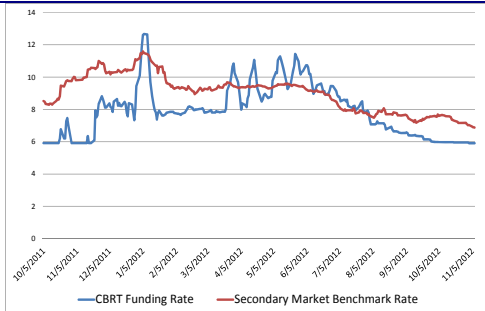


# Turkey Weekly Macro Comment

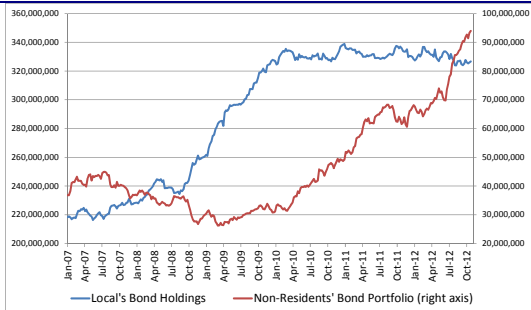
19 November 2012

## Bond Rates vs CBRT Funding Rate



Source: Central Bank of Turkey

## Domestic & Foreign Bond Portfolios



Source: Central Bank of Turkey

## The Banality (Banalization?) of Death

- We know there is no such verb as “banalize”, but we chose to use it anyway. Banality would sound too neutral, too devoid of a subject and would not help us much in making our point.
- The future was missing until very recently; for Turks and Kurds alike. Yet politics in its true sense is contemplation about the future. It is, or should be, like a public tender in which projects regarding the future compete.
- On the economic front, the MPC meeting to be held tomorrow is the juicy material for the week.
- In the light of the latest depreciation of TL through moral suasion, we believe a cut in the lower end has become less relevant and that the MPC will stop at a cut in the upper end only

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## **The Banality (Banalization?) of Death**

We know there is no such verb as “banalize”, but we chose to use it anyway. Banality would sound too neutral, too devoid of a subject and would not help us much in making our point. We are talking about the hunger strikes that were brought to an end by merely a single order from jailed Kurdish insurgency leader Ocalan. There is fortunately no dead prisoner among thousands who have been on a hunger strike for almost 70 days and there are also no reports of anyone in critical condition. A very vulgar ex-post assessment of the hunger strikes is in place now: who has won if anyone has? PM Erdogan does indeed seem to have emerged out of this with minimal damage as he took a very strong position by declaring hunger strikes as blackmail and chose not to give an inch. Certain ministers of his adopted a much milder language including the Minister of Justice and said they would do everything at their disposal to end the strikes and another highly regarded Minister who almost begged hunger strikers to end their strikes with a rhetoric that was embracing and yet not desperate. This could all be a coordinated effort on the part of the AKP put on stage as a bad cop-good cop show which could have ended up with some damage on the part of PM Erdogan who assumed the bad cop role. But it did not. How about the BDP, the ethnic Kurdish Party? I would tend to think that they lost some (considerable) face and leverage by declaring at first that they had no impact on hunger strikers and that it was a totally independent effort on their part. The “thing” was beyond their realm, so to say. End yet it ended with a single sentence from jailed leader Ocalan which might be interpreted as some sort of reincarnation for him but it is definitely at the expense of BDP and its role in the political system, which we think is a pity.

We can indulge in this sort of “delicate political analysis” in an attempt to better understand what this hunger strike episode meant, what its implications are, who are the winners/losers etc. but we will not do so. We do not find any particular phenomenon too interesting in itself when the bigger picture is still some sort of mystery to a lot of people who have been drowning in details and focusing on particular incidents, most of which entailed “collateral damage” figures on both sides.

