FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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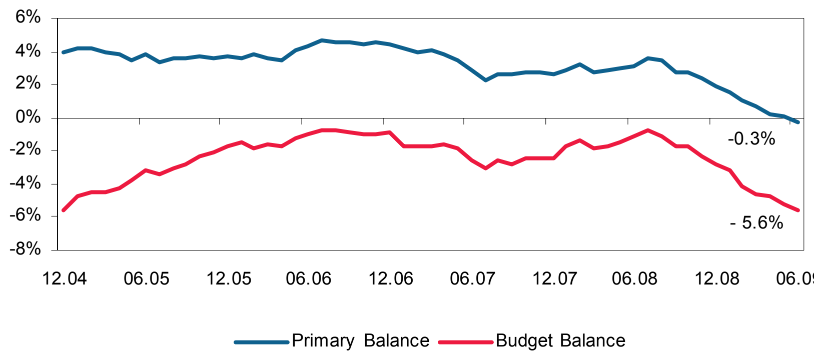
Medium Term Postponement…

The delay in the announcement of a medium term economic program is beyond comprehension although the markets seem to have lost interest in it for some time. Even the Central Bank told in its last Inflation Report that a convincing medium term fiscal program is necessary for the single-digit interest rate to be permanent. However, media reports hint at further delay in the announcement of this program and the new deadline seems to be October 17th, when the 2010 Budget Law will have to be sent to the Parliament. According to these reports, the official forecasts for the general economy in the Medium Term Program (MTP), which indeed should have been released by end-May, are ready but the announcement will be merged with the 2010-2012 budget where the main macro figures will be set by October. Of course, the long-waited MTP will be announced until the mentioned official deadline for the budget, but it will most likely be clear whether the program is backed by IMF or not during the IMF-World Bank meeting in Istanbul at the beginning of October. While the work is in progress about the economic program, IMF once more emphasized the importance of debt sustainability and mending the short-term deviations in the budget through medium term measures in its newly published projections on Turkey. **Recall that, in the Pre-Accession Program, which was previously sent to EU, the budget deficit to GDP ratio rises to 5.8% this year and declines only marginally to 5.4% in 2010 and 5.0% in 2014. Taking this framework as reference, IMF forecasts that debt-to-GDP rate elevates to 58.1% in 2014, from 46.9% this year.** We consider, such a sharp deterioration is a warning that Turkey risks loosing the proceeds of the prudent economic policies achieved in the previous years. In 'The State of Public Finances: A Cross-country Fiscal Monitor' report, IMF summarizes the **preliminary strategies to ensure fiscal sustainability** in G-20 countries. **For Turkey, IMF sets the target as stabilizing the debt-to-GDP ratio by 2011. The measures IMF finds necessary to attain this**

Central Government Budget Balance (% of GDP, 12-month rolling)



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

PEP 2009 – 2011 Macroeconomic Framework

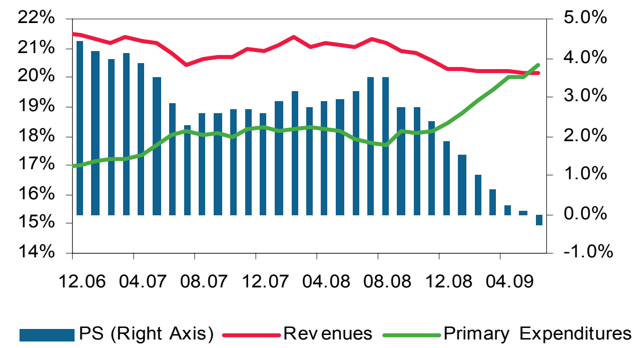
	2008	2009f	2010f	2011f
GDP (% y/y)	1.1	-3.6	3.3	4.5
C/A balance / GDP	-5.7	-1.9	-3.0	-4.0
IMF Defined PS/GDP	1.9	-0.6	0.5	0.6
Debt Stock/GDP	39.5	43.1	44.1	43.4

