

FORTIS BANK

Macro Scope

26 January – 1 February 2009

Weekly Economic and Strategic Review

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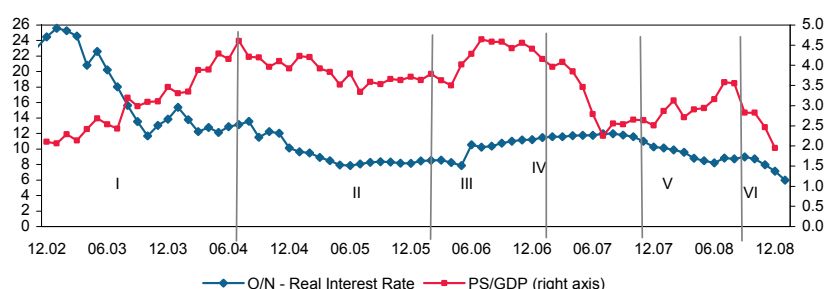
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Love of Symmetry...

With the announcement of the December central government budget figures, our concerns about the deterioration in fiscal performance, an issue that we have raised several times during last year, turned out to be right. Our stance on the fiscal performance was different from general market view, which seemed more satisfied with the results. At the end of the year, the realizations could not even meet the targets which had been revised down in the middle of the year in the context of 2008 Medium Term Fiscal Framework. Glancing at the primary surplus (PS) to GDP ratio, which is the best indicator for the fiscal performance; it regressed below 2% in the central government budget, while the similar ratio for the consolidated government sector was around 1 pp lower than 3.5% target. These results pointed to a substantial deterioration vs. both the average 5% PS produced during 2003-2006 and 3.5% registered in 2007. We anticipate that the repercussions of the slowdown in the growth and expenditure boosting regulations, which are the sources of this deviation, will be felt more strongly in the upcoming period. In that context, it will not be surprising to see further deterioration in the budget outlook for the following months. Meanwhile, the government will most likely be urged for providing support to different sectors, which started to have more trouble due to the deepening recession. Moreover, many opinion leaders would suggest that the government should continue easing the fiscal balance in accordance with the external conjuncture, following the examples in Europe or the U.S. All of these mean that there will be a tremendous pressure on the government to loosen budget. Under this outlook, it has become more important to maintain the right balance in the fiscal policy and to be careful about where to spend the scarce public money. This objective may be achieved via the commitment for amending the short term expansionary fiscal policy in the future or by an implementation of a flexible fiscal rule. Hopefully, the IMF deal will clarify the uncertainties about this policy. We had provided a detailed analysis for the budget performance in our *MacroBrief* released within the week. Here instead, we want to assess the complementary roles of fiscal and monetary policies adopted by governments.

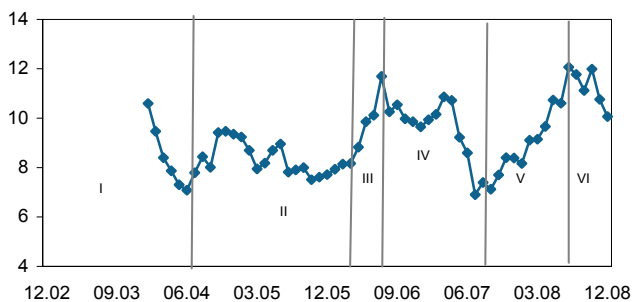
Monetary and Fiscal Policy Stances (2002 - 2008)



Source: Ministry of Finance, Treasury, CBRT, Fortis Economic Research and Strategy

