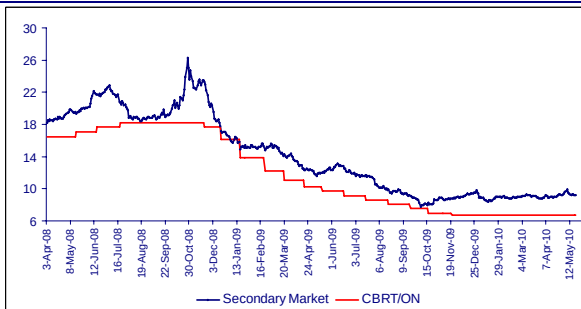


Turkey Weekly Macro Comment

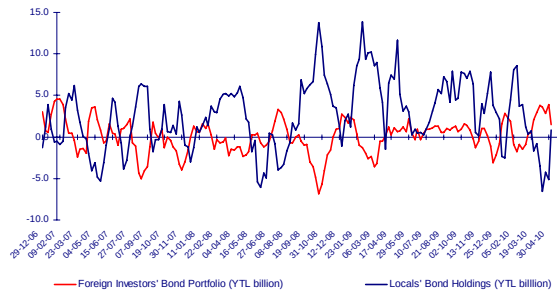
24 May 2010

Bond Rates vs O/N



Source: Central Bank of Turkey, YK Economic Research

Domestic & Foreign Bond Portfolios (4W change)



Source: Central Bank of Turkey, YK Economic Research

A Transformation No One Dare Define

- The 33rd General Convention of the main opposition party CHP introduced a new leader to Turkish politics who seems to have been inspired by all social democrat leaders the world has seen including Baykal (new Chairman Kilicdaroglu's own words), whom he toppled down in the Convention.
- The average person aspires for prosperity and upward mobility, sometimes unfortunately at the expense of or simply ignoring others. Being equated at the bottom is not an appealing sales pitch to the average constituent. This point may still be missed by politicians that declare themselves to be "social democrats".
- The upshot of all this so called transformation in the main opposition party is quite vague at the moment.
- The second expectations survey of the month should provide some breathing room for the CBRT that switched to a new regime by adopting the one week repo rate as the new policy rate.
- Capacity utilization figure for the month of May was announced Monday afternoon and the headline and the seasonally adjusted figures are both up month on month.
- More signs of normalization on the credit front as consumer credits continue their reasonably stellar performance while commercial credits had a weak showing for a change.

Cevdet Akçay

Chief Economist, Yapı Kredi Bank & Yapı Kredi Yatırım

Tel: +90 212 319 8430 cevdet.akcay@yapikredi.com.tr

1.1 General Outlook

The 33rd General Convention of the main opposition party CHP introduced a new leader to Turkish politics who seems to have been inspired by all social democrat leaders the world has seen including Baykal (new Chairman Kilicdaroglu's own words), whom he toppled down in the Convention. When you have such an exhaustive list, you practically end up delivering no list that will help the curious observant figure out what your aspirations might be. That is just one example of **the categorical stalemate that the new leader Kilicdaroglu will be facing; the thin line between vagueness that serves as a safeguard and "to the point precision" which will by default reduce risk aversion and make you susceptible to questioning and inquisition.** He seems to have opted for the first one at the moment. Kilicdaroglu has also adopted a very populist rhetoric, but deliberately so for political purposes one might say. He seems to have targeted the poorest 10-15% of the constituency which mostly voted for the AKP in previous elections. Outside the core constituencies, there is a significant floating-vote constituency in Turkey which every party tries to seduce in every election. And "recklessly shifting" these floaters can indeed do, but you have to speak their language to entice them. That is what the new CHP leader is trying to do, and how successful he will be in his endeavors is a question mark.

As a hard core bureaucrat, Kilicdaroglu has focused and specialized in corruption cases (his selected field of expertise) and has successfully caused the outing of two prominent AKP figures from their posts. How much more ammunition he has left is a question the answer to which is beyond us, but probably none as he would have used it during his mayoral candidacy campaign if he had had any more. **His populist rhetoric may, let us opt for an optimistic interpretation, just be bait for vote attraction, but a Turkish politician should know better, I believe. When he attempts to gain credibility and popularity in the eye of the economically lower strata of the Turkish society, he tries to accomplish that through his commitment that "he will not live in a villa".** This might have worked in the Turkey of 1970s when villa as a concept was exactly what Kilicdaroglu has in mind now; the true sign of "unattainability". Today's Turkey is nowhere comparable to Turkey in the 70s not only in number of villas we have but also in terms of what the concept itself entails. What he also probably overlooked is the proportion of CHP voters among villa owners; the establishment and the economic/social elite in Turkey categorically vote against the AKP and mostly for the CHP. Most importantly, the economically lower strata of the society is interested in knowing whether they will have proper housing first (all with sense on all spheres of political life give it to the AKP when housing policies are mentioned; Turkish Administration of Public Housing (TOKİ) has almost worked miracles for the have-nots in less than a decade), and those who have made it that far and aspire for a modest "villa" of their own in a relatively cheap piece of land they will be able to afford wonder if they will ultimately be able to do it. **The average person aspires for prosperity and upward mobility, sometimes unfortunately at the expense of or ignoring others. Being equated at the bottom is not an appealing sales pitch to the average constituent. It might be difficult to grasp this for hard core bureaucrats whose perceived mission has been to protect the State from the schemes and wheelings and dealings of the private sector. Yet they have to keep in mind that every single voter they are trying to seduce**

(the recruited politicians that they have become now) is the quintessential private sector agent regardless of the economic strata they belong to.

The upshot of all this so called transformation in the main opposition party is quite vague at the moment. You may not choose to call it a transformation in the first place and this view can not be easily thrown aside. Here is the question the advocates of this “no transformation/mere window dressing” view are entitled to ask: What were the main issues of discrepancy between the old CHP administration and the new one? Do not think for long as you may not be able to find one. There had been the misperception for quite some time that there was a problem with previous Chairman Baykal, but no one dared formulate precisely what it was. When nothing of essence could be brought up for a fully backed anti-Baykal campaign (please refer to our previous Weekly for more on this issue of anti-Baykal sentiment and its fictitious nature), the sex tape somehow and fortunately came to the rescue of those demanding a change of power and here we are. Where Kilicdaroglu differs from Baykal on issues like the Constitutional Reform Package (we do not mean his vague and undirected remarks toward a more contemporary constitution as that means totally different things to different people here but Baykal was murmuring the same words while he was opposing the CRP), the Kurdish initiative, the EU agenda, Cyprus, Turkey-Armenia relationship, the visa-free zone approach of the AKP for the region, etc. is still an enigma and probably will stay as one forever as there is most presumably no discernible difference between their views. What was this slick indecent exposure tape incident about then? The jury is still out on that, but time will tell us for sure as not only known secrets but true secrets have also been prone to full disclosure recently and that is not likely to change going forward.

