



Macro Scope

15 - 21 March 2010

Weekly Economic and Strategic Review

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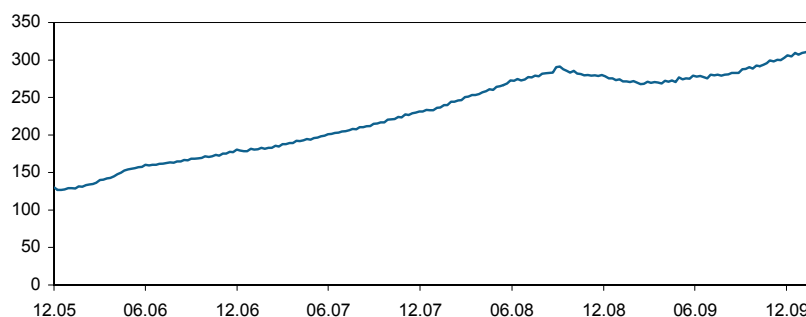
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The Economic Meaning of an Umbrella on a Sunny Day...

Proven time and time again, upward or downward trends in the amount of credit extended to households or to the real sector by banks is not a definitive precursor to economic upswings. **For the most part, credit acts as a financial accelerator of current economic trends. In other words, a substantial change in the credit volume can either bolster a recovery or deepen a slow down.** In this respect, efficacious financial transmission mechanism in a country helps strengthen the monetary policies of central banks. For that exact reason, monetary authorities closely follow developments in the credit market, the interest rates, and credit conditions in general and intervene when developments are not related to macro economic fundamentals. Obviously, credit started dwindling, beginning in October 2008 when the crisis was well underway in Turkey, banks became more circumspect in extending credit and elevated credit interest rates – over 20% at the time – caused an even further shrinkage in the GDP in the last quarter of 2008 and in the first quarter of 2009. Subsequently, credit gathered strength as economic activity rebounded from the bottom. With slackened monetary policies showing delayed results, interest rates fell to historic low levels, thus led the credit volume exceeding pre-crisis levels. As of February 19th, calculations based on data from the Turkish Central Bank indicate that the credit volume was approximately 10 percent above peak levels prior to the crisis while the weighted-average interest rate pointed to a record-low 8.6 percent for commercial loans. Although fairly close to deposit and bond interest rates, this is still about 2 percent above the policy rates issued by the Central Bank. However, before looking at interest rates in more detail, we should ask the question: **Is the credit outlook currently a cause for alarm with a monetary policy still reeling in shock from inflation?**

Banking System Loan Volume (Weekly, Bln TRY)

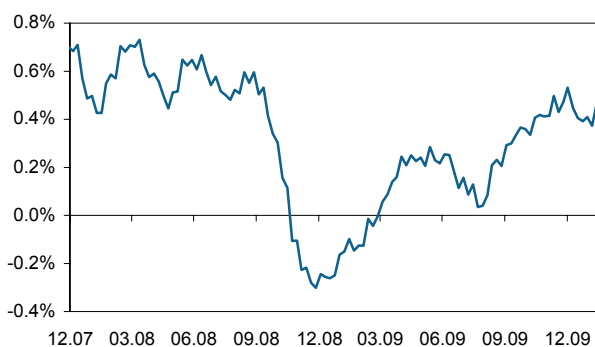


Source: CBT, Fortis Economic Research and Strategy

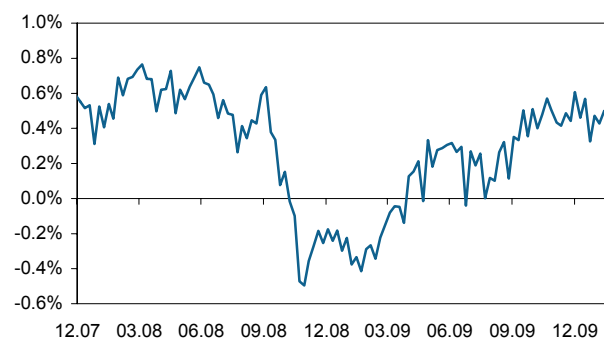
(* Consumer finance companies are added to the total loan volume. FX loans are converted to TL using fixed currency rate.

