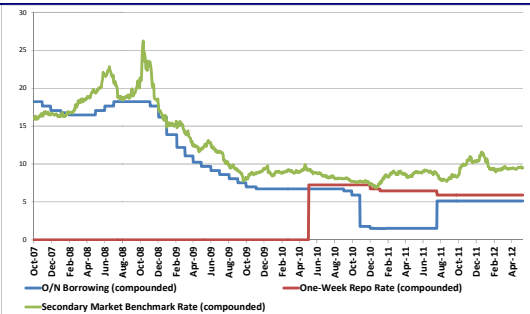


# Turkey Weekly Macro Comment

28 May 2012

## Bond Rates vs O/N

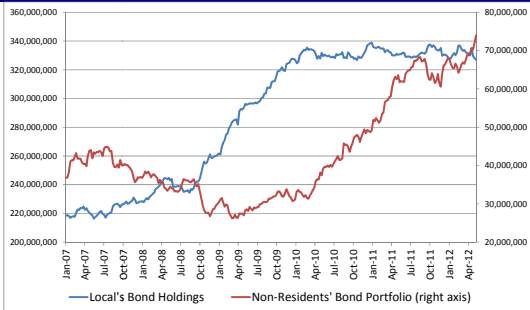


Source: Central Bank of Turkey, YK Economic Research

## Another Take on Political Normalization by a Novice of Politics

- We would like to retreat from what we had said some months or roughly a year ago about the disappearance of the political commentary from our Weekly and temporarily make a political comment about what is recently going on in Turkey; that is to say, about the confusion created (intentionally?) by the AKP command chain including PM Erdogan himself at the forefront of it all.
- As abrupt and unexpected as last week's incidents may seem or as chaotic the setting may accordingly look at the moment, there is a bigger implication that all this mess intrinsically pushes to the very surface of political realm here in Turkey: further normalization of politics.
- This may not be very intuitive and may even sound paradoxical if your benchmark of normalization is biased. More on this and the absence of any paradox inside.
- The loss of momentum in industrial production story that we had been displaying for some time is fully compatible with the capacity utilization data releases of late.
- The most striking piece of data in the weekly set may as well be the significant increase in the absolute size and also the share of non-residents in the bond market.

## Domestic & Foreign Bond Portfolios



Source: Central Bank of Turkey, YK Economic Research

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## **Another Take on Political Normalization by a Novice of Politics**

It is yet another fairly weak week in terms of economic data and we will briefly touch upon those that were released last year. But first, we would like to retreat from what we had said some months or roughly a year ago about the disappearance of the political commentary from our Weekly and temporarily make a political comment about what is recently going on in Turkey; that is to say, about the confusion created (intentionally?) by the AKP command chain including PM Erdogan himself at the forefront of it all.

The extremely unfortunate Uludere incident whereby 34 citizens of Kurdish ethnicity were bombed and killed by fighter planes due to an intelligence screw up<sup>1</sup> culminated into something far exceeding its already high dramatic nature due to loss of lives. A current and an ex-minister clashed in a drastic fashion regarding the unapologetic rhetoric adopted by the current minister, the latter labeling it inhumane and anti-AKP, and the PM joined the bandwagon in a very shocking way by adjoining the abortion issue to Uludere incident. He explicitly compared the insensitivity shown toward lives lost due to abortion to the sensitivity shown towards loss of lives in Uludere, further claiming that efforts to discredit Turkey in the Uludere incident had some linkages to supposed efforts to reduce the fertility rate in Turkey. Regardless of how sensible, strategically tactful, or prospectively successful with respect to catching the pulse of the public at large this rhetoric will sound to you, there is a bigger implication that all this mess intrinsically pushes to the very surface of political realm here in Turkey: *further normalization of politics*.

