

FORTIS BANK

Macro Scope

13 – 19 July 2009

Weekly Economic and Strategic Review

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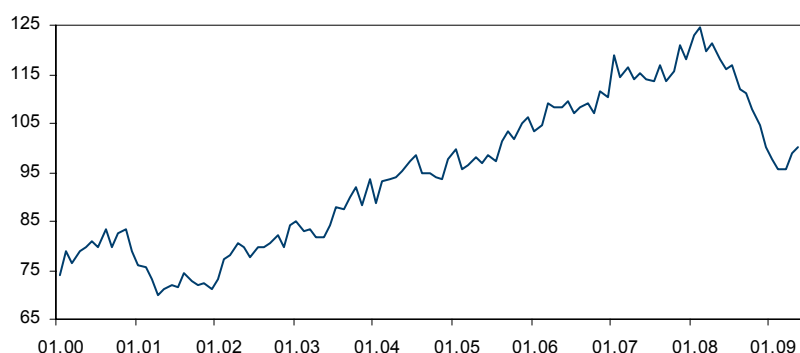
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Light So Dim, At The End Of The Tunnel...

May reading of industrial production showed that despite the improving domestic sales bolstered by the tax cut incentives in many sectors, the economic recovery will remain weak unless there is a meaningful rebound in foreign demand. This also reinforced our expectation for a gradual pick up in the economy. After the industrial production reached the rock bottom in March by sliding 23.8% y/y, there has been a cumulative 21% increase since then. The annual contraction in the industrial output moderated to 17.4% in May. Accordingly, after the production regressed by an annual 22% in 1Q, there was a slight recovery in the first two months of 2Q, as the decline in output shrank less by 17.8% in those months. On the other hand, exports started falling in October last year and there has been no sign of abating so far. Based on Turkish Exporters' Association preliminary figures, exports tumbled by 35% y/y in 2Q, a worse performance than 1Q. Moreover, there are signals that exports will continue suffering a similar weakness in July. Considering the abysmal performance in exports, it becomes clearer why we do not expect a visible recovery in the industrial production until 4Q this year. **The silver lining in the May output data was that the seasonally adjusted figures confirmed the month of March as the trough of the economic cycle, with the monthly improvements remaining on course since then.** Yet, based on the seasonally adjusted figures that we calculated (please see our *Global Economist*, July 09), the production rose by only 1.2% m/m in May atop of April's 3.2% increase. Meanwhile, the annual contraction was sharper than our forecast for 15.7% decline, which was also the consensus. **In other words, after the economy left the rock-bottom behind, it is now recovering, but at a slower pace than we assumed. This outlook increased the downside risks to our 5.5% contraction estimate for 2009 GDP.** All in all, as is the case across the globe, the strength in the leading indicators fails to be matched by similar positive outlook in hard data. Therefore, the perception of economic outlook turns to be market negative.

Industrial Production Index (Seasonally Adjusted)

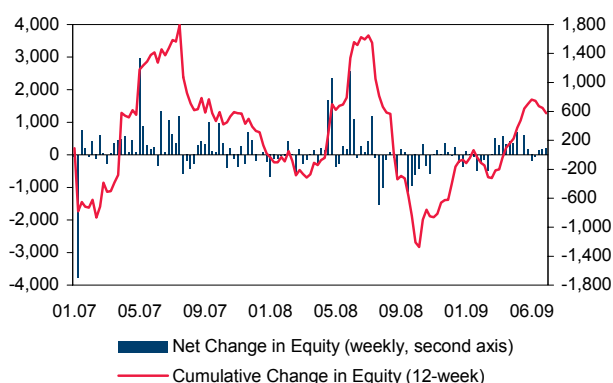


Source: TURKSTAT, Fortis Economic Research and Strategy

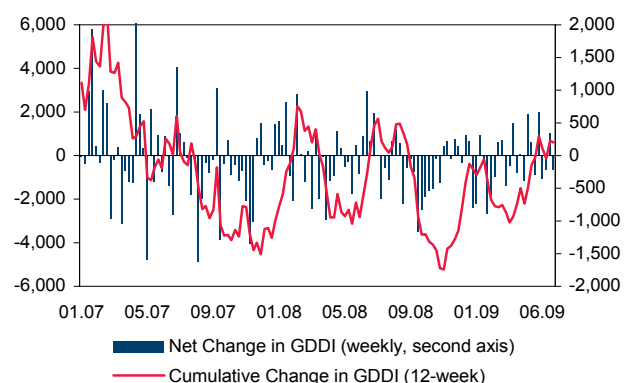
We think that the recent sell-off pressure in the developed countries' bourses, especially in the U.S., is the result of the worries regarding the strength of recovery. These worries are reasonable. However, if the stock markets had not printed hefty gains from March lows to June (for example S&P surged by 42% between the March 9th and mid-June), this pressure would not have been felt as severely as it is now. **Therefore, rather than being a trend reversal, we think that this market movement is a correction which will provide a more consistent valuation with the current economic outlook.** The Turkish stock market posted more than 60% gain in the same period, yet there is no clear sign for a downward correction of this robust performance so far. As is known, we assumed that the initial recovery in the Turkish economy would be strong for a couple of months on the back of inventory meltdown, yet we considered that interpolating this recovery to the rest of the cycle would not be realistic. It was a U-type recovery with an extended bottom that we had assumed. Therefore, **we think that eventually, similar worries would start weighing in Turkey.**

