

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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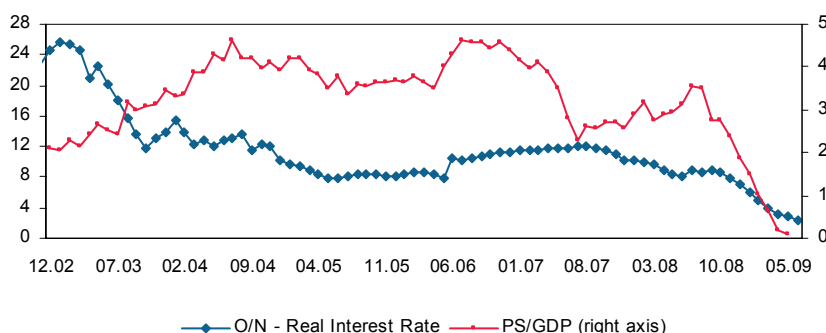
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So Far, Gone Too Far...

The developments over the last week showed that the economy officials do not have any intention yet to end the monetary and fiscal easing at home. Since the onset of the easing, the policy rate has been slashed by 800 bps in total and the 12-month cumulative IMF-defined primary surplus in the central government budget regressed to 0.1% of GDP in end-May from 3.5% in August 2008. The continuation of the easing bias seems quite surprising to us, considering that the worst of the recession was seen in March and there has been signs of recovery since then. Despite the lack of stabilization in exports yet, the domestic consumption boosted by the tax cuts gives support to industrial production to bounce from the trough. **Apparently, the natural process of the recovery that emerged as a result of inventory adjustment per se was insufficient for the economy officials so that they are making efforts to further stimulate growth.** The inventories, which had resulted in sudden production cuts and job losses, have started to unwind and further stimulus to the economy will only bring forward the future growth to an earlier date but will not change the underlying trend. That is why these policy decisions should be analyzed more closely. **Once the economy sees the turning point mentioned above, we reckon that these measures would only steal from the future growth rate.** The public intervention and monetary policy measures are normal to expect when the consumption and investment almost freeze. On the other hand, once these measures start bearing fruits, one should expect that the deteriorated debt dynamics are not pushed further and road maps are introduced to amend the widened budget balance in medium term. Otherwise, fiscal easing may turn into a norm, as was the case before 2001, rather than being used selectively in certain conditions. In that case, the budget plans would lose accountability and the funding would be diverted to the Treasury rather than the real sector (crowding-out effect). This is a serious threat to the economy and we will continue expressing our concerns as to the danger of surrendering the achievements of recent years for short term benefits.

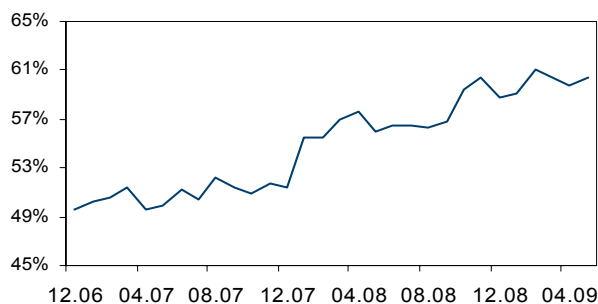
Monetary and Fiscal Policy (*)



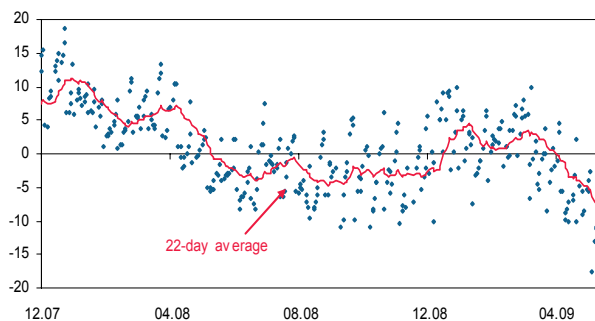
(*) The high and low levels are pointing to a tight and loose policy implementation, respectively, for both of them.
Source: Fortis Economic Research and Strategy

Having discussed about the drawbacks of the recent policy choices, we want to mention about last week's MPC meeting, where the Bank cut the policy rate more than expected and signaled for further easing, while putting into force new measures to support the liquidity conditions in the markets. As our last monthly *Glocal Strategy* report mentioned in detail, the Central Bank did not introduce the technical rate cut and instead extended the maturity of repo auctions up to three-month. **If the technical rate cut had been introduced, this would have been taken as a sign that the IMF program would not be launched.** This is because, in normal circumstances, the IMF loan to be secured by the Treasury would lower the borrowing need and the banking system liquidity would turn to positive again, so that there would be no need for a technical rate cut. Lately, there is increasing number of signs that there will be no IMF deal in the short term or even there will not be any deal at all. Nevertheless, the Central Bank did not prefer to give such a message at that point and they used the following statement instead: ***“Even though the liquidity conditions in the markets have been tight for some time, the uncertainties about the long term liquidity conditions still remain and for now it is hard to make a clear presumption about whether the current liquidity shortage will become permanent. Therefore, the timing of technical rate cut will be decided later.”*** The extension of the one-week funding maturity would help the banking sector to bear the brunt of the Treasury's borrowing more comfortably, considering that they are the major buyers of government debt due both the primary dealership system and the current conjuncture. We reckon that the banks has 60% share in the outstanding government debt securities and that is highest ratio since 2001 crisis. Separately, based on BRSA 's daily data, the share of banks' security portfolio to the total loans soared by 10 pp to 60% from October 2008 onwards. ***This pressure on the banking sector will remain unless the trends in the budget outlook change. Therefore, the recent measures to enhance the liquidity conditions seem important to help banks shoulder the sizeable portfolio without shifting the interest rates higher especially in an environment of struggling economic recovery.***

Banks' Share In Outstanding Government Debt



Open Market Operations (TRY bn) (*)



(*) Positive values show that the Central Bank is draining the excess liquidity from the markets, while negative values show that the Bank provides funding to the market to close the liquidity shortage.

