



Macro Scope

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Weekly Economic and Strategic Review

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The Rule is Dead, Long Live the Rule...

The new fiscal rule – which we were suggesting could replace the IMF anchor before the last IMF stand-by agreement ends – is expected to establish fundamental principles like transparency, predictability and accountability in public finance and to include quantitative limitations on basic fiscal variables. Although the new fiscal policy's debut was a bit delayed, our reaction to it is highly favorable. That said – and we have said this before – we realize that the fiscal rule is no magic wand but it does have good intent. A final assessment can only be made after the new guidelines have been put into place and the first results come in. Furthermore, fiscal rule should not be designed based on parameters alone. The legal infrastructure – including the essentials of implementation, supervision and auditing – also plays an important role. While **the new policy seems to be broad in scope and of clear parameters, it cannot easily be viewed as a best practice because of its inherent lack of monitoring and supervision.** In the Flash Note published following the introduction of the draft fiscal rule, we stressed that the policy's reach should extend beyond the central government to also cover local administrations, including big budget municipalities. At the same time, it was obvious that the guidelines would not cover state-owned enterprises (SOEs) but at least they have different criteria (on an aggregate basis, there will be no borrowing requirement for SOEs). As for the parameters selected for the fiscal rule formula – which are expected to remain unchanged for the ten-year implementation period – the choices for the four relevant parameters are: 0.33 for the (y) and (k) coefficients that show the convergence speed, 1 percent for the targeted public gap, and 5 percent for the average mid-term real growth rates. The (y) coefficient, which shows the speed at which the budget deficit's deviation from the long-term target would be recovered, is set at 0.33, closer to the upper limit. This is, in our opinion, a good choice.

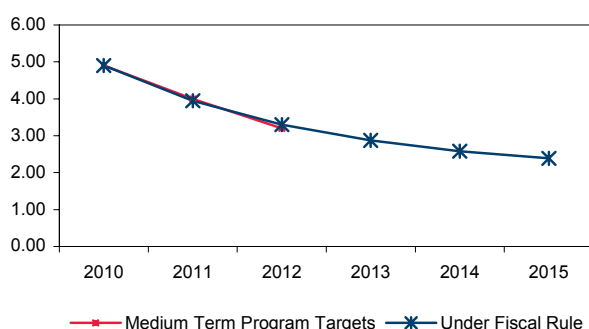
Main Fiscal Rules and Applying Countries

Type of Fiscal Rule	Country Name
Budget Balance Rule	Germany, Belgium, Denmark, Estonia, Finland, France, Ireland, Spain, Italy, Lithuania, Portugal, India, Chile, Brazil, Peru, Argentina, Japan, Sweden, England
Expenditure Rule	Germany, Belgium, Czech Rep, Denmark, Finland, France, Netherlands, Ireland, Italy, Luxembourg, Slovakia, Peru, Argentina, Japan, Sweden
Borrowing and Debt Stock Rule	Germany, Czech Rep, Estonia, Spain, Letonia, Lithuania, Luxembourg, Hungary, Poland, Slovakia, Slovenia, Brazil, Argentina, England
Revenue Rule	Germany, Belgium, Denmark, Finland, France, Netherlands

