

Macro Scope

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Weekly Economic and Strategic Review

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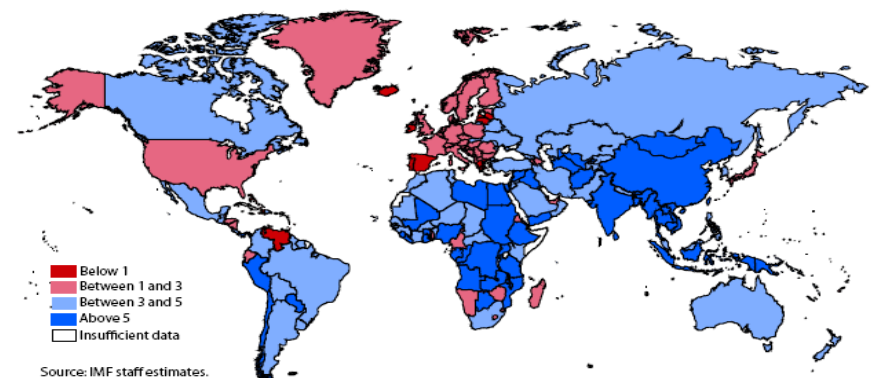
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Multi-Tasks of CBT in A Multi-Speed Recovery...

Just as the IMF was about to push up its forecasts for the global economy for the second time and the habitual pessimists had all but given up awaiting a double-dip recession, S&P's decision to cut Greece's and Portugal's credit ratings by three and two notches, respectively, dealt a major blow to the global recovery. When concerns first surfaced about the financial sustainability of certain EU member countries a few months ago, we weighed in with the following: *"Initially, public sector spending was increased to try to make up for the loss of business due to the drop in private sector consumption and investment brought about by the crisis. Yet the situation quickly worsened as government overspending tipped the budget balance and public sector debt ratios deteriorated. It was clear right from the start that this course of action was unavoidable – the cost of benefiting from the economic recovery. Consequently, as budget balances worsened, the importance of drafting exit strategies from the relaxed fiscal policies was continually stressed, and in some cases such plans were initiated. But back then it was almost impossible to think of drafting a plan for the weak links in the chain – that is, for the economies that could barely resolve their financial difficulties even before the crisis hit – let alone to implement such a plan. This in turn meant that these weak economies would become a target for the market players."* While our primary concerns about the sustainability of debt levels still stand, **we contend that isolating the weak links in the chain would likely contain the damage and avert a potential epidemic.** Hence the view that this downgrading of credit ratings is a "post mortem" affirmation by the ratings agencies that simply mimics market pricing sentiments. If in the short run, however, no steps are taken to assuage fears (i.e. of Greece defaulting and ultimately a double-dip recession), and **if unease escalates to such a point that it threatens financial stability, it will be essential to assess the impact of such a situation on macroeconomic indicators and the resulting burden on the economic recovery.**

