



Macro Scope

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Weekly Economic and Strategic Review

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Patch the Budget, Match the Target!

For those who could not follow the last minute developments on 2009 budget plans, we want to underscore the substantial expenditure caps introduced in especially investment appropriations. With those revisions, 2009 central government budget revenue is now targeted at TRY248.8bn vs. TRY259.2bn expenditures, out of which TRY201.7bn portion is planned to be used for primary expenditures. All in all, the budget is seen to produce TRY10.4bn deficit and TRY47.1bn primary surplus (PS). However, it is unclear whether this means that the approved 2009 budget is calling for a fiscal tightening, unlike rising voices for fiscal loosening in line with the global conjuncture. We believe neither is true. The aim of the revisions made until now was to bring 2009 budget figures in line with the new year's macroeconomic conjuncture, as far as allowed by limitations in the legislative process. That is because there was no time to construct a more realistic budget proposal from scratch or to completely change the previous proposal that was unrealistically built on 4% growth projection. In essence, once the budget proposal passes the Budget and Planning Commission, income-cutting and expenditure-boosting changes are not possible to impose at the General Assembly of the Parliament. Originally, the government had an ambitious 16% annual expansion forecast in the tax proceeds in 2009. However, such a target seems no longer possible given the soured growth prospects. Assuming that tax revenue will only grow by as much as the price deflator (the deflator is projected to be 7.5% in 2009 program), the tax incomes fall short of the target by 1.4% of GDP, or TRY15.0bn. In that context, the Turkish Parliament accepted a proposal about cutting some 10.0%-16.5% of expenditure appropriations in some items of 2009 budget. The size of the caps were claimed to reach TRY3,061mn that corresponds to 0.3% of GDP. The government also announced a regulation on salary payments of municipal employees that would erase another TRY500mn (0.05% of GDP) from the public spending. In addition, with a last minute ruling, the government also pledged to step back from appropriating privatization proceeds to energy and transportation investments. The government assumes TRY12.6bn privatization proceeds in 2009. In practice, by not spending these revenues on investment projects, except for the TRY2.5bn to be transferred to South Anatolian Project and the regional development projects, the government assumes another expenditure cut by an equal amount. In essence, this measure does not bring any change in terms of the central government budget primary surplus, as the revenues and expenditures will be cut by equal size. However, this expenditure cut would improve the IMF based PS, which ignores the privatization revenues yet takes into account of all types of expenditures.

All in all, in preparation for the IMF deal, the size of the expenditure cuts has reached approximately TRY14bn in 2009 budget: The general budget appropriations for investment expenditures and purchase of goods and services are cut by TRY3.6bn, while the government will save another

TRY9bn – TRY9.5bn by not spending the privatization proceeds on infrastructure investments in energy and transportation. Having launched these measures, the expenditure caps have reached more or less a similar size to the possible shortfall in the tax revenues.

Normally, a tight fiscal discipline is supposed to be supportive for the bond markets and would give more room for the Central Bank's monetary policy maneuvers. Yet, what really matters for the level of the interest rate are the repercussions of the budget outlook on Treasury's borrowing program, and more specifically on the domestic debt rollover ratio. Unfortunately, both the borrowing and non-borrowing sources to finance the domestic and foreign debt services are in a more depressed position than the preceding years. The Treasury announced 2009 borrowing strategy last week, despite the lingering uncertainty about the size of the expected IMF loan. Based on this program, the Treasury assumes to service TRY153.9bn debt: TRY97.0bn for repayment of the principle and TRY56.9bn for interest payments. The domestic and foreign debt services are foreseen at TRY135.1bn and TRY18.7bn, respectively. TRY112.6bn out of the domestic debt service will be destined to the market, while TRY16.1bn and TRY6.4bn will be redeemed to public institutions and to the Central Bank, respectively. As a result, **the Treasury assumes to bring the total debt roll over ratio to 77.8% that is the highest level since 2006. However, while making this projection, the Treasury appears fairly optimistic on some non-borrowing tools and yet quiet conservative on some others. This ratio matters a lot for its role in determining the size of the transfers that will be available from the overall savings pool of the economy for the private sector. The lower the ratio, the lesser the crowding-out effect would be. In other words, the banking sector would have more resources to allocate to the firms and households through credit channel. This means of support has become more critical under the current tightening credit conditions.** Therefore, we think that it would be a useful study to consider different scenarios for the debt rollover ratio.

Treasury Financing Program

(TRYbn)	Treasury's Scenario			Fortis' 2009 Scenarios		
	2007 (R)	2008 (P)	2009 (F)	Optimistic	Baseline	Pessimistic
Total Debt Service	166.5	146.4	153.8	153.8	153.8	153.8
Domestic Debt Service	140.3	129.6	135.1	135.1	135.1	135.1
Foreign Debt Service	26.2	16.8	18.7	18.7	18.7	18.7
Total Financing	166.5	146.4	153.8	153.8	153.8	153.8
Non-borrowing Sources	48.5	49.5	50.5	50.5	50.5	50.5
Primary Surplus	34.3	24.4	28.5	26.8	16.1	5.4
Privat.+Unemp. Ins. Fund	5.3	9.2	7.5	6.5	4.5	2.5
Receipt of Guarant. Loans	2.2	0.5	0.5	0.5	0.5	0.5
Total Financing	122.0	107.0	117.3	120.0	132.7	145.4
External Borrowing	17.8	10.7	12.2	27.2	24.2	15.1
Domestic Borrowing	104.2	96.3	105.1	92.8	108.6	130.3
Change in Cash Account	2.7	1.7	0.0	0.0	0.0	0.0
Domestic Debt Rollover Ratio	74%	74%	78%	69%	80%	96%

Source: Treasury

(R)-Realization (P)-Projection (F)-Forecast

Scenario Assumptions: **Optimistic:** US\$12bn IMF loan in 2009, cash based PS is 2.5% of GDP (similar to 2008), TRY5.0bn privatization revenue / **Baseline:** US\$10bn IMF loan in 2009, cash based PS is 1.5% of GDP, TRY3.0bn privatization revenue / **Pessimistic:** US\$4bn IMF loan in 2009, cash based PS is 0.5% of GDP, TRY1.0bn privatization revenue.

