

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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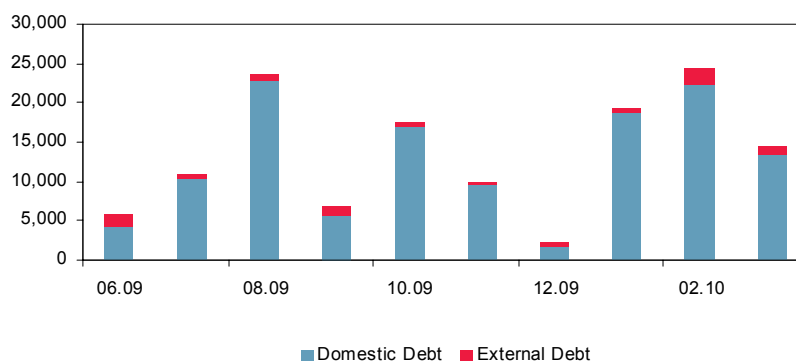
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Piece By Piece, In Pieces...

For a long time, we have been underlining that the further the IMF deal is delayed, the greater would be the risks on the budget balance and the debt stock. Last week, Deputy Prime Minister Babacan, who is also in charge of economic coordination, held meetings with economists and stated that they were working on the deal process and that it would be meaningless to talk with the IMF officials before the government reaches a consensus. In fact, the lack of a general agreement in the cabinet about launching a program added to the already climbing doubts about the process. As we emphasized many times before, the framework of the IMF program once agreed is turning invalid through time and it necessitates modifications due to the changing conditions and the government's new implementations launched during the period that elapses since agreeing on the framework. Eventually, every time the government and IMF resume talking, they end up building the program from scratch with new fiscal measures involved. Last week, there were also important developments in that context which may change the size of the fiscal measures urged by IMF. **The first one was the government's new bill that aimed to ease the fiscal burden on municipals. This new regulation would result in higher central government budget deficit.** The bill proposed not to make deductions from the central government revenue transfers to municipal administrations against their tax and social security premium liabilities in May, June, July and August. This exemption, which was also introduced for temporary periods in 2007 and 2008, is expected to add some TRY1.2bn to the budget deficit. Recall that the government had introduced a new regulation in the beginning of this year to raise the amount transferred from the central government budget to the municipals and this has constituted one of the main obstacles in reaching a compromise with IMF. This is a good sign that the IMF would unlikely be happy with the

Treasury's Total Debt Payment Schedule (based on issuances until end of April, TRYmn)

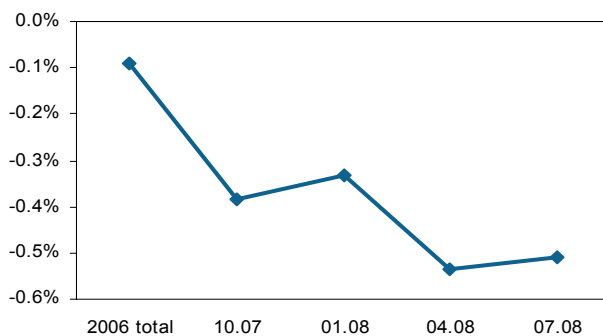


Source: Ministry of Finance, Fortis Research

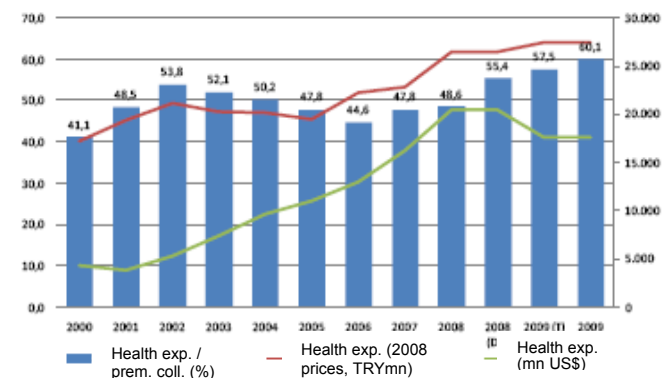
government's new bill, either. **The second important development was the launch of a new regulation that assumes to issue non-cash government domestic debt instruments (GDDI). Different from the first one, this regulation would not add directly to the budget deficit, but nevertheless would hurt the debt dynamics.** The proposal was originally designed in order to transfer TRY1bn to the Credit Guarantee Fund but the government also injected another bill that assumed to transfer TRY2.57bn to the Turkish Grain Board. The regulation enables the Treasury to issue GDDIs for financing the deficit of the Turkish Grain Board in 2009.

