

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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Hope For Best And Prepare For Worst...

Ahead of the local elections on Sunday, we will be discussing about likely trajectory in the post-election term. Before proceeding, however, let us first review the most recent outlook on the political competition. The recent polls suggest that the balance would not change substantially *vis-à-vis* the general elections. For instance, according to poll of Konda Research Company, which had made the most accurate forecast before 2007 general elections, the ruling AKP will have 47.9% votes, while A&G Company suggests the AKP's votes will be a little lower at 42.5%. The AKP's priority would be to sustain their 46.6% vote share attained in 2007 general elections. If their vote falls short of this target, the benchmark would be the 42.2% vote share and 12 out of 16 metropolitan municipalities secured by AKP in the preceding local elections. **The importance of the local elections for the economy and the key uncertainties attached to it are related to the IMF deal. The question is which result would pave the way for launching an IMF program.** There are two different comments on this issue. While some argue that the ruling party's success would accelerate the deal process, there are also views which are in strict controversy. There is also a third commentary advocating that no matter what the election results are, the likelihood of a deal is higher now, given the fact that U.S. President Obama's second trip across borders is planned to Turkey on April 6th (a geopolitically critical area given the U.S.' strategy for Middle East) and that IMF launched an overhaul of its lending framework. **As a baseline scenario, markets assume that an IMF deal will be launched after the elections and the sole risk here seems to be the case where agreement is delayed to after April-May term.** At that point, the launch of an overhaul in IMF's lending conditions a few days ago, as well as the establishment of the new IMF Flexible Credit Line (FCL) (that would replace the Short-Term Liquidity Facility (SLF) introduced in October) deserves careful interpretation. Later in this report, we will explain the context and meaning of this new facility and the changes in lending conditionality. Reza Moghadam, director of the IMF's Strategy, Policy and Review Department, said the changes would apply to countries that have existing IMF programs or are negotiating new ones, such as in the case of Turkey. The press reports read this statement to mean that Turkey is among the eligible countries for the new facility. However, his words **by no means imply such eligibility and should not be interpreted to suggest that Turkey may use FCL, instead of stand-by arrangement.** Given the qualification criteria (*) for the FCL and considering that Turkey's intention for IMF deal is linked to balance of payments problem, the odds of a conventional stand-by agreement is higher.

While the FCL is the key element of the IMF reforms, the overall overhaul includes modernizing IMF conditionality, enhancing the flexibility of the Fund's regular stand-by lending arrangement, doubling access limits, simplifying cost and maturity structures for its lending, with an aim to make the access to funds easier so that the Fund can respond effectively to the various needs of all

member countries. The FCL is defined as a credit line to provide large and upfront financing with flexible repayment schedule to members with very strong fundamentals(*) and sound economic policies that are not plagued by large imbalances or high outstanding public debt. Another opportunity, so-called High Access Precautionary Stand-by, is created for the other countries which will not qualify for FCL. **The modernization of conditionality is to be achieved in two key ways. First the IMF will rely more on pre-set qualification criteria (ex-ante conditionality) rather than on traditional (ex post) conditionality as the basis for providing countries access to Fund resources. In addition, structural reforms will be monitored in the context of program reviews, rather than through the use of structural performance criteria. With the elimination of structural performance criteria, a member does not have to request a waiver for a criterion that was not met.**

In the week behind, Romania secured a total of EUR20.0bn credit line, with IMF providing EUR12.9bn, EU providing EUR5.0bn and the remaining EUR2.0bn coming from the World Bank and other multilateral lenders' resources. Even though Romania had started to seek IMF fund later than Turkey, they became the third European country that secured stand-by agreement. We reckon that the IMF credit appropriation to Romania is 11 times of its quota. **If the same ratio holds for Turkey, that would correspond to some US\$20.0bn credit line.** In the stand-by agreement after 2001 crisis Turkey had used credit line that was 11.7 times of its IMF quota and this was the highest ratio at that date. **Yet, we want to underline that this potential loan size mentioned above is the net amount.** Currently, Turkey has an outstanding debt of 5.3 SDR (US\$8.0bn) to IMF. Accordingly, while the gross credit line will be higher, net amount will remain limited.