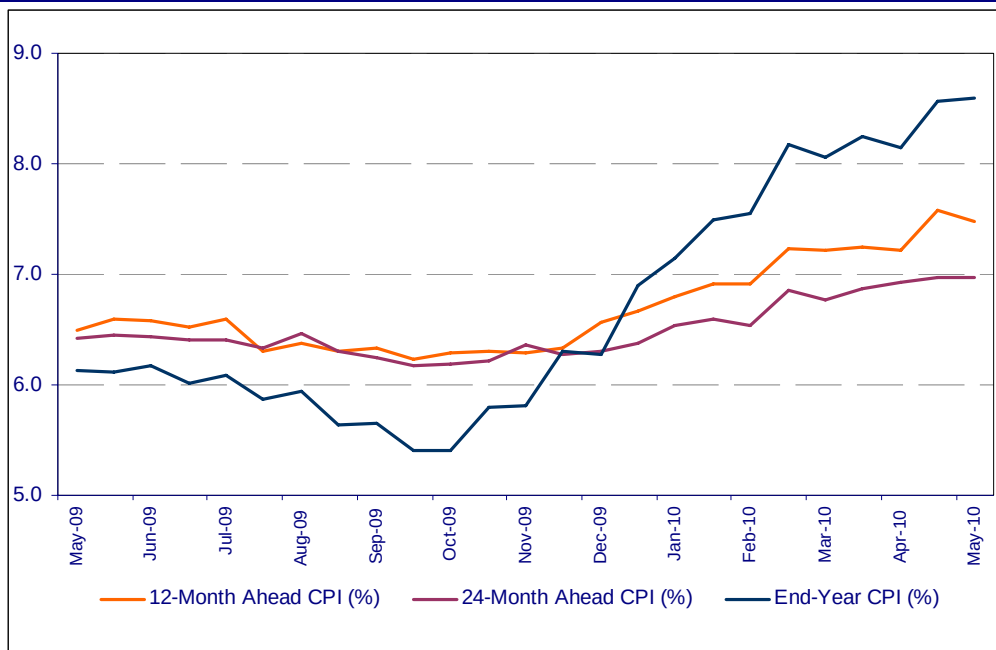
The division in Turkey was very keen, trenches were dug deep, and the struggle would end with clear victory for one side and defeat for the other with certainty. The picture is more blurred now compared to the one before the Convention. There are some who assert that there might be some constructive opposition coming out of this so called new structure in the CHP in the sense that they could proclaim themselves as better/smoothen operators of some policies that the AKP has subscribed to in the last 8 years. But we could also have implementation of the very same strategies under a new leadership which simply assumes more credibility solely due to the “the guy next door” feeling that the new leader supposedly emits. If an outside observer, say a foreign investor, mostly sides with the policies that the AKP has been following in the last 8 years, then the very same opposition with the same negligible degree of constructivism and thrashing the AKP more forcefully is indeed to be perceived by him as destabilizing.

The CHP is adopting a rhetoric that intends to appeal to masses that traditionally found themselves close to the AKP. The AKP might very well do the same finally and dump its complacency regarding constituent recruitment. Their rhetoric and strategies need better PR campaigns, more compelling argumentation, and more appealing messengers than the ones they currently employ. That may very well be the blessing in what some call the curse that has come on them; the newly transformed born again CHP that is.

1.2 Macro Data

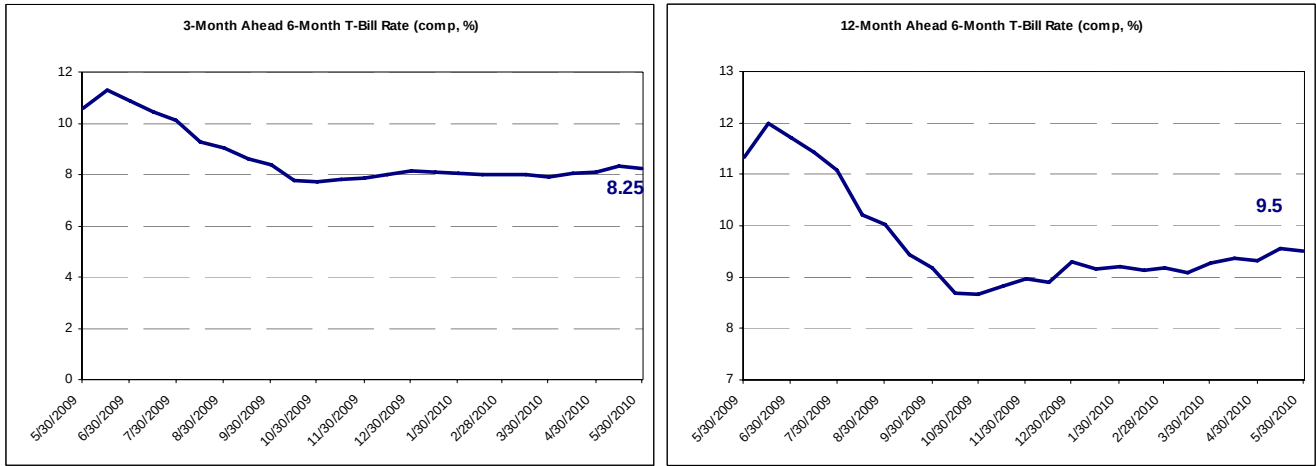
The second expectations survey of the month should provide some breathing room for the CBRT that switched to a new regime by adopting the one week repo rate as the new policy rate. The auction mechanism has also changed and the Bank can now determine both quantity and price. The overnight market may become a bit volatile, but the Bank wants the banking sector to be more active in liquidity management and move itself gradually from the position of almost sole liquidity provider. This is not tantamount to a tightening of policy, and the most recent expectation survey is quite encouraging for not initiating one at this juncture. Inflation expectations are mostly intact; 24-month ahead expectation is virtually intact at 6.97% while 12-month ahead inflation expectation came down to 7.48% from 7.58% in the earlier survey. Interest rate expectations on both the short and the long tenor issues have also come down somewhat and these are indicative of a tendency to bet on low inflation/low interest rate combo even in a growing economy. That is the ultimate test for the Turkish economy as we alluded to a number of times in our earlier reports.

