FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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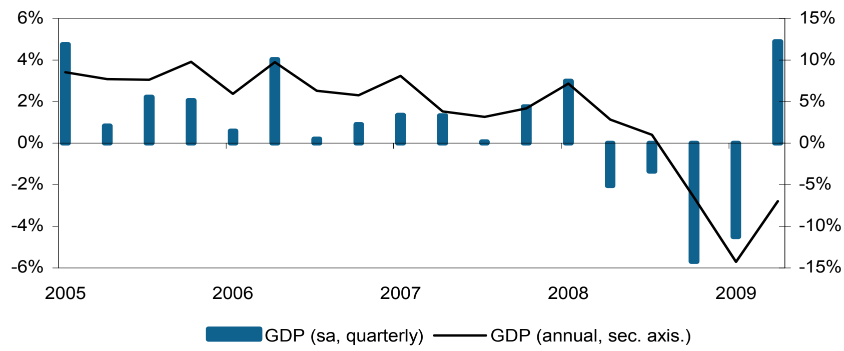
Finding The Right Path To Recovery...

As is well known, since we left the worst behind in the crisis, we monitor the pace of the economic recovery through industrial production. Before touching on the most recent outlook here, let us emphasize this: **As a natural response to the retrenchment in the domestic and external demand, production contracted at first and then started to recover, thanks to the revival in especially the domestic demand. In other words it is the consumption that drives production not vice versa.** Glancing at the empirical evidence, the first thing we had seen was the slump in automotive and white goods sales as the volatility in the financial markets and the associated uncertainties during the summer of 2008 hit consumer confidence, leaving the producers with excess stocks. As a result, the initial impact of the crisis was abrupt decline in production to align the stocks of finished goods with the new weak demand level, accompanied by sales promotions to speed up the process of unwinding stock piles. The consumer confidence started to rebound from especially December onwards with the support of the appealing price deals and this improvement became even more pronounced on the back of tax cuts from March onwards. Eventually, production rose, marking the timing of the bottoming out in the economy. **It would be useful to keep in mind the sequence of events as described above, since the cycle would evolve in the future depending on the interaction between consumption and production.** Note that while the expected recovery in production continues running its course, the consumer confidence and consumption tendency have been losing some steam over the last two months. In July industrial output retreated by 9.2% y/y, which a milder decline vs. June. However, the seasonally adjusted data hints that the economy is recovering at a very sluggish pace. Moreover, the June output, which had fallen by 0.4% m/m in seasonally adjusted terms, was revised down. Unless the consumption tendency is redirected to a new strengthening pattern (via a credible economic program, tax cuts, etc.), the downside risks on the output recovery, which has already made a weak start, would increase.

GDP (seasonally adjusted, quarterly vs. annual change)

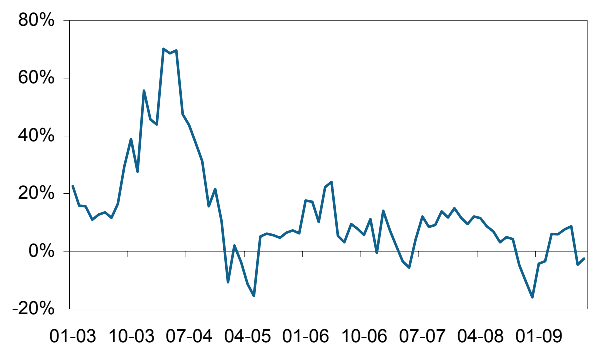


Tramo-Seats is used for seasonal adjustment and religious holidays are taken into account.
Source: TURKSTAT, Fortis Economic Research and Strategy,

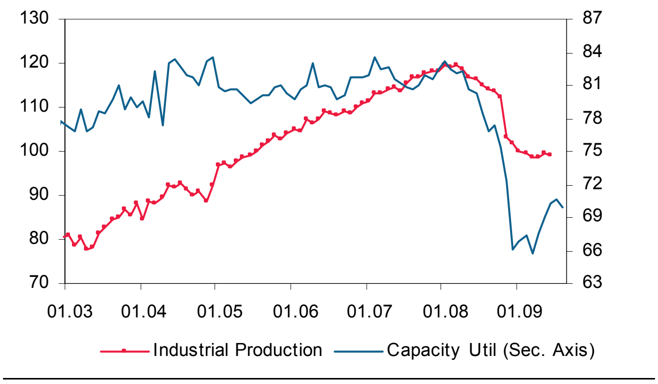
Other than the automotive and white goods sales, the CNBC-e Consumption Index is also useful in giving a more general and comprehensive idea about the demand outlook. Even though the index rose in August vs. the preceding month both in nominal and seasonally adjusted terms, there was y/y decline similar to July. Accordingly, the index regressed by 3.6% y/y in the first two months of 3Q, compared to 7.4% gain in 1Q. The visible decline in capacity use was the second negative clue for August outlook. The capacity use fell sharply to 69.7% from 76.2% in the same month last year and 72.3% in July. There was also a slight fall in seasonally adjusted terms, after 4 consecutive months of improvement.