This might sound paradoxical at first as one could easily come up with the following question, for instance: why bring the issue of abortion at a juncture like this even if your soul aim is to derail the agenda into a more manageable setting for you? My novice answer would be the following: there is not a designated answer to this question in particular but a broader one which suggests that more and clearer demarcation lines will inevitably show up in the realm of politics as those lines hitherto have been very bold and have been used to divide or categorize the voter base on the basis of vulgarly simple factors. The clash of rhetoric

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<sup>1</sup> Some hint at deliberate derailment of intelligence the ultimate aim of which was to put the AKP administration in a very vulnerable position vis-à-vis the people of the region. The investigation is still under way, but lack of transparency (which could be swallowed up to some point) and the duration of the so called investigation in particular are bothering those that are anxiously waiting for the announcement and punishment of those responsible for the killings. The administration, in turn, is asking for unconditional placement of public trust in them regarding the issue, which is understandably a problematic request in an incident of this order.

between two high ranked AKP officials and the abrupt introduction of a non-issue as a prime issue into Turkish politics is plainly indicative of this “diversification of demarcation lines” or the necessity to cross tabulate the voter base on the basis of a higher number of criteria. This is a phenomenon that is pushed forward by political normalization, period. Political entities either understand this and act proactively and thus ride on the wave of this normalization or they lag behind the transformation that continues mostly beyond their control and risk the danger of falling captive to that normalization.

At the expense of being quite crude and vulgar in terms of elucidation, let us try to explain what we mean only by using the issues introduced above. Until fairly recently, one could argue that there was only one demarcation line in Turkey which in a nutshell could be formulated as follows: do you fully respect the result of a democratically held election regardless of who turns out to be the victor or do you think certain circumstances could allow for the intervention of the State apparatus (the military, the judiciary, and the bureaucracy) into politics and let them rid the elected entity of its duly earned power to rule? While this might truly sound vulgar to our foreign readers, this *was* the *only* demarcation line in our early stage of normalization. It has turned out to be too vulgar to be true in today’s Turkey both due to normalization itself and also due to further issues in the normalization process which have given birth to new demarcation lines. Take the Kurdish issue (or saga rather), of which the Uludere incident is just one case, and the attitude towards solution suggestions. Those voters that still could be categorized with respect to the first demarcation line (although a significantly higher number of people seem to be leaning towards full respect for election results no matter how adverse the result could seem to them) could have within-category differences with respect to the Kurdish problem. Moreover, of those who fall into the same category with respect to the first and boldest demarcation line and also with respect to solution options could again differ amongst themselves with respect to the choice of rhetoric regarding the Uludere incident, and as we said before that difference is nothing trivial in terms of top down approach to politics here. Finally, as a teaser, add to this the seemingly out of nowhere abortion issue and you have, in a sense, a decision tree with an increasing number of branches, and these increasing number of branches correspond to different “politics” in the true sense of the word.

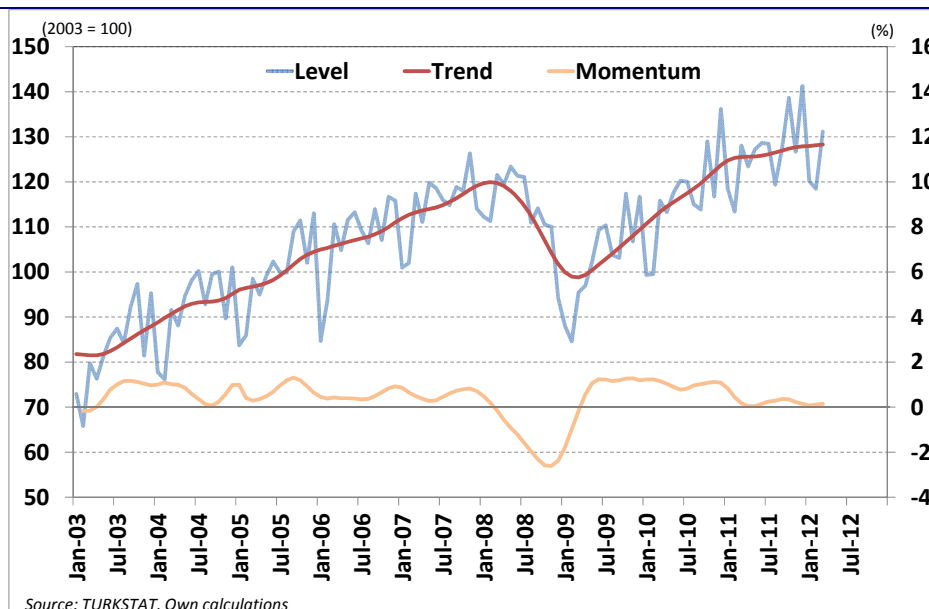
In short, here is our take: nothing in politics is indeed out of the blue; whatever takes place ultimately takes place for a reason and there is hardly any room for paradoxes in politics. It is