Inflation Expectations



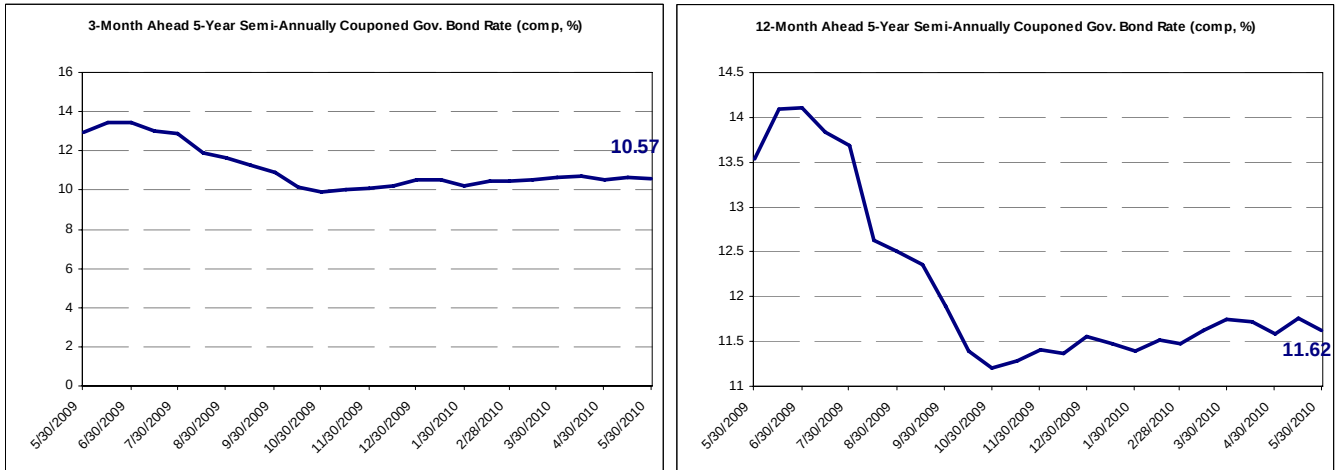
Source: Expectations Survey, Central Bank of Turkey

Interest Rate Expectations



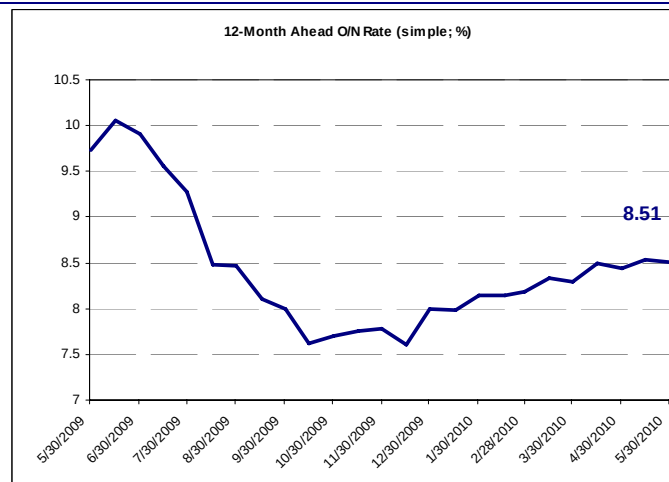
Source: Expectations Survey, Central Bank of Turkey

Interest Rate Expectations



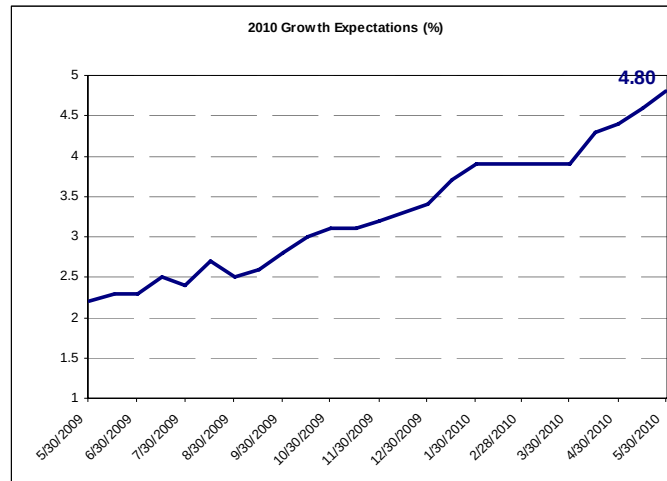
Source: Expectations Survey, Central Bank of Turkey

O/N Expectations



Source: Expectations Survey, Central Bank of Turkey

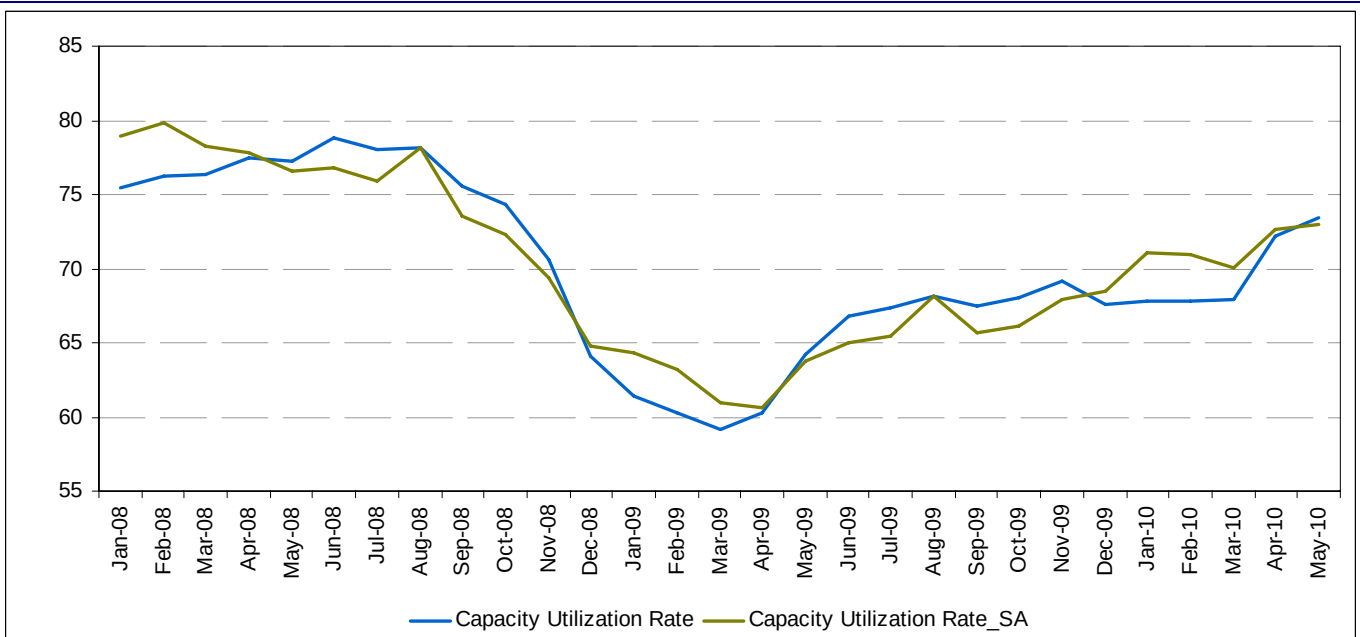
Growth Expectations



Source: Expectations Survey, Central Bank of Turkey

Capacity utilization figure for the month of May was announced Monday afternoon and the headline and the seasonally adjusted figures are both up month on month. The adjusted figure is up barely and it might be suggesting a new plateau around 73% levels. Combined with the correction on the IP front which according to our filters has been losing momentum as of late, the plateau argument may end up being plausible but more data are needed for a more definitive conclusion.

