FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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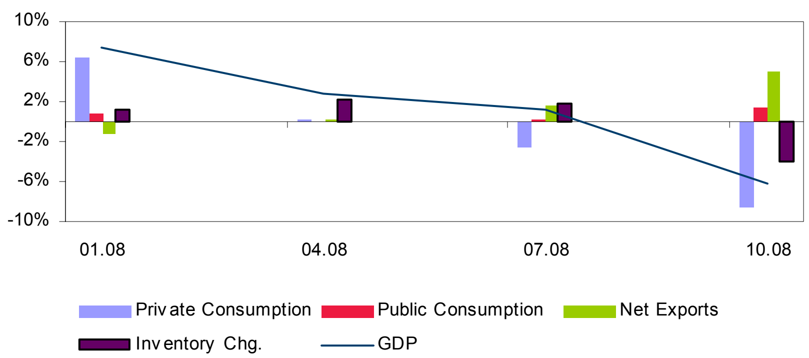
There Must Be Some Kind Of Way Out Of Here

In the week behind, 4Q08 GDP data, which also clarified the picture for the whole year, showed one more time that the backward looking data flow will continue to depress the mood. GDP contracted by 6.2% y/y in 4Q08, a worse performance than envisaged. The upward revisions in the preceding quarters' readings lifted the annual growth to 1.1% which is fairly close to our forecast. The economy will probably shrink even more substantially in the first two quarters of 2009, suppressing the overall year's GDP at a dismal 5% contraction. On the other hand, leading indicators both in the domestic and external arena hint that worst is behind for the economies, or at least we are quite close to see the rock-bottom. In that context, returning to positive growth rate in 4Q is very likely, following some moderation in the economic contraction in 3Q09 GDP. The strength of recovery will depend on economic policies at home and on the performance of developed countries in the external arena. We anticipate that the GDP will shrink by 10.8% and 8.5% in 1Q09 and 2Q09, respectively. The pace of contraction will likely lose steam afterwards, with GDP declining by 3.8% in 3Q, followed by 3.1% positive growth in 4Q. Similarly, Central Bank stated in the last MPC meeting summary that the domestic demand would improve gradually, stimulating faster depletion of inventories in the upcoming period. Separately, the Bank anticipated that the deterioration in exports would come to halt, yet the Bank gave no reference to a recovery signal. On the other hand, Central Bank appeared more pessimistic about the global economy, claiming that the likelihood of 'early recovery' in the global economy (recession ending in 2H09), envisaged as an alternative scenario in the January Inflation Report, had almost diminished. However, it should be emphasized that the Bank relied on estimates of multinational institutions while assessing the external outlook, rather than using their own forecasts.