These types of GDDIs are non-cash issues and they do not influence the Treasury's cash balance or the central government's budget balance. However, they do boost the debt stock. These instruments had been intensively used during the restructuring of the banking sector in the aftermath of the 2001 crisis, with sizeable amount of non-cash bonds located at the accounts of the state banks' and the CBRT. The non-cash government bonds that were transferred to the state banks aimed to finance their pre-crisis duty losses, while the CBRT accepted to receive those instruments in return of capital injection to the state banks. Going back into history, the non-cash debt stock had reached TRY49.5bn by the end of 2001 with the domestic debt to GDP ratio skyrocketing to 79% and triggering concerns as to the sustainability of the debt. Coming today, the non-cash debt stock contracted to TRY25.9bn yet prevented a faster improvement in the debt to GDP ratio. **If the non-cash bond issues are expanded for other institutions as well, those bad memories may start worrying us more deeply.** Digging into the details of the domestic debt stock, we learned that TRY1bn of 1-year bonds were issued to Turkish Grain Board on 4.3.2009, while the whole amount of this issue was paid (early redemption) in March 2009. **Even though the two regulations mentioned above have different impacts, eventually they would both end up with higher borrowing need for the Treasury, especially once the non-cash bond issues are converted into cash transfers.**

Primary Surplus of Local Administrations (4Q Rolling, % of GDP) (*)



Health Expenditures to Premium Collection Ratio of SSIs



(*) The latest available data for local administrations fiscal balances is provided by the Finance Ministry for September 2008.

Source: Finance Ministry, EPRI, Fortis Economic Research and Strategy

Moreover, the surge in the transfers to the social security institutions (SSI) has been one of the most important reasons behind the deterioration in the fiscal outlook and this increase is set to remain as a drag on the budget in the upcoming period. The fiscal balance of the SSIs has been problematic on both the revenue and the expenditures sides. The health expenditures remain uncontrollable for a long time, while the revenues are hit by the slowdown in premium collection amidst the contracting economic activity. Moreover, the Treasury has been paying for the 5 pp of the overall premium payments of employers and that also boost the transfers to the SSI from the central government budget. **Apart from the conjectural impacts, the ratio of the health expenditures to premium collection has been deteriorating, as well, which is concerning for the fiscal sustainability. Based on the Fiscal Monitoring Report of Economic Policy Research Foundation of Turkey (EPRI), this ratio hit its highest level at 60% in February.** According to EPRI's

analyses, the financing need for the SSIs accounted for the 40% of the (27.8%) increase in the primary expenditures printed in 1Q. Therefore, as of end-March, around 70% of total expenditures and 60% of primary expenditures in the central government budget was linked to the transfers to the non-budgetary institutions and individuals. In other words, budget has changed into a structure which mostly finances the deficits or expenditures of mostly non-budgetary institutions.

All in all, the uncertainties regarding the IMF deal is likely to continue amidst the lack of any consensus and will of the government officials. Moreover, the framework of the IMF program once agreed is turning invalid through time due to the new stimulus plans launched by the government and the need to build the program from scratch every time the stand-by talks are resumed is causing a substantial loss of time. Meanwhile, the decisions that would lift the budget deficit keep mounting, making it difficult to agree with IMF on fiscal framework and the measures presented beforehand. Also, new regulations which would not add directly to the budget deficit, but would hurt the debt dynamics are also on the scene now. Adding to this, there are some other problems such as the SSIs fiscal balance that can not be resolved due to the slowing structural reforms. Therefore, the budget remains under more pronounced pressures due to the combination of structural weakness and conjectural impacts.