In reality, a disquieting outlook in normal times results from an overheating economy, causing a sharp rise in credit volume, which leads to a deterioration in general price setting behavior, with input costs of manufacturers easily passed on to consumers. However, an overheating economy is not the best term to describe current economic climate. **The real problem is the fact that resource utilization in the economy has continued to rise while real rates have remained in negative territory for some time, and rising inflation merely eggs this on.** Recently, both consumer credit and total credit volume, including commercial loans, have visibly stepped up, especially in the closing months of last year and in the first few months of this year. The average weekly increase over an eight-week period, which we track in order to minimize both weekly and monthly fluctuations, stands at 0.4 percent for both credit groups. This figure may appear to indicate a strong rise in credit but is actually slightly below the average increase prior to the crisis. In any case, this rate could still be considered supportive for domestic demand and economic activity. On the other hand, it is not easy to call for a hike in interest rates or an increase in required reserves with current outlook. Decisions taken by the Central Bank affect the banking system with some delay and start affecting economic activity within three to nine months and inflation within nine to eighteen months delay. **So precise timing is what we expect to come out of the Central Bank's own judgment. However, if another acceleration in credit volume comes about, compared to today's, we can expect measures like pulling back liquidity facilities and raising the Turkish lira deposits' required reserves before a hike in interest rates.**

Weekly Changes in Consumer Loans (*)



Weekly Changes in Total Loans (**)



Source: CBT, Fortis Economic Research and Strategy

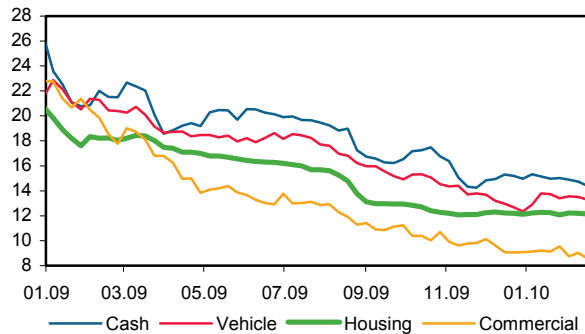
(*) Individual credit volumes of consumer finance companies are added to the consumer loans (excluding credit cards). (**) Consumer finance companies are added to the total loan volume. FX loans are converted to TL using fixed currency rate. The figures are eight-week averages of the weekly changes.

An extension in credit results from loosening credit conditions as well as from appealing interest rates. How this interaction works is easily explained. **First, overnight interest rates and interest rates on short-term repos set the lower limit of deposit interest rates at banks; however, the rates given by the banks are usually above this limit.** This margin was about 1 percent prior to the crisis and is now about 2.5 percent. **Secondly, credit interest rates hold a favorable margin over deposit interest rates.** This margin is 3-4 points in consumer credit and 1-2 points in commercial loans. According to analyses by the Central Bank of Turkey, the margin between credit and deposit interest rates represents factors such as borrower's re-payment risk, maturity mismatch risk and the limitations of available funding for banks. In times of uncertainty, this margin widens; on the contrary, in times of strong growth, the margin drops to zero, and even becomes negative in other than cash loans. **Thirdly, this interaction includes the relative position of credit interest rates against yields in bonds which is an alternative asset for banks.** Creating bond portfolios when the margin shrinks and focusing on loans when it widens is considered rational behavior by the banks.

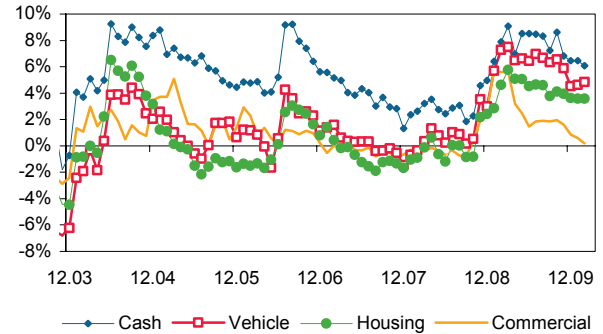
At present, a considerable margin is being maintained in credit interest rates, except on commercial loans. In our opinion, this prevents a widening

growth in credit volume as in previous years. However, this should not cause complacency since commercial loans make up a sizeable 60 percent of the credit volume. And it should not be forgotten that commercial credit interest rates are more susceptible to policy rates of the Central Bank.