(*) Pre-Accession Programme

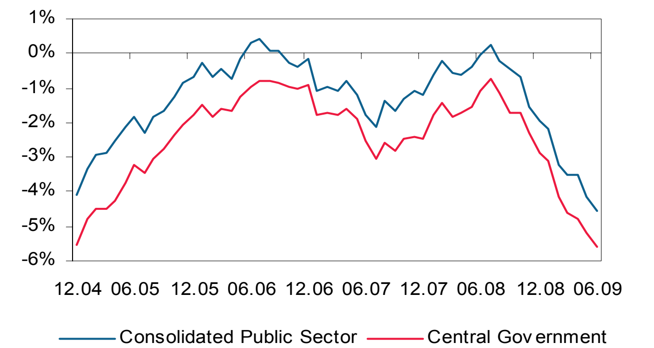
target are *non-renewal of fiscal stimulus, improved expenditure control, local government reform, introduction of fiscal rule and continuation of tax administration*. IMF says that, these measures are the result of views of IMF staff on the intentions of the country authorities, based on discussions and announcements and in addition to functioning of automatic stabilizers (recovery of revenues). **Another important finding of this report for Turkey is that the level of debt-stabilizing primary balance level for the average of next 5 years is 1.7% of GDP,** after an estimated 0.2% deficit this year. In the Pre-Accession Program, the government assumed a much looser 0.5% primary surplus for 2010 and 2011. Finally we will mention the IMF's assessments on the size of the fiscal expansion during the crises which is calculated as the difference from the budget balance at the end of 2007. This yields a **fiscal loosening at 3.7% of GDP but only 0.8 pp of this is crisis-related discretionary measures, while the remaining part is due to automatic stabilizers.** By the way, the measures here captures only those taken between September 2008 and March 2009, therefore the impact of the economic stimulus package launched on June and revenue-enhancing measures introduced in July are not in the numbers.

In order to put these forecast into context, we need to compare them with where we stand now. We prefer to use the IMF defined budget figures, which give a clearer picture of the budget performance by excluding the one-off revenues, and we work with the 12-month cumulative numbers as a trend indicator. We normally look at the primary surplus but this time we included the budget deficit to the analysis. To make things a bit more complicated, there are the central government (CG) budget figures as well as consolidated government sector (CGS) figures to consider. The latter also includes the social security funds, Unemployment Insurance Fund, state economic enterprises and extra budgetary funds on top of the CG budget, so is a wider definition. In our previous reports, we calculated that CG budget produced a primary deficit of 0.3% of GDP in 12-month cumulative terms, as of June, while based on CGS calculations there is a slight surplus of 0.2%. The budget deficit, on the other hand, appears at 4.5% of GDP based on Ministry of Finance definition and 5.6% in IMF defined CG budget. **In the absence of new fiscal measures, we expect the primary surplus and budget deficit to come worse than both the forecasts in the Pre-accession Program and the mentioned IMF report, with primary deficit approaching 2% and budget deficit exceeding 7.5% by end-2009.**

Central Government Budget (% GDP, 12-month cumulative) (*)



Budget Balance (% GDP, 12-month cumulative) (**)



(*) IMF defined figures (**) The latest data available for the non-budgetary public institutions is April. Therefore, figures for May-June are assumed flat vs. May-June 2008.
Source Finance Ministry, Treasury, Fortis Economic Research and Strategy

We are also concerned with the extent of the fiscal loosening. **We reckon that as of June 2009, the deterioration in the budget balance reached 4.5 pp since September 2008, with the primary expenditures accounting for some 70% of the expansion in the deficit and the remaining 30% is due to the receding revenues.** Our calculations reveal a greater fiscal expansion than IMF estimations. However, note that the deterioration in the budget deficit was 1 pp after March, which was the end date in the IMF's analysis. Therefore, in essence our results seem close to those of IMF.

All in all, the current budget outlook is even far dismal than assumed by IMF, meaning that stabilizing the debt to GDP ratio by 2011 would be a more challenging task for Turkey, while more measures would have to be taken in the short term and a higher primary surplus would be needed to resume the fiscal discipline in the medium term.

