



Macro Scope

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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

High Interest In Low Rates...

There are more concrete clues that the World economy is heading towards an economic slowdown originating from Europe. Even though we do not take this as the harbinger of a double dip, the impact is felt more noticeably on interest rates. Since the fiscal measures have already been put into life, the countries are now more dependent to monetary policies, or low levels of interest rates, to support economic recovery. This will likely delay the Central Banks' rate hikes all around the world, while the same will be true for CBT as well. Moreover, the foreigners' share in the outstanding Turkish local bond portfolio has declined to very low levels over the last years, while their share is highly likely to increase going forward in tandem with the normalization of the backdrop. This factor may also play the role of sustaining the downside pressure on long term yields. In this weekly, in addition to these issues, we will mention the easy financing outlook of the Treasury and we discuss the implications for the interest rates.

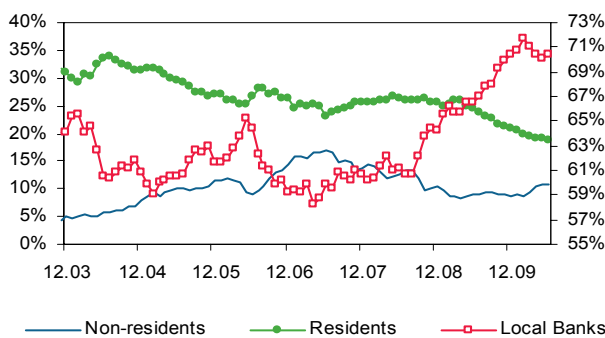
The governments have relied heavily on fiscal tools so far and pushed their budgets to limits in the last years for stimulating economic activity. In that respect, their climbing debt stocks have made the fiscal measures indispensable in order to avoid debt crises. It was the first time that the countries pledged to gradually introduce such precautions when the G20 leaders met in the end of June. They planned to introduce fiscal measures to reduce budget deficits by half until 2013 and stabilize debt to GDP ratios by 2016. Against this gradual tightening, economy still needs support in some way, since the recovery has failed to gain ground yet. Therefore, in the near future, support from monetary policies would be more necessary; **meaning that the interest rates would be kept at low levels for an extended period of time and would not be increased until getting satisfactory signals of recovery or only limited hikes would be introduced should inflationary pressures occur.**

As a proof of that, recently, the Fed rate expectation for the end of 2011 has declined considerably. Based on the Fed funds futures, in April, the Fed was priced to push the policy rate to 1.75-2.00% by the end of 2011, while nowadays the Bank is foreseen to increase the rates to a more limited 0.75%. Similarly in the Eurozone, 3-months money market rate forecasts declined from 2% to 1.25% - 1.50% interval. This change in perceptions regarding the monetary policy stance in developed countries would be a signal for other countries and would give another motivation to the Central Banks across the globe to delay rate hikes. **Note that no country that is hit by the global crisis in some degree, especially the developing countries, would ever want their currency to appreciate, since this would translate into a smaller share in the already contracted world trade. Note that the countries which start rate hikes earlier would have their currencies appreciated. Therefore, the longer they keep inflation tamed by better expectation management and economic reforms, the later comes rate hikes and the more advantageous the countries would**

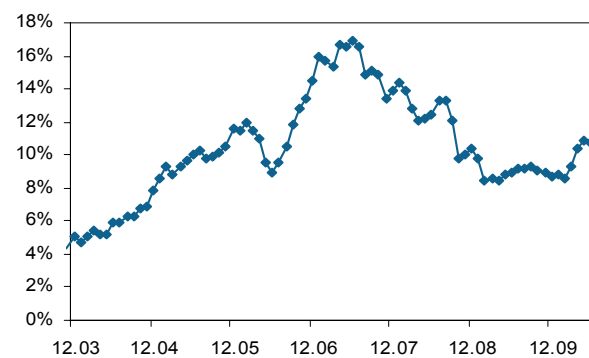
be. To put it differently, low interest rates would help stimulating domestic demand by credit growth, while this would also avoid currency appreciation and hence improve competitiveness in foreign trade. In that respect, we believe that undertaking reforms to keep inflation tamed and to strengthen economic fundamentals would provide the best solution in the long term to the recent hot debates on exchange rate policy. The government said the discussions on the fiscal rule in the Parliament are delayed to a later date in October, which is not a good sign for the government’s commitment on economic reforms.

