

FORTIS BANK

Macro Scope

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Weekly Economic and Strategic Review

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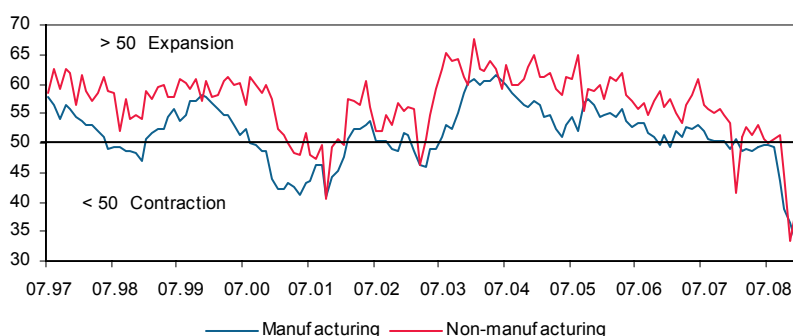
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Ability of Stability...

In the beginning of a new phase in the economic cycle, investors mostly want to know whether the change is for real and how strong the impact will be. Whereas, once that cycle starts becoming mature enough, the attention shifts to the indicators that would signal whether the economy is turning around. The current state of the economy would be a good example to this. Now that the economy has suffered a fairly deep and long lasting contraction period, the hard data that comes with certain lag (such as GDP or industrial output) does not give much valuable information, any more. Instead, investors are very much eager to know whether the worst of the contraction is over. This can also be thought of as the market players' efforts to balance the expected return from their investment decisions and the associated risks. When the markets believe that economy will likely be bottoming out soon, the expected return would look very appealing, while the risks would be worthwhile to bear. Eventually, that upside potential gives enough incentive to the investors to bet on "the worst is over" scenario. However, to bring a permanent market rebound into sight, the leading indicators and the hard data to come would need to signify that the pace of contraction stabilizes and then the economy enters into a recovery phase. **The recent developments were promising in the sense that they indicated some stabilization in the economic outlook.** The announcement or talks of stimulus packages in many countries, especially the U.S., managed to boost investor morale, while for the first time the PMIs in most countries (including Turkey) showed some improvement in January, after tumbling continuously for months. Keeping in mind that PMIs had successfully signaled the approaching recession, such an improvement deserves consideration. Nevertheless, in order to convince us, those indices must continue improving in the upcoming few months, as well.

U.S. Institute For Supply Management (ISM) - Purchasing Managers' Index (PMI)



Source: ISM, Economic Research and Strategy

As shall be remembered, it was December 2007 when the U.S. PMI had first tumbled to below 50-threshold that separates the economic expansion and

contraction periods. Thereafter, this index continued slumping for a year and fell to 32.9 in December 2007. It took 3 months and 6 months for the Japan PMI and Eurozone PMI to follow suit, respectively. As these two countries entered into contractionary cycle with some lag, we are not surprised to see their PMIs slid further in January. Therefore, the important question to ask would be whether the improvement in the U.S. PMI will be sustained, after the index bounced to 35.6 in January.

There are further signs of bottoming out in various other leading indicators, as well. For example 10-year U.S. Treasury yields have been rising since the beginning of January and the yield curves in many countries are getting steeper as if the markets are starting to price normalization in the long run.

The steepening of the yield curve has turned more visible in Turkey, as well. While the O/N equivalent of the short term yields surface in the range of 11.5%-12.00%, the same rate for the benchmark bond and the longer term yields hover at 14% and above. This also gives an idea about the expected interest rate cuts in the short term, as well as about the future path of interest rates.

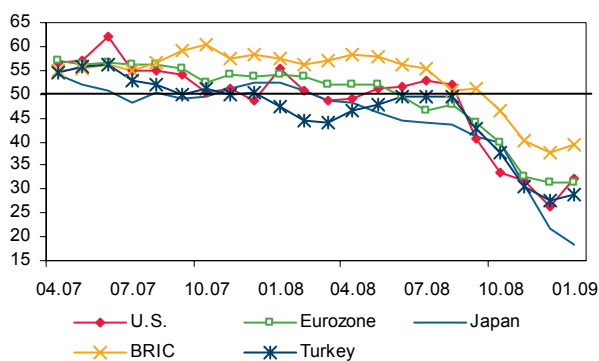
Meanwhile, the Baltic Dry Index, a measure of the freight rates of raw materials, bounced more than 70% in January, after collapsing sharply towards record lows since the middle of last year. The price of Brent oil and industrial metals (copper) also have ascended lately, though at much slower rates. **However, the strength of recovery in industries would depend much more on the pace of inventory adjustment that has been taking place over the recent months.** As we had mentioned before, the uncertainty about the economic outlook and the loss of confidence pushes consumers to postpone their consumption decisions. That in turn results in inventory built-up due to declining sales and this process ends up with production cuts. During this process, producers' priority is more to revive consumption and to deplete inventories via offering good bargains.

Therefore, in this period, the absence of energy and food price pressures to weigh on household budget and fiscal stimulus (tax cut) packages from governments is important. If those decisions that aim to bolster domestic demand are delayed or prove insufficient, it would take longer to deplete the inventory pipelines and eventually the expected surge in production would be hindered.

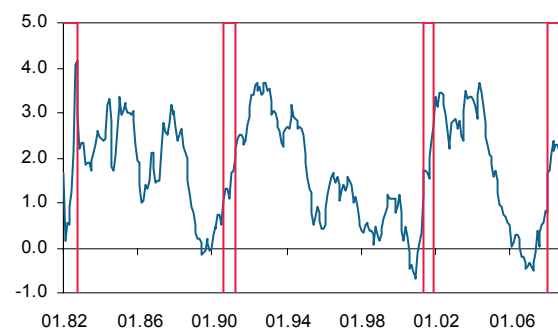
Moreover, the U.S. employment and housing sector outlook, which have important implications for domestic demand, suggest that the correction is still running its course, so that depressed household income and negative wealth effect would continue suppress consumer spending.

