



Macro Scope

7 - 13 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

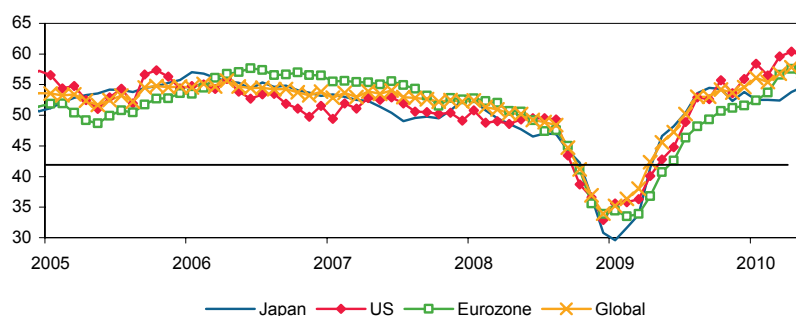
Nilufer Sezgin (Assistant Manager)
Tel: +212 318 37 90
Email: nilufer.s@fortis.com.tr

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

Making the Trend Your Friend...

Last week, we stated that despite the EU debt crisis we do not envisage a new recession in the global economy and expect the moderate recovery to continue. Furthermore, we emphasized that the likely scenario was the strong growth in the first half of the year giving way to a slower growth trend in the second half. This assessment is supported by the general outlook for May, released this week, of the PMI, a leading indicator of economic activity. The dramatic decline in China's PMI negatively affected growth expectations given that this country is the engine of the global economy. China's PMI contracted from 55.2 in April to 52.7 in May – the lowest level in the last 11 months – and aside from a few exceptions (including Turkey) the global PMI trend was a downward one compared to the previous month. The decrease in the Global PMI, calculated by the aggregation of individual country indices, was limited; the level was still one of the highest reached in this series and indicated that economic activity continued to expand. This did not, however, prevent the emergence of expectations that the strong expansion seen in the manufacturing industry so far this year would give way to a slower growth rate. As we have for some time pointed to the discrepancy between the stock markets, which have already bought the economic recovery story, and industrial output, it is normal that we would describe developments overcoming this discrepancy as healthy. Let us not forget that a continued recovery in industrial output means production will sooner or later reach levels more compatible with stock market figures. While it is good that the markets have bought into a slowdown in global economic growth, it is extremely difficult to anticipate the extent of it. We remember well that a slowdown in the pace of economic activity was observed long before the recession that began in the last quarter of 2008, and at that time it was not clear that this would result in economic contraction. For recession to set in, triggering events (Lehman's bankruptcy) had to occur that would abruptly cut demand by sharply lowering consumer confidence and leave producers with unsold inventories in a period of economic slowdown.

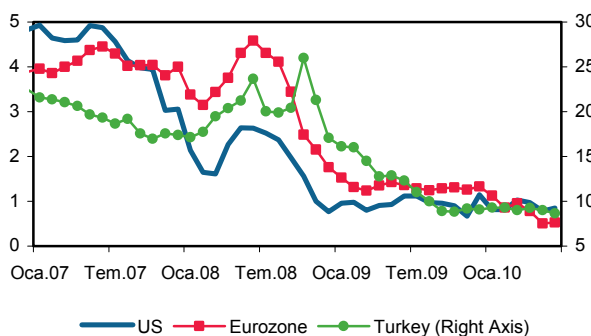
Global PMI (Expansion > 50 > Contraction)



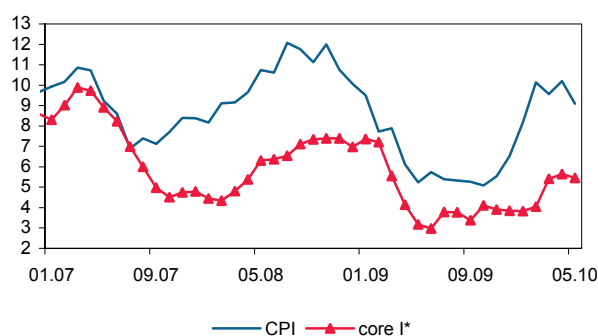
Source: Reuters, Markit, Fortis Economic Research and Strategy

It would not be wrong to say that dataflow gained importance in the short term at this point in the cycle. That being said, it is as usual not the actual data per se but its influence on future expectations that is meaningful. And it is widely known how frequently and easily expectations can change. Until not long ago, the prevailing mood was that central banks must act quickly and withdraw their liquidity support as well as normalize monetary policies in line with strong growth expectations; this mood changed as worries over the debt crisis in Europe came to the fore. Indeed, while the results of a survey conducted in April revealed fears that the Fed would raise interest rates in the final quarter of this year, a month later the same survey showed that these expectations had been postponed until the end of the first quarter of 2011 at the earliest. In the Fed futures market, contract prices reflected these expectations and the Fed interest rates are calculated to reach 1% only at the end of 2011. **The development of such views was helped not only by the prevalent growth outlook but also by the relatively moderate levels of inflation maintained in the developed countries, particularly in the US.** At the end of April, annual growth rates for the CPI and core PCE indices, which the FED considers important, stood at 0.9% and 1.2% respectively - far below the 2% target inflation rate and close to historic lows. With the drop in fuel and commodity prices due to diminished growth expectations and despite the serious monetary expansion that occurred during the crisis, a considerable amount of time will likely have to pass before inflation becomes a real threat. And this combination of growth and inflation perceptions seems to have recreated a bond-friendly market environment. As a result, yields for ten-year US and eurozone bonds hit their lowest point since the first quarter of 2009 when the crisis was at its worst. Ironically, bond yields have entered a period of decline at a time when everyone is talking about sovereign risk. **Turkey, despite its relatively tight liquidity conditions, has taken advantage of this situation and pressures on the Treasury and Central Bank have been relaxed. A marked improvement in the inflation outlook is essential, however, for this situation to be permanent.**