also wrong to think of politicians as agents that design and run politics, especially in transforming societies like Turkey. There are times when the evolution of society takes the lead and forces political agents to get “derailed”. The gist of our argument is that this is no derailment per se, but the outcome of the necessity for a political entity to redefine itself in a transforming society where bold demarcation lines are getting fainter and fainter over time and other lines are simultaneously emerging.

### Macro Data

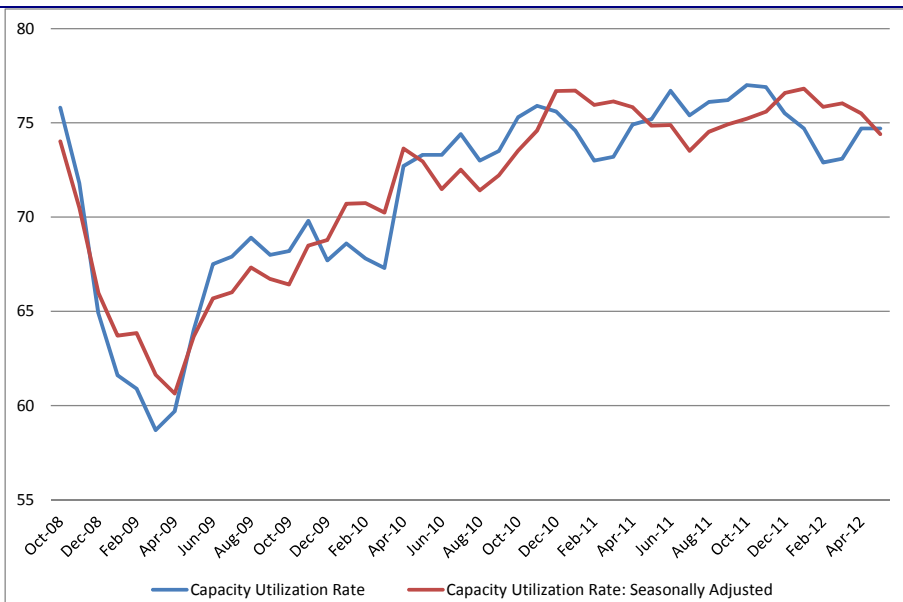
There is only one piece of data release from last week, capacity utilization, and it entails no surprises. Capacity utilization was constant in May at 74.7% with respect to the previous month, but was one percentage point less in seasonally adjusted terms. The loss of momentum in industrial production story that we had been displaying for some time is fully compatible with the capacity utilization data releases of late. The two pictures clearly depict the latest episode as of the end of 2011 as the period in which the loss of momentum in IP coincides with the reduction in capacity utilization tendency.

**Industrial Production ( Seasonally and Working Day Adjusted )**



Source: TURKSTAT, Own Calculations

## Capacity Utilization



Source: Central Bank of Turkey

We remind our readers once again that there is still nothing in these data that would provide support to a hard-landing scenario, the darling scenario of so many houses until very recently.