Capacity Utilization

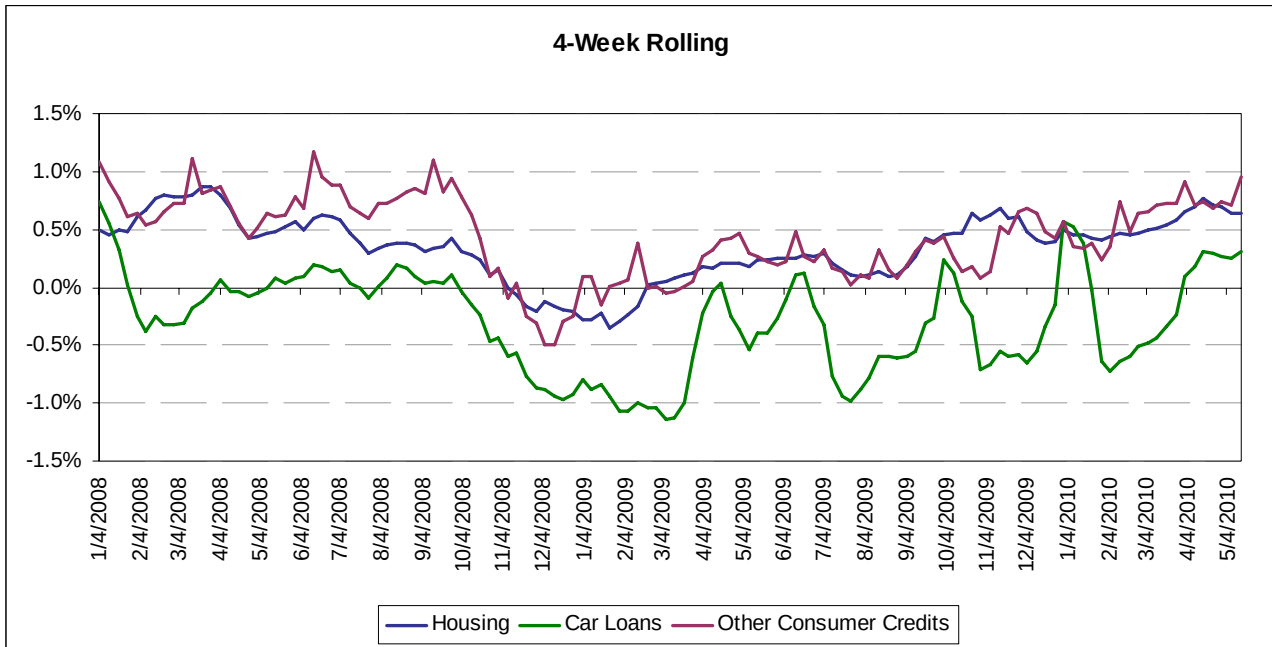


Source: Turkstat, YK Economic Research

1.3 Weekly Data (all weekly data terminate on May 7, 2010 while consumer credits are one extra week updated)

More signs of normalization on the credit front as consumer credits continue their reasonably stellar performance while the increase observed in commercial credits stems from the sharp depreciation in the Turkish lira in the week May 7 from 1.48 levels to 1.56 levels. TL denominated commercial credits was indeed down by roughly TL 1.0 billion in the period in question.

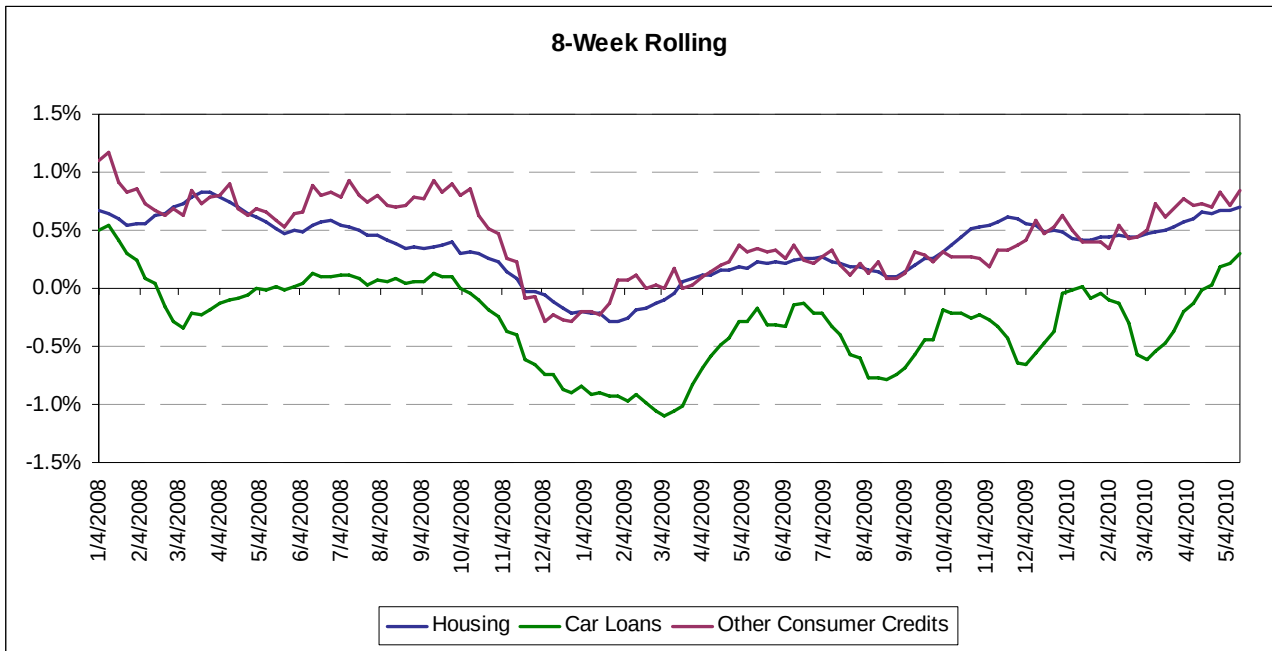
Consumer Credit Volume (*)



