has totally transferred the foreign exchange risk to the Treasury and is expected to increase the currency substitution in the economy. It is now necessary to take measures to restore public confidence and extend the maturity structure of the domestic debt and so help anxieties regarding roll-over problems.