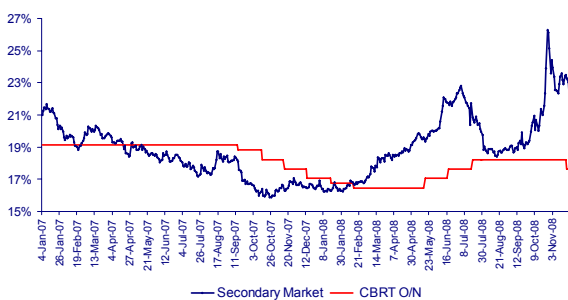


Turkey Weekly Macro Comment

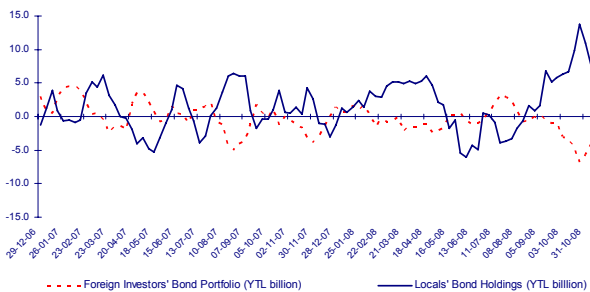
24 November 2008

Bond Rates vs O/N



Source: Central Bank of Turkey, Yapi Kredi

Domestic & Foreign Bond Portfolios (4W change)



Source: Central Bank of Turkey, Yapi Kredi

Going Once, Going Twice..... , Still Not Gone.

- *Disappointment among constituents seems to be contagious as political parties started taking up policies that are controversial at best, and most presumably leading to some loss of membership or loyalty on their part.*
- *Who will end up with vote gains in this auction for votes? Still not certain, and hence out title this week, but it may well be the AKP after all.*
- *My conjecture is that the reform process slowdown, the change in rhetoric and strategy, and other sources of the liberals' discontent with the AKP's performance do not have their roots in the AKP's acquired omnipotence feeling – such a feeling is in my view nonexistent.*
- *The drastic rate cut by the MPC was mostly labeled premature, counterproductive, borderline irresponsible, etc...The ultimate gauge will be the change in market rates and inflation expectations, and the fact that it was unexpected could render the move much more effective provided it was indeed a prudent one.*
- *Nothing of interest on the credit front beyond what we mentioned last week which was interesting enough anyway.*
- *IMF deal announcement is imminent, but that does not mean that the announcement is likely to come as early as this week or the next. There should be significant differences between the two parties and it would be a significant shock if the AKP acquiesces this easily and accepts the Fund's target or estimate figures for most variables of interest.*

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1.1 General Outlook

I had talked in depth about what I labeled as bad strategy choice by the AKP in the last few Weekly publications, and I had some feedback from certain irreversibly anti-AKP sources that my stance regarding the AKP had started to resemble theirs. In the mildest words I can use, that is stretching it a bit. Mine was more of a disappointment in the strategy and rhetoric chosen prior to local elections, and honestly a deep one, but my perception of Turkey's dynamics including that of AKP is still thousand light years apart from those who happen to take me as a new recruit into their camp. *I totally disapprove of the strategy chosen not only because I believe it won't be bearing any fruits, but also because it encourages certain sentiments that the AKP should have tried to get rid of as they surprisingly did in the past.* It also encouraged jingoistic rhetoric the likes of which may have started popping up in a random fashion now, for instance with the words of a most unexpected member of the Cabinet, the ever so silent Vecdi Gonul, the Minister of Defense.