The bigger picture in the Kurdish problem is of pivotal importance for the future of Kurds and Turks alike. There was a time when previous state structure(s) in Turkey tried to overcome the problem via warfare and reciprocated in kind to the Kurdish armed insurgency which

unsurprisingly was quite merciless against non-collaborating Kurdish entities and security and military forces of the State. That is precisely what any insurgency does in its initial phases of rebellion. At some point, futility of reciprocation in kind will become obvious (the Sri Lanka example being the only exception according to some but the jury may still be out on that) and you (the insurgency) will be able to cash in your gains (raised awareness pertaining to the cause of the problem) in the political realm.

This is precisely where the Kurdish problem in Turkey seems to have reached a deadlock. After thirty years of bloodshed and oppression on Kurdish politicians some of whom had been taken away from the Parliament and put into prison within hours to stay there for years about two decades ago, there is a strong Kurdish group in the parliament, roughly 100 municipalities governed by Kurdish politicians, numerous Kurdish NGOs, a sizeable media serving their cause, and even a trade and business network under the control of the PKK. Commonsense would suggest that transition away from armed insurgency into political struggle would become the motto at some point with these “gains” having been accomplished. Not really. Struggle in the Parliament could have been supported by acts of civil disobedience aiming to render the movement legitimate and righteous in the eye of the world public opinion. While demanding democracy, the Movement is extremely jittery about a multitude of representative entities, sees no harm in directly threatening alternative Kurdish political formations, and indulges in self-celebration over dead bodies on both sides.

Kurdish insurgency has not been able to produce “politics” here for the last three decades. They were relentlessly prevented from attempting to do so one could say, and there is some truth in that argument in principle, but they probably would not have done so any way as the Turkish side had no intention of producing politics either. It was all about “accounting” and coming up with the right cost figures from “transactions” that had taken place in the past. At best, accounting involved the current day, but it was mostly an assessment of the past defined by pain and misery.

The future was missing until very recently; for Turks and Kurds alike. Yet politics in its true sense is contemplation about the future. It is, or should be, like a public tender in which projects regarding the future compete. That never was the case on this land. The political discourse brought to this land by the AKP took almost everyone by surprise, Turks and Kurds alike once again, for the simple reason that it involved the future. AKP’s contemplation about

the future of the country was (can be by default; everyone has the right to subscribe to any opinion he wishes to) labeled dangerous, infeasible, formidable (à la English as well as à la French, very different connotations), glamorous, reasonable, intelligent, ridiculous, you name it. But there was contemplation about the future. You could like it, love it, have fears about it, hate it, whatever. But there was contemplation about the future. That was the tough part to adapt to for all. And adaptation blues continue. Victim mode is prolonged and a self-righteous attitude is never abandoned. That strategy would be feasible in old times with the previous State structure(s), but these are different times and the ill-meaning State that the Kurdish movement seems to be wishing for is simply not there. They should adjust to the new setting, fight for their demands in the system in which they have sizeable representation, and contribute to the normalization of the political system in Turkey via their well-defined and well-expressed contemplation of the future of Turkey.

“Banalizing” death through glorification of martyrdom either through warfare or through hunger strikes is unlikely to serve their cause or anyone’s cause at this time and age for that purpose. Banality of death is a very dangerous state of mind as it locks you into an accounting process that at best takes today into account and severs all your ties with the future. When the future is out of question, politics is out of the window and what is presented to us as politics is nothing but a mere charade. It is high time that Turkey with all her (potential) political agents chooses the future over the present and the past.

On the economic front, the MPC meeting to be held tomorrow is the juicy material for the week. Quite a number of analysts are expecting cuts both in the upper and lower end of the corridor. We were of the same opinion as well until Governor Basçi came out with his threshold real exchange rate interval citations and caused some sell off in TL. In the light of this latest depreciation of TL through moral suasion, we believe a cut in the lower end has become less relevant and that the MPC will stop at a cut in the upper end only; the end which the banking system is sensitive for pricing purposes. We believe a cut there is extremely likely as commercial loans continue to perform quite poorly. We are also aware of the fact that poor performance on that front does not necessarily imply that a cut is in place as we might be in a price-insensitive setting for loan demand/extension purposes. The existence of such a setting is not a remote possibility. We touched upon this issue in our last Weekly, commenting that the Medium Term Plan, while putting forth reasonable, unambitious targets/predictions for the economy for the next two years, might be causing

