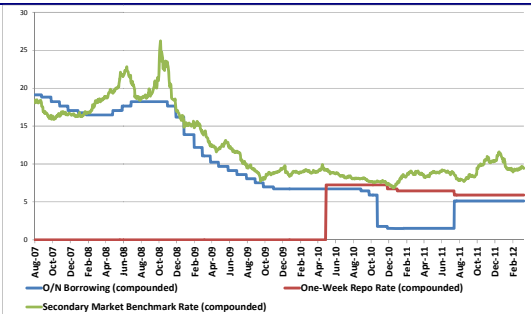


# Turkey Weekly Macro Comment

02 April 2012

## Bond Rates vs O/N

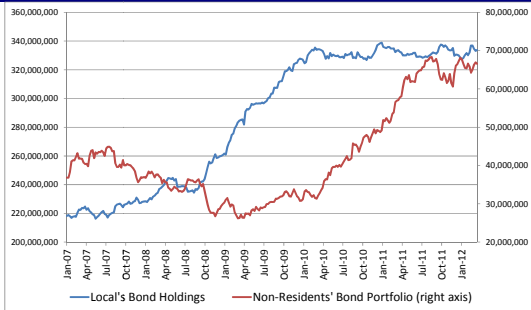


Source: Central Bank of Turkey, YK Economic Research

## Confusion during Divergence and Convergence Alike

- 2011 GDP numbers were announced this morning and our long held view of perverse growth dynamics is coming to an end very much the way we had anticipated.
- 2012 will presumably serve as a “transition year” and when end of 2012 GDP numbers are announced next year, they should not be celebrated as signals of a new era whereby Turkish growth will register contributions from net exports on a sustainable basis.
- Foreign trade data for February was the story of last week and most market analysts were “pleasantly surprised” by the figure of USD 5.9 billion which was roughly 20% less than their expectations. Systemic surprises (??) indeed seem to be on the way.
- A short paragraph inside on research culture in financial markets based on our experience alone; intended only for the interested.

## Domestic & Foreign Bond Portfolios



Source: Central Bank of Turkey, YK Economic Research

**Cevdet Akçay**

Chief Economist, Yapı Kredi Bank & Yapı Kredi Yatırım

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

## **Confusion during Divergence and Convergence Alike**

2011 GDP numbers were announced this morning and our long held view of perverse growth dynamics is coming to an end very much the way we had anticipated. The more interesting question has been for some time the current account dynamics that is naturally linked to growth; market consensus was, and still is, that current account dynamics will not be affected in a discernible fashion by the reduction in growth (what we call the “normalization” of the growth process). More on that below when we talk about foreign trade data, but here are a few takes on GDP numbers announced:

- i) Taking into account the most recent figures including revisions done as of 1Q2010, annual GDP growth rates of 9.2% and 8.5% in 2010 and 2011, respectively, are nothing short of breath-taking by any standards. Yet, they do not necessarily depict a costless “achievement” in the sense that a surging current account deficit most of the time overshadowed the growth story and made any feasible prospective growth story less doable than it actually would be.
- ii) These two annual growth figures came on top of a minus 4.9% in 2009 and thus correspond to very significant output volatility; indeed, one that is presumably unprecedented in the EM realm. A 14 percentage point change in output growth maintained at its new high level for another year could be a great sales pitch for a politician but output volatility is not a very innocent concept very much like any other volatility from an economist’s standpoint. Growthmania was closely linked to the surge in loans and made the slowing down process questionable although for all the wrong reasons (perceptions matter for sure, and the perception had been for a very long time that the CBRT was messing up with monetary theory, trying to be too innovative, and thus flunking big time its cooling down and disinflation tests).
- iii) Growth is normalizing once again and 2012 will serve more like a transition year, we believe. If one looks at the contribution of categories with respect to the expenditures method, 2011 was mostly a typical high growth picture for Turkey:
  - a) Private consumption and private investment expenditures led the way in terms of contribution to growth with 5.3 and 4.5 percentage point contributions, respectively.

- b) Public sector consumption and investment expenditures contributed less than 0.5 percentage points, demonstrating once again that you are dealing with one of the most private sector led economies in the world. Reliance on private sector for growth purposes is a theme that will remain intact for the foreseeable future here.
- c) Net exports stole from growth but not in a striking manner. The contribution stood at a mere minus 1.4 percentage points. We expect this innate trait of the Turkish economy to be reversed in 2012 due to “normalization” of growth, as we stated numerous times in our reports before. 2012 will most presumably register a growth rate above 4% quite in contrast to all expectations in the market and the contribution of net exports will be positive in a somewhat unusual fashion. This is solely from the “transition year” nature of 2012 and should be celebrated as the beginning of a new era whereby Turkish growth will register contributions from net exports on a sustainable basis. That still looks like a virtual impossibility at the moment, but there is a window of opportunity which might be taken advantage of and used to mitigate the (negative) impact of net exports on growth in reasonably high growth years. Our Discussion Piece titled “Only Seeking License to Speculate on Current Account Dynamics” pointed to the existence of this window of opportunity in its conclusion section and we believe the prospect is still very much alive.<sup>1</sup>

As for Q4 figures alone, it was quite interesting to observe that the biggest contribution came from net exports, 3.2 percentage points, in a reasonably high growth quarter and that is further testimony to our long-held “normalization but no recession” view (normalization overall and transition year 2012 bets). Public sector contribution was a total of minus 1.1 percentage points, fully negating the 1.1 percentage point contribution coming from private sector investments. Hence, Q4 is not a very typical “reasonable growth” quarter and we should observe this unorthodox growth dynamics to continue in a weaker sense in 2012 and phase out gradually. What will be left at the end, hopefully, will be a more balanced growth dynamics with reliance on domestic absorption somewhat reduced. If the contribution of net

