

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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Apparent Risks And Plans Being Planned...

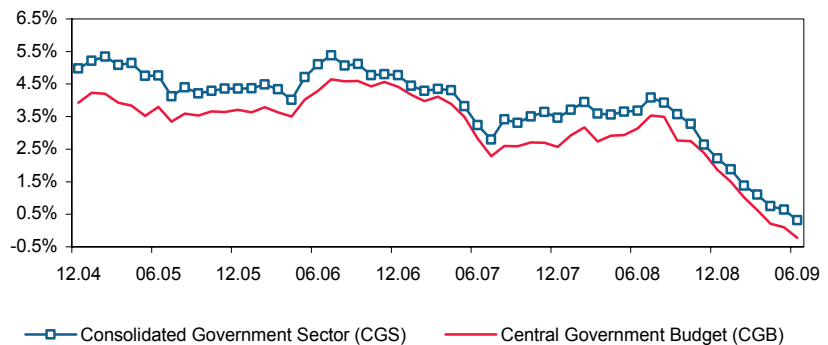
The data disclosures over the recent term yielded more cautious perceptions about the global economic outlook and the recovery prospects. However, amidst this soured sentiment, the corporate outlook, especially the banking sector, started to top the agenda through the earnings season that has just kicked off. Since the pace of economic recovery is the main determinant of the economic outlook and the market tone, the balance sheets are under scrutiny for clues regarding this pace. Against this backdrop, a number of local issues may come to the forefront in the period ahead. Apparently, the first of these issues would be related to whether the government will introduce a comprehensive economic program. While we believe that a well-framed program may serve as an alternative to the IMF deal, markets would like to see the implementation first in order to get convinced that the government will remain committed to the program in the long term. We will look at the program assumptions and fiscal measures in order to see some meaningful progress here. Therefore, we will first take a look at the current fiscal outlook through analyzing the recent data and developments. In that context, another important issue for the short term is the Treasury's elevated borrowing need and whether this need will weigh on the interest rates. Under the context of our forecasts for the Treasury's redemptions, we will analyze also this issue with a long term perspective.

The June budget figures showed that the deterioration continued without cutting pace. The central government budget produced TRY1.4bn primary deficit in June, indicating at a visible weakness vs. last year's TRY5.1bn primary surplus (PS). In June last year, there were TRY3.2bn one-off transfers, which are not included to the IMF-defined figures and that made the deterioration in the central government budget to seem more dramatic. Yet, we reckon that IMF-defined primary deficit in this June is at TRY1.6bn, which is still visibly weaker than TRY1.5bn PS produced last year. Accordingly, 12-month rolling IMF-defined primary balance to GDP ratio declined to -0.2%, the first ever negative reading, while the consolidated government sector PS regressed to a tiny 0.3%.

Moreover, the government continues introducing new expenditure boosting regulations. The new hazelnut support policy released last week was one such example. Even though this attempt may be considered as a correct one in terms of long term fiscal discipline, it will add a total TRY2.6bn to the budget within a 3-year period. Based on our estimates, TRY1.1bn portion of this amount will be added to the budget in 2009. Yet, the increase in the special consumption tax (SCT) on gasoline introduced right after this announcement hints that the government has a different attitude than before in terms of the budget policies. The Finance Ministry is claimed to anticipate TRY1.6bn additional revenue in 2009 on this tax hike. Recall that, when the government announced the stimulus package back in June and extended the tax cuts in certain sectors, the additional burden on the budget was planned to be compensated by tax hikes on tobacco

products, as well. These attempts to counter the impact of the new incentives through balancing measures are indication of a change in the government's view on budget discipline. Nevertheless, note that we will not be optimistic unless a comprehensive and convincing economic program is put into force, either alone or with IMF, and gives the roadmap as to how the current rise in the expenditures will be amended in the period ahead.

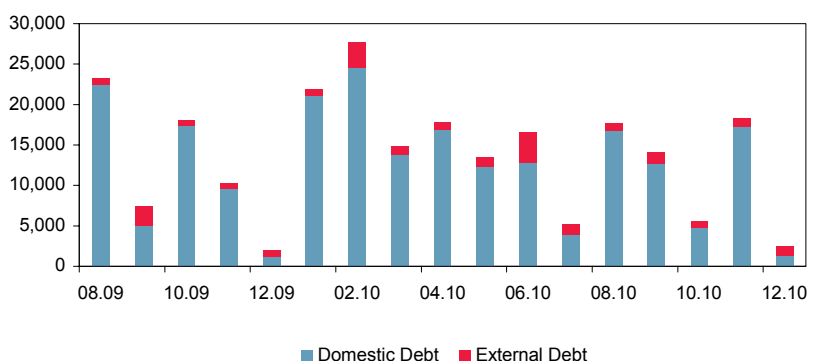
Program Defined Primary Surplus (%GDP)