investment/expansion decisions to be postponed. This is most probably for the following reason: When politicians target unambitious growth numbers, animal spirit fades away as investors envisage the policy maker as a pessimistic decision maker and hence concentrate on the downside risk and take into consideration the left-hand side tail risk only. Put in a somewhat more vulgar jargon, potential investor tends to think how he would end on the wrong side if he were to expand but growth turned out to be, say, half of the 4% target/prediction. That it may as well be 5.5% is neither a relief nor does it provide any meaningful help in the decision making process. Hence the price insensitive setting possibility we mentioned above, which, in turn, would challenge a seemingly easy upper end cut decision. Nevertheless, the cost of not going with a cut is presumably higher than that of going with one and we do anticipate another cut in the upper end.

We do have a problem with the signaling to the market via the real exchange rate index as was done last week by the CBRT. It is not that we oppose moral suasion as a strategy. Quite to the contrary, it can be a very prudent strategy and may enable the policy maker to refrain from costlier alternatives. The tool that you use, if you use one that is, in your moral suasion argument has to be as non-malleable as possible though. Real exchange rate index does not seem to possess that capacity by any means. The index cannot be informative with respect to under or over-valuation by design.<sup>1</sup>

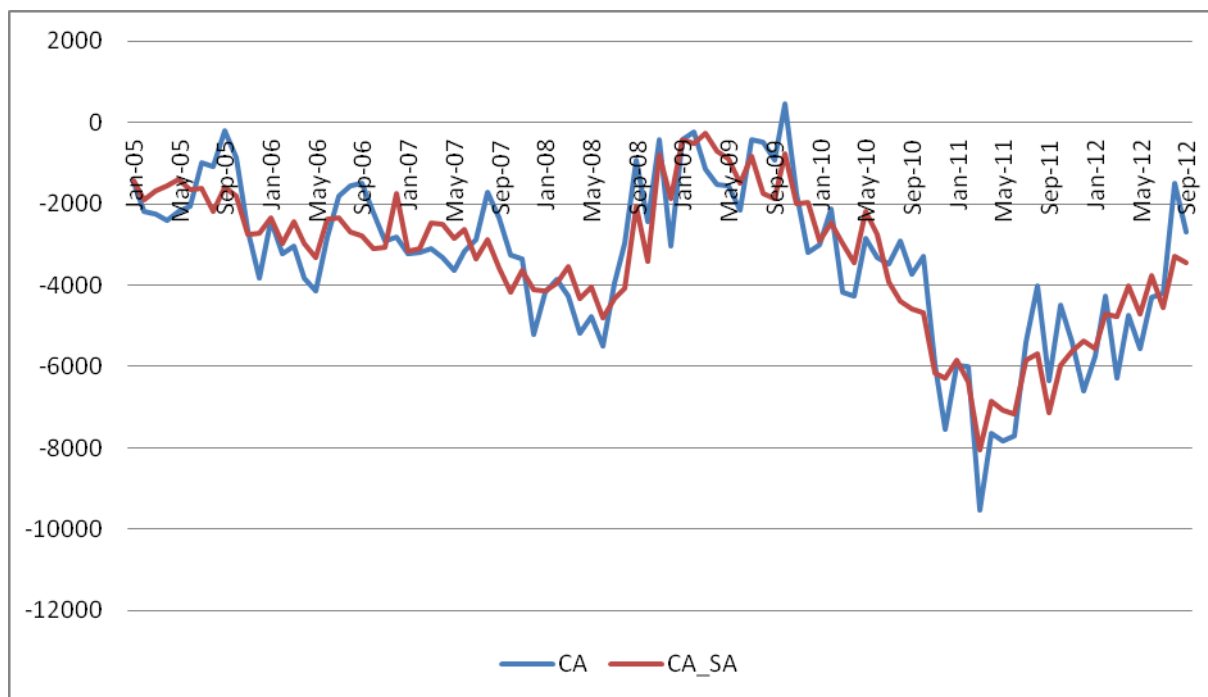
Macro data.... Unemployment rate in the month of August was up discernibly from 8.4 to 8.8%, but the increase in seasonally adjusted (SA) terms was milder by 10 bps only, from 9.1 to 9.2%. We probably have seen the bottom for the unemployment rate as the graph below suggests. If economic activity picks up towards the end of the year, we might be able to stabilize unemployment rate around 9% levels in SA terms.