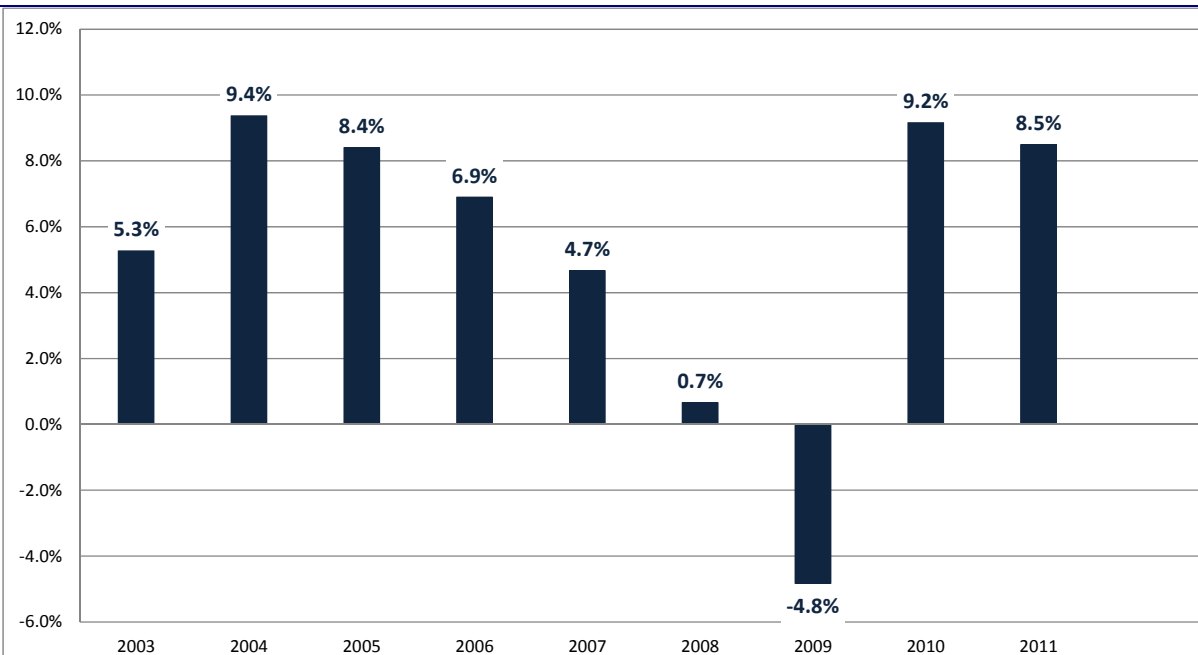
---

<sup>1</sup>[http://www.ykyatirim.com.tr/discussion/discussion/Only%20Seeking%20License%20to%20Speculate%20on%20Current%20Account%20Dynamics-9\\_Mar\\_2012.pdf](http://www.ykyatirim.com.tr/discussion/discussion/Only%20Seeking%20License%20to%20Speculate%20on%20Current%20Account%20Dynamics-9_Mar_2012.pdf)

exports converges to zero in the immediate future while growth remains reasonably high, that would be an immense success story by Turkish standards. We do not have the double-filtered decomposed GDP figures in expenditure-category basis, but in seasonally adjusted terms, QoQ changes are all negative with the exception of private investment (private consumption and public spending being the other items). Double-filtered result will presumably be the same, but we do not have that at the moment.

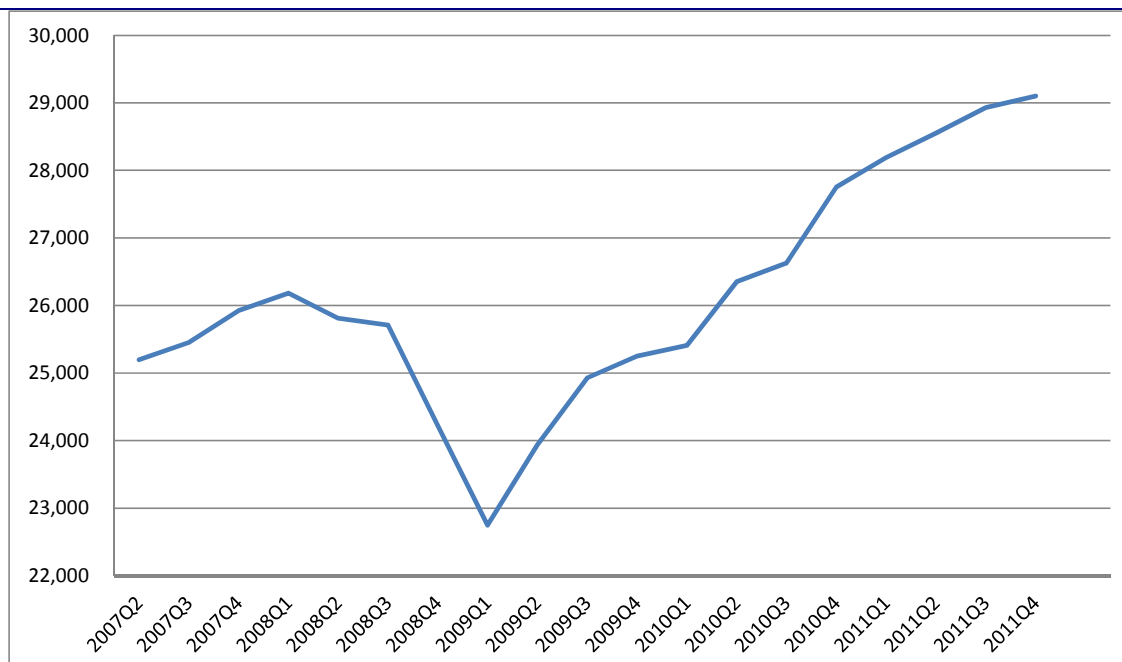
Forecasting or even extracting the trend in GDP is a very difficult task in Turkey due to data limitations. Any attempt that includes the pre-2003 period is likely to distort the picture in an incurable fashion and post-2003 period is simply too short to use for statistical purposes. The best proxy for trend is presumably the double filtered QoQ growth series. A rudimentary approach to that series (charted below alongside other GDP graphs) indicates that there is a visible yet tamed slowdown tendency in the economy which is indeed welcome following two years of spectacular yet unsustainable growth rates.