The Central Bank's 50 bps rate cut was more than expected. However, the real surprise was to see the Bank leaving the door open for further easing, despite the growing recovery signs in the economy. This was signaled through following phrase: “the next rate cut may be measured and it seems necessary for the monetary policy to maintain an easing bias for a considerable period.” Yet, the Bank also added that “they will consider a deceleration in the pace of rate cuts or a pause should the signs of improvement in economic activity turn into a robust recovery.” This was the most ambiguous message ever in the MPC statements regarding the interest rate decisions. Everybody can read it and interpret the robust recovery in different ways. Even though this phrase indicated that the interest rate decisions will be more data dependent from now on, it is not clear how the robustness will be measured. Therefore, the MPC will be flexible in their judgments. As we have been underlining for a long time, we expect the recovery in the domestic demand to continue in a short term thanks to the extension of tax cuts and other

incentives. Yet, this tendency would hardly be fully reflected to the industrial production as there is no contribution from the external demand. **It is obvious that in annual terms, the output will contract further. Yet, more important criteria would be the monthly change of the seasonally adjusted data, which is in the positive territory now. We will watch whether this will be the case going forward.**

In brief, the natural process of the recovery seems to be insufficient for the economy officials so that they are making efforts to further stimulate growth by continuing the monetary and fiscal easing. We think that these measures, which will only bring forward the growth to an earlier date but will not change the underlying trend, would only steal from the future growth rate. Accordingly, the Central Bank is doing what is expected from them, trying to reduce the pressure on the bond market by underpinning the liquidity conditions. Apparently, the Central Bank preferred to save the two important trump cards - direct purchases of government debt securities and technical interest rate cut - until the end of the monetary easing period. Moreover, the Bank mentioned about a possible deceleration or pause in the rate cuts for the first time, in an uncertain manner though and this sounded like we are very close to the end of monetary easing period.

Economic and Political Agenda

- This week, while the Real Sector Confidence Index will be important at home, Eurozone flash PMIs and Fed's rate decision may come to the forefront in the external arena. Separately, U.S. durable orders and housing data will also be critical.
- In the meantime, the Treasury will re-issue the benchmark bond and the fixed income bond due 28.08.2013 on Tuesday, ahead of Wednesday's redemption of TRY3.64bn.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	CB's Expectation Survey, June II	-	June 22 nd	-
High	Real Sector Conf. Ind., June	-	June 23 rd , 14:00	-

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	Ifo Index, June	-	June 22 nd , 8:00 GMT	85.0
High	Eurozone	Services Flash PMI, June	-	June 23 rd , 7:58 GMT	45.3
High	Eurozone	Manufacturing Flash PMI, June	-	June 23 rd , 7:58 GMT	41.2
High	U.S.	Existing Home Sales, May	mn	June 23 rd , 14:00 GMT	4.8
High	U.S.	Durable Orders, May	% m/m	June 24 th , 12:30 GMT	-0.2
High	U.S.	New Home Sales, May	Mn	June 24 th , 14:00 GMT	0.36
High	U.S.	Fed's Rate Decision	bps	June 24 th , 18:15 GMT	no change
Medium	U.S.	GDP (final), 1Q	% q/q	June 25 th , 12:30 GMT	-5.7
Medium	U.S.	Core PCE, May	% m/m	June 26 th , 12:30 GMT	0.2
Medium	U.S.	Michigan Sent. Index, June	-	June 26 th , 13:55 GMT	-

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - mn)	950.1	936.6	1,028.0	1,136.2
GDP (US\$ - bn)	734.9	592.8	637.1	688.9
GDP Growth (y/y % chg)	1.1	-5.0	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	-40.2	-63.8	-69.7
Exports (FOB, excl. luggage trade)	132.0	98.2	98.7	106.4
Imports (CIF, incl. gold)	201.7	138.4	162.5	176.0
Current Account Balance (US\$ - bn)	-41.6	-13.8	-34.7	-37.6
Current Account Balance / GDP (%)	-5.7	-2.3	-5.4	-5.5

Financial Indicators Forecasts

	June 19 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.5566	1.5500	1.5500	1.5500	1.6400	1.5500	1.6300
EUR/TRY	2.1713	2.1400	2.0900	2.0200	2.1700	2.0200	2.1200
FX Basket	3.7279	3.6900	3.6400	3.5700	3.8100	3.5700	3.7500
EUR/US\$	1.3949	1.3800	1.3500	1.3000	1.3200	1.3000	1.3000
O/N	8.75%	8.50%	8.50%	8.50%	11.50%	8.50%	12.50%
Benchmark Bond	12.20%	12.50%	13.00%	13.50%	15.00%	13.50%	14.00%

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