Before assessing the scenarios, we want to summarize our views on the Treasury's assumptions. There are two assumptions that seemed very optimistic to us. First of all, the Treasury presumes that the cash based PS will be higher than 2008. This is quiet ambitious, given the adverse repercussions of depressed growth outlook on the tax incomes, especially in the absence of any revenue boosting measures. Secondly, the Treasury's assumption for the privatization proceeds is also ambitious in such an environment of weak M&A trends across the board. Nevertheless, TRY1.5bn transfers from the Unemployment Insurance Fund will be supportive for this financing source. Against this backdrop, external borrowing target seemed very cautious, considering the loan expected from the

IMF deal (we expect US\$17.5 – 23.0bn in 2009 and 2010). The major part of the credit line will likely be front-loaded. It is claimed in the media that US\$1.3bn and EUR1.3bn loans will be provided from the World Bank and European Investment Bank in 2009. This alone suggests that the target set for external borrowing, excluding TRY6.6bn Eurobond issue, will be easily surpassed.

Our baseline scenario assumes a lower primary surplus and privatization revenue vs. higher external borrowing. This yields a domestic debt rollover ratio of 80%. In the worst case scenario, this ratio rises to approximately 100%. The worst scenario may further delay the improvement in the TRY liquidity of the banking system and the Central Bank may need to fund the system for a longer time, so that the banks may need to remain cautious in expanding their loans to the private sector.

In conclusion, 2009 budget proposal has become more realistic with the last minute changes launched in preparation for the IMF deal. Yet, rather than bringing a fiscal tightening, these measures will do no more than preventing the picture from getting worse. Even though the borrowing need will not increase, it will be a challenging year for the Treasury's financing and even the IMF loan may not be able to prevent the domestic debt rollover ratio from touching its highest level since 2006.

Economic and Political Agenda

- At home while the industrial production will be critical this week, Central Bank's expectation survey also will be on the agenda.
- Glancing at external arena, U.S. non-farm payrolls seems to be the most critical data of the week. This data may be influential on shaping the scenarios for the global growth outlook.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Weak	Cash Based PS, Jan.	TRY bn	Jan. 7 th	-4.9
Medium	Industrial Output, Nov.	% y/y	Jan 8 th , 7:00 GMT	-17.0 (-12.8)
High	CB's Expectation Survey, Jan. I	-	Jan 9 th	-
Medium	CNBC-e Consump. Index, Dec.	-	Jan. 11 th , 7:00 GMT	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	Services PMI, Dec.	-	Jan. 6 th , 9:00 GMT	42.0
High	U.S.	Non-manufacturing ISM, Dec.	-	Jan. 6 th , 15:00 GMT	37.0
Medium	U.S.	Pending Home Sales, Nov.	% m/m	Jan. 6 th , 15:00 GMT	-1.0
Medium	U.S.	ADP Employment Rep., Dec.	K	Jan. 7 th , 13:15 GMT	-475
High	Eurozone	GDP (2 nd revision), 3Q	% q/q	Jan. 8 th , 10:00 GMT	-0.2
High	U.K.	BoE Rate Decision, Jan.	bps	Jan. 8 th , 12:00 GMT	-50
High	U.S.	Non-farm Payrolls, Dec.	K	Jan. 9 th , 13:30 GMT	-500
Medium	U.S.	Unemployment, Dec.	%	Jan. 9 th , 13:30 GMT	7.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2007	2008f	2009f	2010f
GDP (TRY - mn)	853.7	992.4	1,102.8	1,203.6
GDP (US\$ - bn)	658.8	753.2	709.8	807.1
GDP Growth (y/y % chg)	4.6	1.5	1.5	4.0
PPI (y/y % chg)	5.9	9.6	5.0	5.0
CPI (y/y % chg)	8.4	10.3	7.5	6.7
Trade Balance (US\$ - mn)	-62.8	-72.8	-50.5	-58.4
Exports (FOB, excl. luggage trade)	107.3	132.1	141.4	155.5
Imports (CIF, incl. gold)	170.1	204.9	191.9	213.9
Current Account Balance (US\$ - mn)	-37.7	-42.2	-22.3	-28.0
Current Account Balance / GDP (%)	-5.7	-5.6	-3.1	-3.5

Financial Indicators Forecasts

	Jan. 5 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5293	1.5500	1.6500	1.6000	1.6000	1.6000	1.5000
EUR/TRY	2.1289	2.1700	2.2770	2.1600	2.1600	2.1600	1.9800
FX Basket	3.6582	3.7200	3.9270	3.7600	3.7600	3.7600	3.4800
EUR/US\$	1.3921	1.4000	1.3800	1.3500	1.3500	1.3500	1.3200
O/N	15.00%	14.50%	13.50%	13.00%	13.00%	13.00%	14.50%
Benchmark Bond	15.90%	15.60%	16.50%	15.90%	14.90%	14.90%	16.60%

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