#### GDP Growth YoY



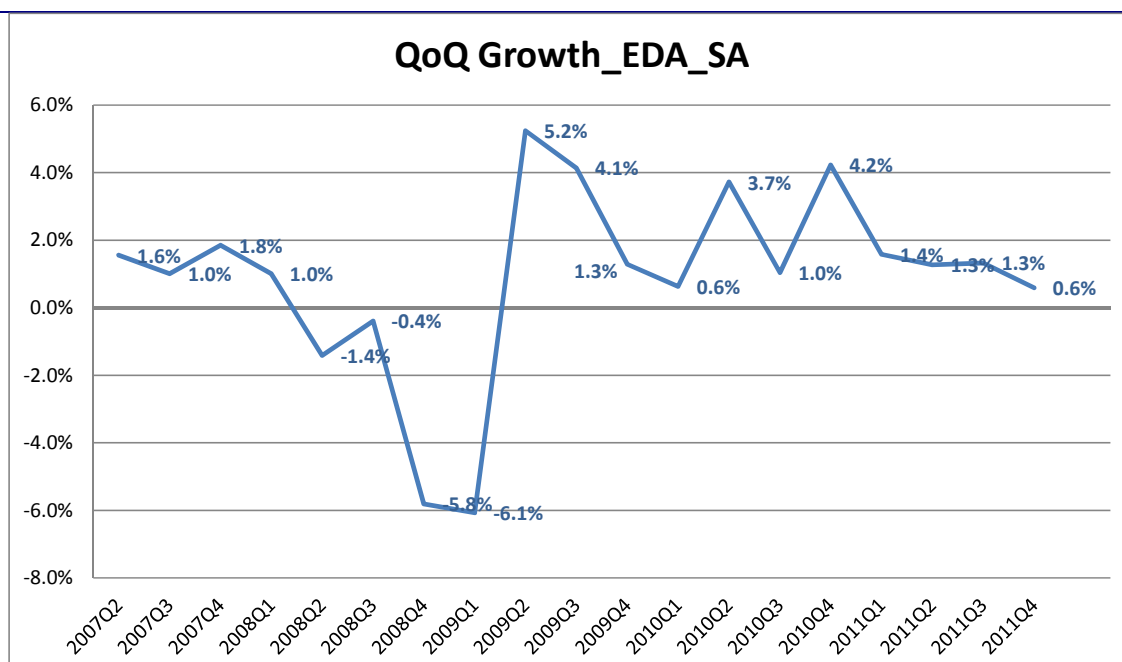
Source: TURKSTAT

### GDP Level (Seasonally and Working Day Adjusted Series)



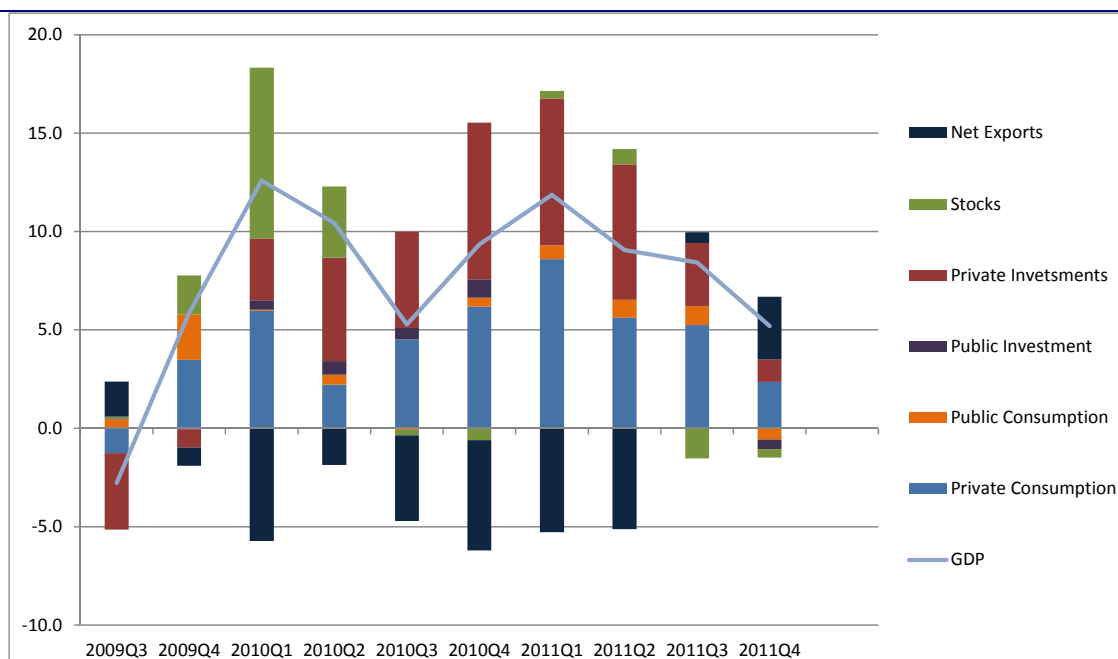
Source: TURKSTAT

### GDP Growth ( QoQ - Seasonally and Working Day Adjusted Series)



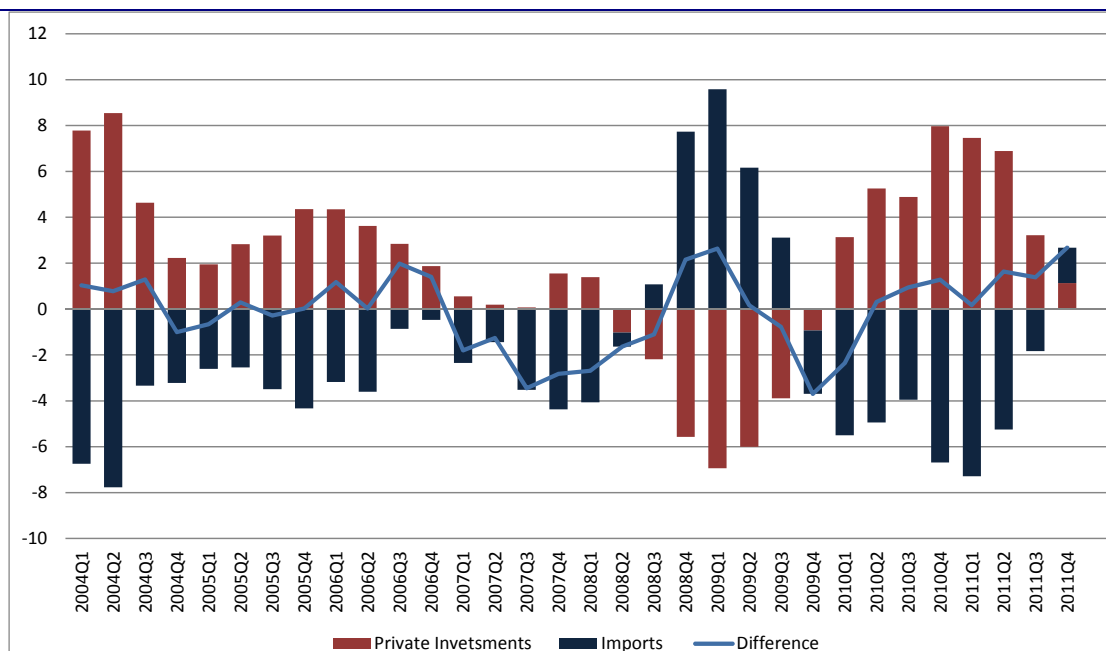
Source: TURKSTAT

## Contributions to GDP



Source: TURKSTAT