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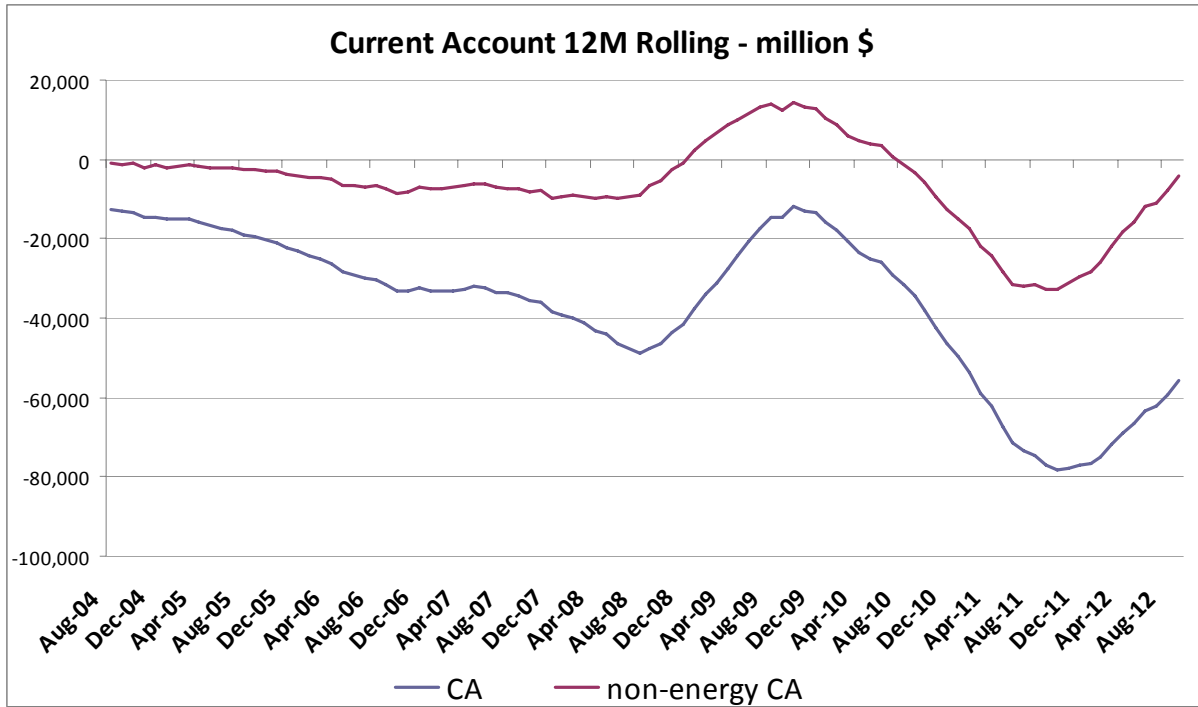
<sup>1</sup> For instance, one can think of the index as the observed level in the observation equation in a state-space setting and try to estimate (equilibrium) real exchange rate dynamics. This is just one of many possibilities one can be and economists have been thinking of, but the gist of our argument is that it is a difficult judgment call when it comes to currency evaluation.