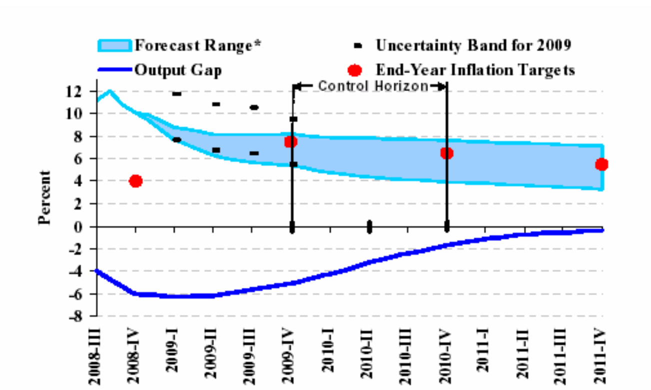
Contribution of Expenditures to Growth



Source: CBRT, TURKSTAT, Fortis Economic Research and Strategy

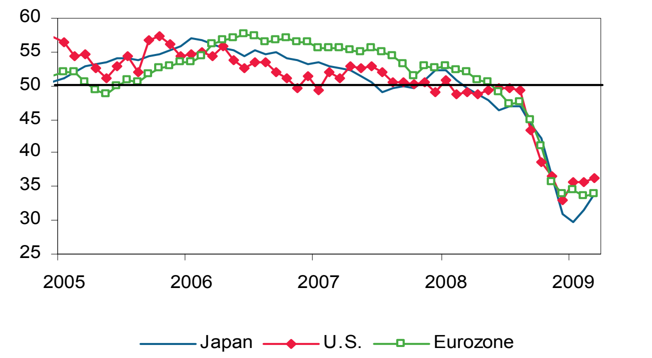
Central Bank's anticipation about the timing of the trough in domestic economic activity is crucial in terms of stock market and bond market performance, as the turn in the cycle would change all the game plans. Unfortunately, on this issue we do not have as much clue as we have about the Bank's thoughts on the global economy. However, assuming that the Bank still stick to their baseline scenario, the pace of quarterly output gap (*) projection, released in the Bank's Inflation Report may give some hint. The Bank had anticipated the output gap improving slowly to 5.0% in 3Q and 4Q, after touching 6.0% in the first two quarters of 2009. Reading from the graphs of earlier years, we realize that output gap had reached around 8.0% during the peaks of 1994 and 2001 crises, followed by a rapid recovery. The above described projection suggests that the **Bank presumes that the GDP contraction this year would remain milder than the 2001 crisis. However, this may be about to change: by ruling out the early recovery scenario (the optimistic scenario for growth), the Bank seems closer to an upward revision in output gap forecasts when they disclose the Inflation Report at the end of April.** All in all, the measured rate hikes incorporated into the early recovery scenario are also out of the agenda now. Instead, the Bank says the upcoming rate cuts would be measured and it might be necessary for monetary policy to maintain an easing bias for a considerable period. This assessment is in line with our expectation that the policy rate would regress by 50 bps to 10% in April, remaining flat thereafter until the end of the year. Yet, we should not rule out the possibility that the measured rate cut period may be extended by a few months, bringing the policy rate to single-digit level and that level may persist for some more time.

Central Bank's Inflation and Output Gap Forecasts



Source: CBRT, Fortis Economic Research and Strategy

PMIs In Developed Countries



Source: Reuters, Fortis Economic Research and Strategy

4Q GDP also affirmed the rapid deterioration in fiscal performance. The public investment and expenditures contributed a total of 1.4 pp to growth rate in 4Q. This is a greater contribution compared to all the preceding quarters and is also consistent with the rapid weakening of budget performance started over the last months of last year. Coming to 1Q09, the deterioration in the budget has turned more pronounced. If the government does not take any measures to avert the dismal repercussions of the recently announced expenditure-boosting regulations, it is certain that the primary balance will enter into the negative territory. Separately, given the 4Q outlook, a sizeable GDP contraction is now inevitable for 2009. (Our forecast is 5.0% contraction). Therefore, once the projections for tax revenues and social security premium collection are revised, the additional resource need of the budget would increase in 2009. Accordingly, in the IMF reviews, which are expected to start in a month, the Fund would urge for additional measures to cap the expenditures. The government which was not satisfied with the result of local elections may not easily put into force some expenditure tightening measures under these conditions. Therefore, the only way out seems to be IMF offering more flexibility in the budget, allowing for the primary balance to be in deficit this year. In the following lines, we will be mentioning about a report by Economic Policy Research Foundation of Turkey (EPRI), whose 2009 budget projections are broadly consistent with our forecasts released in our earlier reports.