Nevertheless, this outlook in short-term rates makes bonds more attractive and there is still investor appetite here despite the historical low level of interest rates. In that respect, especially foreign demand for local bonds has increased. In essence, foreign investors purchases in the bond market started to accelerate from February onwards, with their cumulative purchases since then reaching US\$6.2bln as of July 9th. This pushed their share in the bond market to 10.8% by the end of June from 8.6% in February. However, this compares low with peak at 16.9% in 2007. With current domestic debt stock, foreign investors should add approximately US\$15bln to their portfolio in order to re-attain this market share. Even though we do not expect such a robust inflow in the short term, it seems there is room for foreigners to add to their portfolio in Turkey.

Shares of Investor Groups In Bond Market



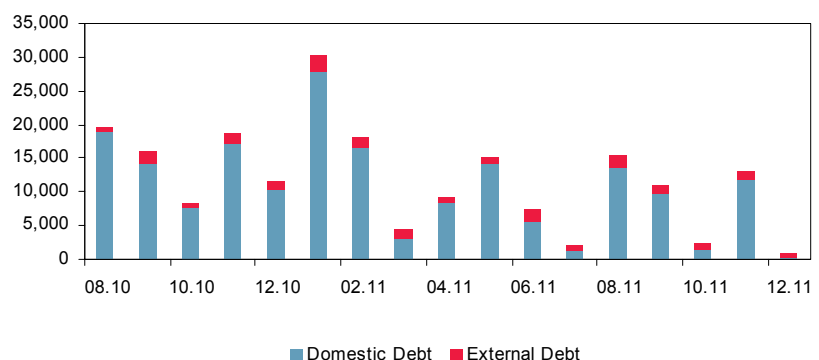
Foreign Investors’ Share In Local Bond Market



Source: CBRT, Fortis Economic Research and Strategy

Government borrowing, which is the source of concerns in many countries (recall how the strong interest in Greece’s 6-month T-bill won raves), has not been a problem for a long time in Turkey. Last year, domestic debt rollover ratio going beyond 100% level created some short term concerns, yet Turkey never struggled with a debt crisis thanks to the domestic banks’ strong robust demand. The Treasury had projected a high debt rollover of 99% for the whole year, yet they are now set to finalize this year with lower ratio, thanks to the good performance of tax income on the back of economic recovery. Our projection for the domestic debt roll-over ratio is 92%. This is still high when compared to the

Treasury’s Total Debt Payment Schedule (TRY mln)



Source: Treasury, Fortis Economic Research and Strategy

75% average roll-over ratio between 2006 and 2008, but it is sufficient to apply downward pressure on bond yields. We reckon that the domestic debt rollover was 87% in the first half of this year and bringing this ratio to 99% in the second half would be necessary to meet our forecast for the whole year. Focusing only on market borrowing, the rollover ratio slid to 92% in the first half of the year from last year's 114%. However, to meet our 97% forecast for the whole year, the Treasury would need to raise more money than the redemption by pushing the ratio to 102%, excluding the public sector redemptions and borrowing. Nevertheless, we still argue that this will not apply significant pressure on interest rates as the increase in financing need will be easily met by growing demand in the market.

		2010 Fortis Forecasts				
		2009 (R)	2010 (T)	Jan.-June	July-Dec.	Jan.-Dec.
(TRY bln)						
Total Debt Services		148.9	200.3	105.5	87.8	193.3
Domestic Debt Service		134.2	182.6	95.6	81.1	176.7
<i>to Market</i>		111.0	153.6	74.6	72.6	147.2
<i>to Public Institutions</i>		23.2	29.0	21.0	8.5	29.5
External Debt Service		14.6	17.7	9.9	6.7	16.6
Total Financing		148.9	200.3	105.5	87.8	193.3
Financing Other Than Borrowing		4.8	5.0	8.4	8.8	17.2
Primary Surplus		-4.5	-4.3	4.7	7.0	11.7
Receipts From On-Lending & Guar, Deb		0.8	8.7	0.6	0.4	1.0
Other		8.5	0.6	3.1	1.4	4.5
Total Borrowing		150.2	195.3	92.9	83.2	176.1
External Borrowing		11.3	13.7	9.6	3.4	13.0
Domestic Borrowing		138.9	181.6	83.3	79.8	163.1
<i>from Market</i>		126.1	-	68.8	74.0	142.7
<i>from Public Institutions</i>		12.8	-	14.5	5.9	20.4
Use of Cash Account		-6.9	0.0	4.2	-4.2	0.0
Domestic Debt Rollover		104%	99%	87%	99%	92%
Market Domestic Debt Rollover		114%	-	92%	102%	97%