IMF Growth Forecasts - Average Real GDP Growth in 2010 - 2011

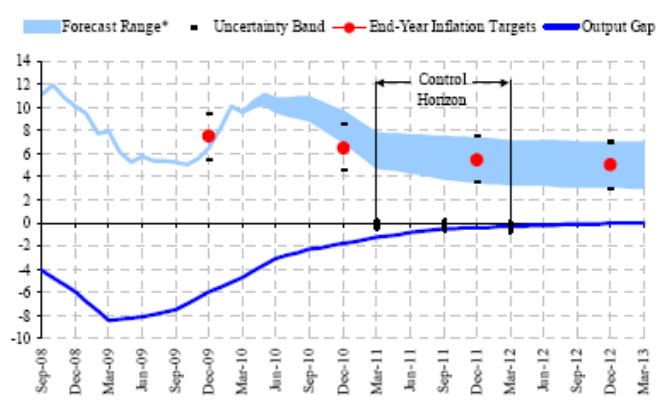


Source: IMF World Economic Outlook, April 2010

Likewise, a lack of action in this regard could prompt serious corrections to the stock, bond, forex and credit markets in addition to aggravating daily volatility. **In fact, debt sustainability seems to be the only area which may bring about a new global economic downturn.** That Greece's current CDS premium has shot up to over 900 basis points – the highest in the world – and that the two-year Euro bond rates have jumped up to as high as 38 percent indicate that the markets have started to put a price on Greece's inability to service its debt, either in full or in part. Consequently, the markets have begun to discuss such options as fully restructuring the loans and creditors taking some 20 to 40 percent haircut despite approved EU and IMF loan facilities amounting to EUR 45bn. The EU, however, strenuously denies any such possibility.

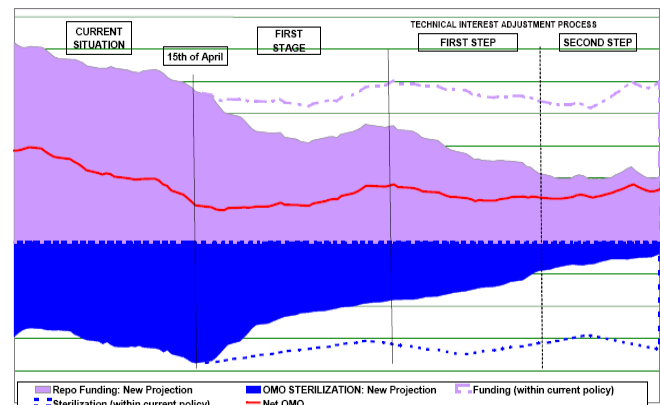
Until uncertainties subside, however, central banks worldwide can be expected to stress the need to implement policies that are more conservative and geared towards financial stability. Accordingly, the liquidity measures heavily resorted to during the crisis and gradually withdrawn in recent weeks would regain prominence, particularly during times of rising counterparty risks. Incidentally, the ECB could implement measures to flood the banking system with excess liquidity, particularly at times of increasing TED and OIS spreads (i.e., the spreads between the banks' short-term borrowing rates and the benchmark rates of risk-free Treasuries with matching tenors), which point to a deterioration of liquidity conditions in the financial sector and a poor outlook for credit risks. **Interestingly, these developments are spurring the Central Bank of Turkey to take action as well.** First of all, although the Central Bank was gradually reducing its funding volumes through repo transactions for some time, in line with its monetary policy exit strategies, the sudden upsurge in funding volumes on the day following the credit rating downgrading reaffirmed the Bank's commitment to maintaining financial stability. Our previous assessments of the graphs in the Central Bank's strategy memorandum saw repo funding volumes in May remaining between TRY 12bn and TRY 14bn, and gradually coming down to TRY 8bn in June. Whether the Bank decides to reverse its course of action on repo funding volumes or delay deploying certain elements of its exit strategy will depend on how the financial markets play out.

Central Bank Inflation and Output Gap Forecasts



Source: CBT,, Fortis Economic Research and Strategy

Liquidity Shortage and Central Bank Operations in Exit Process (*)



Secondly, CBT said in the Inflation Report that the liquidity measures are normalized gradually over the short term and that policy rates are kept constant at current levels for sometime followed by limited increases starting in the last quarter of 2010, despite earlier rate hike expectations that brought forward recently. In the second Inflation Report of 2010, there was also a significant upward revision to the end-2010 forecasts. While the previous forecast of 6.9% increased to 8.4%, 0.4 pp of this stemmed from the stronger growth, 0.15 pp of it from oil prices, 0.55 pp from food prices and 0.4 pp from higher than expected effect of tobacco and oil tax hikes. However, the end-2011 forecast was revised up by a marginal 0.2 pp to 5.4%. Our 2010 and 2011 forecasts currently stand at 8.0% and 6.0%.

