



Macro Scope

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Weekly Economic and Strategic Review

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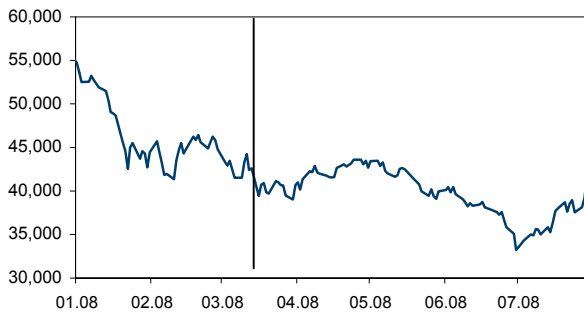
So Far, So Good...So What!

Now that Turkish economy has got rid of one of the most important uncertainties that have pushed the country into a major underperformance period, there emerges an immediate need to reconsider our forecasts about the economy and the markets. That is what we are going to address in this weekly.

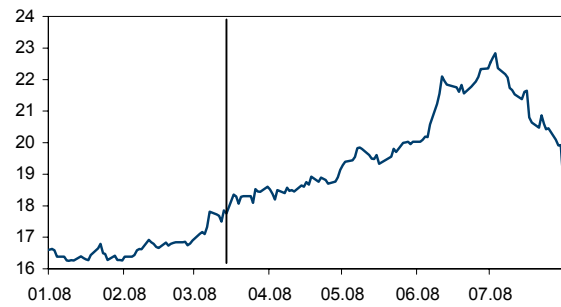
As should be recalled, in our previous reports, we were mentioning that this year Turkey has remained under considerable stress due to twin shocks and the uncertainties that followed. The first one was the global credit crisis, whose repercussions keep spreading even today. Throughout these reports we stated that the impact of the battered external backdrop in Turkey has remained as a substantial deterioration in the market performance, while underlining that the economy is also in danger since the impact through trade and credit channels may start putting a greater drag going forward. The second shock was the case filed to the Constitutional Court against the ruling AKP to ban it from politics. We had listed two dismal repercussions of this adverse shock. First, the economic outlook had started to take a back-seat in the government's agenda, as the politicians had lacked any clear idea about the duration of the case back then. And second, the uncertainties regarding the political picture that would have appeared after the Constitutional Court's verdict had irritated consumer and investor sentiment. Eventually the Court decided not to close the party, with the verdict being finalized in a very short time. **The most important implication of this decision for analysts and economists are the waned political uncertainty that would have otherwise occupied the agenda for a long time.** If the party were closed, then there would have been wide spectrum of scenarios, while in the opposite case there is only one scenario which is welcomed by the market players. Even before the Court announced the verdict, the market players already started to bet on a market-friendly outcome. Needless to say, as a first thing to do, the Turkish markets started to recoup their previous underperformance suffered since March 14th. **In order to assess the possible extent of the recovery in local markets, we need to distinguish between the damage generated by the global credit crunch and the generated by the political jitters.** We believe that the most appropriate reference point would be the valuations of the Turkish markets right before the closure case was filed. Back in March 14th, the aggressive sell-off pressure since the beginning of the year had sent the ISE100 Index down to as low as 42,500. The losses started to become more apparent after the AKP closure case. With the Court's decision not to ban the party, the index made it way back to those levels again. However, the trend in the upcoming period will depend on the external markets. Glancing at the interest rate outlook, even before the AKP case, the bond yields were surfacing at 18%, which was some 150 bps above the funding rate. Note that the bond yields happen to exceed the funding rate during periods of heightened risk perception. Nowadays, this gap has narrowed to 60 bps, which is even more

tamed compared to the pre-math of the AKP case. Further decline towards 18.2% may be possible once the entire risk premium is pared back and the rest would depend on the expectations regarding the future pace of inflation. The Central Bank's dovish tone also supported the downtrend in the yields. In the last MPC statement and the Inflation Report, the Central Bank signaled that the current level of the policy rates is appropriate for disinflation and seemed biased for no change, even though leaving the door open for further increases through the end of the year.