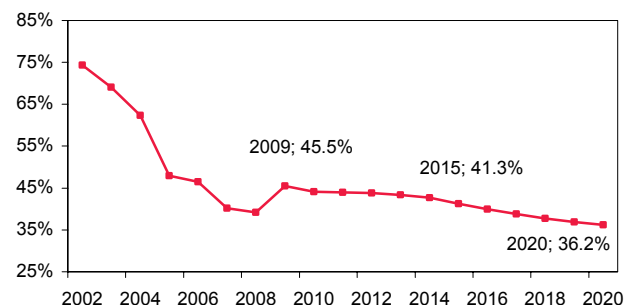
The selected coefficient shows that the deviation would be recovered in three years. If the coefficient were set at 0.20, then the recovery period would stretch to five years to cover the deviation. The (k) coefficient, which shows the speed at which the cyclical effect would be reflected in the public finance gap, is set at 0.33, again closer to the upper limit. We would have preferred, of course, a smaller coefficient as limiting fiscal response against growth would make a better fiscal sense. We realize that the target general government budget deficit (a*) of 1 percent is in the middle of the proposed range – a neutral choice. Any choice closer to the lower limit could have instigated a faster drop in the debt stock. What's more, the 5 percent for the long-term average of the growth rate (b*) is preferred, as it is closer to the upper limit. The question that now begs an answer is this: what is the Turkish economy's post-crisis potential growth rate? Opting for a high threshold would not only limit the contraction in the public deficit implied by the formula if the growth rate turns out to be high, but would also require a further boost in the public deficit if the growth rate turns out to be low. In a year where the base effect is so pronounced, growth expectations, which are still short of the 5 percent mark, point to a more conservative stance.

Our assessment is based solely on the information available in the presentation; the draft bill may introduce clearer definitions. Thus while any criticism on the scope and parameters of the new policy would be limited, there would no doubt be more questions about other aspects of this policy. For one, the idea that that the Court of Auditors will audit the supervision and reporting carried out by the Finance Ministry does not seem ideal given that other countries also include independent audits. This may be reasonable during times of economic normalcy, but it was obvious from the sharp rise in the budget deficits observed in developed countries with fiscal laws during the economic crisis, that these rules do not prevent tax cuts or rises of primary expenditures during difficult times. Moreover, it is not clear what kinds of sanctions and measures would be required if an inconsistency were to arise following an audit by the Court of Auditors, and no assurances exist as to the no-return policy on the replacement of such a law with other legislation should troubles arise. Another deficiency in this formula is that it lacks a debt stock target together with the fiscal rule, as applied by numerous countries. Indeed, the revenues used in budget financing, such as the proceeds of privatizations that are not included in the budgets, do affect debt stock but are hardly considered part of the scope of the policy.

Budget Deficit Under MTP and Fiscal Rule (% GDP)



EU Defined General Government Nominal Debt Stock (% GDP)



(*) General government defined by EU standards comprises four sub-sectors: central government (including revolving funds and nonbudgetary institutions), local authorities, and social security funds (including unemployment insurance fund).

Source: Treasury, Ministry of Finance, Fortis Economic Research & Strategy

What this rule would do to budget deficit levels and debt stock in the long term is also crucial knowledge. According to a statement from the Treasury, general government budget deficit would approach 1 percent over a 10-year period and the ratio of debt stock to GDP will come down to 30 percent in the same period. In contrast, our estimates for 2020 are 2 percent and 36 percent, respectively.

Last but not the least, a statement delivered by Mr. Çanakçı on behalf of the Treasury covered other significant findings, such as the assertion that the policy – which includes an implicit and quite ambitious debt target – requires no additional tightening during its incarnation, and that the numbers are consistent with those in the Mid-Term Program.

To sum up, we welcome the implementation of fiscal rule next year, as it could potentially be a significant anchor for the Turkish economy. This new policy cannot, however, be described as a best practice given its limited provisions concerning monitoring and supervision despite its broad scope and clear parameters. Nevertheless, we expect the fiscal rule to be well received in the current conditions of a debt crisis agenda.

