



Macro Scope

14 - 20 June 2010

Weekly Economic and Strategic Review

Haluk Burumcekci (Managing Director)
Tel: +212 318 34 49
Email: haluk.burumcekci@fortis.com.tr

H. Erkin Isik, CFA (Manager)
Tel: +212 318 34 05
Email: erkin.isik@fortis.com.tr

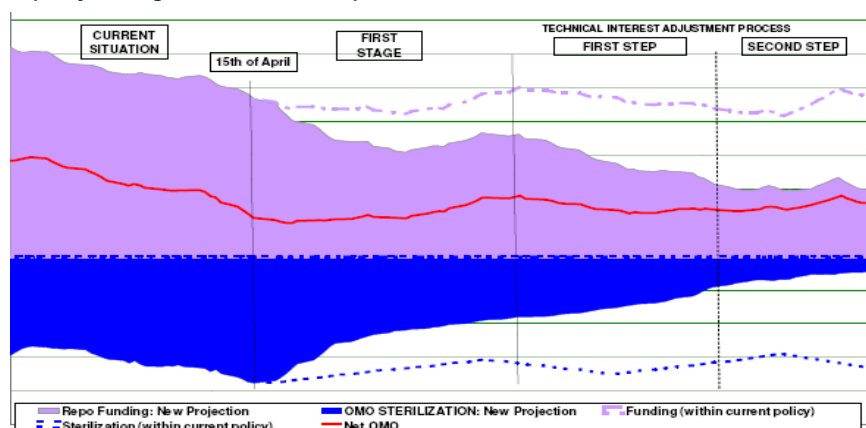
Nilufer Sezgin (Assistant Manager)
Tel: +212 318 37 90
Email: nilufer.s@fortis.com.tr

Email: research@fortis.com.tr
Tel: +212 272 79 98
Fax: +212 275 44 05

Technique Foul...

After its monthly meetings, the Central Bank's (CBRT) Monetary Policy Committee (MPC) releases its general economic assessment and signs as to which direction monetary policy will take. As usual, everyone is anxiously awaiting the news from the MPC's meeting of June 17. The Central Bank is strongly expected to keep policy interest rates pegged for some time, given the increasing risks to foreign demand with the continuing problems in the EU and the more moderate inflation rate in May as a result of food price adjustments. The fall in CPI had also a positive effect on inflation expectations, which constitutes the most explicit risk for the current stance on monetary policy; and as a result, the year-end CPI expectations fell below the CBRT's inflation estimate to stand at 8.1%, while CPI expectations for next 12 and 24 months declined slightly. In general, we expect the MPC to stick to its assessments made during the previous meeting. Remember that MPC did not refer to the interest rate hike itself and nor the timing but mentioned that interest rates had to be maintained at current low levels for a while. We believe that if the MPC would not change the wording of this sentence, then the Bank would have the leeway it might need to manage monetary policy in unexpected circumstances. **Another issue we expect to be clarified is whether the technical interest rate adjustment will move to the second phase.** The first phase was launched at the May meeting and the policy interest rate was fixed at 7% as a one-week repo auction interest rate. Looking at the Central Bank's Monetary Policy Exit Strategy released on April 14 – even though this strategy did not mention any dates – it would seem that under normal circumstances a month would be sufficient to move into the second phase. But when the CBRT liquidity shortage and repo funding forecasts shown in the graph below did not coincide with the actuals, the rise of repo funding to TRY 22bn clearly indicated that the CBRT's new projections had not materialized and things would continue as they had – before leading us to comment that the conditions for entering the second phase are not yet in place.

