



Macro Scope

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Weekly Economic and Strategic Review

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Return of the Fiscal Skeletons?

Establishment of fiscal discipline and the transparency, as well as the strong fiscal performance secured via a high level of primary surplus, have been among the most striking accomplishments during the transformation process the Turkish economy has experienced since 2001. In that context, **the government's attempts that threaten both the fiscal performance and the universal fiscal principles, such as the discipline, transparency and auditing, are concerning**, especially after experiencing last year's deviations in the budget targets.

The first of those mentioned attempts is the government's plan for reducing the social security premiums charged to the employers by 5 points, despite the fact that government had previously committed to the IMF not to and although State Minister in charge of economics had previously ruled out such a discount in 2008 due to budget constraints. If this discount is put into force, the burden on the budget is estimated to be YTL4.2bn and YTL5.5bn (ratio to GNP is 0.6%) for the year of enforcement and the consecutive year, respectively, based on the numbers at the Pre-Accession Economic Program submitted to the EU.

The second and most dangerous attempt against the universal fiscal principles is the government's proposal for establishing a non-budgetary fund to finance the infrastructure projects in transportation. The proposal assumes transferring all the transport-related revenues to this fund, which will be deposited at the CBRT. Accordingly, the expenditures financed by this fund will be out of the control of the Court of Auditors and instead will be audited once in a year by Prime Ministry's Supreme Auditing Commission. The spending from this fund will also be exempted from any saving caps that shall be introduced in the context of maintaining fiscal discipline. As is known, when the government decides to introduce expenditure caps, usually the investment appropriations are curbed and the projects like this get hit first.

When we first got to know that the draft pack for discounting the social security premiums was submitted to the Parliament at end-January, it was hoped that the government would have stepped back from this mistake. However, Transport Minister Yildirim's remarks last week about establishing the fund for transport projects convinced that the government is quite determined. He said that they will establish a fund to finance the transport projects amounting to YTL29bn and the majority of the transport ministry linked revenues in the budget will be transferred to that fund in order to finance infrastructure upgrades throughout 10 years. The Planning and Budget Commission of the Parliament has still been discussing about the proposal, which assumes to transfer the below listed revenues to the fund:

- 90% of proceeds from the privatization of the assets and companies that are owned by the Transport Ministry and/or institutions under the ministry.
- The whole amount of the rental revenue that the State Airports Administration receives for airports.
- 90% of revenues from bridge and highway tolls and 90% of the revenues transferred to Treasury from the privatization of the vehicle inspection stations.
- 80% of the Telecommunications Authority's revenues left after discounting its expenses once in every quarter, along with 90% of income that accrues from all sorts of license issues.

Separately, the proceeds from the privatization of the ports before the enforcement of the legislation are also assumed to be added to the fund.

As can be seen, this proposal will both lead to a weaker control over the expenditures and result in contraction of revenues. Moreover, the transfer of some of the privatization revenues to the fund will adversely affect the Treasury's cash facilities. As is known, according to the current implementation, the Privatization Administration's (PA) proceeds from privatization revenues cannot be registered as revenue item under the central government budget unless specified with a law and instead those revenues are transferred to the Treasury's cash accounts. Through this way, some YTL9bn transfers from the PA were used for debt service in 2007.

The third attempt that has the potential to have dismal repercussions on the budget and the overall fiscal discipline is the regulation for increasing the budgetary transfers to the municipalities and local administrations. In the recent days, it is claimed in the media that the mentioned transfers that reached YTL13.3bn in 2007 will be expanded by YTL4.2bn to YTL17.5bn. In the current procedure 5% of the budget revenues are transferred to the 16 metropolitan municipalities, 1% to the other municipalities and 1.2% to the special provincial administrations. However, while calculating the amounts to be transferred, Private Consumption Tax and Private Communication Tax are not included. The new system assumes to take those two tax items into account, as well.

We think that any single one of those proposals, if put into practice, would be enough to further harm the effectively suspended relations with the IMF, which keep postponing the finalization of the last stand-by review. Since there has not been much progress in the structural reforms, the relations with the IMF have mostly been settled on the Fund's surveillance function. Turkey still does not have a mechanism to replace this. Although it was claimed that there has been a consensus with the IMF over a certain fiscal frame, the rule to be applied (budget deficit, ceiling on primary expenditures or borrowing limitation, etc) was not specified. In this situation, the attempts that would jeopardize the fiscal discipline and the performance would make it harder setting an agreement for a new program.

