

# FORTIS BANK

## Macro Scope

20 - 26 April 2009

## Weekly Economic and Strategic Review

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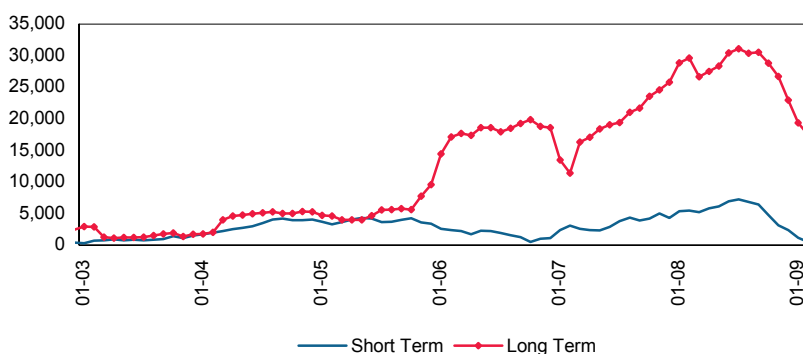
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### Cut To The Chase...

Last week, the government announced the Pre-Accession Program (PEP) which can be taken as one of the boldest steps launched by the government for an IMF program. There were comprehensive revisions laid out in the PEP for the macroeconomic outlook. At the bottom line, government's acknowledgment of the current depressed economic outlook and construction of a new framework for the key macroeconomic variables in a consistent manner with the weak growth performance is a positive development. Yet, we think this should be just the beginning and the government needs to take more steps. That is because, the forecasts in the program are still optimistic and the fiscal framework depicted in the program falls short of what we hoped. You can see our detailed assessments regarding the program in our last monthly *Glocal Strategy*. The government expects 3.6% GDP contraction, 13.5% unemployment rate, 5% budget deficit, 0.5% primary deficit and 43.1% debt stock to GDP ratio for 2009. However, these forecasts would need to be downgraded further in the preparatory period of the new stand-by program. Yet, the actual problem seems to be the fiscal issue. PEP lacks a commitment for a strong fiscal stance even in 2011 and the implementation of the fiscal rule to limit the deviations from the target is planned to be secured by as late as 2011. We do not think that IMF would favor such an extended period of loose fiscal policy, meaning that negotiations would turn more challenging for Turkey. On the other hand, if IMF turned more flexible on these issues especially after G20 decisions, given the extraordinary global conjuncture, the accomplishment of the IMF deal with little delay and little changes on the fiscal front mentioned above may be possible. Another important point to underline is related to the size of the deal. The external financing gap foreseen in PEP, which would approximately be equal to the size of the IMF loan, is fairly different than the recently ballooned estimates. Accordingly, if the outlook depicted in PEP turns to be valid in the stand-by agreement, it would not be realistic to expect the loan size to surpass US\$20bn substantially.

Private Sector Foreign Debt Flows (Net, Last 12- month Cumulative, US\$m)

