FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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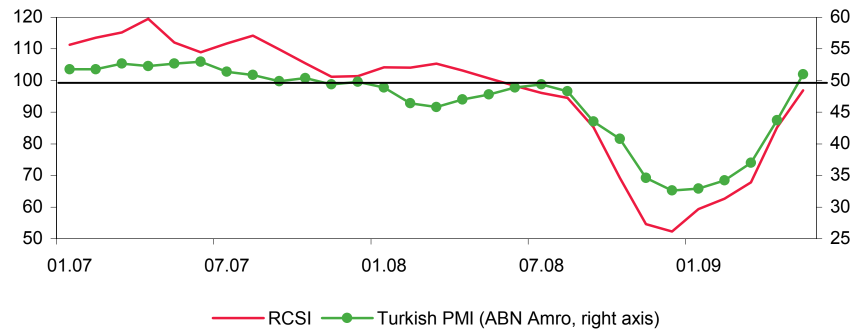
V Are Leading For U…

The leading indicators, which mostly consist of confidence indices, showed that the improvement in the manufacturing and services continued at an even accelerating pace from March onwards. Despite the widespread mistrust to the confidence indices, we believe even the most pessimistic analysts are now changing their call from "the worst is not behind" to "the recovery will be slow." They may even start panicking in a while and become worried that their scenarios are far from reflecting reality, given the leading indicators point at a V-type recovery in some countries. Turkey is among the few countries, where the leading indicators suggest such a rapid recovery potential. Based on the data provided by Markit, which runs these surveys across the globe, aside from China and India, Turkey is the only country who has PMI reading above the critical 50-threshold, which separates the expansion and contraction periods of the economy. As a more striking point, this index had been below 50 since November 2007, before the onset of the economic contraction. Also as supportive evidence, the CBRT Real Sector Confidence Index, which is a similar indicator, surged to 96.9 in May, approaching the critical 100 threshold. **All these developments reinforced our baseline scenario that the global recession would be over in 2H09 and Turkey would reach positive growth rate in 4Q09. This is the normal pattern the economies would follow during inventory adjustment process. What is still ambiguous is the timing of return to the potential growth, i.e. the elimination of the excess capacity that emerged through the sharp declines in production and employment**. We would not get very excited about this issue unless a visible recovery is achieved in the foreign demand (exports). Note that private investment, which is the most important stimulus of the growth in the medium-long term, may remain weak for a considerable time, given the uncertainty associated with the evolvement in demand conditions and the current excess capacity. **Briefly, we stick to our projection that V-type recovery in the leading indicators would bring only U-type recovery to the economy.**

Real Sector Confidence Index and Turkish PMI

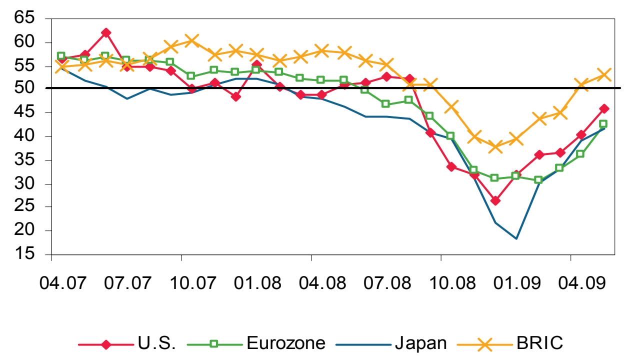


Source: CBRT, ABN Amro, Fortis Economic Research and Strategy

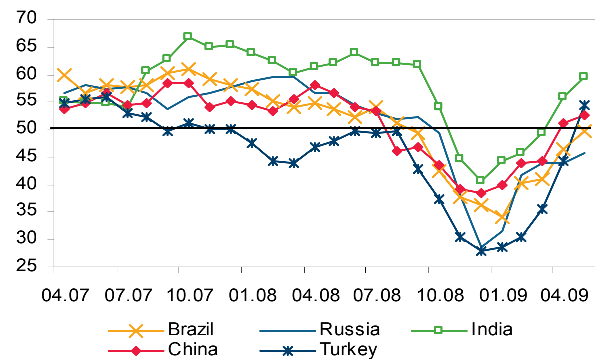
On the other hand, while the Turkish economy still lacks IMF deal or alternatively its own comprehensive medium-long term program, the government continued to announce new stimulus packages. Note that these stimulus plans put upside risks on the economic activity in the short term. The extension of temporary tax cuts and new incentives for job creation would help the domestic demand sustain its recovery. However, not only this recovery achieved by temporary measures would hardly turn into a permanent trend, but also the hampered fiscal balances would have negative repercussions on the medium-long term growth outlook. **Let us make it clear that we are not against those measures, but we are worried that these measures are not prioritized correctly and are not implemented in a comprehensive manner. Moreover, there is no road map for how to amend the current deterioration in fiscal balances in the next years.**