Liquidity Shortage and Central Bank Operations in Exit Process



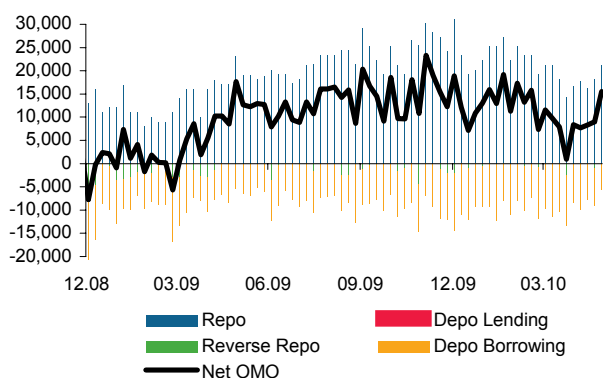
Source: CBT, Fortis Economic Research and Strategy

Let's take a minute to remember just what this second phase entailed...The CBRT noted in its Monetary Policy Exit Strategy that if the liquidity shortage grew in line with current forecasts, it would move into the second phase of the technical interest rate adjustment. In the second phase:

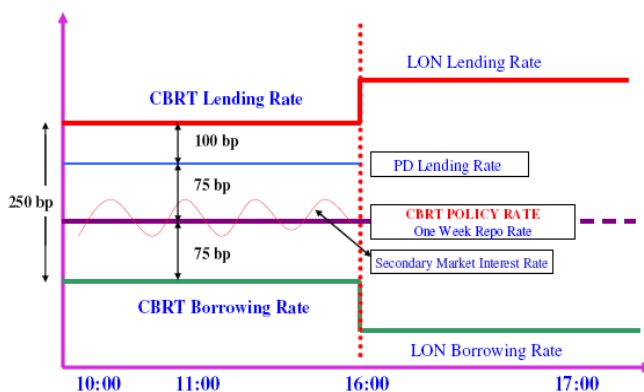
- i. The difference between the one-week repo auction interest rate and the overnight borrowing rate may be increased. The secondary market average overnight borrowing rate will be based on the one-week repo auction interest rate.
- ii. The difference between the one-week repo auction interest rate and the overnight borrowing rate may be increased by raising the one-week repo auction interest rate if the Monetary Policy Committee decides that monetary tightening is required, or overnight rates will be kept around the same level as the declared borrowing interest rate level if the MPC decides not to make any change to the policy interest rate. If there is occasional volatility, the overnight rates will be prevented from exceeding the one-week repo auction rate.

Let's try to illustrate this with an example. We will assume that the decision is made at the June meeting to move into the second phase of the technical interest rate adjustment process and that policy interest rates are not changed. **In this situation, the CBRT's overnight borrowing rate would drop from 6.50 percent to 6.25 percent, and the CBRT would lower the overnight lending rate from 9 percent to 8.75 percent given the anticipated keeping of a 250 bps difference between the two interest rates. The CBRT's policy interest rate would stand at 7 percent, which is the one-week repo auction rate, and after these decisions the targeted range for the secondary market (ISE repo) overnight interest rate would be around (preferably slightly below) 7 percent.** As its lower limit of quotations is decreased and interest rates are increased in O/N repo transactions, the interbank money market (IMM) operating under the CBRT would become less attractive and the situation would likely dissuade lending to CBRT. The positive side of this development would be higher TRY exchanges between banks in the OTC. On the flip side, it is important to remember that if the CBRT fades from view, the volatility in overnight interest rates would intensify.

Central Bank Open Market Operations (mn TL)



Second Step of Technical Interest Rate Adjustment



LON: Late Liquidity Window PD: Primary Dealers.
Source: CBRT, Fortis Economic Research & Strategy

According to the CBRT's balance statement dated June 4, its total repo funding is TRY 17.0bn and the liquidity shortage in the banking system is TRY 10.7bn. The CBRT withdraws back TRY 6.4bn of total repo funding through IMM activities. This structure is likely to change in the second phase of the technical interest rate adjustment process, and withdrawal through IMM activities may no longer be necessary. Our calculations based on the CBRT's scenario lead us to believe that the second phase will start when the liquidity shortage remains consistently below TRY 8bn. Starting the second stage when the liquidity shortage is higher runs the risk of overnight interest rates fluctuating in a wider range around 7 percent.