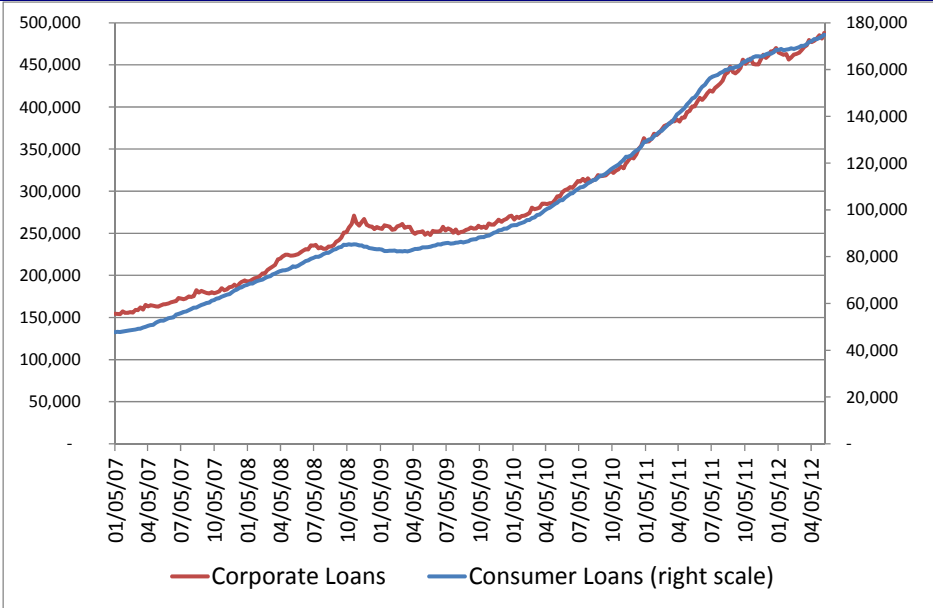
### **Weekly Data (all weekly data terminate on May 11, 2012 while consumer credits are one extra week updated)**

Consumer loans had a lackadaisical showing once again in the third week of May and the CBRT keeps a close eye on developments here as well as other variables that hinge on monetary policy, directly or with a transmission. The tight stance is likely to be maintained both due to the status of TL as of late (depreciating somewhat as a result of Euro area concerns) and also the intention of the CBRT to keep loan expansion under strict control in order not to facilitate a second 2011-like massive expansion.

The most striking piece of data in the weekly set may as well be the significant increase in the absolute size and also the share of non-residents in the bond market. Yield curve inversion

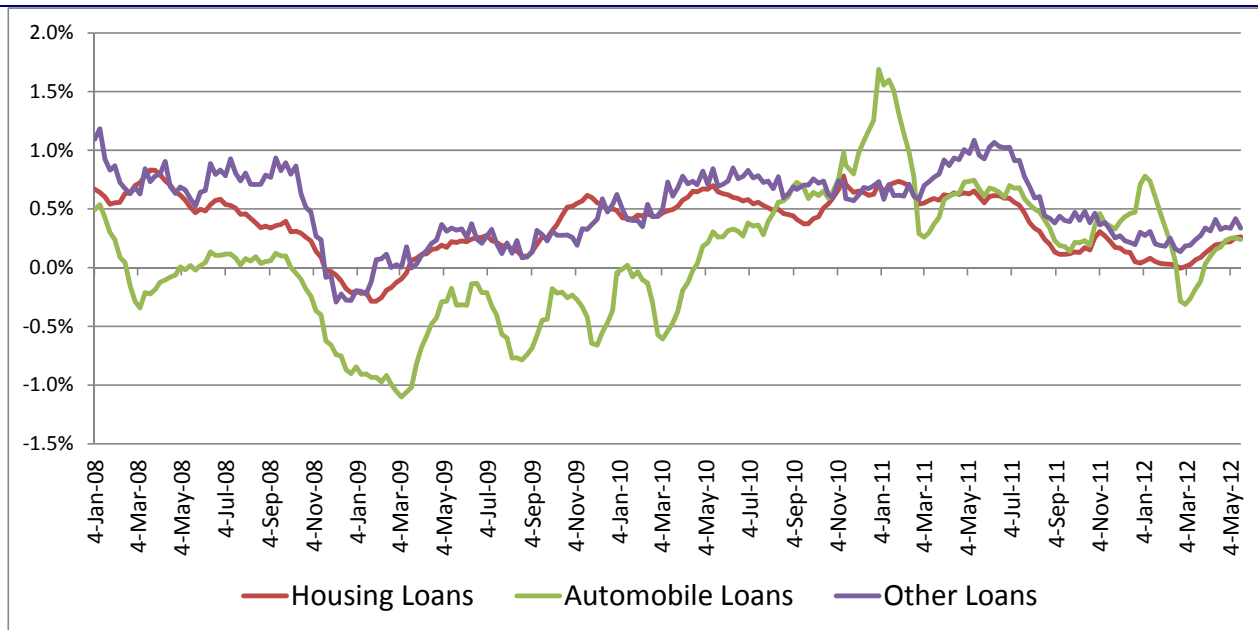
stemmed mostly from the nonresident appetite for longer tenor issues and that appetite is likely to remain intact going forward. A positive disinflation shock accompanied by decent growth and/or rating upgrade to investment status will serve as a game-changer for the longer end, we believe.