Source: Central Bank of Turkey, Yapı Kredi Economic Research

(*)Weekly % change of 4W rolling

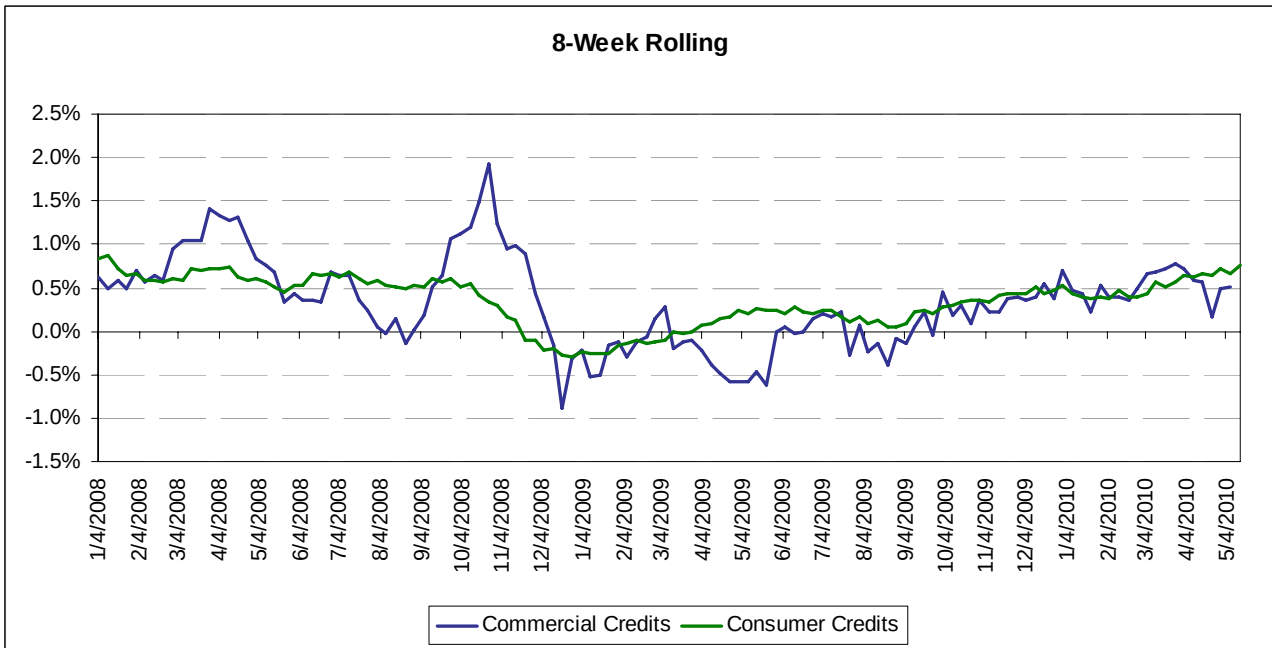
Consumer Credit Volume (*)



Source: Central Bank of Turkey, Yapı Kredi Economic Research

(*)Weekly % change of 8W rolling

Commercial & Consumer Credit Volume (*)

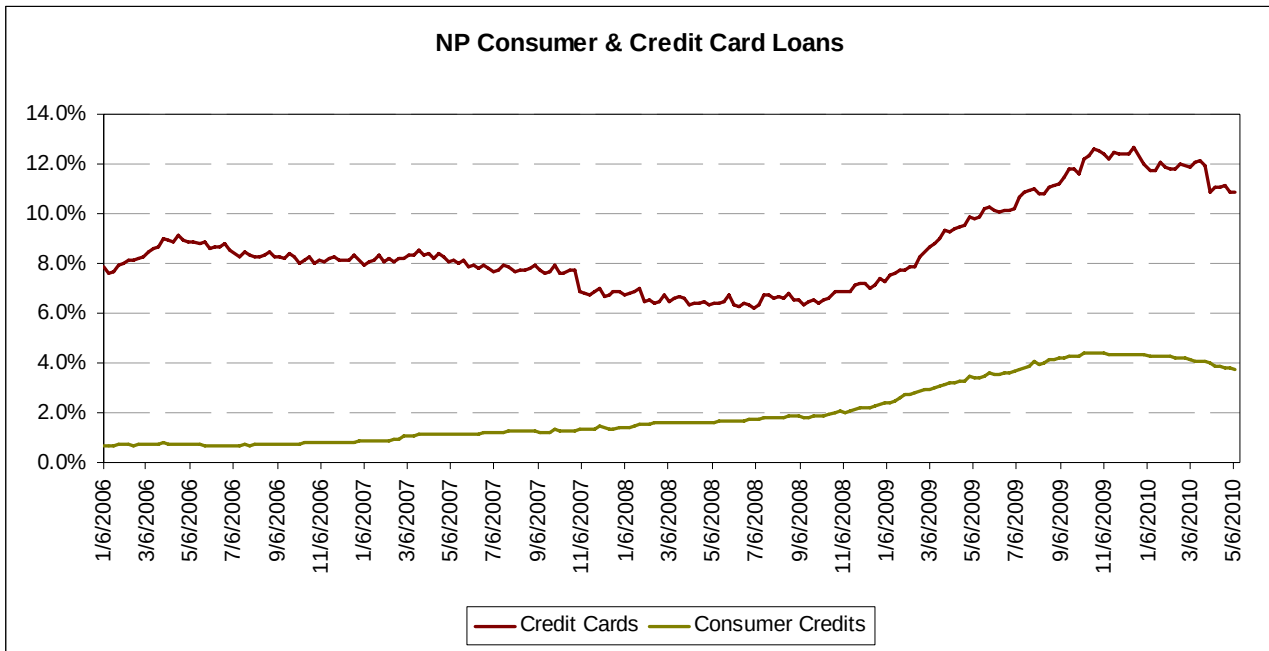


Source: Central Bank of Turkey, Yapı Kredi Economic Research

(*)Weekly % change of 8W rolling

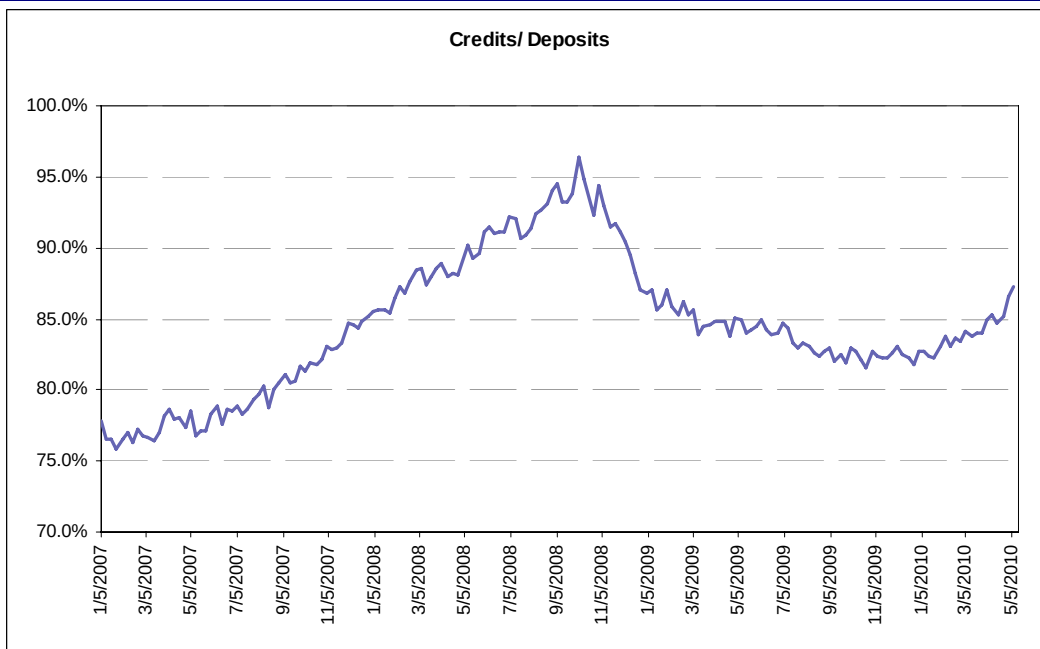
Loan deposit ratio is up, NPL ratio for consumer credits is down while that for credits cards is flat, and all indicators are still hinting at a normalization and recovery process the pace of which is not unsatisfactory at the moment (the choice of double negatives is deliberate as we still have questions in our minds regarding the pace of recovery).