The GDP, disclosed within the week behind, contracted by 7.0% y/y in 2Q, better than both the consensus for 8.2% contraction and our forecast of 8.4% shrinkage. The manufacturing industry shed only half of what was suggested by the monthly industrial production data. This wide difference between the two industry data was the key reason behind the surprise. **On the other hand, the good news was the 4.9% q/q rebound in seasonally adjusted terms in 2Q, after a cumulative retrenchment of 13.6% from 2Q08 to 1Q09. Technically, this put an end to the recession. However, more up-to-date data suggests that the recovery did not continue at an equally strong pace in 3Q.** It was no surprise that the private sector investment and the stock changes were more than fully responsible from the contraction, while the recovery in private consumption remained weaker than hinted by the leading demand indicators. The retrenchment in private consumption cut pace visibly, thanks to the tax cut incentives and other sales promotions. Nevertheless, private consumption fell by 1.2% y/y vs. 10.2% decline in 1Q. Note however that the preliminary demand indicators were even consistent with annual increase here (as the analysis of the consumption index shows above). **In brief, the details of the GDP indicate at a stronger than expected production activity, yet a weaker than assumed consumption. Recalling that "it is the consumption which drives production not vice versa," as we said in the beginning of this report, there should be no ambiguity which of these surprises we attach a greater importance.**

CNBC-e Consumption Index (Annual Change)



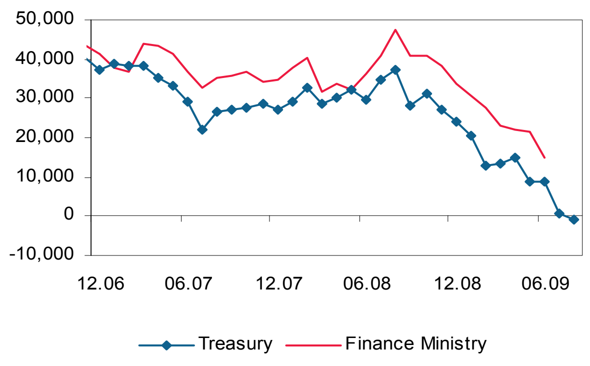
Industrial Production vs. Capacity Utilization (Seasonally Adjusted*)



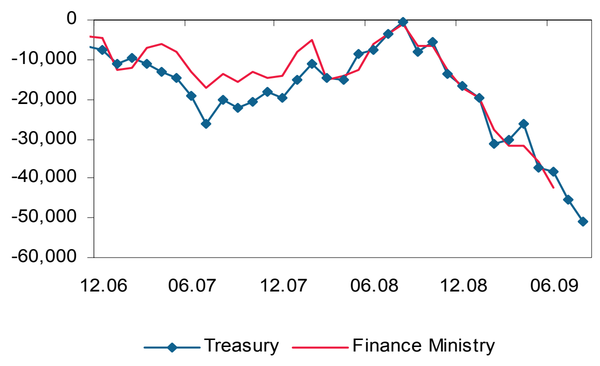
Source: TURKSTAT, Fortis Economic Research and Strategy

Another important data disclosed in the week behind reflected the ongoing deterioration in the budget outlook. While the outlook here turns even more worrying considering the recent disappointing news regarding the IMF deal, this would have repercussions on the short term economic recovery, as well as the medium term growth prospects. Even though Treasury's TRY10.3bn cash-based primary surplus (PS) in August gave a good impression at first sight, in essence the data was not that encouraging, considering also some TRY5.1bn tax proceeds delayed from July. The realizations were consistent with a y/y weakening compared to TRY12.0bn PS in August last year. Accordingly, the 12-month rolling cash based budget balance produced TRY1.0bn primary deficit for the first time since we keep records from 1999 onwards, while the cash balance produced more than TRY50bn overall deficit. The cash data is a good indicator for the accrual based central government budget announced by the Finance Ministry, despite some differences between the two. Therefore, the July-August central government budget which is likely to be disclosed in the middle of the month due to fiscal holiday is also set to give an adverse picture.