## Contributions to GDP – Private Investments vs. Imports

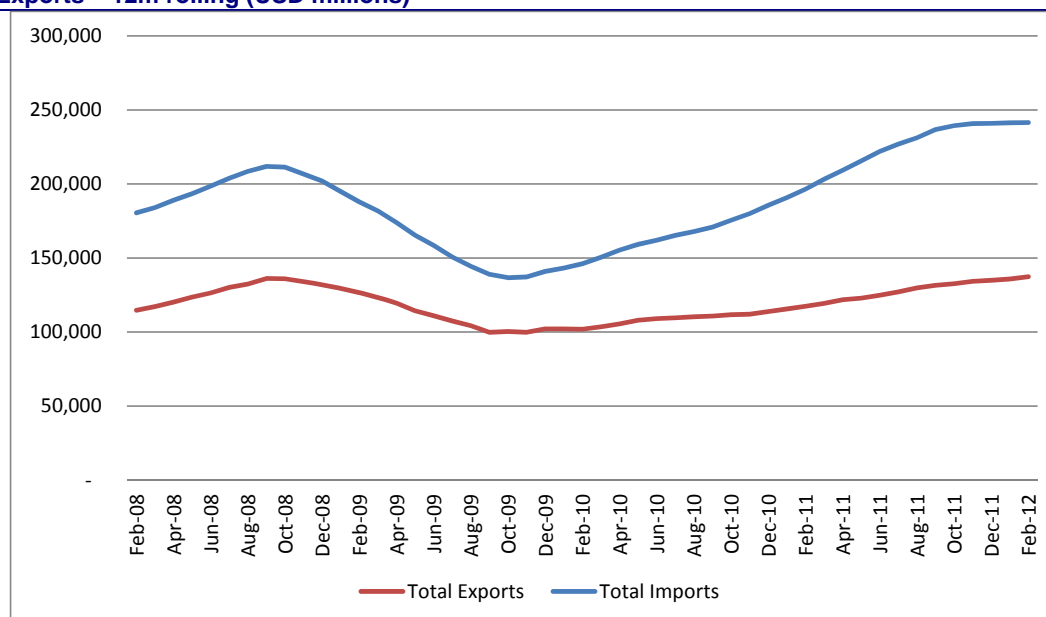


Source: TURKSTAT

Foreign trade data for February was the story of last week and most market analysts were “pleasantly surprised” by the figure of USD 5.9 billion which was roughly 20% less than their expectations. Some were so taken aback by the figure that one trade report ended talking