In our report published as we were about to enter 2008, we had claimed that the most critical issue would be the nature of the agreement between the government and the IMF. In case a weaker IMF anchor is preferred, it would curb the motivation for proceeding with the expected micro reforms (suppressing labor cost, improving labor market, lowering unregistered economy, giving incentives for intermediate goods production, etc.) or would cause in delays of the implementations due to the ongoing structural problems in the budget (one-off revenues, greater share of indirect taxes, inability to fully control expenditures, etc.). Our worries seem to have come true in a way. **The mentioned attempts (lowering the labor costs without appropriating the necessary source, attempts that would deepen the structural problems in the budget) would leave no choice but a program with a weak anchor.** We have doubts, however, whether this would be the right decision under the current conjuncture that tends to deteriorate even further.

In conclusion, while we are worried with government's attempts which would jeopardize the fiscal discipline established till now, we think there is still hope that

the government may step back since none of them have yet passed the Parliament. Under the current conjuncture the right decision should have been in favor of a tighter fiscal control over expenditures that would help securing a better performance than last year, rather than decisions that would end up loosening the budget performance. After all, the expected slowdown in the economic activity would mean that the tax revenues may not meet the targets. Unless the government decides to withdraw those attempts, then both finalizing the current stand-by program and agreeing on a new one would be harder. Those who advocate that IMF program is a not compulsory for Turkey should also think how credible a home-made fiscal rule would be in that case.

Economic and Political Agenda

- On Friday, TURKSTAT will disclose the long-awaited results of the updated national account statistics with a base-year of 1998 under a revised method and coverage.
- Fed Chairman Bernanke's speech due Friday will be important this week, in addition to the U.S. CPI and retail sales data.
- The Treasury will issue the 6-month reference bill due 10.09.2008 and the benchmark bond due 7.10.2009 on Tuesday, in preparation for its YTL4,104mn redemption on Wednesday.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis forecast	Consensus
Medium	CNBC-e Cons. Ind., Feb.		Mar. 10 th , 7:00 GMT	-	-
Medium	Industrial Output, Jan.	% y/y	Mar. 10 th , 8:00 GMT	10	10
Weak	Cash Based PS, Feb.	YTL bn	March 10 th	5.0	-
High	C/A deficit, Jan.	US\$ mn	Mar. 10 - 14 th , 15:00 GMT	4,600	4,209
Medium	Cent. Gov. Budget PS, Feb.		Feb. 11 - 14 th	-	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	ZEW Index, Mar.	-	Mar. 11 th , 10:00 GMT	-39
Weak	U.S.	Foreign Trade Balance, Jan.	US\$ bn	Mar. 11 th , 12:30 GMT	-59.5
Weak	U.S.	Export & Import Prices, Feb.	%	Mar. 15 th , 12:30 GMT	0.6 & 0.8
High	U.S.	Ret. Sales, Tot. & ex-auto, Feb.	%, m/m	Mar. 13 th , 12:30 GMT	0.2 & 0.2
High	U.S.	Core CPI and CPI, Feb.	%, m/m	Mar. 14 th , 12:30 GMT	0.2 & 0.3
Medium	U.S.	Michigan Sentiment Ind., Mar.	-	Mar. 14 th , 14:00 GMT	71.0

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2006-2009

	2006	2007f	2008f	2009f
GNP (TRY - mn)	575.8	639.4	695.2	759.5
GNP (US\$ - bn)	399.7	491.3	558.5	589.5
GNP Growth (y/y % chg)	6.0%	4.5%	4.5%	5.0%
PPI (y/y % chg)	11.6	5.9	4.0	4.3
CPI (y/y % chg)	9.7	8.4	5.5	4.5
Trade Balance (US\$ - mn)	-54.0	-62.8	-68.0	-66.7
Exports (FOB, excl. luggage trade)	85.5	107.2	121.9	138.1
Imports (CIF, incl. gold)	139.6	170.0	189.9	204.8
Current Account Balance (US\$ - mn)	-32.2	-38.0	-43.2	-40.8
Current Account Balance / GNP (%)	-8.1%	-7.7%	-7.7%	-6.9%

Financial Indicators Forecasts

	Mar. 7 th	1M	3M	6M	12M	2008	2009
US\$/TRY	1.2101	1.2108	1.2321	1.2675	1.2866	1.2900	1.3000
EUR/TRY	1.8541	1.8404	1.8358	1.8379	1.8012	1.8300	1.8200
FX Basket	3.0642	3.0512	3.0678	3.1054	3.0878	3.1200	3.1200
EUR/US\$	1.5322	1.5200	1.4900	1.4500	1.4000	1.4000	1.4000
O/N	15.25%	15.25%	15.00%	14.75%	14.25%	14.50%	13.00%
Benchmark Bond	17.70%	17.20%	16.50%	15.90%	15.30%	15.60%	13.90%

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