Yesterday, Prime Minister Erdogan unveiled the details of the new measures, yet as usual, there was no clear information about the associated cost. **This is a serious problem in terms of transparency and predictability of the fiscal policy.** Separately, the door is left open for the extension of tax cuts implemented in various sectors. Recall that, there is a detailed list in PEP (Pre-Accession Program) about the cost of fiscal measures launched to cushion the crisis. Based on this list, we reckon that if the VAT+SCT (special consumption tax) cuts continue 3 more months, this would delete an additional TRY1.9bn from revenues. While the newspapers claim that the total cost of temporary hiring in public sector and paid internships would be TRY1.3bn, PM Erdogan said they would add a lower TRY1.0bn. Separately, the cost of new investment incentives is reckoned to be TRY1.8bn for 1.5 years. **If all these facilities are fully used, the budget deficit to GDP ratio, which we expect to reach 7.8% by the year-end, may increase by an additional 0.5 pp.**

PMI Output Indices (G3 and BRIC)



PMI Output Indices (BRIC and Turkey)



Source: JP Morgan, Markit, Fortis Economic Research and Strategy

All in all, we find the new stimulus system beneficial in terms of the private investment, which is the most important trigger for medium-long term growth outlook. Nevertheless, as we stated above, private investment may remain weak for a considerable time, given the uncertainty associated with the evolvement in demand conditions and the excess capacity. In fact, the following quote from columnist Asaf Savas Akat in daily Vatan (02.06.2009) clarifies our view very well: *"Let us divide the determinants of investment into two. One of them is called the financing facilities and financing cost. The other one is income flow to be accrued from investment. The first one is still pretty common in Turkey. The private companies are expected to undertake hefty amount of investments if there is a plenty of and cheap loan available in the economy. In other words, it is the funding availability that limits the private investments and there would be private investments as long as there is the funding for it. The endless debates over external financing need in Turkey are in essence the result of the above understanding, which assumes that the domestic savings fall short of satisfying the existing investment demand. Accordingly, the inflow of external funds into the* *domestic economy is enough for securing a high level of private investment.* ***The mechanism proposed by Keynes entirely contradicts to this. (According to him) at first, the companies analyze the sales potential of the goods to be produced through the new investment. The sale revenues are determined by supply-demand balance. If there is limited supply but demand is more alive, the investment would be profitable. Otherwise, the company does not undertake the investment even if there is available funding for it.*** *In this process, the financing is the dependent variable. If there is abundant demand for investment, the financial system creates the necessary funding. Accordingly, the causality is reversed in the external financing gap.* ***The external financing gap is not the reason for the elevated investments; the reason of the financing gap is the elevated investments.*** *In this framework, the weak link of the conjecture is the private investments. In the recession periods, demand pulls investments down and vice versa. Even if the consumption recovers, the excess capacity in the economy weighs on investment demand. This vicious cycle prevents rapid growth. In brief,* ***the most critical problem of Turkish economy going forward is the revival of private investment demand."***

To conclude, we stick to our projection that V-type recovery in the leading indicators would bring only U-type recovery to the economy. While Turkey lacks IMF deal or alternatively its own comprehensive medium-long term program, the new stimulus packages raise upside risks on the economic activity in the short term, but we are worried that hampered fiscal balances would have negative repercussions on the medium-long run growth outlook. Besides, even though domestic consumption has the greatest share (70%) in GDP, the recovery would hardly gain steam unless investments and external demand also improve. The excess capacity across the globe would likely to continue suppressing those components of growth.

Economic and Political Agenda

- The week ahead will be full of critical disclosures at home. Both fresh signals about the growth outlook and the fiscal performance will be important. Coming to external arena, the agenda will be relatively quiet. The most critical disclosure seems to be the U.S. retail sales.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis *(Consensus)*
High	Industrial Output, Apr.	% y/y	June 8th, 7:00 GMT	-18.0 *(-18.3)*
Medium	Cash Based PS, May	TRY bn	June 8th	4,200
High	CB's Expectation Survey, June I	-	June 9th	-
Medium	CNBC-e Consump. Index, May	-	June 10th, 7:00GMT	-
Medium	Capacity Use, May	%	June 10th, 7:00GMT	*(68.8)*
High	C/A deficit, Apr.	US$ mn	June 10th, 14:00 GMT	-1,200*(-1,330)*
High	Central Gov. Bud. PS, May	TRY mn	June 10 – 12th	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	U.S.	Foreign Trade Balance, Apr.	US$bn	June 10th, 12:30 GMT	-29.0
High	U.S.	Retail Sales, May	%, m/m	June 11th, 12:30 GMT	0.2
Weak	U.S.	Export & Import Prices, May	%	June 12th, 12:30 GMT	0.4 & 1.0
Medium	U.S.	Michigan Sent. Ind., June	-	June 12th, 13:55 GMT	69.9

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

	June 5th	1M	3M	6M	12M	2009	2010
US$/TRY	1.5335	1.5800	1.5500	1.5500	1.6500	1.5500	1.6300
EUR/TRY	2.1750	2.2100	2.1200	2.0500	2.1800	2.0200	2.1200
FX Basket	3.7085	3.7900	3.6700	3.6000	3.8300	3.5700	3.7500
EUR/US$	1.4183	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	13.00%	13.50%	13.50%	13.50%	15.00%	14.00%	14.00%

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