Moreover the output gap forecasts for 2010 and 2011 were revised slightly downwards. Despite some escape clauses, like more than expected impact from high inflation expectations, or looser than expected fiscal policy, the tone in the quarterly Inflation Report of Central Bank was more dovish than what the market expects. While the inflation forecasts were revised upwards, the Bank said that they expect the measured rate hikes to start in last quarter and forecast the short-term rates to stay in single digit levels in the foreseeable future. **Bearing in mind the elevated inflation expectations, recovering demand conditions and the upward risks on inflation, we consider this to be too dovish.**

However, seeing Central Bank so committed on this, we returned back to our original forecast (first rate hike starting in October and a total hike of 150bps this year) that we apply throughout the year. Beware that there will be an additional 50bps hike due to the change in the reference rate from O/N rates to weekly repo rates in the upcoming months. Also, we stick to our terminal policy rate of 10% in mid-2011 despite the Bank's forecast to keep it at single digits throughout the three-year forecast horizon.

(*) Monetary Policy Exit Strategy

<http://www.tcmb.gov.tr/yeni/announce/2010/ANO2010-12.php>

Economic and Political Agenda

- This week at home, the most important data are April CPI and PPI that will be released on Monday. Meanwhile, there will be a loaded foreign agenda this week. Manufacturing and services PMIs in EU and manufacturing and services ISMs in the US will be critical. The US non-farm payrolls and unemployment rate and ECB's rate decision will also top the external arena agendas.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	PPI, Apr.	%m/m	May. 3 rd , 7:00 GMT	0.8 (0.85)
High	CPI, Apr.	%m/m	May. 3 rd , 7:00 GMT	(0.94)
Medium	CBNC-e Cons. Confi. Index, Apr.	-	May. 3 rd , 7:00 GMT	-
Medium	TEA's Preliminary Exports, Apr.	mn US\$	May. 3 rd	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	Manufacturing PMI, Apr.	-	May. 3 rd , 7:58 GMT	57.5
High	U.S.	Core PCE, Mar.	% m/m	May. 3 rd , 12:30 GMT	0.1
High	U.S.	Manufacturing ISM, Apr.	-	May. 3 rd , 14:00 GMT	59.6
High	U.S.	PPI, Mar.	%, m/m	May. 4 th , 9:00 GMT	0.7
Medium	U.S.	Factory Orders, Mar.	% m/m	May. 4 th , 14:00 GMT	0.3
High	Eurozone	Services PMI, Apr.	-	May. 5 th , 7:58 GMT	55.5
High	U.S.	Non-manufacturing ISM, Apr.	-	May. 5 th , 14:00 GMT	56.0
High	Eurozone	ECB Rate Decision	bps	May. 6 th , 11:45 GMT	no change
High	U.S.	Non-farm emp. and unemp., Apr.	ths,%	May. 7 th , 12:30 GMT	175, 9.7

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	954.0	1,090.6	1,198.1	1,311.5
GDP (US\$ - bn) (*)	616.6	722.2	777.2	834.8
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	-62.8	-70.6	-70.5
Exports (FOB, excl. luggage trade)	102.2	115.6	132.6	144.4
Imports (CIF, incl. gold)	140.8	178.3	203.2	214.8
Current Account Balance (US\$ - bn)	-13.7	-35.3	-39.8	-36.9
Current Account Balance / GDP (%)	-2.2	-4.9	-5.1	-4.4

(*) 2009 values are our forecasts

Financial Indicators Forecasts

	Apr. 30 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.4804	1.5000	1.5200	1.5200	1.5300	1.5200	1.5600
EUR/TRY	1.9601	2.0100	2.0700	2.1000	2.1400	2.1300	2.1800
FX Basket	3.4405	3.5100	3.5900	3.6200	3.6700	3.6500	3.7400
EUR/US\$	1.3240	1.3400	1.3600	1.3800	1.4000	1.4000	1.4000
Policy Rate	6.50%	6.50%	6.50%	7.00%	10.00%	8.50%	10.00%
Benchmark Bond	9.20%	9.40%	9.70%	10.80%	11.50%	11.00%	11.50%

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