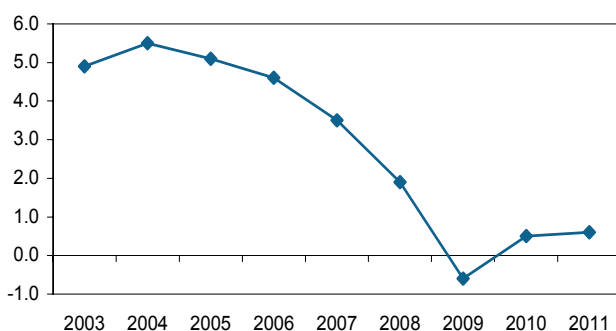


Source: CBRT, Fortis Economic Research and Strategy

This assessment is actually based on the fact that the government envisages US\$17.4bn decline in the F/X reserves in PEP, mostly on the back of US\$14bn net loan repayment in 2009 by the real sector and banks, as their debt roll over ratios are hit by the global credit crunch. We had mentioned about the external financing gap in our weekly *MacroScope* reports released on 17<sup>th</sup> of November last year and March 2<sup>nd</sup> this year. Our assumptions for other key components that would form the external financing deficit (C/A deficit, foreign direct investment and portfolio investment) are in line with the PEP. Yet, there arises dissimilarity when it comes to the assumption about the private sector loans, which is the major determinant of the financing need. We reckon that the framework in PEP assumes a debt roll over ratio of 85% for the private sector. The gross external debt repayment of the banks and non-bank private sector entities would be around US\$90bn for this year, while PEP assumes their net repayments would be US\$14bn, which basically means they would roll on 85% of their debt to come due this year. In our previous analyses, we showed that the external financing gap surpasses the US\$30bn in the case of 70% debt roll over ratio. Glancing at balance of payment realizations, this ratio appeared at 85% on average from September 2008, when Lehman Brother went bankrupt, to February 2009 and that level was preserved in the first two months of the year. Going forward, maintaining that level will be critical in order to prevent further increase in the external financing need, while we think that even the news effect would be helpful in case of an announcement about the finalization of the deal.

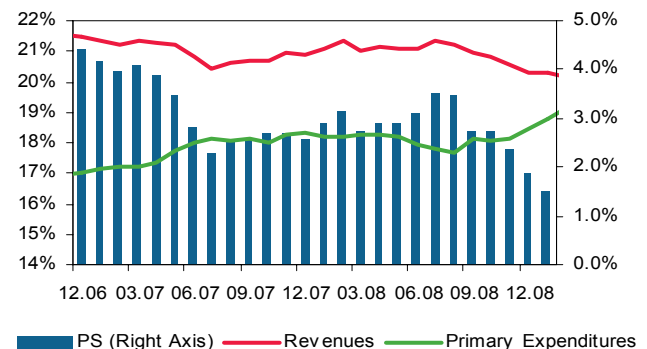
**Meanwhile, the deepening of the deterioration in fiscal outlook, as highlighted by March budget realizations (please see our *MacroBrief- Safe Steps Towards Target*), as well as the rapid increase in the unemployment rate towards record high levels may require the concept of the IMF deal to be transformed.** As is known, the aim of the program is to prevent the private sector from getting hit by the balance of payment crisis. Yet, after these downbeat results mentioned above, the focus of the program may turn to be the public finance again. After restructuring of the public sector in 2001 crisis, the risks had shifted to the private sector from the public sector. In that period, while the public debt stock to GDP ratio regressed to 43% from 79%, the external liabilities of the private sector mounted to US\$125bn from US\$30bn. Yet, coming today, expanding public expenditures especially in 2009 were accompanied with the tax cuts incentives, alarming that the reversal of the transformation period described above may accelerate going forward.

Public Sector Primary Balance (Program Defined, % GDP)



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

Central Government Budget Indicators (Program Defined, % GDP)



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

PEP also provided a detailed list about the cost of fiscal measures launched against the crisis, claiming that the measures taken up to now added TRY19.1bn and TRY15.3bn burden to the budget in 2009 and 2010, respectively. Yet, we think that originally not all of these measures were launched with the idea of cushioning the crisis. The amount of measures which do not have direct or immediate impact on the budget was stated to be TRY11.3bn for 2009. By any means, these are very big figures and even the climbing unemployment rate alone sounds like the risk on budget deficit is still on the upside in the short term.

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**Macro Economic Outlook, 2009 - 2011**


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	2008	2009f	2010f	2011f
<b>GDP (% y/y)</b>				
<b>PEP*</b>	1.1	-3.6	3.3	4.5
<b>Fortis</b>		-5.0	4.0	5.0
<b>C/A balance / GDP</b>				
<b>PEP</b>	-5.7	-1.9	-3.0	-4.0
<b>Fortis</b>		-1.5	-5.0	-5.1
<b>IMF Defined PS/GDP</b>				
<b>PEP</b>	1.9	-0.6	0.5	0.6
<b>Fortis</b>		-2.1	1.0	1.1
<b>Debt Stock/GDP</b>				
<b>PEP</b>	39.5	43.1	44.1	43.4
<b>Fortis</b>		44.5	43.8	42.6

(\*) Pre-Accession Programme

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The debt dynamics would be influenced adversely and hit Turkey's risk premium if amending the fiscal deterioration stretches into a long time. The evidence of the piling risks as to the public sector is most obvious through the Treasury's auctions, where the domestic borrowing appears fairly higher than the redemptions. While the domestic debt roll over ratio soared to 142% in April, this ratio was 108% in the first 4-month period of the year. As a reminder, at the time we had mentioned about the alternative borrowing scenarios for Treasury in our preceding monthly *Glocal Economist* report, we had underscored that the debt roll over ratio would reach 105% under the assumption of US\$5.0bn IMF loan for the remaining part of this year. Such a high ratio was last seen before 2000. Unfortunately, the current outlook is even worse than the scenario we depicted in our monthly.