**Consumer/Commercial Credits - Levels**



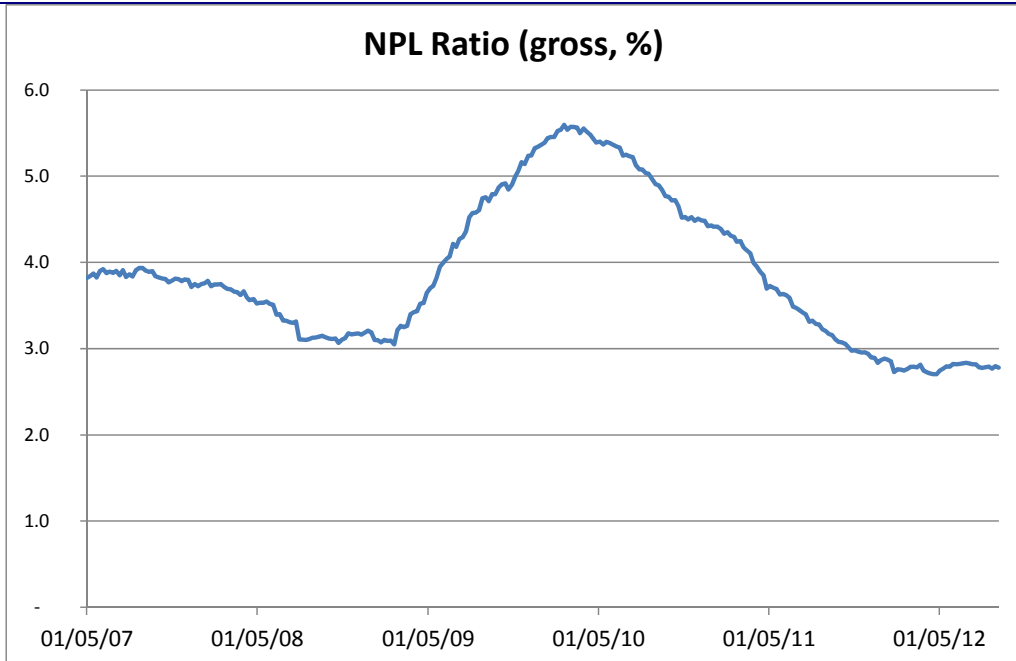
Source: Central Bank of Turkey, Yapı Kredi Economic Research