NPL



Source: Central Bank of Turkey, Yapı Kredi Economic Research

Credit/Deposits Ratio



Source: Central Bank of Turkey, Yapı Kredi Economic Research

Markets

by Murat Berk / Economist and Investment Strategist

Habituated to Surroundings

"The power to become habituated to his surroundings is a marked characteristic of mankind. Very few of us realize with conviction the intensely unusual, unstable, complicated, unreliable, temporary nature of the economic organization by which Western Europe has lived for the last half century. We assume some of the most peculiar and temporary of our late advantages as natural, permanent, and to be depended on, and we lay our plans accordingly. On this sandy and false foundation we scheme for social improvement and dress our political platforms, pursue our animosities and particular ambitions, and feel ourselves with enough margin in hand to foster, not assuage, civil conflict in the European family."

John Maynard Keynes-"The Economic Consequences of the Peace, 1921"



This dynamics between the global macro headwinds from the “core” and the tailwinds of strong bottom up fundamentals in most EMs continue. Right now, the former is gaining the upper hand but strengthening in the latter still matters.



Macro fundamentals continue to improve, and though they are admittedly backward looking, we believe they will continue to heal over the course of the year.



On the other hand, recent financial market developments are somewhat concerning and we do believe this correction is different from others over the past year.



Writing in 1967, before he had formulated his Financial Instability Hypothesis, the brilliant economist Hyman Minsky identified the starting point for his analysis. “Capitalism is essentially a financial system, and the peculiar behavioral attributes of a capitalist economy center around the impact of finance on system behavior.”



We are well aware and have discussed, that the financial markets can drive the fundamentals in positive feedback loops. Weak prices can lead to restrictive funding markets (and lower collateral value), causing financial conditions to tighten, which can ultimately affect the real economy. Though it is premature to call for a double dip in the global economy, this tail risk is growing.



We've observed repeatedly that in this highly interconnected global economy and markets, no country can be an island anymore. Soft decoupling is a reality for EM but complete decoupling remains an untested hypothesis.



Various indicators continue to point stress in credit markets (i.e. LIBOR-OIS spread), EM and BBB spreads have started to widen after ignoring much of the weakness in short-term lending markets.



As opined here two weeks ago: “Having said that, recent events may be seen as letting the genie getting out of the bottle and the next advance could become part of a bigger topping process. But history seems to suggest that this process usually takes more time to play out.” As said last week: “We believe that some cracks in the foundation of this bull market have started to become more visible and a change in trend could occur in the coming months.”

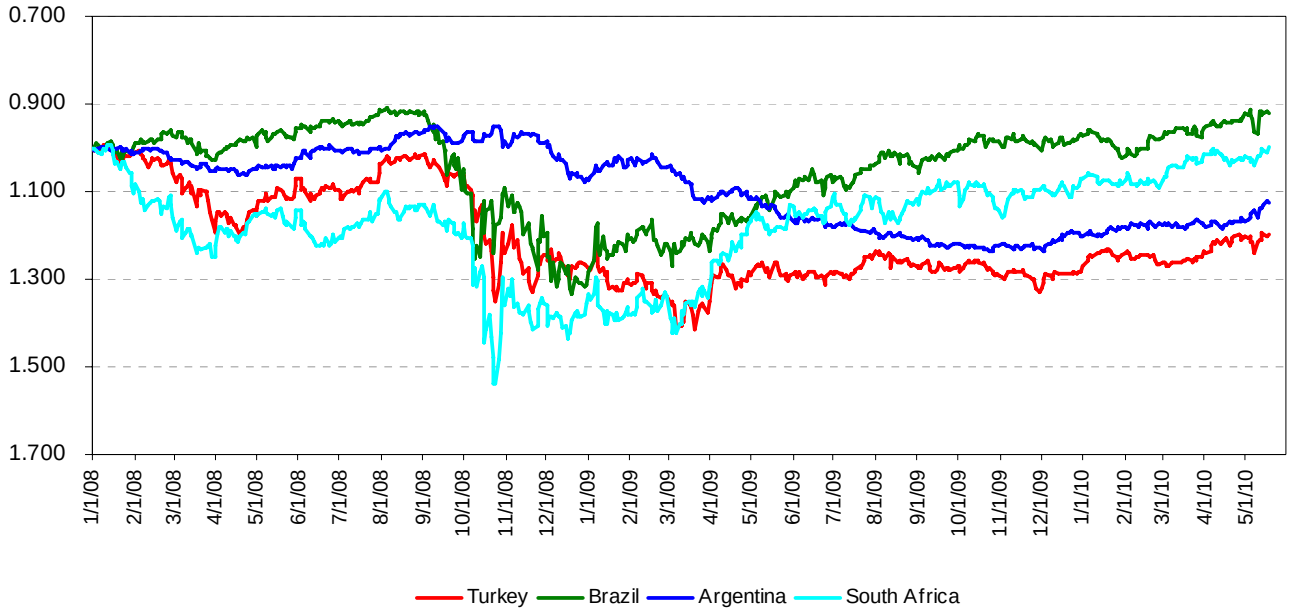


We believe it’s good news that sentiment has turned more pessimistic (i.e. the EUREX put/call ratio has moved to an all-time high, implying bearish sentiment) but we have yet to see a change in tone out of credit land which will serve as an important indication that the foundation for a longer bounce is in place. However, the coming bounce in risk assets could be occurring within a topping process and could stall at recent highs (i.e. at SPX at around 1200).