On the other hand, Economy Minister Simsek spoke before the media in the week behind and his remarks affirmed our assessments highlighted in our last two reports. Economy Minister Simsek stated that if agreed, IMF deal would be a stand-by loan agreement with a maturity of 18 months to 3 years, while he emphasized that **the amount of the fiscal measures is among the key issues to be resolved to reach a deal:** *"The issue is the size of the expenditure caps and revenue enhancing measures... The size of the fiscal measures is set to change since the macro forecasts are revised. (...) In essence, we had achieved certain progress in January. We had agreed on maintaining a certain level of primary surplus. (However) Once we launched the new stimulus packages there would have been additional compensation required. Back then we could not agree (on that). This issue needs to be reviewed when they return (for deal talks)."* He also added that IMF withdrew their demand for the **autonomy of Revenue Administration**, an issue on which the sides had failed to agree before. Yet, Simsek said that they are still working on **auditing of the tax collection**. He claimed that once they make some progress on this issue in a way not to press taxpayers to declare their sources of income, IMF would be invited for talks depending on Prime Minister Erdogan's consent.

In any case, if the IMF deal can be launched right after the local elections, this may propel the momentum created by the recent measures such as tax cuts that aim to revive the domestic demand and the launch of Credit Guarantee Fund (Treasury Secretary Simsek claims that the Treasury is still working on it) that aim to restore the credit mechanism. If the government could come up with **a comprehensive program that would provide a strong fiscal stance in the medium term**, we would be more optimistic about the future and the tentative signs of recovery in the economy (as shall be mentioned in the following lines) would be taken more seriously.

As we underscored before, **the data disclosures keep suggesting that across the globe, economic activity bottomed out in 1Q and the contraction finally stabilized.** March reading of Eurozone flash PMI confirmed this tendency, as well. Note that the recovery in this region came later than the U.S. and the developing countries, in line with our expectation. Meanwhile, Turkish Real Sector Confidence Index kept increasing in the third consecutive month. This

outlook reinforced our projection that we saw the trough of industrial production in February, followed by recovery since then. In a short while, a more critical concern would turn to be the pace of recovery. Yet, we do not anticipate a visible acceleration in the short term, given the lack of recovery signs in the exports.

All in all, the local elections are taken as a milestone after abysmal atmosphere suffered over 1 and a half year. The markets anticipate that the political picture will not change substantially and IMF deal will be reached short after the local elections, by which the initial signals of recovery process would be underpinned, thanks to some stabilization and reassured confidence. If the course of events evolves in line with the expectations, we may be more optimistic about future. Yet, we think that the rapid deterioration in fiscal performance poses a greater risk than market assumes on the timing of IMF deal.

(*) The criteria for the purposes of assessing qualification for an FCL arrangement:

(1) a sustainable external position; (2) a capital account position dominated by private flows; (3) a track record of steady sovereign access to international capital markets at favorable terms; (4) a reserve position that is relatively comfortable when the FCL is requested on a precautionary basis; (5) sound public finances, including a sustainable public debt position; (6) low and stable inflation, in the context of a sound monetary and exchange rate policy framework; (7) the absence of bank solvency problems that pose an immediate threat of a systemic banking crisis; (8) effective financial sector supervision; (9) data transparency and integrity.