**Consumer Credit Volume (\*)**



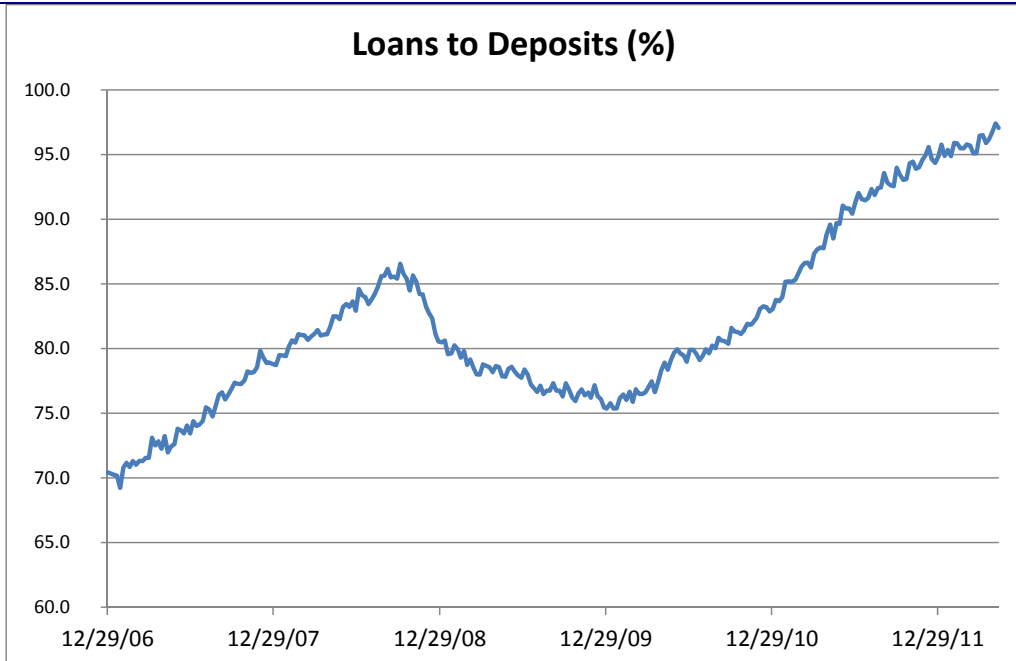
Source: Central Bank of Turkey, Yapı Kredi Economic Research  
 (\*)Weekly % change of 8W average

**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*

### **Looking Beyond the Immediate Horizon-Part 3: Forever Young**

*Lets dance in style, lets dance for a while.  
Heaven can wait were only watching the skies.  
Hoping for the best but expecting the worst.  
Are you gonna drop the bomb or not?  
Forever Young-Alphaville*

*“Every one imagined two works; to no one did it occur that the book and the maze were one and the same thing.”  
Jorge Luis Borges-The Garden of Forking Paths*

Hegel’s view of history became enormously influential in politics more through the writings of those influenced by him.

Still, the spread of Hegel’s ideas isn’t limited to the politics. I think most people who have been following the major economic and market issues may have encountered Hegel without noticing it. For example, when major subjects come up for discussion in public about economies and markets, one of the most common responses is “they’ll think of something.” Ask the person who says this to explain, and you’ll usually be told that every time the world runs into a problem “they” find something to fix things. This is Hegel in disguise, reframed in terms of economics and markets. The logic of historicism is very clear, history’s arrow points in the direction of progress, and so whatever happens, the result will inevitably be more progress.

One symptom of this is the perceived certainty and associated security that whatever problem comes up, it has a ready solution. The problem is that the real life is a complex adaptive system. In such a system, feedback loops and unexpected and unintended consequences.

On the other hand, some of the major theorists of cyclic history – Kondratiev, Schumpeter, Spengler, Toynbee – and philosophers such as Giambattista Vico and Karl Popper and their works have challenged the historicist view the belief that history represents a fixed arrow and has a clear direction and a purpose.

Cyclic views of history are out of fashion these days while historicism seems to be gaining importance. Although people usually lump them together as “metanarratives,” and insist that they should not be taken seriously, for our purposes, the question that needs to be asked of them is simply whether they help to make sense of the course of events. Here the vision of cyclic history is one of the places where something more useful might be found.