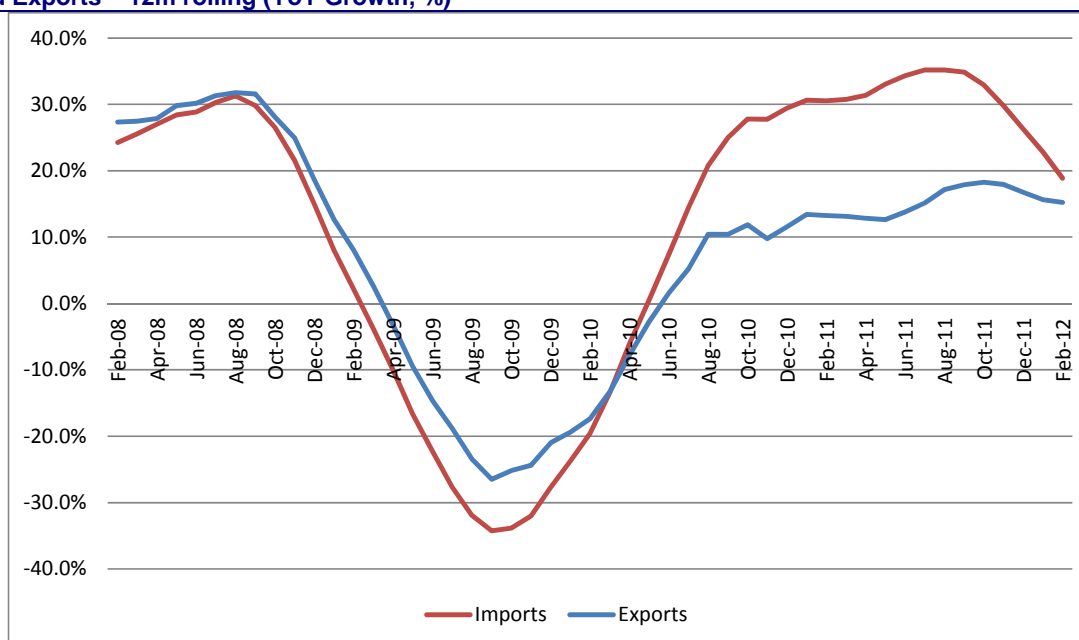
about core inflation while another said trade balance was easing because growth reversed from its peak (must by default be referring to imports as imports are a function of income) though it said inside that exports were the main driver. Almost all reports contain a “we had said so” aura but we do not remember a single soul who had truly said markets would be pleasantly surprised by lower than anticipated deficit numbers on the external front. We had not seen a single piece of research that pointed to either that or to the consensus view that CAD would NOT be coming down though growth would be reduced discernibly. The data can be confounding if processing is not done with rigor. Then you end up seeking a counterpart to your confusion in the policy maker’s reaction set; a state of affairs that we described as “confirmation bias” on the part of some analysts. Evidence of this bias continues to erupt almost on a daily basis and trade data is the most recent case of that.

Imports and Exports – 12m rolling (USD millions)



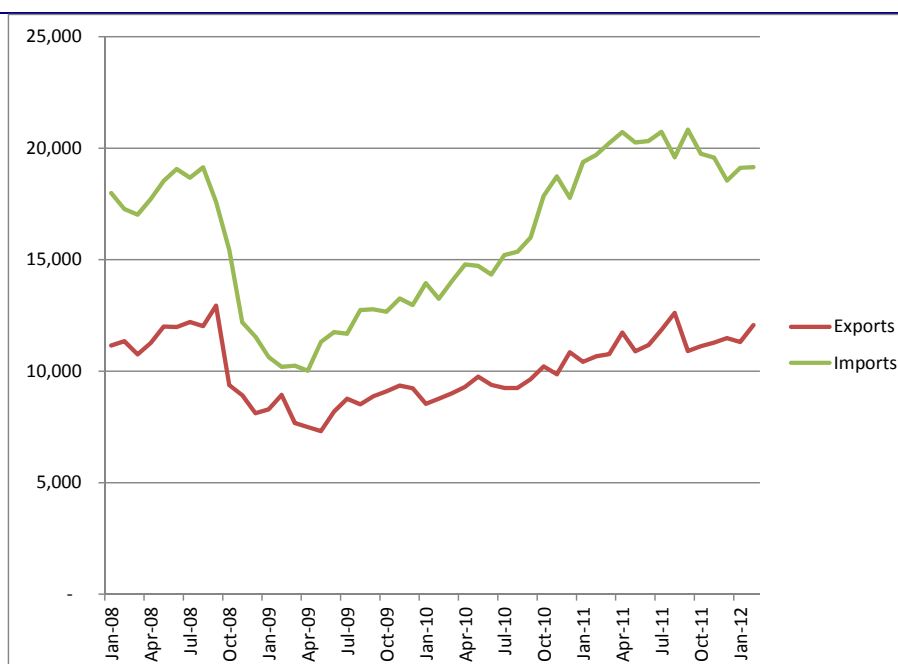
Source: Turkstat, YK Economic Research

### Imports and Exports – 12m rolling (YoY Growth, %)



Source: Turkstat, YK Economic Research

### Imports and Exports - Monthly (USD millions) –Working Day and Seasonally Adjusted series



Source: Turkstat, YK Economic Research

We have published quite a number of research pieces that suggested the exact opposite of the consensus view. And, we had said in each case that these were ultimately statistical pieces of