Primary Surplus (TRYbn, 12-month cumulative)



Budget Balance (TRYbn, 12-month cumulative)



In conclusion, we believe consumption pattern has a more important role in the economic cycle than production. Therefore, the ongoing anticipated recovery in the production activity does not seem much important for the future pace of the economic cycle. On the other hand, the rebound in the private consumption in 2Q GDP that lagged behind the performance in the leading demand indicators, the weakening in preliminary consumption data in 3Q, discouraging news regarding the IMF deal and the ongoing deterioration in fiscal performance raise the uncertainties regarding the economic recovery.

Economic and Political Agenda

- The Finance Ministry will likely announce the July and August budget realizations together this week. The cash-based budget gave us a clue about the deterioration in the fiscal performance. The Central Bank rate decision due Thursday will be the other key event to top the agenda at home. While the analysts are almost sure of a 50 bps rate cut, the signals regarding the future meetings will be important. The external agenda is quiet loaded this week. In the U.S., besides the leading industry indicators like New York Fed and Philadelphia Fed, retail sales, inflation, housing data and industrial output will be important.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis *(Consensus)*
Medium	Cent. Gov. Bud. PS, July - Aug.	TRY mn	Sep. 14 - 18th	-
Medium	Unemployment, June	%	Sep. 15th, 7:00 GMT	-
Medium	TURKSTAT Consumer Confid., Aug.	-	Sep. 16th, 8:00 GMT	-
High	MPC Rate Decision	bps	Sep. 17th, 16:00 GMT	-50 *(-50)*

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	ZEW Index, Sep.	-	Sep. 15th, 10:00 GMT	61.0
Medium	U.S.	New York Fed Index, Aug.	-	Sep. 15th, 12:30 GMT	12.75
Medium	U.S.	Core PPI and PPI, Aug.	%, m/m	Sep. 15th, 13:30 GMT	0.1 & 0.7
High	U.S.	Retail Sales, Aug.	%, m/m	Sep. 15th , 12:30 GMT	1.2
High	U.S.	Core CPI and CPI, Aug.	%, m/m	Sep. 16th , 12:30 GMT	0.1 & 0.3
Medium	U.S.	Capacity Use & Ind. Prod, Aug.	% & %m/m	Sep. 16th , 13:15 GMT	69.0 & 0.6
High	U.S.	Build. Perm. & Hous. Starts, Aug.	mn	Sep. 17th, 15:30 GMT	0.58 & 0.59
Medium	U.S.	Philadelphia Fed Index, Sep.	-	Sep. 17th, 15:00 GMT	6.0
Medium	Japan	BoJ Rate Decision	%	Sep. 17th	no chg.

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - bn)	950.1	926.1	1,016.1	1,123.5
GDP (US$ - bn)	734.9	597.5	647.2	690.1
GDP Growth (y/y % chg)	0.9	-6.0	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	-36.1	-62.2	-67.4
Exports (FOB, excl. luggage trade)	132.0	94.5	102.7	106.1
Imports (CIF, incl. gold)	201.7	130.6	164.9	173.5
Current Account Balance (US$ - bn)	-41.3	-11.2	-31.6	-34.1
Current Account Balance / GDP (%)	-5.6	-1.9	-4.9	-4.9

Financial Indicators Forecasts

	Sep. 11th	1M	3M	6M	12M	2009	2010
US$/TRY	1.4978	1.5000	1.5000	1.5600	1.5800	1.5000	1.5800
EUR/TRY	2.1796	2.1900	2.1300	2.1800	2.1300	2.1300	2.0500
FX Basket	3.6774	3.6900	3.6300	3.7400	3.7100	3.6300	3.6300
EUR/US$	1.4552	1.4600	1.4200	1.4000	1.3500	1.4200	1.3000
O/N	7.75%	7.25%	7.00%	7.00%	8.50%	7.00%	10.00%
Benchmark Bond	9.40%	9.50%	10.50%	11.50%	12.00%	10.50%	12.50%

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