

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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Fill In The Blanks With Some Common Sense...

Now that the Turkish Parliament announced a 15 day adjournment from this week onwards, there remains little doubt that the resumption of talks with IMF about a stand-by program is delayed to after local elections on March 29th. Market players mostly assume that such a credit agreement will eventually be reached within this year, which is our baseline scenario, as well. Nevertheless, one should also be aware of the risks related to the domestic economy and the external financing outlook in the absence of any IMF program. For that purpose we will revisit our previous analysis on Turkey's financing need, incorporating the new figures to the picture, while we will also go over the Treasury's financing outlook, as last mentioned in our monthly *Glocal Strategy*. Eventually, this report will also touch upon the implications of this worse case scenario on risks associated with the rapidly easing fiscal and monetary policies. In order to make a projection for Turkey's external financing need in 2009, we started by C/A deficit. The C/A deficit will likely regress to US\$12.9bn at the end of this year on the back of our forecast for 1.0% economic contraction and sliding commodity and energy prices. This is the first item on the list that needs to be financed. Adding US\$13.3bn sovereign debt redemption of the public sector and US\$92.5bn of private sector external debt repayments, the total external financing need ends up being somewhere around US\$119bn. On the financing front, assuming that public debt roll over ratio will be 100%, FDI will reach US\$7.0bn and that there will be no contribution from the net portfolio flows in equity and bond markets, the banks and private sector net drawings of foreign loans will have to reach US\$99bn in order to close the gap. Securing this amount via private sector loans means that the private and banking sector must roll over 107% of their debt. If the roll over ratio remains at a lower 100%, the financing gap will be US\$6.0bn, while the gap widens to US\$34bn if they can only roll over 70% of their debt, as was the case in the average of last two months in 2008.

External Financing Balance (US\$bn)

EXTERNAL FINANCING NEED			
C/A Deficit			12.9
Loan Repayments			105.8
Private			92.5
Non-financial Private Sector			56.1
Long term			30.2
Short term			25.9
Financial Institutions			36.4
Long term			12.0
Short term			24.4
Public			13.3
Long term			12.9
Short term			0.4
TOTAL			118.7
EXTERNAL FINANCING DEFICIT			
Private Sector % 100 Roll over	5.9	Private Sector % 70 Roll over	33.7
ASSUMPTIONS FOR OTHER FINANCING SOURCES			
Foreign Direct Investment			7.0
Portfolio Investment			0.0
Public Borrowing			13.3

However, 70% roll-over seems more realistic amidst the growing financial sector jitters and reviving fears that crisis is not yet coming to end. The size of the possible financing gap alone underscores the critical importance of the IMF deal, never mind the fact that IMF deal would contribute a lot to medium-long term structural reforms. **We reckon that the crucial issue to be concerned in the lack of IMF support would be the sharper-than-envisaged economic contraction, rather than a balance of payment crisis. As another consequence, the economy would lean more on domestic sources in order to meet the external financing deficit. Given that the sustained deterioration in the fiscal performance has already been putting pressure on the Treasury's borrowing, the crowding out of the funds available to the private sector would be felt more deeply in that case.**

As we had mentioned in our monthly *Glocal Strategy*, in the absence of fiscal measures, the consolidated government sector primary surplus (PS) to GDP ratio may slump to 1.0%, or even below that. From a short term perspective, the most significant result of the fiscal loosening would be felt through the Treasury's borrowing program. We continue assuming that there will be a credit agreement with IMF in our baseline scenario. Incorporating various other assumptions (the details can be found in our February *Glocal Strategy* report and in the footnotes of the table below), our baseline scenario suggests that the domestic debt roll-over ratio would climb to 88%, the highest level since 2005. **More strikingly, in the pessimistic scenario, which assumes there will be no IMF deal, the roll-over ratio soars to as high as 99%, a level not seen since 2000. This in turn would mean more fiscal dominance, adding to the problems associated with banks' loan supply and possibly lifting interest rates.**