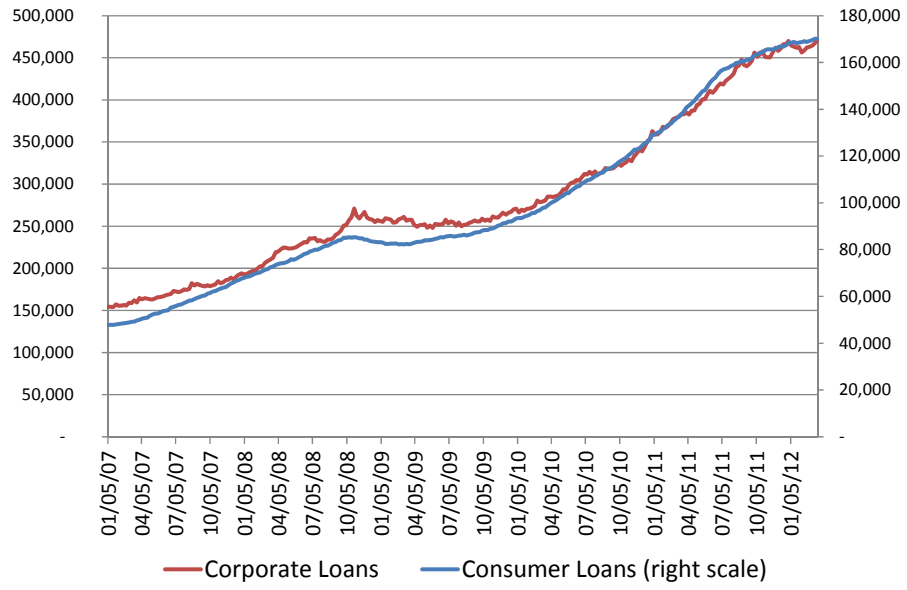


research that contained uncertainty as an innate nature no matter how immaculate and impeccable we tried to keep out methodology. Hence, we refrained from making bold statements by default and our inferences which shaped our view should be taken with a dose of caution, we warned our readers. What has been striking to us was the abundance of bold views/statements with hardly any decent piece of research backing them up. When we confronted such views, and only on the basis of research conducted by ourselves, we ended up being opinionated contrarians, an outcome we still have trouble understanding. The basic problem seems to be the following as much as we can define it: what we attempt to do here is research related to macro/market issues. Inevitably, we use statistical tools as empirical work is the only area in financial markets that one can indulge in “academically” so to speak. Theoretical modelling falls into the realm of hard core academics. Nevertheless, research in financial markets is still quite akin to empirical research in academia but it seems to be subject to totally different criteria, a much looser one indeed. When much more is at stake in markets than in academia, why pointing to a flaw in a piece/report/research is unacceptable is beyond us. Academia is much harsher and more cut-throat than markets when it comes to assessment of written work, and the lackadaisical attitude of markets in this respect is tantamount to a gentlemen’s agreement for all the wrong reasons. In a world where expectations and their shaping is of pivotal importance, a joint effort to end up in the most plausible seems to be devoutly rejected and we all end up in a setting where everyone is entitled to his/her opinion regardless of the soundness of the backing material. It is a quite inefficient way of accumulating knowledge if nothing else.

### **Weekly Data (all weekly data terminate on March 16, 2012)**

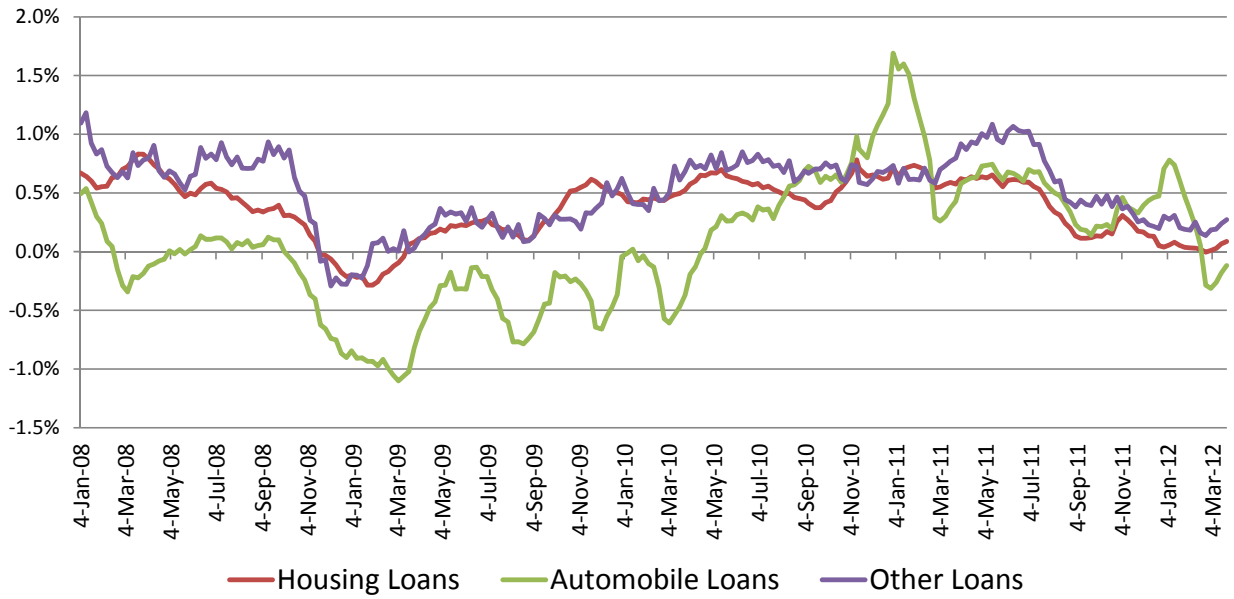
Just a single sentence regarding loans in general: despite the reasonable increases in loan volumes on a weekly basis as opposed to the misleading recession prone outlook in loans a few weeks ago, YoY increase in loans will continue to come down; yet another indicator of the “normalization” process we had bet on a long time ago.

### Consumer/Commercial Credits - Levels



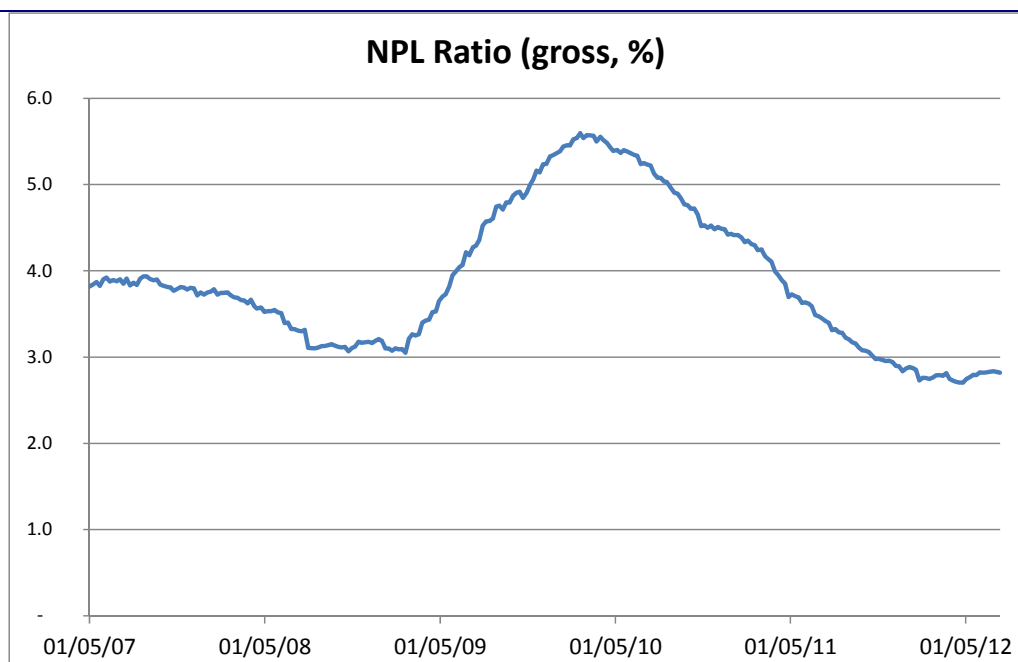
Source: Central Bank of Turkey, Yapı Kredi Economic Research