All in all, while it is very promising to see the official targets are finally revised, even the revised projections are still optimistic. Accordingly, there is need for further steps in terms of public finance and this program should be just the beginning towards outlining a more realistic picture. Herein, there may be two set of options to be preferred: a relatively worse economic outlook and a sizeable amount of loan or a more tamed economic contraction and a smaller amount of loan. If IMF offers more flexibility on fiscal prudence than we expect and accepts a slow fiscal improvement, the amount of loan would hardly surpass US\$20bn. On the other hand, the dismal trend in budget and unemployment rates may urge the government's projections to be revised again and the focus of the program may shift to the public finance similar to what happened in the earlier stand-by agreement, instead of saving the private sector from the adverse repercussions of balance of payment crisis.

## Economic and Political Agenda

- This week, April reading of Real Sector Confidence Index may give important signals whether the economic contraction will be cutting pace in the upcoming period. Separately, Treasury will hold TRY1.2bn redemption at home on Wednesday, with TRY1.1bn portion being F/X denominated.
- Meanwhile, the economy officials will attend the Spring Meetings of IMF and World Bank. Turkish officials had told earlier that IMF talks may start in these meetings or prior to them. We will also watching IMF growth forecast for Turkey, when IMF releases the new projections for the world economy on April 22<sup>nd</sup>.
- Glancing at external arena, while the U.S. housing data and durable goods orders will be important, the flash PMIs will be eyed in Eurozone. Meanwhile, in the U.S., there will be a busy balance sheet week that will be at market focus.

### Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	CB's Expectation Survey, Apr. II	-	Apr. 22 <sup>nd</sup>	-
High	Real Sector Confidence Ind., Apr.		Apr. 24 <sup>th</sup> , 14:00 GMT	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	ZEW Index, Apr.	-	Apr. 21 <sup>st</sup> , 9:00 GMT	-3.5
Medium	Eurozone	Services Flash PMI, Apr.	-	Apr. 23 <sup>rd</sup> , 7:58 GMT	41.5
Medium	Eurozone	Manufacturing Flash PMI, Apr.	-	Apr. 23 <sup>rd</sup> , 7:58 GMT	34.5
High	U.S.	Existing Home Sales, Mar.	mn	Apr. 23 <sup>rd</sup> , 14:00 GMT	4.65
Medium	Germany	Ifo Index, Apr.	-	Apr. 24 <sup>th</sup> , 8:00 GMT	82.5
High	U.S.	Durable Orders, Mar.	% m/m	Apr. 24 <sup>th</sup> , 12:30 GMT	-1.4
High	U.S.	New Home Sales, Mar.	mn	Apr. 24 <sup>th</sup> , 14:00 GMT	0.34

## Macro-Economic and Financial Forecasts

### Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - mn)	950.1	948.8	1043.5	1152.3
GDP (US\$ - bn)	734.9	596.7	635.0	687.0
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	6.0	6.0	5.5
Trade Balance (US\$ - mn)	-69.7	-34.8	-60.4	-66.2
Exports (FOB, excl. luggage trade)	132.0	94.7	100.3	108.0
Imports (CIF, incl. gold)	201.7	129.5	160.7	174.2
Current Account Balance (US\$ - mn)	-41.6	-8.9	-31.5	-34.3
Current Account Balance / GDP (%)	-5.7	-1.5	-5.0	-5.0

### Financial Indicators Forecasts

	April 10 <sup>th</sup>	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5950	1.6000	1.6000	1.6000	1.6800	1.6000	1.6800
EUR/TRY	2.1018	2.0960	2.0800	2.0800	2.2176	2.0800	2.1840
FX Basket	3.6968	3.6960	3.6800	3.6800	3.8976	3.6800	3.8640
EUR/US\$	1.3177	1.3100	1.3000	1.3000	1.3200	1.3000	1.3000
O/N	9.75%	9.25%	9.00%	9.00%	11.00%	9.00%	13.50%
Benchmark Bond	12.40%	12.00%	12.00%	12.00%	15.00%	12.00%	14.50%

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