This more cautious sentiment regarding the economic recovery hit the stock markets, while on the other hand it created a **bond market friendly atmosphere.** The 10-year U.S. Treasury yields, which hit 4% in mid-June, regressed to 3.4% nowadays. Similarly, at home, the compound benchmark bond yield fell to as low as 11.4% from above 13.0%. We still think that the record wide output gaps across the globe will be closed through time and hence medium-long term outlook will not be favorable for the bond yields, as the inflation expectations would sour again. Yet, **we believe that until the signs of a strong recovery turn apparent enough to erase all the doubts, bond yields would remain low or at least would continue to resist soaring in the short term.** Our view finds further support from the recent remarks by Central Bank officials as to more room for interest rate cuts and the Bank's cautious stance against the recovery signals. Moreover, in order to boost the liquidity, the Bank even considers GDDI purchases, an unconventional monetary policy tool not used before. A marked increase in bond yields at home is likely to be delayed until this uptrend becomes a broad-based movement, i.e. when the yields start ascending simultaneously across the globe. In an earlier week, we had listed the necessary conditions for such an increase. ("The Turn Of A Friendly Card", *MacroScope* due May 14th)

Changes in Non-Residents' Equity Portfolio (US\$ mn)



Changes in Non-Resident's GDDI Portfolio (US\$ mn)



Source: CBRT, Fortis Economic Research and Strategy.

The tides between the equity and bond market in the world may be reflected in a different way to the domestic markets on the back of residents' and foreigners' current positions and their market shares. **Based on Central Bank's weekly data, foreign investors added a cumulative US\$1.8bn to their equity portfolios in March-June period, when the ISE100 index was increasing sharply. On the other hand, their bond holdings rose by a limited US\$0.4bn.** As the foreigners' trade decisions determine the trend in the Turkish stock market, even a lower amount of foreign fund inflows than the preceding periods proved sufficient. On the other hand, the primary dealer domestic banks have the

biggest share in the bond market and they prefer to purchase GDDIs rather than extending loans. Therefore, even though the foreign inflows remained limited, the bond yields preserved their downtrend.

While this outlook makes the Istanbul Stock Exchange more vulnerable to any change in the global risk perception, the bond market performance turns to be affected by, apart from the risk perception regarding the country, banks' competition to expand deposits, short term liquidity conditions and Treasury's borrowing program.

All in all, while we think that the recent sell-off pressure in the developed countries' bourses, especially in the U.S., is the result of the worries regarding the strength of recovery, this market movement is a correction which will provide a more consistent valuation with the current economic outlook rather than being a trend reversal. Since we assume a U-type recovery with an extended bottom for Turkey, as well, we think that eventually, similar worries would likely start weighing in Turkey. The latest industrial production data showed that there would be a sluggish recovery, as we expected so that the risks to growth outlook remained on the downside. While this created a bond market friendly atmosphere, we believe that until the signs of a strong recovery turn apparent enough to erase all the doubts, bond yields will remain low or at least will continue to resist increasing in the short term.

Economic and Political Agenda

Thursday's MPC meeting seems to be the most important event of the week at home. The rate cut expectations are in a range of 25-50 bps. Meanwhile, Treasury will issue 6-month T-bill on Monday, together with the discount bond due 11.05.2011 and 5-year CPI-linked bond on Tuesday ahead of Wednesday's TRY7.5bn redemption. Glancing at external arena, while the retail sales (Tuesday) are critical in the U.S., Fed's economic recovery comments will be eyed in the FOMC minutes (Wednesday). Separately, Goldman Sachs, Intel (Tuesday), Google, JP Morgan (Thursday), BoA, Citigroup, General Electric (Friday) will be among the important earning reports of this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	Unemployment, Apr.	%	July 15 th , 7:00 GMT	-
Medium	Consumer Confidence, June	-	July 16 th , 7:00 GMT	-
High	MPC Rate Decision	bps	July 16 th , 16:00 GMT	-50 (-25 / -50)
Medium	Central Gov. Bud. PS, June	TRY mn	July 13 - 17 th	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	ZEW Index, July	-	July 14 th , 9:00 GMT	45.5
Medium	U.S.	Core PPI and PPI, June	%, m/m	July 14 th , 12:30 GMT	0.1 & 1.0
High	U.S.	Retail Sales, Tot. & ex-auto, June	%, m/m	July 14 th , 12:30 GMT	0.4 & 0.5
High	U.S.	Core CPI and CPI, June	%, m/m	July 15 th , 12:30 GMT	0.2 & 0.5
Medium	U.S.	New York Fed Mnf. Ind., July	-	July 15 th , 12:30 GMT	-6.0
Medium	U.S.	Capacity Use & Ind. Prod., June	%	July 15 th , 13:15 GMT	67.9 & -0.6
High	Japan	BoJ Rate Decision	%	July 15 th	no change
High	U.S.	Philadelphia Fed Mnf. Index, July	-	July 16 th , 14:00 GMT	-5.0
High	U.S.	Build. Perm. & Hous. Starts, June	mn	July 17 th , 12:30 GMT	0.53 & 0.54

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

	July 10 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5413	1.5500	1.5500	1.5500	1.6400	1.5500	1.6300
EUR/TRY	2.1516	2.1400	2.0900	2.0200	2.1700	2.0200	2.1200
FX Basket	3.6929	3.6900	3.6400	3.5700	3.8100	3.5700	3.7500
EUR/US\$	1.3960	1.3800	1.3500	1.3000	1.3200	1.3000	1.3000
O/N	8.75%	8.25%	8.00%	8.00%	9.50%	8.00%	11.00%
Benchmark Bond	11.60%	11.00%	11.00%	12.00%	12.50%	12.00%	14.00%

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