EPRI report originated different scenarios based on varying growth rate assumptions with the aim of exploring the effect of economic activity on central government budget balance. For example, **in the case of 5% economic contraction, the budget deficit to GDP ratio becomes 6.0% while the primary balance to GDP ratio appears at -0.2%.** However, note that **these forecasts do not comprise the additional fiscal burden linked to the stimulus packages introduced by the government after the 2009 budget plan was published. If these additional burdens were also integrated into the simulations, EPRI's 5% GDP contraction scenario would have come in line with our 7.0% projection for budget deficit to GDP ratio.** With this work, EPRI suggested that the fiscal policies, which aim to revive the economy in 2009, should be organized as a "targeted expenditure plan," with measures being designed in a systematic manner by taking the implications on budget into consideration. Moreover, the framework of these policies should be convincing for consumers so that the confidence turns positive. EPRI conclude that this is the policy framework needed in order to maximize the positive effect of expansionary fiscal policies on economic growth and minimize the dismal impact on budget deficit in the long term.

In conclusion, we think that 2008 GDP realization was in line with our forecast and the data supported our anticipation of a sharp contraction in 2009. We believe that the consensus about 2009 GDP will be pulled further downwards to near our projection. Central Bank signaled that the output gap may widen somewhat, despite their positive assessments about the domestic demand. Accordingly, the upcoming rate cut (or cuts) is expected to be measured. In this context, a more pronounced deterioration in budget performance would be inevitable in the upcoming period, so that there is a greater need than ever for a comprehensive and convincing fiscal policy that would also help improving consumer confidence.

(*) Output Gap: It is the gap between the actual GDP and potential GDP in an economy. The potential GDP is the theoretical GDP level which is estimated by using the labor endowment and capital endowment, as well as the productivity level in the country. If the actual GDP remains below the potential GDP, output gap emerges. In this case, demand is assumed not to produce any inflationary impact.

Economic and Political Agenda

- At home, the industrial production and C/A balance seem to be the most critical developments of the week. Separately, CNBC-e's Consumption Index will be important as it will show us whether the recovery in the expenditures will continue. Additional to this major data disclosures, the Treasury will re-issue CPI-linked bond due 14.08.2013 on Monday, while they will also issue the new benchmark bond due 02.02.2011 and 5-year FRN on Tuesday ahead of Wednesday's domestic debt service of TRY2.7bn. Meanwhile, U.S. President Obama will come to Turkey on April 6th - 7th.
- Glancing at external arena, BoJ and BoE will unveil their interest rate decisions. Meanwhile, the markets will be closed in the U.S. and in the several European countries on April 10th.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis *(Consensus)*
High	Industrial Output, Feb.	% y/y	Apr. 8th, 7:00 GMT	-22.0 *(-21.7)*
Weak	Cash Based PS, Mar.	TRY bn	Apr. 8th	-0.9
High	CB's Expectation Survey, Apr. I	-	Apr. 9th	-
Medium	CNBC-e Consump. Index, Mar.	-	Apr. 10th, 7:00 GMT	-
Weak	Capacity Use, Mar.	%	Apr. 10th, 7:00 GMT	-
High	C/A balance, Feb.	US$ mn	Apr. 10th, 14:00 GMT	800 *(791)*

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	GDP (final), 4Q	% q/q	Apr. 7th, 9:00 GMT	-1.5
High	Japan	BoJ Rate Decision	%	Apr. 7th	-
High	U.K.	BoE Rate Decision	bps	Apr. 9th, 11:00 GMT	no chg.
Weak	U.S.	Export & Import Prices, Mar.	%	Apr. 9th, 12:30 GMT	-0.1 & 1.0

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 3rd	1M	3M	6M	12M	2009	2010
US$/TRY	1.6127	1.5500	1.5500	1.5800	1.6600	1.6000	1.6800
EUR/TRY	2.1475	2.0429	2.0150	2.0540	2.1912	2.0800	2.1840
FX Basket	3.7602	3.5929	3.5650	3.6340	3.8512	3.6800	3.8640
EUR/US$	1.3316	1.3180	1.3000	1.3000	1.3200	1.3000	1.3000
O/N	10.50%	10.00%	10.00%	10.00%	11.50%	10.00%	13.50%
Benchmark Bond	13.60%	13.50%	13.00%	13.00%	15.20%	13.00%	14.50%

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