As a tangent, in “The Affluent Society” Galbraith asserts that conventional wisdom is based primarily on tradition and does not accommodate changes in society and so must be viewed with skepticism. He observes that the early economic theorists—the leading figures being

Smith, Ricardo, and Malthus—of the previous centuries based their theories in a world economy characterized by poverty. Galbraith then provides an overview of major currents in economic theory since the Industrial Revolution in the mid-nineteenth century. A predominant current of twentieth-century thought—the “central tradition” of economic theory—was the idea that financial crises, such as the depression, are a normal occurrence of economic cycles.

Thus and broadly speaking, what we have seen in the last two decades is that incredible technological advances, a productivity revolution, and momentous financial innovation had altered the course of economic and financial history. The views that this represented the final validation/victory of liberal democracy (e.g Fukuyama’s “End of History”) and that the business cycle has been tamed (“The Great Moderation”) became stronger upon self-validation by each passing year of positive growth, rising asset prices amid low consumer inflation and low macro volatility. Obviously this “New Paradigm” in which policymakers are omnipotent and markets are blindly following policy signals is a very compelling, alluring and seductive story. But I believe passionately that this is deeply flawed analysis.

I think here is where the analytical rubber meets the road. In order for this “New Paradigm” to work policymakers had to make a seemingly simple - yet quite extraordinary for free markets-implicit (and explicit when needed) promise of low downside risks. Thus, in the guise and name of "free markets," thoughtleaders have created rampant credit creation to keep things functioning smoothly with low surface volatility, while at the same time making the system more fragile.

Also, I continue to believe that some overriding issues are today lost in the discussion; lost in all the pontificating. Years of credit based growth may have distorted asset prices, corporate incomes and cash flows and spending, government receipts and expenditures, investments and trade balances. So to stabilize today's (possibly maladjusted) system will, require either continues sytrong credit strong growth, heavy government intervention and/or higher inflation.

So, apart from the obvious moral hazard issue, what's the problem with hyperactive policymaking and implicitly promising the avoidance certain outcomes? The answer has to do with illusion of control I think. In trying to manage expectations, suppress volatility and to gain so called credibility and market confidence, hyperactive policymaking can create even bigger risks. What if there’s a point where they can not fix things?

Still, that’s not a popular message, and I’m guessing that it’s going to become a great deal more unpopular. However, from my perch, given the high debt levels in the developed world, demographics and the fact that credit cycles are more mature even in most EMs now, unless a massive breakthrough in energy extraction technologies occur, economies around the world may have to adjust to less household spending and higher inflation, which will over time lead to major changes in the pattern of spending and fewer imports and less energy consumption. Moreover, economies will likely be in the need to adjust and adapt to being much less dependent on finance and credit growth – and "output" will become more product-based as opposed to "services"-based in the developed world.

It’s here, that I glance down and see the void opening up beneath the foundations of the current system and it’s also here that I find myself remembering the need for less romantic and idealized but potentially far more productive task of remaining flexible, open minded and

optimistic. Aiming for perfection and quick fixes are not reasonable goals and may even backfire—there will be significant obstacles in the way in what will probably turn out to be a period of big changes. But looking beyond the developed world, there are many reasons to be more optimistic. The lives of people in developing parts of the world are improving. For example, the United Nations has recently announced that it had achieved its goal of cutting global extreme poverty in half five years early. This is great news and will hopefully have very positive social and economic repercussions around the world.

*“In contrast to Newton and Schopenhauer, your ancestor did not believe in a uniform, absolute time. He believed in an infinite series of times, in a growing, dizzying net of divergent, convergent and parallel times. This network of times which approached one another, forked, broke off, or were unaware of one another for centuries, embraces all possibilities of time. We do not exist in the majority of these times; in some you exist, and not I; in others I, and not you; in others, both of us. In the present one, which a favorable fate has granted me, you have arrived at my house; in another, while crossing the garden, you found me dead; in still another, I utter these same words, but I am a mistake, a ghost.”*

Jorge Luis Borges-The Garden of Forking Paths

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