



Macro Scope

25 – 31 January 2010

Weekly Economic and Strategic Review

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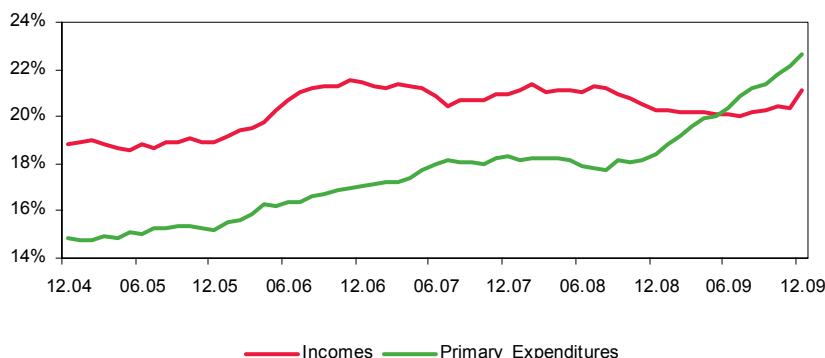
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Play The Game By The Rule...

2009 budget depicted a more benign outlook than the revised targets in the Medium Term Program (MTP) (TRY52.2bn vs. TRY62.8bn). While we said this was a positive development, we also indicated that thanks to this improvement in the base period, 2010 budget targets look more attainable now (*Please see our Flash Note – Budget report released on January 15th*). Based on our estimates, while the 12-month program-defined primary deficit to GDP ratio improved to 1.5%, the consolidated government sector (CGS) primary deficit (includes SEEs, Social Security Institutions and non-budgetary funds in addition to the central government budget) to GDP ratio appeared at 1.1%. Thus the program defined figures were also better than the revised official forecasts of 2.2% and 2.1% deficits respectively. In that case, since the primary deficit forecasts for 0.8% and 0.3% for 2010 and 2011 are close to actual 2009 figures, these budget targets seem to be more realistic in an economic recovery environment. **However, despite the measures, the lingering increase in the primary expenditures keeps being disturbing.** As of end-December, primary expenditures to GDP ratio climbed to its historical high level of 22.6%, surpassing the average 18% printed in the pre-crisis period. Accordingly, recent improvement in the incomes stemming from the economic recovery did not give a relief to us. **The maximum level of incomes to GDP ratio was 21.5% even in the strong growth periods and this sounds like if the uptrend in the expenditures does not end, it would be difficult for primary deficit to regress below 1%.** Such a bounce in the primary expenditures is the result of a choice which can be easily explained in the current conjuncture. The difficult thing is to reverse this tendency under the vulnerable economic activity outlook. The expenditures, especially the social security and related transfers, seem to be out of control, pointing to a need of structural reforms. Meanwhile, to hope for help from the indirect taxes once a problem appears in the budget front does not look good in terms of the fiscal quality.

Central Government Budget Incomes and Primary Expenditures (to GDP)



Source: Fiscal Ministry, Treasury, Fortis Economic Research and Strategy

Glancing at MTP, while the central government budget income to GDP ratio is foreseen to be 21.4% in 2010-12 period, the primary expenditures are expected to regress gradually to 21.0% from 22.2%. Considering that the average of incomes was 20% in 2004-07 period and was 21% in 2007, when the GDP was close to our 2010 GDP forecast, **in the lack of new measures, the downside risks to income targets in MTP seem to be increasing.** On the primary expenditures front, while the 2009 budget deficit remained lower than the revised target, the expenditures appeared 0.3 points higher than the assumed figure. Under this scene, **the additional measures seem to be necessary in order to reach the targeted regression in the primary expenditures in 2010.**