Summing it up, being concerned about the surging debt ratios, IMF prepared an outline for the member countries' exit strategies from loose fiscal policies and roughly put forward the targets and the necessary measures for Turkey. However, even though the preparations for the medium term program have been ready in technical level, further delay seems likely as the government prefers to merge the announcement of the program with the 2010-2012 budget. That is why it is uncertain for now whether those strategies would ever be adopted. The tendency implied by the current budget outlook points at a much worse outlook than IMF projections, raising the risk that the targets and the measures mentioned in the IMF report may change, especially considering the delay.

Economic and Political Agenda

- In the week ahead, there are important indicators at home for both the economic activity and the fiscal performance. In the external arena, in addition to the hard data for July, such as the retail sales and the industrial output, inflation and consumer confidence would top the agenda. The rate decisions from BoJ and Fed will be at focus, as well. Neither of the banks are expected to change the rates.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis *(Consensus)*
High	Industrial Output, June	% y/y	Aug. 10th, 7:00 GMT	-11.0 *(-12.6)*
Medium	C/A deficit, June	US$ mn	Aug. 10th, 15:00 GMT	-2.2 (-2.1)
Medium	Cash Based PS, July	TRY bn	Aug. 10th, 15:30 GMT	-5.6
High	Capacity Use, July	%	Aug. 11th, 7:00 GMT	*(72.7)*
Medium	CNBC-e Consump. Index, July	-	Aug. 11th , 7:00 GMT	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Weak	U.S.	Unit Lab. Cost & Prod., 2Q	% q/q	Aug. 11th , 12:30 GMT	-1.5
Weak	U.S.	Unit Lab. Cost & Prod., 2Q	% q/q	Aug. 11th , 12:30 GMT	3.7
Medium	Japan	BoJ Rate Decision	%	Aug. 11th	no change
Medium	U.S.	Foreign Trade Balance, June	US$bn	Aug. 12th , 12:30 GMT	-28.45
High	U.S.	Fed's Rate Decision	bps	Aug. 12th , 18:15 GMT	no change
High	Eurozone	GDP (flash), 2Q	bps	Aug. 13th , 9:00 GMT	-0.8
Weak	U.S.	Export & Import Prices, July	%	Aug. 13th , 12:30 GMT	0.4 & 0.1
High	U.S.	Ret. Sales,Tot.&ex-auto, July	%, m/m	Aug. 13th , 12:30 GMT	0.3
High	U.S.	Core CPI and CPI, July	%, m/m	Aug. 14th , 12:30 GMT	0.2 & 0.1
Medium	U.S.	Capacity Use, July	%	Aug. 14th , 13:15 GMT	68.1
Medium	U.S.	Industrial Production, July	%, m/m	Aug. 14th , 13:15 GMT	0.0
Medium	U.S.	Michigan Sent. Ind., Aug.	-	Aug. 14h , 13:55 GMT	68.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - mn)	950.1	933.8	1,024.6	1,132.9
GDP (US$ - bn)	734.9	591.0	637.9	689.4
GDP Growth (y/y % chg)	1.1	-5.5	4.0	5.0
PPI (y/y % chg)	8.1	4.0	5.0	4.0
CPI (y/y % chg)	10.1	5.5	6.5	5.5
Trade Balance (US$ - bn)	-69.8	-39.1	-62.6	-68.3
Exports (FOB, excl. luggage trade)	132.0	98.1	98.4	106.1
Imports (CIF, incl. gold)	201.7	137.2	161.0	174.4
Current Account Balance (US$ - bn)	-41.5	-12.8	-33.6	-36.3
Current Account Balance / GDP (%)	-5.7	-2.2	-5.3	-5.3

Financial Indicators Forecasts

	August 7th	1M	3M	6M	12M	2009	2010
US$/TRY	1.4617	1.4650	1.5000	1.5200	1.5800	1.5000	1.5800
EUR/TRY	2.1034	2.1000	2.1000	2.1000	2.0900	2.1000	2.0500
FX Basket	3.5651	3.5650	3.6000	3.6200	3.6700	3.6000	3.6300
EUR/US$	1.4390	1.4300	1.4000	1.3800	1.3200	1.4000	1.3000
O/N	8.25%	7.75%	7.25%	7.25%	7.75%	7.25%	10.00%
Benchmark Bond	10.20%	10.00%	10.50%	10.50%	12.00%	10.50%	12.50%

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