Banking Sector TRY Liquidity (TRYmn)	
Short Term Funding	41,465
Repo	44,192
<i>CBT Repo</i>	16,711
<i>Repo with Customers</i>	1,806
<i>Mutual Funds</i>	20,196
	0
From Banks (net, including foreign)	8,051
Recivables From Money Market (Net)	-10,778
<i>CBT Reverse Repo</i>	0
<i>CBT Depo Borrowing</i>	-8,337
	0
Bond Portfolio	225,043
ST Funding / Bond Portfolio	18.4%
ST Funding / Total Liabilities	7.2%

Source: BRSA, CBT, Fortis Econ. Res. & Strategy

Finally, we would like to look at the general outlook for the banking system's short-term funding resources that we touched upon previously with updated figures (see table). Apart from the CBRT, banks obtain by repo TRY 20bn from investment funds and TRY 1.8bn from customers. As of the end of April, these short-term funds, including the Central Bank's, slightly exceeded TRY 44bn and showed that nearly 18 percent of the banks' bill-bond portfolios are funded through this mechanism, making up 7 percent of the banks' total liabilities.

In conclusion, while we expect the CBRT at its June meeting to stick to its previous assessments of the economy, we also believe that the signal phrase regarding interest rates will continue to provide the CBRT with flexibility to maneuver. As concerns the move to the second and final phase of technical interest rate adjustment process, the continued uncertainty, market fluctuations, and the CBRT's inaccurate liquidity projections mean that adopting a more leisurely pace is the best option. In the meantime, dependence on short-term funding will remain important for banks.

Economic and Political Agenda

▪ This week at home, central government budget, non-farm employment and unemployment rates on Tuesday and Central Bank rate decision on Thursday will be critical. Turkstat's consumer confidence index also will be eyed closely. Glancing at external arena, in Japan Central Bank's rate decision, in the US PPI and CPI figures and housing data and lastly German ZEW index are going to be important.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	Cent. Gov. Bud. PS, May	TRY mn	June 15 th , 7:00 GMT	-
High	Unemployment, Mar.	%	June 15 th , 7:00 GMT	-
Medium	TURKSTAT Consumer Conf, May	-	June 16 th , 7:00 GMT	-
High	MPC Rate Decision	bps	June 17 th , 7:00 GMT	no change

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	ZEW Index, June	-	June 15 th , 9:00 GMT	45.1
Medium	U.S.	New York Fed Man. Index, June	-	June 15 th , 12:30 GMT	20.0
High	Japan	BoJ Rate Decision	%	June 15 th	no change
High	U.S.	Building Permits, May	mn	June 16 th , 12:30 GMT	0.62
High	U.S.	Housing Starts, May	mn	June 16 th , 12:30 GMT	0.65
High	U.S.	Core PPI and PPI, May	%, m/m	June 16 th , 12:30 GMT	0.1 & -0.4
Medium	U.S.	Capacity Use, May	%	June 16 th , 13:15 GMT	74.3
High	U.S.	Industrial Production, May	% m/m	June 16 th , 13:15 GMT	0.7
High	U.S.	Core CPI and CPI, May	%, m/m	June 17 th , 12:30 GMT	0.1 & -0.1
Medium	U.S.	Philadelphia Fed Mnf. Index, June	-	June 17 th , 14:00 GMT	22.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	954.0	1,087.6	1,196.9	1,310.1
GDP (US\$ - bn) (*)	616.6	715.6	776.4	834.6
GDP Growth (y/y % chg) (*)	-4.7	6.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	5.0	5.0
CPI (y/y % chg)	6.5	8.0	6.0	5.5
Trade Balance (US\$ - bn)	-38.6	-61.2	-69.8	-70.4
Exports (FOB, excl. luggage trade)	102.2	104.9	122.9	142.7
Imports (CIF, incl. gold)	140.8	166.1	192.7	213.0
Current Account Balance (US\$ - bn)	-13.8	-34.2	-39.4	-36.9
Current Account Balance / GDP (%)	-2.2	-4.8	-5.1	-4.4