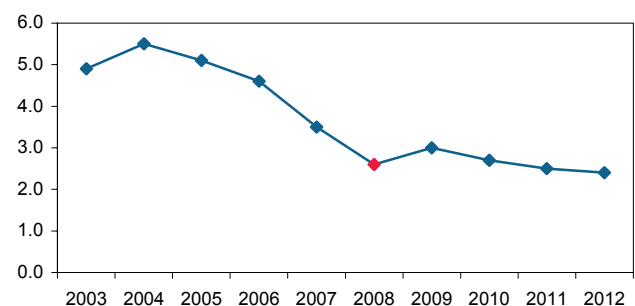
For that purpose, we used the Central Bank real interest rate (by using the 12-month forward looking CPI expectation) as a proxy for monetary policy stance and the PS to GDP ratio as a gauge for the fiscal policy stance. The marked declines (increases) in the real interest rate and PS indicate the easing (tightening) periods. The starting point of our analysis is end-2002, capturing 6-year term. We partitioned this period into six different fragments. In Period I that lasts until mid-2004, the visible tightness in the fiscal policy (PS increases to 4.6% from 2%) provides a strong support to the disinflation process. While the annual CPI regresses to 7.08% in June 2004, this gives room for the real interest rates declining to 12% from 25% on the back of easing monetary policy. Period II between mid-2004 and end-1Q06 is characterized by simultaneous easing of monetary and fiscal policies at a slight pace, with the sour outcome being the deceleration in the disinflation process. During this period, the annual CPI oscillates in the range of 7.5% and 9.5%. Period III which meets with the turbulence of the emerging markets in mid-2006 is a more short-lived vs. the others. In this period the monetary and fiscal policies both are tilted towards a tightening tendency, the reward being the annual CPI hitting its historical low at 6.9% in July 2007. This pans out towards end of Period IV, where the fiscal policy eases sharply (PS from 4.5% to 2.3%) due to the early general elections in July 2007. In Period V, not only this pre-election fiscal easing cannot be amended entirely (PS rises by a mere 1 pp), but also it is accompanied by an expansionary monetary policy. As a result, the annual CPI increases to its record high level of 12.06%. The last period, which continues today, kicks off in July 2008. In this Period VI, monetary and fiscal policies appear to be in a sharp and visible loosening trend for now. Yet, it will be more appropriate to assess this period later. **All in all, the periods analyzed above show that there were successful achievements in terms of inflation whenever monetary and fiscal policies compensate each other (as was the case in Period I and IV), i.e. when the easing bias in one of them is offset by the tightening bias in the other.**

Annual Inflation (CPI, %)



Source: TURKSTAT, Fortis Economic Research and Strategy

PS in Consolidated Government Sector (Program Defined, % GDP)



Source: Ministry of Finance, Treasury, Fortis Economic Research and Strategy

Surely, it can be said that the observations at hand are not sufficient to arrive at clear results for the current period in consideration. The optimum mix for monetary and fiscal policy should also be studied in more detail. **Nevertheless, we think it would be very risky to run a looser fiscal policy on top of the already eased monetary stance after the Central Bank's aggressive rate cuts.** Therefore, it would not be surprising to see that the IMF will be strict about the context of the new program, as well as the fiscal targets and measures to compensate for possible new deviations. We mentioned beforehand that the spending caps have reached TRY14bn so far, and these measures aim at bringing the budget in line with realistic growth and tax targets, rather than introducing a fiscal tightening. Nevertheless, the uncertainties regarding the economic outlook also increase risks associated with the budget performance. In other words, time will show us whether these measures will prove sufficient.

In conclusion, while the weakening tendency of PS as the correct indicator of fiscal performance, became more pronounced in 2008; it will not be surprising to see further deterioration in the following months. On the other hand, it is not

obvious whether new IMF program will reverse this tendency. Considering that implementing fiscal and monetary policies in a way to compensate each other had a positive impact on the post-2001 disinflation process, it would be very risky to run a looser fiscal policy on top of the already eased monetary stance after the Central Bank's aggressive rate cuts. While we think that many opinion leaders will create a tremendous pressure on the government to loosen the budget, it has become more important to maintain the right balance in the fiscal policy and to be careful about where to spend the scarce public money. This objective may be achieved via the commitment for amending the short term expansionary fiscal policy in the future or by an implementation of a fiscal rule. Hopefully, the IMF deal will clarify the uncertainties about this policy.

Medium Term Fiscal Framework (*)

(% of GDP)	2007	2008	2009	2010	2011	2012
Public Sector Primary Surplus (IMF Definition)	3.5	3.5	3.0	2.7	2.5	2.4
CGB	2.5	2.7	2.3	2.0	1.7	1.7
Rest of the Public Sector	1.0	0.8	0.7	0.7	0.8	0.7
CGB Revenues (IMF Definition)	-1.6	-1.4	-1.4	-1.3	-1.7	-1.6
CGB Primary Expenditures (IMF Definition)	20.6	20.4	20.4	20.3	20.2	20.0
CGB Overall Balance (MoF Definition)	18.1	17.7	18.1	18.3	18.5	18.3
Privatization Revenues	0.8	1.2	1.0	0.7	0.5	0.2
Gross Public Debt Stock (EU Definition)	38.8	37.0	35.0	33.0	31.0	30.0

CGB: Central Government Budget

(*) Figures are taken from the Medium Term Fiscal Framework released in the web site of Ministry of Finance on 3rd of May 2008.