Economic and Political Agenda

- While the inflation figures will be important at home this week, U.S. non-farm payrolls and leading ISM indices will be on the forefront in the external arena. Coming to the Eurozone, PMI indices and GDP growth will be released. Separately, the monetary policy meetings of ECB and BoE will be among the important events to watch.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	TEA's Preliminary Exports, May	US\$ mn	June 1 st	7,000
Medium	CBNC-e Cons. Confi. Index, May	-	June 1 st , 6:00 GMT	-
High	ICC Price Index, May	% m/m	June 1 st , 9:00 GMT	0.3
High	CPI & PPI, May	%m/m	June 3 rd , 14:00 GMT	0.40 & 1.50 (0.45 & 0.61)

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	Manufacturing PMI, May	-	June 1 st , 7:58 GMT	40.5
Medium	U.S.	Core PCE, Apr.	% m/m	June 1 st , 12:30 GMT	0.2
High	U.S.	Manufacturing ISM, May	-	June 1 st , 14:00 GMT	42.0
Medium	U.S.	Pending Home Sales, Apr.	% m/m	June 2 nd , 14:00 GMT	0.7
High	Eurozone	Services PMI, May	-	June 3 rd , 7:58 GMT	44.7
High	Eurozone	GDP (1 st revision), 1Q	% q/q	June 3 rd , 9:00 GMT	-
Medium	U.S.	ADP Employment, May	K	June 3 rd , 12:15 GMT	-550
High	U.S.	Non-manufacturing ISM, May	-	June 3 rd , 14:00 GMT	45.0
Medium	U.K.	BoE Rate Decision	bps	June 4 th , 11:00 GMT	no change
High	Eurozone	ECB Rate Decision	bps	June 4 th , 11:45 GMT	no change
Weak	U.S.	Unit Labor Cost & Prod., 1Q	% q/q	June 4 th , 12:30 GMT	3.1 & 1.0
High	U.S.	Non-farm Payrolls, May	K	June 5 th , 12:30 GMT	-520
High	U.S.	Unemployment Rate, May	%	June 5 th , 12:30 GMT	9.2

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - mn)	950.1	941.1	1,036.4	1,145.6
GDP (US\$ - bn)	734.9	595.7	638.5	690.0
GDP Growth (y/y % chg)	1.1	-5.0	4.0	5.0
PPI (y/y % chg)	8.1	6.0	5.0	4.0
CPI (y/y % chg)	10.1	5.5	6.5	5.5
Trade Balance (US\$ - mn)	-69.8	-37.9	-62.0	-67.8
Exports (FOB, excl. luggage trade)	132.0	93.4	98.7	106.4
Imports (CIF, incl. gold)	201.7	131.3	160.7	174.2
Current Account Balance (US\$ - mn)	-41.7	-11.9	-33.1	-35.9
Current Account Balance / GDP (%)	-5.7	-2.0	-5.2	-5.2

Financial Indicators Forecasts

	May 29 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5623	1.6000	1.5500	1.5500	1.6500	1.5500	1.6300
EUR/TRY	2.1655	2.2400	2.1200	2.0500	2.1800	2.0200	2.1200
FX Basket	3.7278	3.8400	3.6700	3.6000	3.8300	3.5700	3.7500
EUR/US\$	1.3861	1.4000	1.3700	1.3200	1.3200	1.3000	1.3000
O/N	9.25%	9.00%	9.00%	9.00%	11.00%	9.00%	12.50%
Benchmark Bond	12.30%	12.50%	12.00%	12.00%	15.00%	12.00%	14.00%

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