Medium Term Fiscal Plan (2010-2012) and 2009 Budget

	TRYbn				to GDP (%)			
	Realization	MTP			Forecast*	MTP		
	2009	2010	2011	2012	2009	2010	2011	2012
Central Government Budget Expenditures	267.3	286.8	298.2	314.4	27.4	27.9	26.7	25.6
Non-interest expend.	214.1	230.1	243.0	259.0	21.9	22.4	21.7	21.1
Personnel	55.9	60.3	64.1	68.4		5.9	5.7	5.6
Gov. Prem. to Soc. Sec. Ins.	7.2	11.1	11.7	12.5		1.1	1.0	1.0
Purch. of goods - serv.	29.6	25.9	27.6	28.8		2.5	2.5	2.3
Current Transfers	91.8	102.2	109.6	117.2		9.9	9.8	9.6
Capital Expenditures	19.8	19.0	18.3	20.1		1.9	1.6	1.6
Capital Transfers	4.3	3.2	3.3	3.5		0.3	0.3	0.3
Lending	5.4	6.9	6.9	6.8		0.7	0.6	0.6
Reserve Appropriations	0.0	1.4	1.5	1.6		0.1	0.1	0.1
Interest Expenditures	53.2	56.8	55.2	55.4	5.4	5.5	4.9	4.5
Central government Budget Revenues	156.4	236.8	253.1	275.4	16.0	23.0	22.6	22.4
Tax Revenues	172.4	193.3	210.2	229.5	17.7	18.8	18.8	18.7
Budget Balance	-52.2	-50.0	-45.1	-39.1	-5.3	-4.9	-4.0	-3.2
Primary Balance	1.0	6.7	10.1	16.3	0.1	0.7	0.9	1.3
Primary Balance (Program-Defined)	-14.5	-8.4	-2.1	4.3	-1.5	-0.8	-0.2	0.4

(*) 2009 GDP is Fortis forecast

Another factor, which is as important as the additional measure need, is the uncertainty about whether this need will be satisfied. **It is a well-known fact that the governments have some difficulties in using their authority only for the economic requirements and they always try to get some more maneuver space for themselves. However, it is obvious that the predictability and transparency to be displayed herein will affect the monetary policy directly; these factors will also have some indirect repercussions on the other decision makers in the economy.** Thus, in order to find a solution to this problem, the **fiscal rule implementations and fiscal responsibility laws** for supporting these implementations started to spread worldwide. Turkey is also expected to join to this global trend. As explained in MTP, while it is targeted that the legal infrastructure related to the fiscal rules will be completed before the first quarter of 2010, starting from 2011 budget year, public fiscal management will be carried out in accordance with the determined fiscal rules. We first mentioned about the fiscal rule in our weekly *MacroScope* report released on May 12th 2008. In that report, IMF discussed that a fiscal rule over expenditures or budget balance would help lowering domestic debt. However, the Fund's suggestion for the fiscal anchor that would replace the primary surplus target arose as an expenditure rule combined with a debt target. This choice seemed rational on the back of lingering uptrend in the primary expenditures. Despite this, the fiscal rule studies, which are almost completed, show that the rule would be used to calculate the required change in the public deficit (*Please see the fiscal rule box given below*).

Within the framework of fiscal rule, public deficit to GDP ratio in the medium-long term is targeted to realize at a level compatible with a sustainable debt structure. **In other words, while the first target is to set the public deficit adjustment for a sustainable debt stock to GDP ratio, the annual deviation of the actual**

deficit from the medium-long term target will also be considered for this purpose. Another factor which will be taken into consideration when determining the adjustment in public deficit is the effect of conjuncture. The adjustment in the public deficit will be higher when the annual growth rate is higher than the long-term growth rate average, lower when the annual growth rate is less than the long-term growth rate average. **Under this context, the fiscal rule will allow the public balance to produce lesser deficit in the years of elevated growth, and vice versa.**

The name of rule sounded like it has a rigid structure. However, y and k coefficients (convergence velocity coefficient of public deficit to medium-long term target and coefficient of conjuncture effects) can be selected and targeted public deficit and long term average of growth rate can be determined freely. Thanks to such factors, it can be said that the fiscal rule has also noteworthy elasticity in it. Therefore, the selection of these coefficients will be of crucial importance. While we think that improvement in the technical studies is a favorable development, on the other hand, we also want to see clearer picture about the legal infrastructure and monitoring of the rule. In our opinion, under the lack of these fundamentals, the fiscal rule could not secure the fiscal discipline.

All in all, even though the budget depicted a more positive outlook than the revised targets, the lingering increase in the primary expenditures keeps spurring some questions about the upcoming period's targets. Meanwhile, governments could not provide the need of elasticity, predictability and transparency in the fiscal policies, affecting the monetary policy and the other decision makers in the economy adversely. In order to find a solution to this problem, the fiscal rule implementations and financial liability laws for supporting these implementations started to spread worldwide and Turkey is also expected to join to this global trend soon. A well-shaped binding fiscal rule in terms of legal infrastructure will provide the above-mentioned flexibilities. Under this scene, independently from the IMF deal, we would take this rule as an important development as we are always saying.