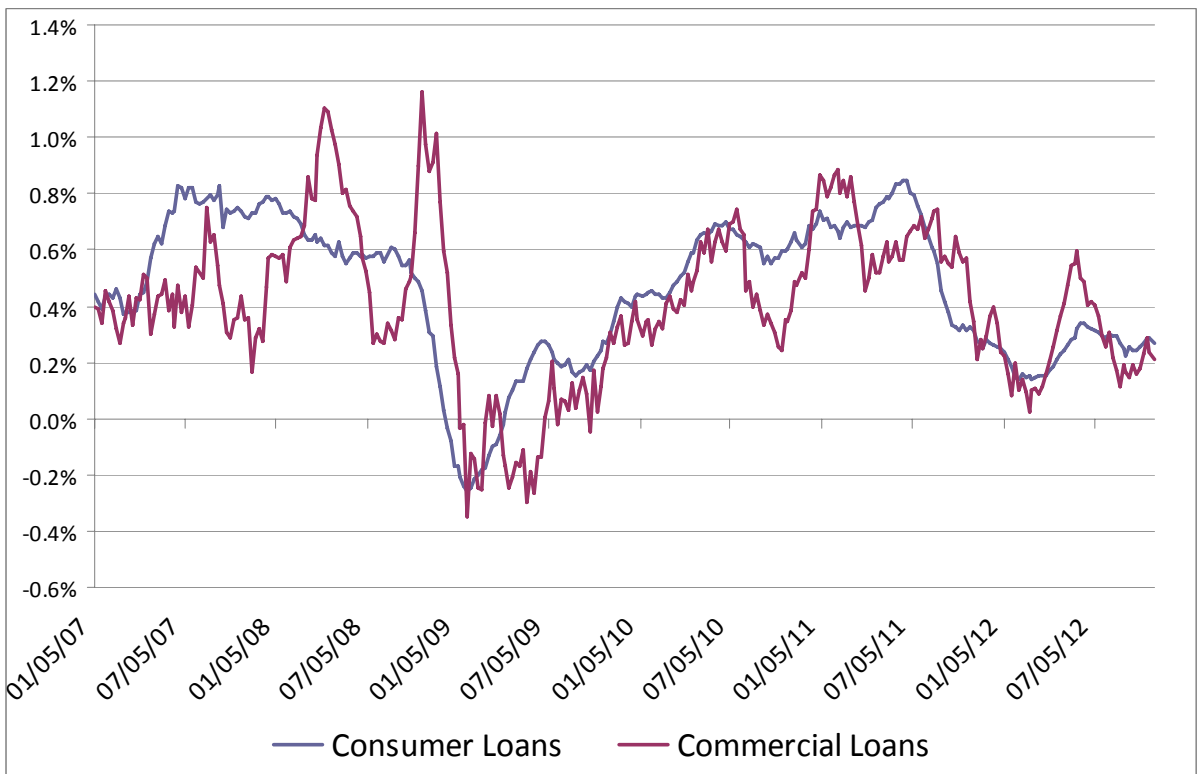
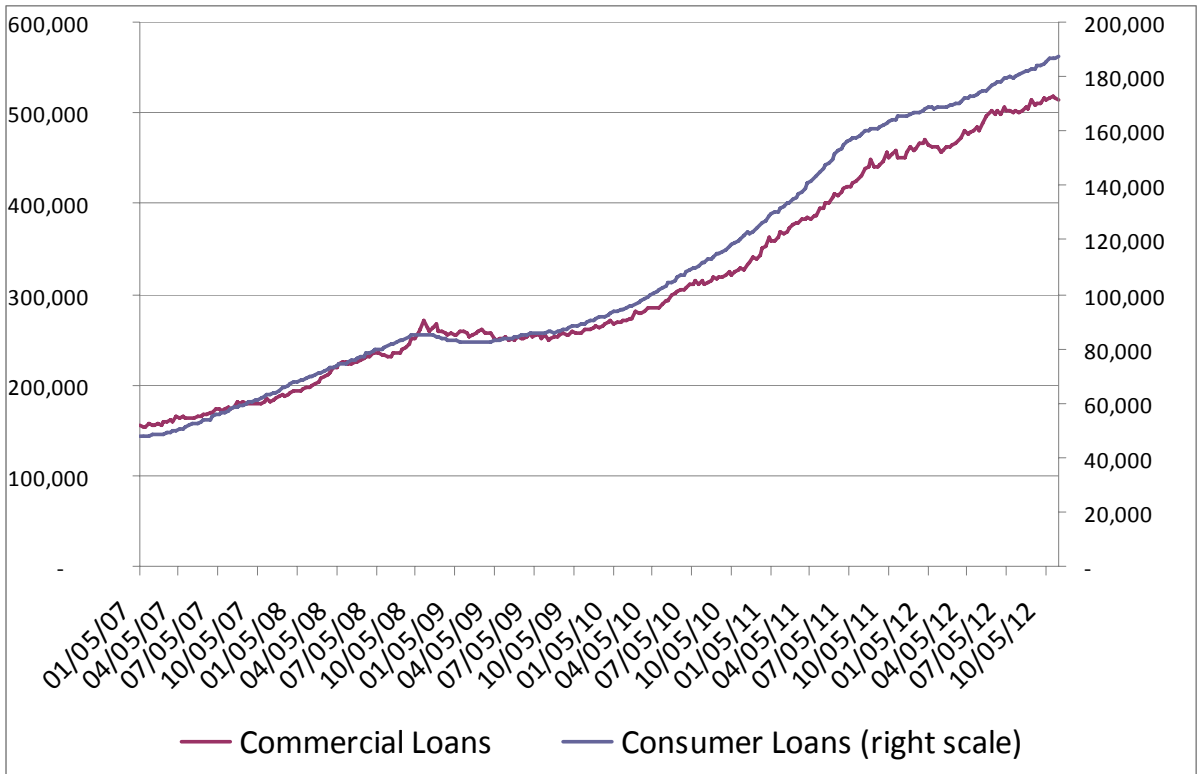
Current account deficit for the month of September at USD 2.7 billion again came lower than market expectation USD 3 billion and the 12-month rolling figure is already at 55.8 billion. If we get similar figures for the last three months of the year, we will be looking at below USD 50 billion CAD at the end of the year. In all likelihood, it looks quite difficult for the year-end figure to exceed USD 52 billion which means we are talking some 6.5-6.6% of GDP CAD. It is quite shocking to see and hear people still continuing to talk about the 10% of GDP CAD which was an anomaly certain to go away when growth process normalized.