Treasury Financing Program

(TRYbn)	Treasury's Scenario			Fortis' 2009 Scenarios		
	2007 (R)	2008 (P)	2009 (F)	Optimistic	Baseline	Pessimistic
Total Debt Service	166.5	146.4	153.8	153.8	153.8	153.8
Domestic Debt Service	140.3	129.6	135.1	135.1	135.1	135.1
Foreign Debt Service	26.2	16.8	18.7	18.7	18.7	18.7
Total Financing	166.5	146.4	153.8	153.8	153.8	153.8
Non-borrowing Sources	48.5	49.5	50.5	27.2	15.0	8.1
Primary Surplus	34.3	24.4	28.5	20.2	10.0	5.1
Privat.+Unemp. Ins. Fund	5.3	9.2	7.5	6.5	4.5	2.5
Receipt of Guarant. Loans	2.2	0.5	0.5	0.5	0.5	0.5
Total Financing	122.0	107.0	117.3	126.6	138.8	145.7
External Borrowing	17.8	10.7	12.2	27.5	19.4	11.3
Domestic Borrowing	104.2	96.3	105.1	99.0	119.4	134.4
Change in Cash Account	2.7	1.7	0.0	0.0	0.0	0.0
Domestic Debt Rollover Ratio	74%	74%	78%	73%	88%	99%

Source: Treasury

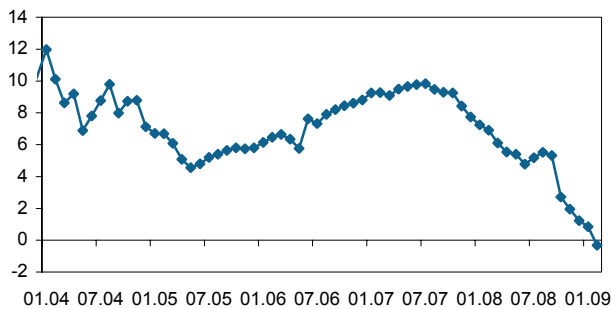
(R)-Realization (P)-Projection (F)-Forecast

Scenario Assumptions: Optimistic: US\$10bn IMF loan in 2009, cash based PS is 2.0% of GDP (similar to 2008), TRY5.0bn privatization revenue / Baseline: US\$5bn IMF loan in 2009, cash based PS is 1.0% of GDP, TRY3.0bn privatization revenue / Pessimistic: No IMF loan in 2009, cash based PS is 0.5% of GDP, TRY1.0bn privatization revenue.

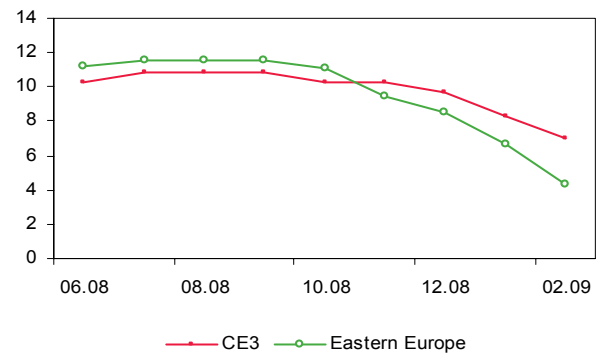
The redemption schedule is quiet light until May and that may give a partial relief. Nevertheless, the rise in debt roll-over ratio would put upward pressure on the interest rates in the medium term or, more specifically it would prevent the long term bond yields from declining. Having said that, it should be clear now what we mean by "risks associated with the rapidly easing fiscal and monetary policies" in the beginning of this report. Considering that there would hardly be any IMF deal in the absence of fiscal measures, the lack of credit line would further add to the upward pressure on the domestic debt roll-over ratio. **If the decline in the commercial loan rates and long term bond yields falls short of the Central Bank's aggressive O/N rate cuts, that should give the Central Bank something to think about.** Easing the monetary policy too much does not seem appropriate amidst the lack of any other measures to avert the growing medium-long term risks. The risk perception across the globe keeps souring, lifting the the countries' risk premiums. Turkey's risk premium surged, with CDS reaching 500 bps and EMBI touching 600 bps. The policy rate in Turkey is 11.5%

and the ex-ante real interest rate is 5.0%, meaning that the real interest rates surfaces on the negative territory when adjusted for risk premium, for the first time in history. In other words, considering that the current yield of Turkey's US\$-denominated long term Eurobonds are 9.5% and above, there is only limited compensation for taking TRY risk. Separately, interest rate differential is rapidly declining between Turkey and Eastern European peers, which are also at their monetary easing cycle.

The Real Interest Rate Adjusted for EMBI Turkey Spread (*)



Interest Rate Differential Between Turkey and Eastern Europe (**)



Source: CBRT, Reuters, Fortis Economic Research and Strategy

Source: CBRT, Reuters, Fortis Economic Research and Strategy

(*) CBRT policy rate is aligned with 12-month forward looking CPI forecast and then it is corrected for EMBI Turkey spread.