Source: Treasury, Fortis Economic Research and Strategy

(R)-Realization (T)-Treasury Program

In conclusion, besides the fact that global economic backdrop would delay the monetary tightening, the demand and supply dynamics that are in support of keeping the long-term rates at low levels should be carefully watched, as well. The Central Bank emphasized some of these points at the last MPC meeting. Earlier the Bank had mentioned the uncertainties regarding the external demand, while this time the Bank made it more clear that there is partial slowdown in external demand. Besides, a new expression to underscore the ongoing importance of risks on global economic has been added. Accordingly, we continue to expect no rate change this year and 200 bps hike in 2011. The timing of the first hike would depend on external factors such as food, energy prices, as well as the impact of global slowdown on domestic economy.

Economic and Political Agenda

▪ The event schedule is going to be light this week. The only important data release at home will be the Central Bank's second expectation survey of the month. Markets are likely to focus on balance sheet disclosures in the external arena. In the US, housing data and in Eurozone, preliminary PMI indexes will be important. Some of this week's balance sheets and EPS forecasts are as such: On Monday IBM (\$ 2.57), on Tuesday Apple (\$3.08), Goldman Sachs (\$2.53), Johnson & Johnson (\$1.22) and Pepsi (\$1.09), on Wednesday Coca-Cola (\$1.02), US Bancorp (\$0.38) and Wells Fargo (\$0.49) and on Thursday, Microsoft (\$0.46), American Express (\$0.76).

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	CB's Expectation Survey, July II	-	July 22 nd , 13:30 GMT	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Building Permits, June	mln	July 20 th , 12:30 GMT	0.57
High	U.S.	Housing Starts, June	mln	July 20 th , 12:30 GMT	0.57
High	Eurozone	Manufacturing Flash PMI, July	-	July 22 nd , 7:58 GMT	55.3
High	Eurozone	Services Flash PMI, July	-	July 22 nd , 7:58 GMT	55.2
Medium	U.S.	Existing Home Sales, June	mln	July 22 nd , 14:00 GMT	5.3
Medium	Germany	Ifo Index, July	-	July 23 rd , 8:00 GMT	101.6

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn)	954.0	1,095.5	1,203.7	1,317.6
GDP (US\$ - bn)	616.6	716.0	779.1	839.3
GDP Growth (y/y % chg)	-4.7	7.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	5.0	5.0
CPI (y/y % chg)	6.5	7.2	6.0	5.5
Trade Balance (US\$ - bn)	-38.6	-64.2	-72.9	-74.2
Exports (FOB, excl. luggage trade)	102.2	103.3	117.8	140.1
Imports (CIF, incl. gold)	140.8	167.6	190.8	214.3
Current Account Balance (US\$ - bn)	-13.8	-37.1	-42.5	-40.6
Current Account Balance / GDP (%)	-2.2	-5.2	-5.5	-4.8

Financial Indicators Forecasts

	July 16 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5316	1.5500	1.5500	1.5400	1.5500	1.5500	1.5600
EUR/TRY	1.9601	1.9800	1.9700	1.9700	2.0400	1.9700	2.1100
FX Basket	3.4917	3.5300	3.5200	3.5100	3.5900	3.5200	3.6700
EUR/US\$	1.2798	1.2800	1.2700	1.2767	1.3167	1.2700	1.3500
Policy Rate	7.00%	7.00%	7.00%	7.00%	8.00%	7.00%	9.00%
Benchmark Bond	8.40%	8.50%	8.90%	9.50%	10.30%	9.20%	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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