Economic and Political Agenda

- At home, this week's data agenda is full with critical data disclosures such as 4Q GDP and inflation. Separately, Treasury will publish April borrowing program on Tuesday. They foresee TRY8.3bn and US\$0.6bn domestic and foreign debt services, respectively. We reckon that the most important redemptions will be held on April 1st (TRY1.0bn + US\$1.7bn), 8th (TRY2.9bn) and 22nd (US\$0.7bn).
- Glancing at external arena, U.S. and Eurozone PMIs and U.S. non-farm payrolls will be on the forefront. Meanwhile, ECB is anticipated to slash the interest rates by 50 bps this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	GDP, 4Q	% q/q	Mar. 31 st , 8:00 GMT	-4.8 (-5.8)
High	Imports & Exports, Feb.	US\$ bn	Mar. 31 st , 15:00 GMT	8.7 & 7.3 (8.7 & 7.3)
Medium	CBNC-e Cons. Conf. Ind., Mar.	-	Apr. 1 st , 7:00 GMT	-
Medium	TEA's Prel. Exports, Mar.	US\$ mn	Apr. 1 st	6,900
High	ICC Price Index, Mar.	% m/m	Apr. 1 st , 10:00 GMT	1.7
High	CPI & PPI, Mar.	%m/m	Apr. 3 rd , 15:00 GMT	1.1 (0.78) & 0.5 (0.98)

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	U.S.	C. Shiller House Price Ind., Jan.	% m/m	Mar. 31 st , 13:00 GMT	-18.6
Medium	U.S.	Cons. Conf. Ind. Mar.	-	Mar. 31 st , 14:00 GMT	27.5
High	Eurozone	Manufacturing PMI, Mar.	-	Apr. 1 st , 7:58 GMT	34.0
Medium	U.S.	ADP Employment Report, Mar.	K	Apr. 1 st , 12:15 GMT	-605
High	U.S.	Manufacturing ISM, Jan.	-	Apr. 1 st , 14:00 GMT	36.0
Medium	U.S.	Pending Home Sales, Feb.	% m/m	Apr. 1 st , 14:00 GMT	-3.0
High	Eurozone	ECB Rate Decision	bps	Apr. 2 nd , 11:45 GMT	-50
High	Eurozone	Services PMI, Mar.	-	Apr. 3 rd , 7:58 GMT	40.1
High	U.S.	Non-farm Payrolls, Mar.	K	Apr. 3 rd , 12:30 GMT	-640
Medium	U.S.	Unemployment, Mar.	%	Apr. 3 rd , 12:30 GMT	8.4
High	U.S.	Non-manufacturing ISM, Mar.	-	Apr. 3 rd , 14:00 GMT	42.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2007	2008	2009f	2010f
GDP (TRY - mn)	853.7	963.9	960.3	1,056.0
GDP (US\$ - bn)	658.8	745.5	564.9	610.7
GDP Growth (y/y % chg)	4.6	1.0	-5.0	4.0
PPI (y/y % chg)	5.9	8.1	6.0	5.0
CPI (y/y % chg)	8.4	10.1	6.0	6.0
Trade Balance (US\$ - mn)	-62.8	-69.7	-29.8	-39.6
Exports (FOB, excl. luggage trade)	107.3	132.0	105.6	117.2
Imports (CIF, incl. gold)	170.1	201.7	135.4	156.8
Current Account Balance (US\$ - mn)	-38.3	-41.6	-6.1	-14.3
Current Account Balance / GDP (%)	-5.8	5.6	-1.1	-2.3

Financial Indicators Forecasts

	March 27 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.6486	1.7000	1.6900	1.6500	1.7100	1.6500	1.7300
EUR/TRY	2.2384	2.3100	2.3000	2.2300	2.2600	2.2300	2.2500
FX Basket	3.8870	4.0100	3.9900	3.8800	3.9700	3.8800	3.9800
EUR/US\$	1.3578	1.3600	1.3600	1.3500	1.3200	1.3500	1.3000
O/N	10.50%	10.00%	10.00%	10.00%	11.50%	10.00%	13.50%
Benchmark Bond	14.20%	14.50%	14.50%	13.00%	15.20%	13.00%	14.50%

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