(**) Eastern Europe: Czech Republic, Hungary, Poland, Rumania and Russia. CE3: Czech Republic, Hungary, Poland purchasing power parity weighted average rate

All in all, Turkey's external financing need appears to be more than US\$30bn, despite our anticipation for a rapid contraction in the C/A deficit. If this gap cannot be fulfilled with IMF deal, the economy would be subject to further contraction. Moreover, this would also lift the Treasury's roll-over ratio to levels not seen since 2001 crisis, making the life harder for the private sector, which is already in trouble. Eventually, the monetary policy would not help at all either, if the Central Bank's unconventional approaches prevent the decline in long term interest rates, amidst the lack of support from other policy areas.

Economic and Political Agenda

- February inflation seems to be the major event in the domestic calendar. Market expects a visible decline in the annual inflation. Another key disclosure will be the summary of MPC meeting where the interest rates were slashed by an aggressive 150 bps. Meanwhile, the Treasury's redemption schedule seems light in March with TRY4.1bn, based on Treasury's earlier projections. We reckon that TRY1.1bn and TRY2.1bn domestic redemptions will be held on March 4th and March 11th, respectively.
- Glancing at external arena, U.S. non-farm payrolls and activity indicators such as ISM are anticipated to affirm that the worst level of the recession is not over yet. Meanwhile, in the Eurozone, PMIs and interest rate decisions will be on the forefront.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	TEA's Preliminary Exports, Feb.	US\$ mn	Mar. 2 nd	6,600
Medium	CBNC-e Cons. Conf. Index, Feb.	-	Mar. 2 nd , 7:00 GMT	-
High	CPI & PPI, Feb.	%m/m	Mar. 3 rd , 15:00 GMT	0.2 & 0.2 (0.28 & 0.45)

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	Manufacturing PMI, Feb.	-	Mar. 2 nd , 8:58 GMT	33.6
High	U.S.	Core PCE, Jan.	% m/m	Mar. 2 nd , 13:30 GMT	0.1
High	U.S.	Manufacturing ISM, Mar.	-	Mar. 2 nd , 15:00 GMT	34.3
Medium	U.S.	Pending Home Sales, Jan.	% m/m	Mar. 3 rd , 15:00 GMT	-2.8
High	Eurozone	Services PMI, Feb.	-	Mar. 4 th , 8:58 GMT	38.9
Medium	U.S.	ADP Employment, Feb.	K	Mar. 4 th , 13:15 GMT	-553
High	U.S.	Non-manufacturing ISM, Feb.	-	Mar. 4 th , 15:00 GMT	41.0
High	U.K.	BoE Rate Decision	bps	Mar. 5 th , 12:00 GMT	-50
High	Eurozone	ECB Rate Decision	bps	Mar. 5 th , 12:45 GMT	-50
Medium	U.S.	Unit Labor Cost & Productivity, 4Q	% q/q	Mar. 5 th , 13:30 GMT	2.8 & 1.6
High	U.S.	Non-farm Payrolls, Feb.	K	Mar. 6 th , 13:30 GMT	-600
high	U.S.	Unemployment Rate, Feb.	%	Mar. 6 th , 13:30 GMT	7.9

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2007	2008	2009f	2010f
GDP (TRY - mn)	853.7	971.7	1,011.2	1,112.5
GDP (US\$ - bn)	658.8	751.6	624.2	678.2
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	-69.8	-37.4	-46.7
Exports (FOB, excl. luggage trade)	107.3	132.0	113.5	126.0
Imports (CIF, incl. gold)	170.1	201.7	151.0	172.7
Current Account Balance (US\$ - mn)	-38.2	-41.4	-12.9	-20.4
Current Account Balance / GDP (%)	-5.8	-5.5	-2.1	-3.0

Financial Indicators Forecasts

	Feb 27 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.6813	1.7500	1.6500	1.6500	1.6900	1.6500	1.7300
EUR/TRY	2.1442	2.2400	2.1000	2.1000	2.1600	2.1100	2.2500
FX Basket	3.8255	3.9900	3.7500	3.7500	3.8500	3.7600	3.9800
EUR/US\$	1.2753	1.2800	1.2750	1.2700	1.2800	1.2800	1.3000
O/N	11.50%	10.50%	10.00%	10.00%	11.00%	10.00%	13.50%
Benchmark Bond	15.30%	15.00%	14.00%	13.00%	14.60%	13.00%	14.50%

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