ISE100 Stock Market Index

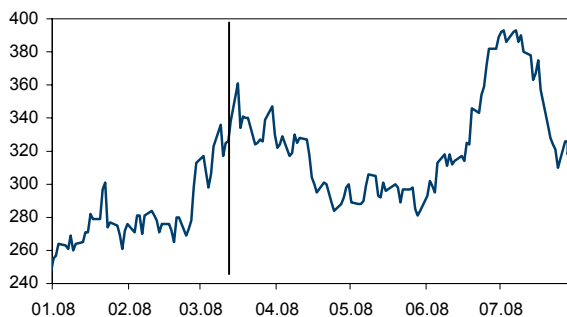


Benchmark Bond Yield (% c.a)

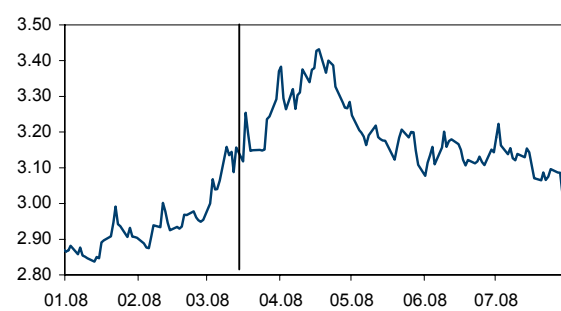


To cut a long story short, the market movements going forward will be a good experience for distinguishing the roles of the global and local developments on the dismal performance suffered in the first half of the year. It is normal to see the local markets closing the performance gap between other countries, while the trend after that point would depend on which global scenario the investors will buy. Currently, the weakness in the U.S. economy is believed to spread out more visibly to other developed and developing countries and this will likely remain to be the baseline scenario as long as the Eurozone data continue implying a weak growth outlook, accompanied by the lack of any recovery signal in the U.S. economy (the cease of the decline in the housing prices or of the slumping payrolls).

EMBI+ Turkey Spread



F/X Basket (1 US\$/TRY + 1 EUR/TRY)



On the other hand, we do not need to change our forecasts and scenarios about economic outlook and key economic indicators. We expect a below-trend growth performance and an above-trend inflation outlook. The correlation between the market performance and the economy is not as strong as thought, as witnessed during the recent negative performance of the markets. Such a relation becomes visible only in times of permanent improvements or deteriorations and it does not happen all of a sudden. The Turkish policy makers should not be satisfied with the cease of the political uncertainties and they need to provide an anchor for the decision makers in the economy. After all, the Court's decision not to dissolve AKP does not guarantee an improvement of the economic outlook, such as an acceleration of the reform program, eliminating the vulnerabilities or introduction of a new anchor like IMF-program. In essence, considering the rising oil prices with an accompanying expansion in the current account deficit, as well as tightening credit conditions in the global financial system, it is a matter of time to see Turkey's key vulnerabilities, which seem to be

of secondary importance for the time being, once again taking a front seat in the agenda. Additionally the local elections due March 2009 may prevent the Parliament which will be closed from this week onwards, to direct its attention and energy towards economic progress when reopened on 1st of October.

Approaching such a risky period, we are concerned to see that there are still risks about the fiscal discipline, as reflected by the Finance Ministry's revised targets, and the economy is still lacking a fiscal rule which would make the new targets more convincing. Similarly, even though the stand-by agreement with IMF was finalized in late April, the government has not yet determined a new program. These are seen as the major obstacles against further improvement in expectations. As we analyzed in the week behind, the Finance Ministry disclosed the official estimates for the 2008 budget realizations. The expenditures were estimated to end higher at TRY232,899mn due to additional burdens such as 5 pp discount on social security premium cost to employers, increase in the transfers to municipalities, support payments to the farmers hit by draught and the transfers to the South Anatolian Project, adding TRY381mn, TRY900mn, TRY450mn and TRY2,300mn, respectively. Meanwhile, the revenues are also seen higher at TRY216,990mn, thanks to the transfers from insurance fund and privatization proceeds. While the IMF-defined targets are not given in the report, the unadjusted primary surplus to GDP ratio is planned to remain unchanged at 4.1% vs. 2007. Normally, one-off revenues from the insurance fund and privatizations are excluded to calculate program-defined primary surplus, while a similar adjustment is yet unclear for the expenditures. Therefore, it is yet vague whether the 3.5% primary surplus target in the program-defined figures are secured or not.