1.4 Appendix

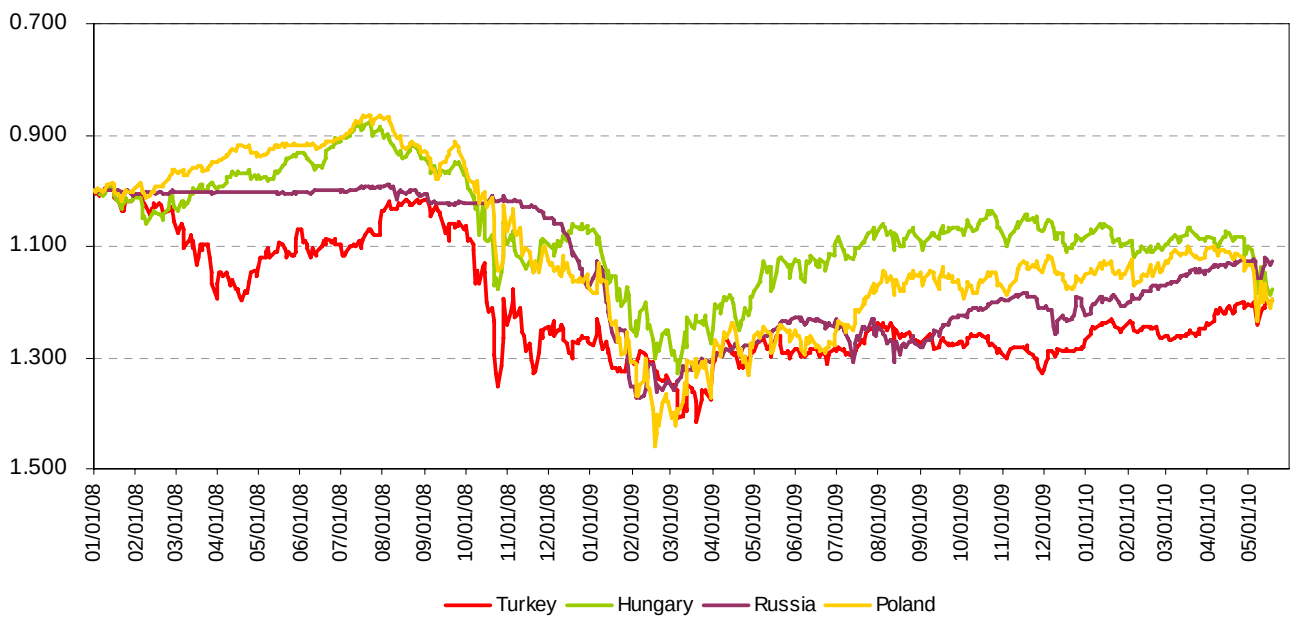
Currency Performances

Figure. Turkey, South Africa, Latin America 1/Jan/2008=1.00 (*)



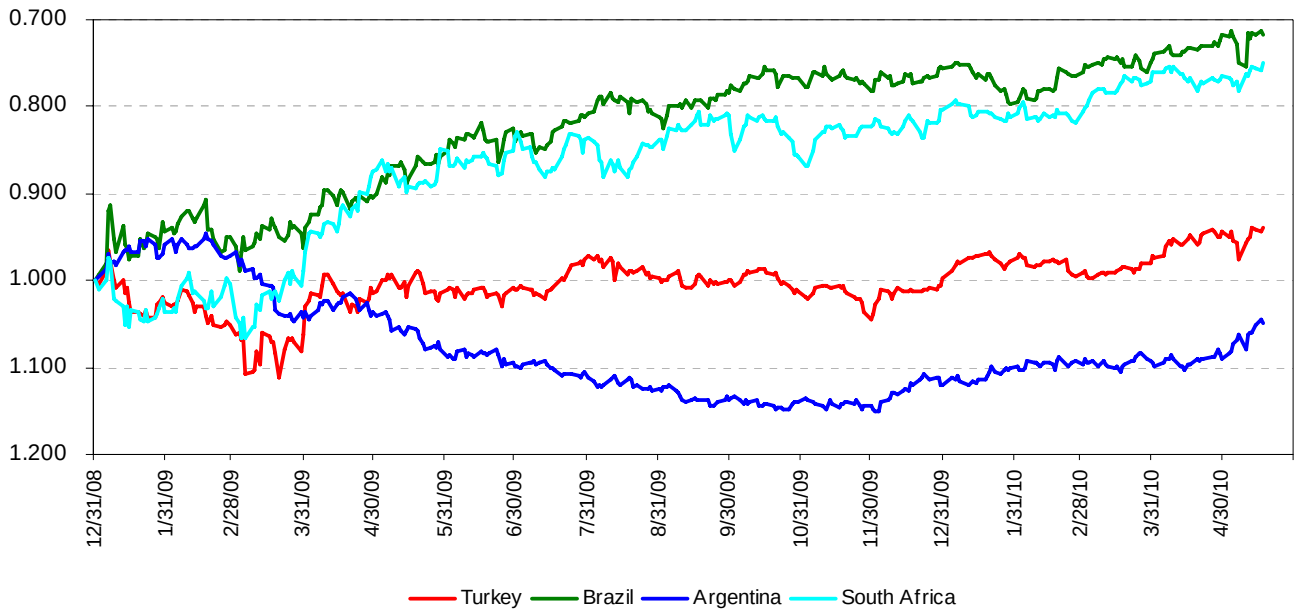
Source: Reuters, Yapı Kredi Economic Research

Figure. Turkey, Eastern Europe 1/Jan/2008=1.00 (*)



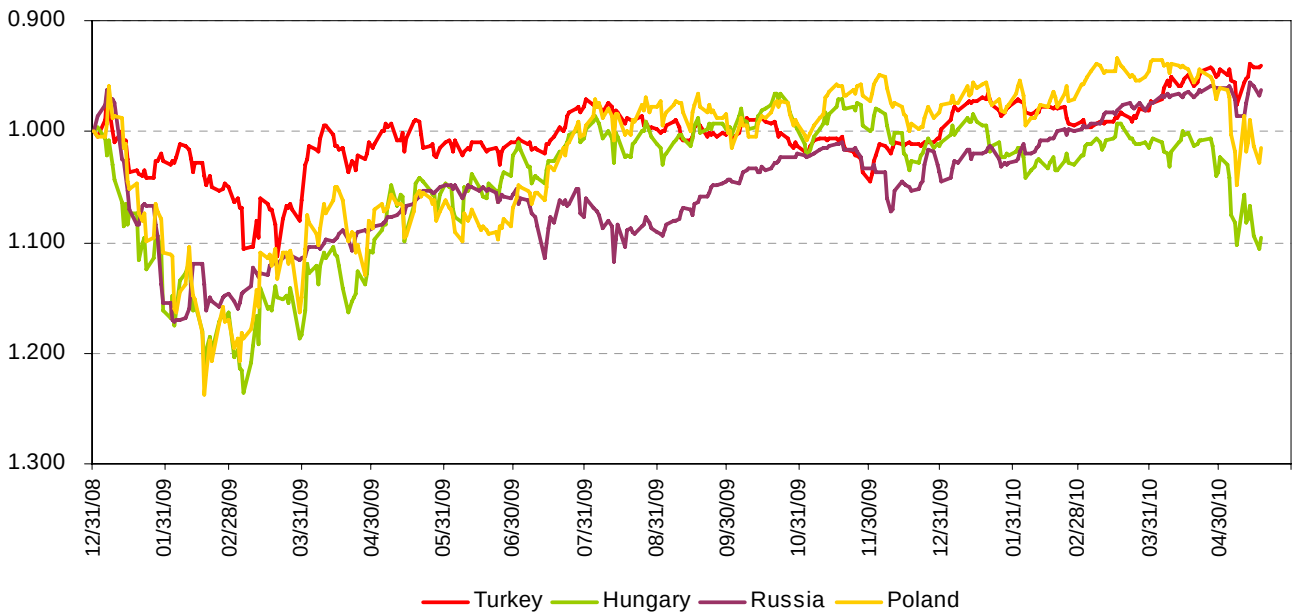
Source: Reuters, Yapı Kredi Economic Research