### Consumer Credit Volume (\*)



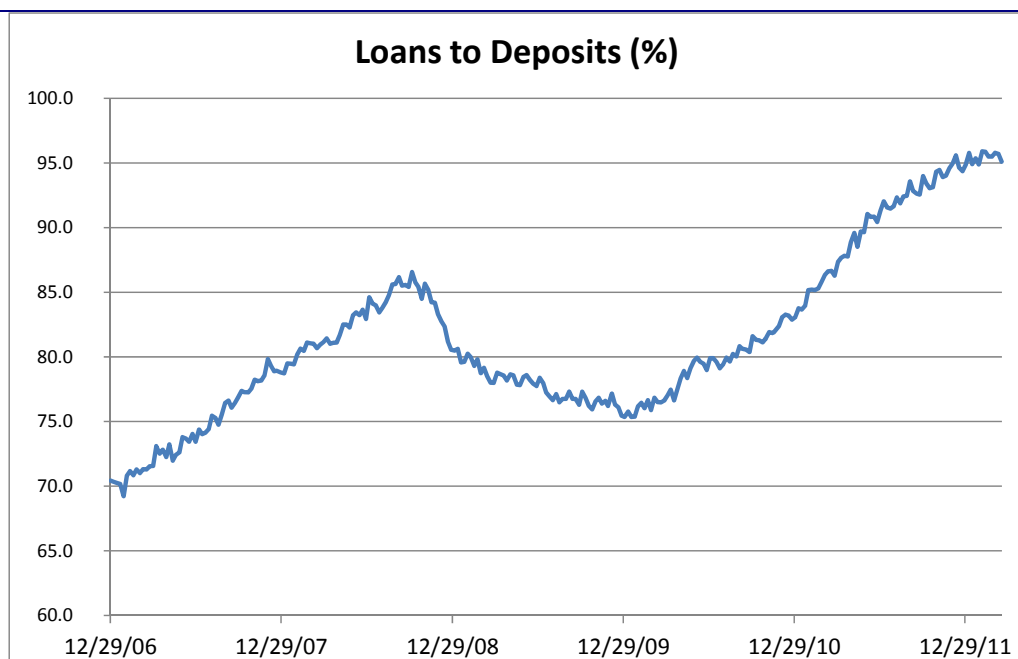
Source: Central Bank of Turkey, Yapı Kredi Economic Research  
(\*) Weekly % change of 8W average

## 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*

### **Stagflationary Impulses and the Real Big Picture Risk**

*"The compulsion to take ourselves seriously is in inverse proportion to our creative capacity. When the creative flow dries up, all we have left is our importance."*

*"In a time of drastic change it is the learners who inherit the future. The learned usually find themselves equipped only to live in a world that no longer exists."*

—Eric Hoffer

*"The final consideration influencing the reader's attitude to this proposal must, however, depend on his view as to the future place in the world's progress of the vast paper entanglements which are our legacy from war finance both at home and abroad. The war has ended with every one owing every one else immense sums of money. Germany owes a large sum to the Allies, the Allies owe a large sum to Great Britain, and Great Britain owes a large sum to the United States. The holders of war loan in every country are owed a large sum by the State, and the State in its turn is owed a large sum by these and other taxpayers. The whole position is in the highest degree artificial, misleading, and vexatious. We shall never be able to move again, unless we can free our limbs from these paper shackles."*

John Maynard Keynes, "Economic Consequences of the Peace", written in the aftermath of the Versailles Treaty

The market debate seems to remain framed as bright versus dark, or goldilocks vs doom. But data as well as the current global conjecture suggest that the debate might shift off its current dichotomy. The internal logic of current policies is likely to propel the trajectory forward to a non-binary/middle ground conclusion. This possibility should figure into any serious investment thesis, in our view.

When markets are depressed it usually leads to forecasters reducing their forecasts and vice versa. Thus, it's not a great surprise that our excellent macro research team was seen as too bullish in 4Q 2011 but looks relatively (vs market expectations) bearish now on growth without actually having changed their growth forecast!

As a tangent, our macro research team had been calling for improvement in the trade balances for a long time based on research they had conducted (would be happy to provide relevant pieces upon request) and were also a bit taken aback by expectations of a reduction in trade/CA deficit with respect to its timing in the sense that reduction expectations in the market were a bit premature.

Thus, for market analysts macro matters a great deal and the difference between a “market consensus” of a group of economic variables and the actual readings is important. For markets, the direction of incremental change (second derivative) matters as well.

Thus, softer than expected data generally lead to downwards revisions with a lag, thus the second derivative becomes negative. At that point market moods usually start to change. Or when actual data starts to disappoint relative to expectations, markets can get in a negative mood, even if the fundamental reality has not changed that much.

Since mid December 2011, markets in risk assets have been characterized by the reflationary sweet spot/goldilocks theme underpinned by low inflation, high growth and abundant liquidity perceptions. The latter is no longer valid and markets have been supported by a positive sentiment/data vs expectations lately, in our view. That support is also likely to become weaker in April and not necessarily due to a major worsening in data. In some ways it does it look like April 2011.