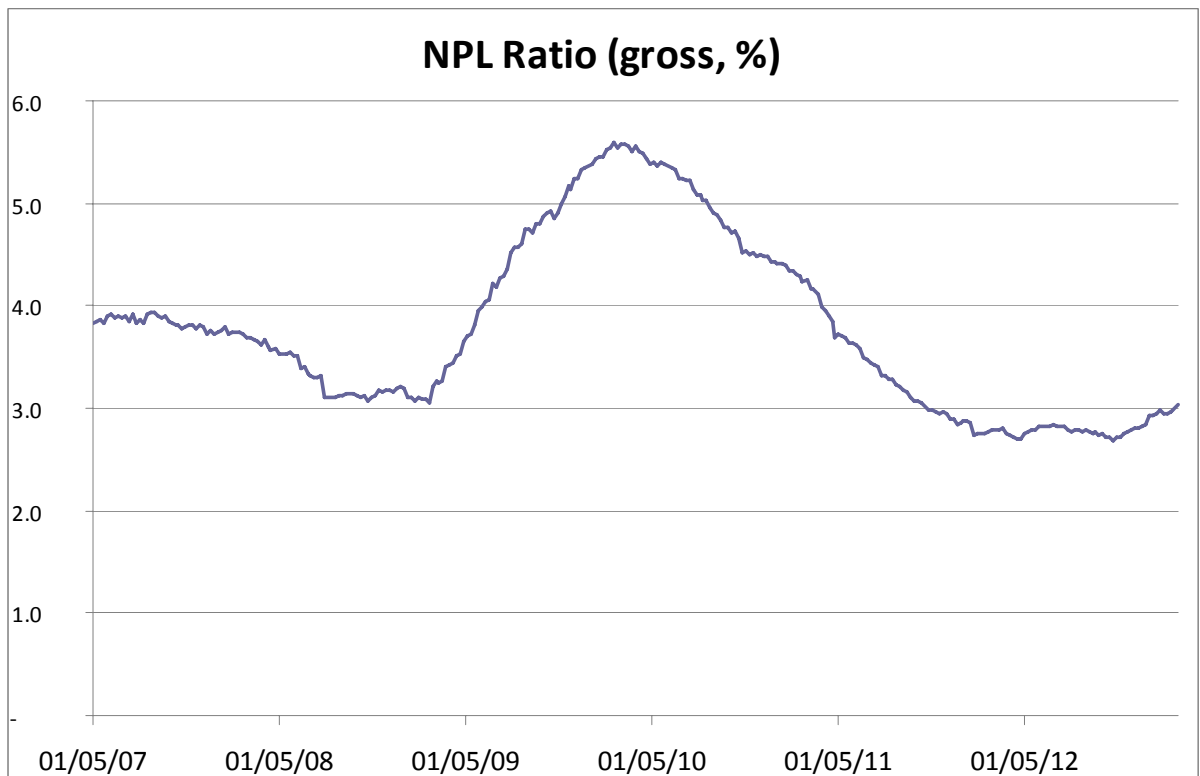
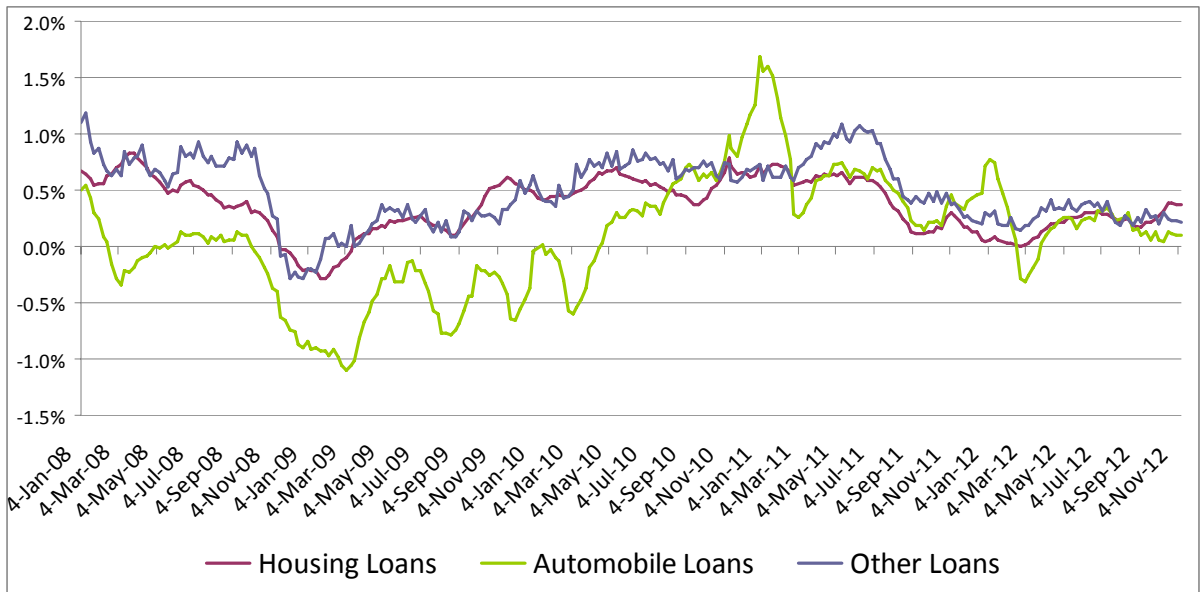