Figure. Turkey, South Africa, Latin America 1/Jan/2009=1.00 (*)



Source: Reuters, Yapı Kredi Economic Research

Figure. Turkey, Eastern Europe 1/Jan/2009=1.00 (*)

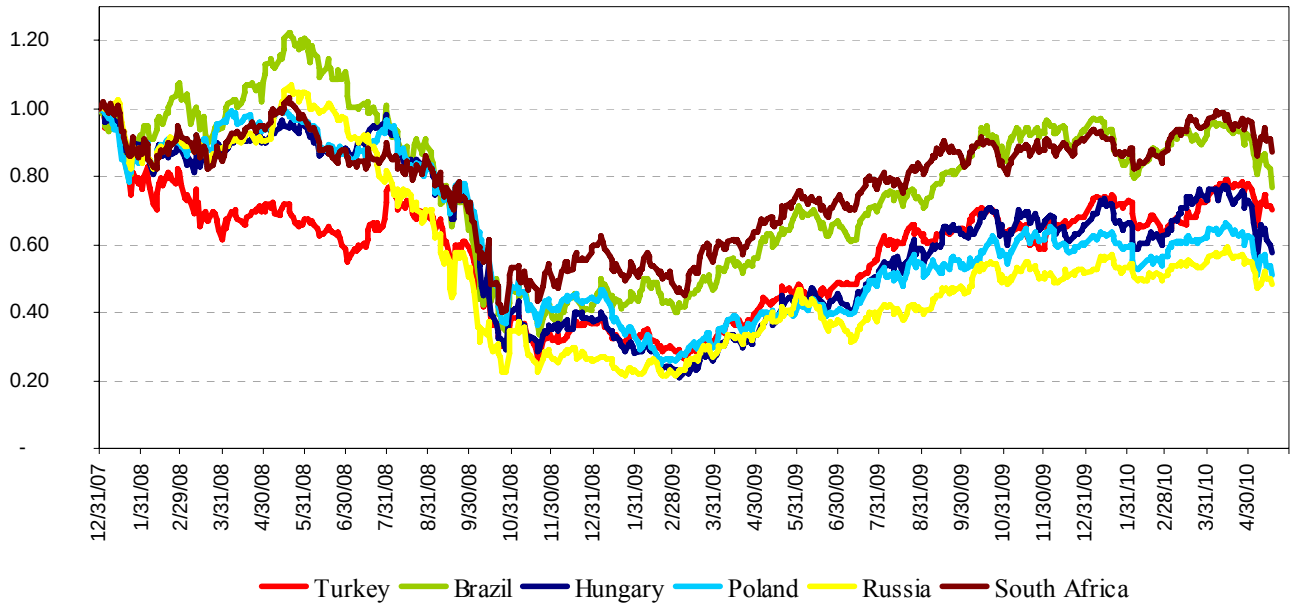


Source: Reuters, Yapı Kredi Economic Research

(*) Currency performances are calculated against a basket consisting of 0,5 USD+0,5 EUR to neutralize movements of the USD/EUR rate. Y axes in the graphs are inverted. Hence downward move of the curve means depreciation of the currency

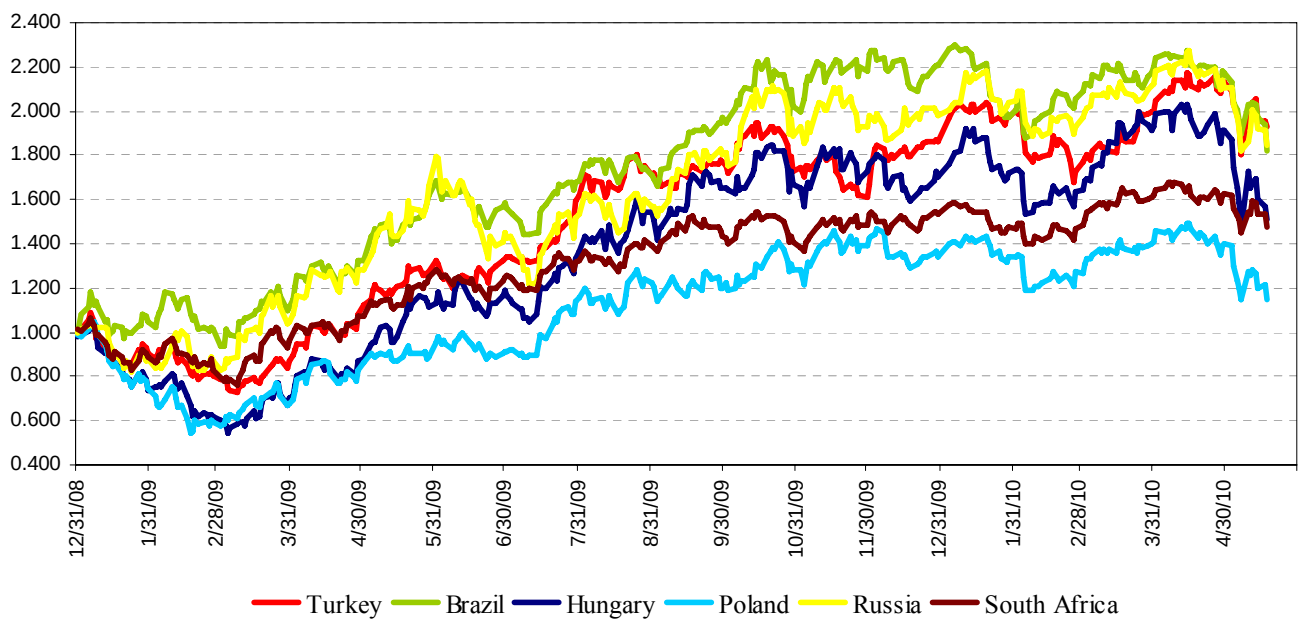
MSCI

Figure. MSCI Turkey versus Other Selected Emerging Markets (12/31/2007=1.00)



Source: Reuters, Yapı Kredi Economic Research

Figure. MSCI Turkey versus Other Selected Emerging Markets (12/31/2008=1.00)



Source: Reuters, Yapı Kredi Economic Research

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