Despite the strong official China’s PMI reading, the unofficial PMI as well as various other Chinese data and the continued weakness in other global growth indicators is noteworthy. Among the latest examples are European and Asian data. Thus, South Korean Exports fell 1.4% on in March, and imports fell 1.2 percent providing yet another indication that the slowdown in world trade could turn out to be bigger than expected.

Also, “issues” in Europe may have slipped to page 3 recently but they could again become frontpage news quickly. Spain’s problems are more or less symptoms of more wide spread fundamental problems. Put most simply, some countries seem to be caught between increasing stagflationary forces and a need to curtail the budget deficit. Unfortunately without the “help” from exchange rates, most policy measures are likely to miss the main points and focus on loose monetary policy and tight fiscal policy. Given where the economies and the credit cycles currently stand, this mix could provide further stagflationary impulses.

a) Meanwhile, the optimism regarding the increased size of the firewall in Europe is likely to remain short-lived, suggesting that EUR rebounds should be seen as opportunities to sell. Maintain EUR/USD shorts.

b) While we do not expect a 1994 type bear market in bonds thanks to policymakers efforts and no exits from loose monetary policy in the foreseeable future, yields around the world seem to be close to bottom lows and it looks we're still in the basing phase. A broadly neutral stance for bonds seems appropriate.

c) The bottom line of stagflationary impulses, mature credit cycles and peak liquidity conditions is that company earnings are likely to flatten out in the months ahead and begin to slightly contract on a year over year basis based on slower growth, higher input costs amid generally limited end-pricing power. US equities may continue to outperform and drag other indexes up, but 1,440 on the S&P500 is likely to cap the year to date rally. Maintain short positions.

In the greater scheme of things, the result of competitive devaluations ("currency wars") and loose monetary policy around the world may be similar to the unintended consequence of leaving the international gold standard and allowing the dollar to devalue in 1971. The consequences of a rapid devaluation of the dollar was a surge of cost-push inflation and rising macro volatility. While, it "helped" in deflating debt in real terms, the devaluation combined with geopolitical events resulted and the political economy dynamics then resulted in cost-push inflation leading to a wage-price spiral. Due to differences like unionization levels and globalization among many others, a wage-price spiral is unlikely this time and that's why a "real" 1970s type stagflation is less likely. That said, latest unit labor costs rises (especially in the US) are interesting and may suggest that Philips curves and output gaps need to be taken with a pinch of salt.

In the last 1970s, entrenched inflation and the bear market in bonds was halted by interest rate shocks by Volker's Fed. However, this time around aggregate debt levels are simply too high and central bankers too keen on the "lessons" of previous debt deflation episodes to invoke proactive policy tightening. Policymakers are likely to continue to be willing to err on the side of being "easy".

Thus, both inflationists who expect run-away price increases and deflationists who expect 1930s type deflation are likely to be proved wrong.

Anyone who is absolutely sure that the Weimar Hyperinflation resulted from the mistake of Rudolf von Havenstein (president of the Reichsbank) printing just too much money may be mixing cause and effect. Also, suggesting fiat currencies and irresponsible policymakers are to blame for every problem, misses the point. A variant of this view is that since policymakers are always mismanaging the economy, the discipline of a gold standard is needed. That's becoming a popular belief again, but it's probably not based on a non/less biased reading of history. The Panic of 1873 and 1893 and the

following depressions, the long recession of 1900-1904, the Panic of 1907 are among examples of panic and economic depressions that happened in an era when the dollar was on the strictest of gold standards and the Fed was not yet formed. Also Britain in the post-WW1 period is another example. Having returned soon after the War to the gold standard (though at an exchange rate that was too high according most historians), Britain spent the 1920s trying to defend that high exchange rate by means of high real interest rates leading Britain into a long recession even well before 1929.

Reading and rereading history and many original texts, it seems to me that, perhaps the great thinkers” (including both “Austrians” and people like Keynes and Minsky) and their important insights were somewhat lost or diluted along the way. The real issue may not be whether growth or inflation rises or declines by this and that. The real risks probably lie not in the economic sphere per se but in the interaction and feedback loops between the financial, economic and geopolitical spheres and the fact that there are so interconnected. Please read the above Keynes quote with this idea in mind, and you may see a different picture starting to emerge.

#### DISCLAIMER

All information enclosed in this e-mail and document has been obtained from sources believed to be reliable and accurate but which without further investigation cannot be warranted as to their accuracy or completeness. There may also appear opinions which are of non-factual nature and subject to change without notice for which Yapı Kredi Yatırım Menkul Değerler A.Ş. cannot be held responsible. This document and its contents are provided solely for the recipient(s), who is/are expected to make their own investment decisions without undue reliance on any information contained in this e-mail. In no circumstances should any information contained herein be used or considered as an offer to sell or a solicitation of any offer to buy the securities or commodities mentioned. Any of the directors, officers or employees of Yapı Kredi Yatırım Menkul Değerler A.Ş. or of their affiliates may serve as a director for companies mentioned in this document. From time to time, Yapı Kredi Yatırım Menkul Değerler A.Ş. and any of its directors, officers, employees or representatives, directly or indirectly, may have positions or otherwise be interested in any transactions, in any securities, or in any commodities mentioned. The views and opinions expressed in this document belong to the members of the Research Team of Yapı Kredi Yatırım Menkul Değerler A.Ş. and do not represent views and opinions of the Yapı Kredi Yatırım Menkul Değerler A.Ş. management. It is possible that individuals employed by Yapı Kredi Yatırım Menkul Değerler A.Ş. elsewhere or affiliates of Yapı Kredi Yatırım Menkul Değerler A.Ş. may disagree with the recommendations or opinions in this document. Yapı Kredi Yatırım Menkul Değerler A.Ş. or their affiliates may, from time to time, perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this document. This document is for the use of addressees only. It may not be copied or distributed to any other persons without the written consent of Yapı Kredi Yatırım Menkul Değerler A.Ş.