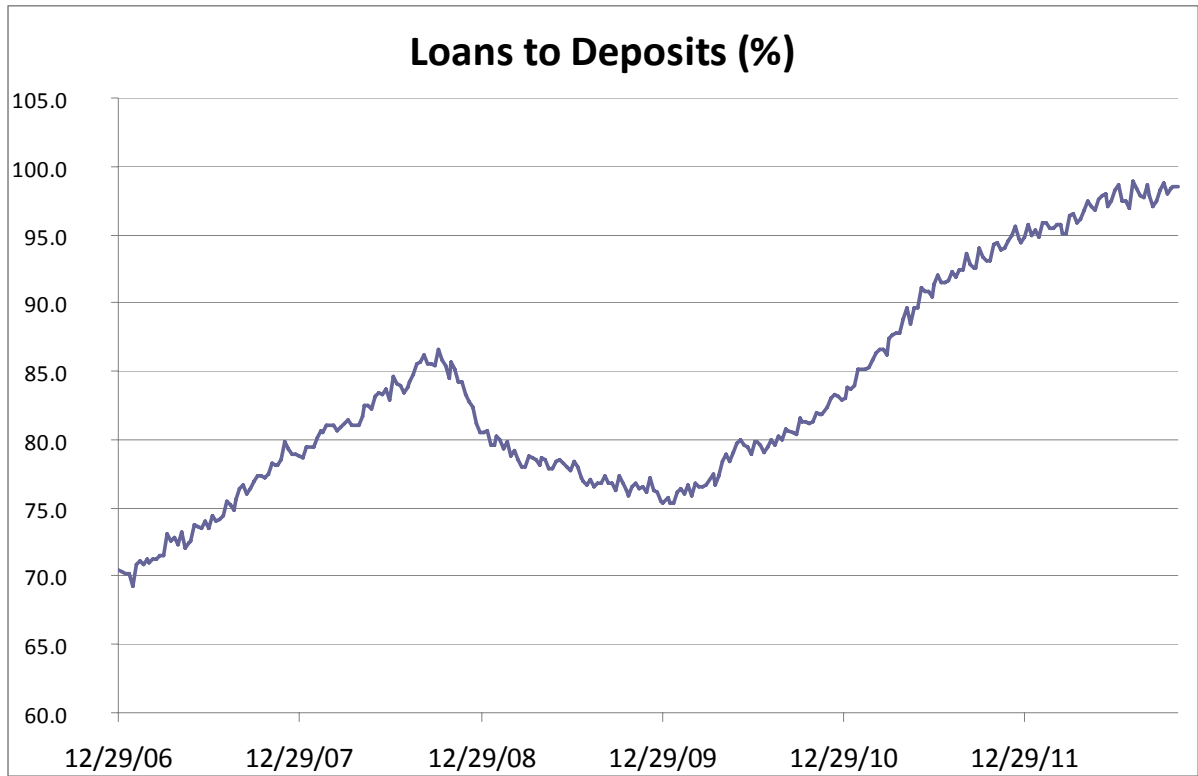
Non-energy current account deficit is almost at “balance” on a 12-month rolling basis, but we are not very comfortable with this definition though it is widely (and wildly) accepted as a core indicator of the non-energy balance. The problem is that energy is not orthogonal to the non-energy component of current account deficit; activity in that component is highly dependent on energy usage. We need a better metric for CA analysis and it is worth thinking about and working on one. We do have the total vs. non-energy graph for you below nevertheless.