Fiscal Rule

can be expressed as $\Delta a = y(a - 1 - a^*) + k(b - b^*)$

Δa : public deficit adjustment/GDP

$a - 1$: previous year realized public deficit/GDP

a^* : targeted medium-long term public deficit/GDP

b : real GDP growth rate

b^* : long term average of real GDP growth rate

y : convergence velocity coefficient of public deficit to medium-long term target

k : reflection coefficient of conjuncture effects

(y and k coefficients are negative. The negative Δa indicates a decrease in public deficit. Values of parameters, definition and content of public deficit, details about application, monitoring and reporting, exceptions and other issues will be finalized during the process of infrastructure formation for fiscal rule.)

Source: MTP

Economic and Political Agenda

▪ In the last week of the month, while the foreign trade balance and the Real Sector Confidence Index will be important at home, the Inflation Report will be published on January 26th. Separately, the Treasury will issue 10-year fixed-income bond on the same day. Glancing at external arena, there will be a busy agenda especially in the U.S., with housing data, durable goods orders and Fed's rate decision topping the agenda. In the meantime, Apple, Texas Instruments, Johnson & Johnson, United States Steel Corp., Yahoo, Boeing, Microsoft, P&G, 3M, Motorola and Chevron will unveil their 4Q earning reports this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	Capacity Use, Jan.	%	Jan. 25 th , 14:30 GMT	-
High	TURKSTAT Consumer Conf., Jan.	-	Jan. 25 th , 14:30 GMT	-
High	Imports & Exports, Dec.	US\$ bn	Jan. 29 th , 8:00 GMT	15.5 & 9.6
Medium	Treas. Borrow. Program, Feb.-Apr.	-	Jan. 29 th	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Existing Home Sales, Dec.	mn	Jan. 25 th , 15:00 GMT	6.03
Medium	Germany	Ifo Index, Jan.	-	Jan. 26 th , 9:00 GMT	95.1
Medium	U.S.	Case Shiller House Price Ind., Nov.	% y/y	Jan. 26 th , 14:00 GMT	-5.6
Medium	U.S.	Consumer Confidence Index, Jan.	-	Jan. 26 th , 15:00 GMT	53.5
Medium	Japan	BoJ Rate Decision	bps	Jan. 26 th	0.1
High	U.S.	New Home Sales, Dec.	mn	Jan. 27 th , 15:00 GMT	0.37
High	U.S.	Fed's Rate Decision	bps	Jan. 27 th , 19:15 GMT	0.25
High	U.S.	Durable Orders, Dec.	% m/m	Jan. 28 th , 13:30 GMT	1.5
High	U.S.	GDP (advance), 4Q	% y/y	Jan. 29 th , 13:30 GMT	4.6
Medium	U.S.	Michigan Sentiment Index, Jan.	-	Jan. 29 th , 14:55 GMT	73.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2008-2011

	2008	2009f	2010f	2011f
GDP (TRY - bn)	950.1	976.6	1,103.2	1,212.5
GDP (US\$ - bn)	734.9	631.2	725.8	759.3
GDP Growth (y/y % chg)	0.9	-5.7	5.0	4.0
PPI (y/y % chg)	8.1	6.0	5.0	4.0
CPI (y/y % chg)	10.1	6.5	7.9	5.5
Trade Balance (US\$ - bn)	-69.8	-38.0	-67.7	-68.7
Exports (FOB, excl. luggage trade)	132.0	101.8	125.5	122.9
Imports (CIF, incl. gold)	201.7	139.8	193.2	191.6
Current Account Balance (US\$ - bn)	-41.9	-13.6	-38.1	-36.9
Current Account Balance / GDP (%)	-5.7	-2.2	-5.2	-4.9

Financial Indicators Forecasts

	Jan. 22 nd	1M	3M	6M	12M	2010	2011
US\$/TRY	1.4715	1.4800	1.5200	1.5200	1.5300	1.5200	1.6100
EUR/TRY	2.0699	2.1200	2.2000	2.1900	2.1900	2.1900	2.1900
FX Basket	3.5414	3.6000	3.7200	3.7100	3.7200	3.7100	3.8000
EUR/US\$	1.4067	1.4400	1.4500	1.4400	1.4400	1.4400	1.3600
O/N	6.50%	6.50%	6.50%	6.50%	8.50%	8.00%	10.00%
Benchmark Bond	8.70%	8.70%	9.50%	10.30%	11.10%	11.00%	11.50%

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