The jobless claims have not yet reached its peak in the U.S., while the new home sales dipped in December to the lowest level since 1963, accompanied by signs of further decline in house prices. We read those signs as a warning to remain cautious about a permanent recovery in domestic demand.

PMI – Output (G3, BRIC and Turkey)



U.S. Treasury Yield Curve (Difference of 10-Y & 3-M Treasury Yields, pps) (*)



Source: Reuters, Fortis Economic Research and Strategy

(*) Area between vertical red lines represent recession

The above arguments would have significant implications for the markets. If there indeed appears a recovery in the short term starting from the U.S., the investor appetite would shift towards the stock markets from the fixed income instruments. Investors may divert funds into equity, which happened to be the worst

performing markets over the recent years, from the bond market, which have been the safe haven for a long time. This change in trajectory would also boost US\$ against EUR at the first place. Glancing at home, if the U.S. recession ends in 2H09, that would be closer to the Central Bank's "*fast recovery in the world economy*" scenario, described in the Inflation Report. In that case, Turkish economy may post positive growth rates in 3Q09 and 4Q09, so that the whole year's GDP contracts only slightly. In that scenario, the Central Bank projects year-end CPI at 7.6%, compared to 6.8% forecasted in the baseline scenario, warning that "*...measured policy rate hikes towards the end of 2009*" may be required. The stock markets and interest rates would be heading up in this economic backdrop, while the outlook for TRY is quite mixed. The portfolio flows may accelerate in parallel to the stronger risk appetite. However, the dismal repercussions of the financial crisis on the credit flows are felt through time and this may prevent a substantial increase in F/X supply.

In conclusion, while the U.S. economic outlook remains weak, there are some tentative signs of stabilization, feeding into hopes of an exit from recession. While we believe that the improvement, basically in leading PMI indicators, deserves consideration, we prefer waiting for a few months to see whether the improvement will be sustained. The turnaround in industrial cycles will depend on the inventory adjustment process, i.e. to what extent the inventory pipelines would be successfully depleted, which would in turn depend on consumer behavior. However, the housing sector and labor market outlooks suggest that the correction is still running its course, so that depressed household income and negative wealth effect would continue to suppress consumer spending. If there indeed appears a recovery in the short term starting from the U.S., the investor appetite would shift towards the stock markets from the fixed income instruments.

Economic and Political Agenda

- The industrial production will likely be the key data of the week, while there will also be other critical disclosures such as C/A deficit and Central Bank's Expectation Survey to top the agenda.
- Glancing at external arena, the U.S. retail sales will be the most important item on the calendar. In the Eurozone 4Q flash GDP will be at the forefront. Meanwhile, the Japanese markets will be closed on February 11th. Separately, U.S President Obama had planned to approve the stimulus package this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	Cash Based PS, Jan.	TRY bn	Feb. 9 th	1.2
High	CB's Expectation Survey, Feb. I	-	Feb. 9 th	-
High	Industrial Output, Dec.	% y/y	Feb. 9 th , 8:00 GMT	-18.0 (-15.2)
Medium	Capacity Use, Jan.	%	Feb. 10 th , 8:00 GMT	(62.8)
High	C/A deficit, Dec.	US\$ mn	Feb. 10 th , 15:00 GMT	-2,700 (-2,167)

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Weak	U.S.	Foreign Trade Balance, Dec.	US\$bn	Feb. 11 th , 13:30 GMT	-37.0
High	U.S.	Retail Sales, Tot. & ex-auto, Jan.	%, m/m	Feb. 12 th , 13:30 GMT	-1.0 & -1.1
High	Eurozone	GDP (flash), 4Q	% q/q	Feb. 13 th , 10:00 GMT	-1.2
Medium	U.S.	Michigan Sentiment Ind., Feb.	-	Feb. 13 th , 14:55 GMT	61.5

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2007	2008f	2009f	2010f
GDP (TRY - mn)	853.7	971.7	981.6	1,076.9
GDP (US\$ - bn)	658.8	747.5	609.7	694.8
GDP Growth (y/y % chg)	4.6	1.0	-1.0	4.0
PPI (y/y % chg)	5.9	8.1	6.0	5.0
CPI (y/y % chg)	8.4	10.1	6.5	6.0
Trade Balance (US\$ - mn)	-62.8	-69.7	-36.2	-45.4
Exports (FOB, excl. luggage trade)	107.3	132.0	118.4	130.2
Imports (CIF, incl. gold)	170.1	201.7	154.6	175.6
Current Account Balance (US\$ - mn)	-38.2	-41.4	-10.1	-17.2
Current Account Balance / GDP (%)	-5.8	-5.5	-1.7	-2.5

Financial Indicators Forecasts

	Feb. 6 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.6318	1.6500	1.6500	1.6000	1.6200	1.6000	1.6800
EUR/TRY	2.0966	2.1100	2.1000	2.0300	2.0700	2.0500	2.1800
FX Basket	3.7284	3.7600	3.7500	3.6300	3.6900	3.6500	3.8600
EUR/US\$	1.2848	1.2800	1.2750	1.2700	1.2800	1.2800	1.3000
O/N	13.00%	12.50%	12.00%	12.00%	12.50%	12.00%	14.00%
Benchmark Bond	15.20%	15.20%	14.70%	14.25%	14.30%	13.70%	16.00%

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