Weekly data... Consumer loans performed reasonably well in the first week of November and registered a weekly increase of TL 693 million but poor showing on commercial loans front continued. A second consecutive reduction this time by TL 2.4 billion on top of the TL 1.8 billion a week ago supports our trend extraction results from last week that the trend for commercial loans has a tough time tilting its head up. This is definitely not the mix that the CBRT or policy makers would prefer but such is the state of affairs at the moment. It will be interesting to see how this will have an impact, if any, on the decision making process of the MPC tomorrow.







## Markets

By Murat Berk / Economist and Investment Strategist

### Recoupling, Decoupling, Underperforming?

Most indicators for US markets have approached oversold readings and Friday's reversal was noteworthy. Also, "market friendly" from Washington may give bulls hope of an early resolution to the fiscal cliff. Thus, chances of a rebound or more meaningful reversal are increasing. However, a true capitulation/washout low could still precede the expected reversal. I've started thinking about covering my S&P 500 short in my global model trading book depending on price action this week.

On the local side of things, we have the MPC meeting yesterday, which will obviously have an impact on markets. While theoretically a more dovish than expected MPC decision should lead to lower yields and arguably higher equities, the case is probably not that clear due to the potential reaction of the TRY.

The TRY has been moving in a very narrow range and appears like a coiled spring. Thus, a major dovish surprise could lead to a fast move there, which could undermine sentiment in equities. However, irrespective of the outcome, I still think equities have entered a distribution phase and Turkish equities could trade weaker than global ones going forward.

In any case, this week should be a volatile one, in my view.

### Sotheby's (red), ISE 100 (white) US high yield ETF HYG (green), 2009 to date



Source: Bloomberg

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