Source: Finance Ministry, Fortis Economic Research and Strategy

The Medium Term Program will be important in that sense. Normally, based on the Public Financial Management and Control Law, the program should have been unveiled by end-May. The government is expected to finalize the report this month. The program should incorporate a cautious growth outlook in order to be convincing. Shall the economy be assumed to contract at a milder rate than 5% that would not be realistic. On the other hand, projecting a deeper contraction would be a more cautious approach, given the fresh GDP and industrial output data. The budget forecasts in the Medium Term Fiscal Framework will be the next important item on the agenda. This government report has already been delayed by a month. We hope to see that the government will draw a tighter fiscal outlook here, with debt to GDP ratio falling from 2010 onwards, as opposed to the loose policy suggested by the Pre-Accession Economic Program released beforehand. Needless to say, the measures planned in order to secure these targets will be important, as well.

Treasury's Total Debt Payment Schedule



Source: Treasury Undersecretariat, Fortis Economic Research & Strategy

PS: Projections are based on debt issuances until July 15th

It is important to get rid of these uncertainties ahead of the Treasury's hefty redemptions in August in order to provide a better borrowing environment for the Treasury. We calculate that, after accounting for the swap auctions, the Treasury has TRY14.4bn to redeem on August 5th. After this most loaded domestic debt service of the month, the next bulky redemption will be TRY6.8bn on August 19th. We estimate that the total domestic debt payments will be TRY22.5bn in August, with TRY17.5bn being destined to the market. The external debt service is quite low at US\$0.5bn, bringing the total financing need to TRY23.3bn. The external

payments will be higher at US\$1.6bn in September, yet the overall financing need will be subdued as the domestic debt redemption is much smaller at TRY5.4bn. The repayment of the eurobond maturing on September 21st inflates the external debt burden in that month. (Note that the Treasury floats new eurobond issues usually in the redemption period.)

Once getting ahead of the bulky August payments, the Treasury has a loose calendar of financing need in the rest of the year. The single exception will be the TRY17.4bn redemption in October, with almost all of it being paid on a single day on October 7th. On the other hand, there will be small amounts of payments on September, November and December. However, during this easy period, the Treasury will probably be getting ready for the loaded redemptions due the first two months of next year.

The high financing need would unlikely be a problem if the risk appetite remains strong, as is the case over the last days, and if the perceptions regarding the domestic outlook do not sour. The share of foreign investors in the outstanding domestic government securities fell to as low as 8.9% from 15.3% in end-2007. There is room for increase in their shares if everything goes well. This would eventually depend on the fiscal discipline. Unless there is any progress here, the Treasury's financing need would remain elevated and the current interest rates may not seem attractive enough to take the risk. We estimate that the domestic debt roll over ratio would be as high as 107% by the year-end and the lack of IMF loan may send this ratio up to 115%. More importantly, our estimate for next year jumps to 95% from 89% without an IMF deal.

Economic and Political Agenda

▪ There will be a quiet data agenda at home this week. The Treasury will issue 5-year FRN on Tuesday ahead of Wednesday's TRY0.98bn redemption. In the external arena, Eurozone flash PMIs and U.S. existing home sales will be important. Separately, U.S. balance sheet disclosures will intensify this week. Texas Instruments (Monday), Coca Cola, Yahoo, Apple (Tuesday), Morgan Stanley, Pepsi, Pfizer, Boeing, Wells Fargo (Wednesday), American Express, McDonald's, Phillip Morris, UPS and Microsoft (Thursday) will be among the important earning reports of this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	CB's Expectation Survey, July II	-	July 22 nd	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Existing Home Sales, June	mn	July 23 rd , 14:00 GMT	4.81
High	Eurozone	Services Flash PMI, July	-	July 24 th , 7:58 GMT	45.2
High	Eurozone	Manufacturing Flash PMI, July	-	July 24 th , 7:58 GMT	43.5
Medium	Germany	Ifo Index, July	-	July 24 th , 8:00 GMT	86.5
Medium	U.S.	Michigan Sent. Ind. (final), July	-	July 24 th , 13:55 GMT	71.0

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

	July 17 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5229	1.5500	1.5500	1.5700	1.6300	1.5500	1.6300
EUR/TRY	2.1476	2.1200	2.0600	2.0600	2.1200	2.0200	2.1200
FX Basket	3.6705	3.6700	3.6100	3.6300	3.7500	3.5700	3.7500
EUR/US\$	1.4102	1.3700	1.3300	1.3100	1.3000	1.3000	1.3000
O/N	8.25%	7.75%	7.25%	7.25%	9.25%	7.25%	11.00%
Benchmark Bond	11.70%	11.30%	11.00%	12.00%	13.00%	12.00%	14.00%

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