Government Bond Yields (2Y, %)



CPI and Core CPI (% chg. y/y)



(*) CPI excluding food, energy, tobacco/alcoholic beverages and gold.

Source: Reuters, Turkstat, Fortis Economic Research & Strategy

In this context, May inflation, and what it portends for the underlying inflation trend will be important. Positive early figures from the Istanbul Chamber of Commerce and Central Bank announcements bode well for annual CPI returning to single-digit levels. In fact, CPI declined by 0.36% m/m in May, visibly lower than the market consensus for 0.4% (it was revised down from 0.6% after the preliminary ITO price indicator was announced on June 1st) and our call for 0.5%. This was mostly due to the 4.4% decline in the food prices, as a correction to the surge in the previous months. In due course, the annual inflation rate declined to 9.1% from 10.2% a month ago. We still expect the annual inflation to remain at these levels for some more time before easing the 8.0% vicinity by the end of this year. The core price indicators also were favorable. The annual price change of Central Bank's favorite core indicator, (I) index, declined by a mere 0.1 pp to 5.5% y/y. In seasonally adjusted terms, according to our calculations, this core indicator increased by only 0.1% m/m and the annualized 2-month price change dropped to 2.3%, confirming the easing

pricing pressures. Moreover, the services prices that we compute declined by 0.1 pp to 6.4%. **The well-behaved underlying inflation trend may help taming the high inflation expectations and ease Central Bank's hand to keep interest rate low for a longer period of time. Accompanied with the downward risks on growth from EU, we revised our policy rate hike expectation for this year from 150 bps to 100 bps but continue to expect the rate hikes to start in the last quarter.** We expect the policy rates to reach 9.5% by mid-2011, 50 bps lower than our previous call.

To sum up, leading indicators for the month of May suggest that the strong growth seen in the manufacturing industry in the first months of the year will give way to slower growth. While we consider this a natural and healthy process, we think it fit to leave the final verdict until macro figures are announced in the short term given how quickly the deterioration in expectations can deepen during a financial crisis. The growth and inflation outlook for developed countries has brought the return of a bond-friendly market environment, but Turkey will have improve its inflation performance to sustain the gains it has made from this environment.

Economic and Political Agenda

▪ This week at home, industrial output, Central Bank's expectation survey, cash based primary surplus data on Tuesday and C/A deficit figure on Friday will be critical. Glancing at external arena, in the U.K and Eurozone Central Bank's rate decisions are going to be eyed closely. In the US, retail sales and Michigan sentiment index will be important.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Industrial Output, Apr.	% y/y	June 8 th , 7:00 GMT	18.5 (19.1)
High	Expectation Survey, June I.	-	June 8 th , 13:30 GMT	-
Medium	Cash Based PS, May	TRY bn	June 8 th	-
High	C/A deficit, Apr.	US\$ mn	June 11 th , 7:00 GMT	-4,500

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.K.	BOE Rate Decision	bps	June, 10 th , 11:00 GMT	no change
High	Eurozone	ECB Rate Decision	bps	June, 10 th , 11:45 GMT	no change
Medium	U.S.	Foreign Trade Balance, June	US\$bn	June, 10 th , 12:30 GMT	-41.0
High	U.S.	Ret. Sales, Tot. & ex-auto, May	%, m/m	June 11 th , 12:30 GMT	0.2 & 0.2
High	U.S.	Michigan Sent. Ind., June	-	June, 14 th , 13:55 GMT	74.0

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	721.9	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	-62.4	-70.6	-70.5
Exports (FOB, excl. luggage trade)	102.2	113.1	132.6	144.4
Imports (CIF, incl. gold)	140.8	175.5	203.2	214.8
Current Account Balance (US\$ - bn)	-13.7	-35.0	-39.8	-36.9
Current Account Balance / GDP (%)	-2.2	-4.9	-5.1	-4.4

(*) 2010 values are our forecasts

Financial Indicators Forecasts

	June 4 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5659	1.5700	1.5300	1.5300	1.5300	1.5300	1.5600
EUR/TRY	1.9214	1.9200	1.9400	1.9900	2.0400	1.9900	2.1500
FX Basket	3.4873	3.4900	3.4700	3.5200	3.5700	3.5200	3.7100
EUR/US\$	1.2270	1.2200	1.2700	1.3000	1.3333	1.3000	1.3800
Policy Rate	7.00%	7.00%	7.00%	7.50%	9.50%	8.00%	9.50%
Benchmark Bond	8.70%	8.60%	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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