Economic and Political Agenda

- At home, this week the eyes will be on the Central Bank's Inflation report on Monday. The same day, the Bank may also publish the summary of the MPC meeting, where the rates were slashed by 2 points. Meanwhile, on Friday the Treasury will announce its borrowing program. We estimate TRY22.9bn domestic debt service and US\$1.0bn external debt service in February. We anticipate the heftiest redemption at TRY14.2bn will be held on February 4th.
- Glancing at external arena, the advance 4Q U.S. GDP will be on the forefront. On Wednesday, Fed may introduce some monetary tools such as long term bond purchases in the FMO meeting, as there is no room for easing the interest rate, which is already at 0-0.25%.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Real Sector Conf. Index, Jan.	-	Jan. 26 th , 15:00 GMT	-
High	Imports, Dec.	US\$ mn	Jan. 30 th , 15:00 GMT	11,000
High	Exports, Dec.	US\$ mn	Jan. 30 th , 15:00 GMT	7,300
Medium	Treasury's Borrowing Prog., Feb.	-	Jan. 30 th	-
High	ICC Price Index, Jan.	% m/m	Feb. 1 st , 10:00 GMT	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Existing Home Sales, Dec.	mn	Jan. 26 th , 15:00 GMT	4.4
Medium	Germany	Ifo Index, Jan.	-	Jan. 27 th , 9:00 GMT	81.3
Medium	U.S.	Case Shiller House Price Ind., Jan.	% m/m	Jan. 27 th , 14:00 GMT	-18.0
Medium	U.S.	Consumer Confidence Index, Jan.	-	Jan. 27 th , 15:00 GMT	38.0
High	U.S.	Fed's Rate Decision	bps	Jan. 28 th , 19:15 GMT	no change
High	U.S.	Durable Orders (ex-transport.), Dec.	% m/m	Jan. 29 th , 13:30 GMT	-1.8
High	U.S.	New Home Sales, Dec.	mn	Jan. 29 th , 15:00 GMT	0.4
High	U.S.	GDP (1 st revision), 4Q	% q/q	Jan. 30 th , 13:30 GMT	-5.2
High	U.S.	Michigan Sent. Ind., Jan.	-	Jan. 30 th , 14:55 GMT	-

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2007	2008f	2009f	2010f
GDP (TRY - mn)	853.7	971.7	981.6	1,076.9
GDP (US\$ - bn)	658.8	747.5	609.7	694.8
GDP Growth (y/y % chg)	4.6	1.0	-1.0	4.0
PPI (y/y % chg)	5.9	8.1	6.0	5.0
CPI (y/y % chg)	8.4	10.1	6.5	6.0
Trade Balance (US\$ - mn)	-62.8	-69.6	-36.2	-45.4
Exports (FOB, excl. luggage trade)	107.3	131.5	118.4	130.2
Imports (CIF, incl. gold)	170.1	201.1	154.6	175.6
Current Account Balance (US\$ - mn)	-38.2	-42.1	-10.1	-17.2
Current Account Balance / GDP (%)	-5.8	-5.6	-1.7	-2.5

Financial Indicators Forecasts

	Jan. 23 rd	1M	3M	6M	12M	2009	2010
US\$/TRY	1.6405	1.7000	1.6800	1.6000	1.6000	1.6000	1.5000
EUR/TRY	2.1348	2.2100	2.1840	2.0800	2.0800	2.0800	1.9800
FX Basket	3.7753	3.9100	3.8640	3.6800	3.6800	3.6800	3.4800
EUR/US\$	1.3013	1.3000	1.3000	1.3000	1.3000	1.3000	1.3200
O/N	13.00%	12.00%	12.00%	12.00%	12.50%	12.00%	14.00%
Benchmark Bond	15.40%	15.20%	14.70%	14.20%	14.30%	13.70%	16.00%

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