In conclusion, it is normal to see the local markets are recouping part of the losses associated with political uncertainties, while the next trend would depend on the external market performances, which would be supportive only if the perceptions regarding the global backdrop improve. On the other hand, we stick to our scenarios for domestic macroeconomic outlook and believe that the lack of any improvement in establishing a new agreement with IMF and a fiscal rule are delaying Turkey's way out from below-trend growth and above-trend inflation pattern.

Economic and Political Agenda

- The July inflation due Monday, seems to be the most important event that will affect the markets this week. The reflections of July data on inflation expectations will be important for the Central Bank's rate decision.
- In the foreign agenda, Fed's rate decision and the accompanying short statement to be announced on Tuesday will be the key event in shaping the international markets. The Fed is seen almost for sure to hold the interest rates constant. Moreover, inflation and growth indicators will be as important as the interest rate decision for clarifying the growth landscape in the U.S. Also, the BoE and the ECB are seen to remain on hold at their meetings this week.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Consensus (Fortis)
High	CPI, July	%m/m	Aug. 4 th , 14:00 GMT	0.4 (0.1)
High	PPI, July	%m/m	Aug. 4 th , 14:00 GMT	0.5 (0.2)
Medium	Industrial Output, June	% y/y	Aug. 8 th , 07:00 GMT	2.5 (1.0)
High	C/A Deficit, June	US\$ mn	Aug. 8 th , 14:00 GMT	5,044 (5,100)
Weak	Cash Based PS, Jul.	TRY bn	Aug. 8	-
High	CB's Expectation Survey, Aug.I	-	Aug. 8	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus (Fortis)
High	U.S.	Core PCE Inflation, June	% m/m	Aug. 4 th , 12:30 GMT	0.2
High	Eurozone	Services PMI, July	-	Aug. 5 th , 08:00 GMT	48.3 (48.8)
High	U.S.	Services ISM, July	-	Aug. 5 th , 14:00 GMT	48.5 (48.5)
High	U.S.	Fed's Rate Decision, Aug.	bps	Aug. 5 th , 18:15 GMT	<i>no chg. (no chg.)</i>
High	U.K.	BoE Rate Decision, Aug.	bps	Aug. 7 th , 11:00 GMT	<i>no chg. (no chg.)</i>
High	Eurozone	ECB Rate Decision, Aug.	bps	Aug. 7 th , 11:45 GMT	<i>no chg. (no chg.)</i>
High	U.S.	Pending Home Sales, June	% m/m	Aug. 7 th , 14:00 GMT	-1.0 (0.5)
Medium	U.S.	Productivity, 2Q	% q/q	Aug. 8 th , 12:30 GMT	2.5 (2.3)

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2006-2009

	2007	2008f	2009f	2010f
GDP (TRY - mn)	856.4	953.1	1,056.8	1,154.0
GDP (US\$ - bn)	658.8	787.7	832.1	887.7
GDP Growth (y/y % chg)	4.5	4.5	5.0	5.0
PPI (y/y % chg)	5.9	13.0	5.0	5.0
CPI (y/y % chg)	8.4	11.0	8.2	7.3
Trade Balance (US\$ - mn)	-62.8	-82.7	-91.3	-98.1
Exports (FOB, excl. luggage trade)	107.2	139.4	155.6	173.3
Imports (CIF, incl. gold)	170.1	222.1	246.9	271.3
Current Account Balance (US\$ - mn)	-37.8	-52.8	-56.4	-60.1
Current Account Balance / GDP (%)	-5.7	-6.7	-6.8	-6.8

Financial Indicators Forecasts

	August 1 st	1M	3M	6M	12M	2008	2009
US\$/TRY	1.1564	1.1800	1.2000	1.2450	1.2750	1.2400	1.2800
EUR/TRY	1.8055	1.8400	1.8350	1.8550	1.8500	1.8600	1.8600
FX Basket	2.9619	3.0200	3.0350	3.1000	3.1250	3.1000	3.1400
EUR/US\$	1.5613	1.5600	1.5300	1.4900	1.4500	1.5000	1.4500
O/N	16.75%	17.00%	17.25%	17.25%	16.25%	17.25%	15.75%
Benchmark Bond	19.00%	19.00%	19.00%	19.00%	17.50%	19.00%	17.50%

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