(*) 2010 values are our forecasts

Financial Indicators Forecasts

	June 11 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5889	1.5800	1.5300	1.5300	1.5500	1.5300	1.5600
EUR/TRY	1.9142	1.9300	1.9400	1.9900	2.0900	1.9900	2.1500
FX Basket	3.5031	3.5100	3.4700	3.5200	3.6400	3.5200	3.7100
EUR/US\$	1.2047	1.2215	1.2680	1.3007	1.3484	1.3007	1.3782
Policy Rate	7.00%	7.00%	7.00%	7.50%	9.50%	8.00%	9.50%
Benchmark Bond	8.80%	8.80%	9.00%	9.80%	11.00%	10.00%	11.00%

Fortis Bank SA/NV Montagne du Parc 3 B-1000 Brussels Belgium Tel: +32 2 565 11 11	Fortis Bank Austria Euro Plaza/D Wienerbergstrasse 41 1120 Vienna Austria Tel: +43 1 81 10 43 81 85	Fortis Bank Czech Republic Myslbek Building Ovocny Trh 8 117 19 Prague 1 Czech Republic Tel: +420 225 43 60 10	Fortis Bank Denmark Gothersgade 49 3. 1123 Copenhagen Denmark Tel: +45 32 71 19 09
Fortis Bank, Succursale en France 30, quai de Dion Bouton F-92824 Puteaux Cedex France Tel: +33 1 55 67 72 00	Fortis Bank Germany Cäcilienkloster 8 50676 Cologne Germany Tel: +49 221 1611-0	Fortis Bank Greece Sygrou Ave 166 17671 Athens Greece Tel: +30 21 09 54 43 70	Fortis Bank Hong Kong 27/F, Fortis Bank Tower 77-79 Gloucester Road Hong Kong Tel: +852 28 23 04 56
Fortis Bank Hungary Deak Ferenc 15 1052 Budapest Hungary Tel: +36 14 83 81 09	Fortis Bank Italy Via Comaggia 10 I-20123 Milano Italy Tel: +39 02 57 53 24 61	BGL 50, avenue J.F. Kennedy L-2951 Luxembourg Luxembourg Tel: +352 42 421	Fortis Bank Norway Haakon VII's gate 10 0161 Oslo Norway Tel: +47 23 11 49 50
Fortis Bank Polska S.A. P.O. Box 15 02-676 Warszawa Poland Tel: +48 22 566 90 00	Fortis Bank Portugal Rua Alexandre Herculano 50-6 Andar 1250-011 Lisboa Portugal Tel: +351 213 13 93 16	Fortis Bank SA/NV, Singapore Branch 63 Market Street #21-01 Singapore 048942 Tel: +65 65 38 03 90	Fortis Bank S.A., Sucursal en España Serrano 73 28006 Madrid Spain Tel: +34 91 436 56 00
Fortis Bank Romania Tipografilor 11-15 013714 Bucharest Romania Tel: +40 21 401 17 02	Fortis Bank Sweden Birger Jarlgatan 25 10396 Stockholm Sweden Tel: +46 8 505 375 59	Fortis Bank Switzerland Rennweg 57 8021 Zurich Switzerland Tel: +41 58 322 09 70	Fortis Bank Turkey Yildiz Posta Caddesi No: 54 Gayrettepe 34353 Istanbul Turkey Tel: +90 212 274 42 80
Fortis Bank SA/NV, UK Branch 5 Aldermanbury Square EC2V 7HR London United Kingdom Tel: +44 20 32 96 80 00	Fortis Bank USA 520 Madison Avenue, 3rd Floor New York, NY 10022 United States Tel: +1 212 418 87 00		

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