The Fiscal Rule Formula and The Definitions

$$\Delta a = y (a_{(t-1)} - a^*) + k (b - b^*)$$

$$\Delta a = -0,33 (a_{(t-1)} - 1) - 0,33 (b - 5)$$

Δa : Adjustment in the general government deficit / GDP

$a_{(t-1)}$: Previous year's general government deficit / GDP

b: Real GDP growth rate

Treasury's Proposed Intervals and The Choice

$$y = 0.20 - 0.33 \quad (0.33)$$

$$a^* = 0.50 - 1.00 \quad (-1.0)$$

$$k = 0.25 - 0.40 \quad (0.33)$$

$$b^* = 3.50 - 5.00 \quad (5.0)$$

- In any given year, the ratio of the general government deficit to the Gross Domestic Product may not exceed the figure arrived at by adding the general government deficit adjustment, to the ratio of the general government deficit to the Gross Domestic Product in the previous year.
- The general government deficit adjustment is the sum of the deficit effect and the cyclical effect.
- The deficit effect will be computed by multiplying -0.33 by the value arrived at by subtracting 1 percent that is the long-term target for the ratio of the general government deficit to the Gross Domestic Product from the ratio of the general government deficit to the Gross Domestic Product in the previous year.
- The cyclical effect will be computed by multiplying -0.33 by the value arrived at by subtracting the average long-term real growth rate of GDP, which is 5 percent, from the real growth rate of GDP in the relevant year.

Economic and Political Agenda

- Market agenda is quite loaded this week. Unemployment data and consumer confidence index on Monday, Central Bank's rate decision on Tuesday and Central Bank's biweekly expectation survey will be important at home. Glancing at external arena, in the US, New York Fed manufacturing index, housing data, CPI and PPI figures will be eyed. In Euro-zone services and manufacturing flash PMI's will be important. In Germany IFO index will be watched carefully.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Unemployment, Feb.	%	May 17 rd , 7:00 GMT	-
High	CNBC-e Cons. Confi. Index, Apr.	-	May 17 rd , 7:00 GMT	-
High	MPC Rate Decision	bps	May 18 th , 16:00 GMT	no change
High	CB's Expectation Survey, May. II	-	May 21 st , 13:30 GMT	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	U.S.	New York Fed Man. Index, May.	-	May 17 rd , 12:30 GMT	30.0
Medium	Germany	ZEW Index, May.	-	May 18 th , 9:00 GMT	50.5
High	U.S.	Building Permits, Apr.	mn	May 18 th , 12:30 GMT	0.68
High	U.S.	Housing Starts, Apr.	mn	May 18 th , 12:30 GMT	0.64
High	U.S.	Core PPI and PPI, Apr.	%, m/m	May 18 th , 12:30 GMT	0.1 & 0.2
High	U.S.	Core CPI and CPI, Apr.	%, m/m	May 19 th , 12:30 GMT	0.1 & 0.1
Medium	U.S.	Philadelphia Fed Mnf. Index, May.	-	May 20 th , 14:00 GMT	22
Medium	Eurozone	Cons. Conf. Index, May.	-	May 20 th , 14:00 GMT	-
High	Eurozone	Manufacturing Flash PMI, May.	-	May 21 st , 7:58 GMT	57.3
High	Eurozone	Services Flash PMI, May.	-	May 21 st , 7:58 GMT	55.5
Medium	Germany	Ifo Index, May.	-	May 21 st , 8:00 GMT	102

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	954.0	1,090.1	1,197.4	1,310.7
GDP (US\$ - bn) (*)	616.6	717.1	776.7	834.9
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	-61.7	-70.0	-70.4
Exports (FOB, excl. luggage trade)	102.2	108.0	124.5	142.7
Imports (CIF, incl. gold)	140.8	169.7	194.4	213.0
Current Account Balance (US\$ - bn)	-13.7	-34.5	-39.5	-36.9
Current Account Balance / GDP (%)	-2.2	-4.8	-5.1	-4.4

(*) 2010 values are our forecasts

Financial Indicators Forecasts

	May 14 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5107	1.5500	1.5200	1.5200	1.5300	1.5200	1.5600
EUR/TRY	1.9050	1.8800	1.9300	1.9800	2.0400	1.9800	2.1500
FX Basket	3.4157	3.4300	3.4500	3.5000	3.5700	3.5000	3.7100
EUR/US\$	1.2610	1.2100	1.2700	1.3000	1.3333	1.3000	1.3800
Policy Rate	6.50%	6.50%	7.00%	8.00%	10.00%	8.50%	10.00%
Benchmark Bond	9.30%	10.00%	10.40%	10.90%	11.50%	11.00%	11.50%

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