Weighted Average Interest Rates For Turkish Lira Banks' Loans



Loans and Deposits Rate Difference



Source: CBT, Fortis Economic Research and Strategy

We conclude that credit is not the cause of growth or slow down but their accelerator. It helps to strengthen the monetary policies of central banks in countries where efficacious financial transmission mechanism exist. For that reason, central banks pay particular attention to developments in credit market conditions. The question is whether the latest rise in credit volume threatens Turkey's monetary policy, now weathering a blow from inflation. Making this assertion under the present circumstances is not that easy. However, both the downward spiral in interests and especially the weight of commercial loans in the overall credit volume should necessitate a close watch.

Economic and Political Agenda

▪ At home, unemployment on Monday and MPC meeting on Thursday will be critical data disclosures. At abroad there is a loaded data agenda. Building permits, housing starts, capacity use, industrial production and Philadelphia Fed index will be eyed closely. In Japan and US, monetary policy meetings will be important.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Unemployment, Dec.	%	Mar. 15 th , 8:00 GMT	-
Medium	Cent. Gov. Bud. PS, Feb.	TRY mn	Mar. 15 th , 8:00 GMT	-
Medium	TURKSTAT Consumer Conf., Feb.	-	Mar. 16 th , 8:00 GMT	-
High	MPC Rate Decision	%	Mar. 16 th , 17:00 GMT	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Capacity Use, Feb.	%	Mar. 15 th , 13:15 GMT	72.6
High	U.S.	Industrial Production, Feb.	% m/m	Mar. 15 th , 13:15 GMT	0.1
Medium	U.S.	New York Fed Man. Index, Mar.	-	Mar. 15 th , 12:30 GMT	22.00
Medium	Germany	ZEW Index, Mar.	-	Mar. 16 th , 10:00 GMT	44.6
High	U.S.	Building Permits, Feb.	mn	Mar. 16 th , 12:30 GMT	0.61
Weak	U.S.	Export & Import Prices, Feb.	%	Mar. 16 th , 12:30 GMT	0.3 & 0.0
High	U.S.	Housing Starts, Feb.	mn	Mar. 16 th , 12:30 GMT	0.58
High	U.S.	Fed's Rate Decision, Mar.	bps	Mar. 16 th , 18:15 GMT	no change
High	U.S.	Core PPI and PPI, Feb.	%, m/m	Mar. 17 th , 12:30 GMT	0.1 & -0.2
High	Japan	BoJ rate decision	%	Mar. 17 th	0.1
High	U.S.	Core CPI and CPI, Feb.	%, m/m	Mar. 18 th , 12:30 GMT	0.1 & 0.1
High	U.S.	Philadelphia Fed Mnf. Index, Mar.	-	Mar. 18 th , 14:00 GMT	18.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	975.6	1,113.7	1,219.8	1,325.7
GDP (US\$ - bn) (*)	630.6	732.7	791.2	847.9
GDP Growth (y/y % chg) (*)	-5.1	6.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	4.0	4.0
CPI (y/y % chg)	6.5	7.3	5.5	5.0
Trade Balance (US\$ - bn)	-38.6	-62.8	-70.7	-70.6
Exports (FOB, excl. luggage trade)	102.2	116.0	132.6	144.4
Imports (CIF, incl. gold)	140.8	178.7	203.2	215.0
Current Account Balance (US\$ - bn)	-13.9	-35.3	-39.9	-37.1
Current Account Balance / GDP (%)	-2.2	-4.8	-5.0	-4.4

(*) 2009 values are our forecasts

Financial Indicators Forecasts

	Mar. 15 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5310	1.5500	1.5300	1.5200	1.5300	1.5200	1.5600
EUR/TRY	2.0811	2.1100	2.1000	2.0800	2.1400	2.1300	2.1800
FX Basket	3.6121	3.6600	3.6300	3.6000	3.6700	3.6500	3.7400
EUR/US\$	1.3593	1.3600	1.3700	1.3700	1.4000	1.4000	1.4000
O/N	6.50%	6.50%	6.50%	6.50%	9.25%	8.00%	10.00%
Benchmark Bond	9.20%	9.00%	10.10%	10.60%	11.50%	11.00%	12.00%

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