Yet such disappointment seems to be contagious as political parties started taking up policies that are controversial at best, and most presumably leading to some loss of membership or loyalty on their part. Such policies will more than compensate losses; that is the rationale behind those moves but I seriously doubt that as well. Take the case of *CHP, the main opposition party. As a political entity that vehemently opposes university education availability to women wearing headscarves, they registered ladies with such attire into party membership the last two weekends with ceremonies that were highly and deliberately publicized.* This is in total contrast to the staunch secular attitude the Party had adopted since the foundation of the Republic and it thus did not go unnoticed by registered members of the Party. Party leader Deniz Baykal defended the decision via rhetoric that was inherently contradictory in itself. In its crudest form, it basically means that as a lady with a headscarf, you can become a member of our party but we oppose your attendance in a university. The natural question that comes to one's mind is: what is the limit on the lady's possible rise within party ranks which needless to say can not be arbitrarily set? A member of the Central Governance Council but not a deputy? Or not even a member of the CGC? Where exactly do we draw the line? On sand, inevitably, and hence the manufactured and fictitious problems of the Turkish political life which consume so much energy that hardly anything is left to fight the real problematic issues. *Symbols have always been important in this culture and so have fights over symbols.* A significant portion of CHP constituency is deeply disappointed in the strategy adopted by Baykal, and there you have another disappointed group which also believes that the chosen strategy will not pay off. I happen to agree, and for the very same reason I mentioned in the last weekly. Why go for the replica when the authentic is selling for the same price?

Not the let down their rivals in the disappointment race, the other main opposition party MHP went after the votes of Alevites, a very controversial religious group in Anatolia the Muslim identity of which is questioned by a significant portion of Sunni Muslims. Alevites had been voting for the secular forces in Turkey since the first multi-party election in Turkey roughly 50 years ago, mostly out of fear of domination by Sunnis. There is a significant Alevite population estimated to be around 18 million and fragmentation within the Alevite constituency has led to a rise in appetite for their votes which are up for grabs much more so than before.

MHP leader Bahceli most presumably wanted to throw Erdogan off by his amicable remarks about the Alevite population, hoping to see an AKP that would remain as silent as a wall in

order not to alienate its Sunni constituency, but the AKP struck back with a surprising announcement the next day. Cem houses, premises that Alevites use for their religious ceremonies, i.e. the counterpart of mosques for Sunnis, were formally recognized as religious sites and thus would get their fair share of funding from the State, and Alevite Dedes, their top religious figures, would be put on State payroll. It is a gigantic step that was also a very easy one to take as the latest experience depicted. *MHP's move ultimately will benefit the AKP, but it would have paid off even more dearly for them had the AKP passed such legislation in the absence of a trap set by the MHP.* The trap worked in the turban case but not this time around as it is not conceived to be an issue as sensitive as the turban case by the establishment. Did this disappoint some MHP constituency? You bet. Disappointment club membership has thus become anything but exclusive, and it is likely to go on like this until elections next March.

A few more words about AKP's strategy choice. I would not want to take what they have done beyond their intentions, but what I am about to say could be some rationalization of the strategy choice they made. We know that in a game theoretic framework, you may push your opponent towards a strategy that suits you best by *initially restricting your own choices intentionally*. PM Erdogan or his advisors of good judgment may have contemplated that the more they resembled their opponents with the intention of stealing away some of their votes, the more tempted the opponents would become to resemble the AKP in return and reciprocate in kind. As the incumbents, the AKP has an inherent advantage in that game, and the act that they had to put did not look awkward on them after all; they happen to be a center right party as well with the same hiccups that such parties suffered in their existence. Headscarf friendly CHP is an almost impossible sell and the Alevite-loving MHP an easier one but still difficult. *Who will end up with vote gains in this auction for votes? Still not certain, and hence our title this week, but it may well be the AKP after all.*

One also has to understand the psychology of the AKP before interpreting its policies or strategy choices. That is a bit beyond me, but I could speculate that the AKP has focused keenly on winning the local elections in a landslide fashion, rendering everything else secondary if not trivial. Once they consolidate their power, the reform process can gain momentum again, although probably not at a pace that I would like it to be. But then again democracy is by definition a slow process, and that might be the half full glass argument there. *My conjecture is that the reform process slowdown, the change in rhetoric and strategy, and other sources of the liberals' discontent with the AKP's performance do not have their roots in the AKP's acquired omnipotence feeling – such a feeling is in my view nonexistent. Quite to the contrary, they stem from a perception of fragility and vulnerability that the closure case reminded them of. Power consolidation is thus everything to the AKP, and until then, anything goes it seems.*

1.2 Macro Data

It was a weak data release week last week but the MPC decision created a lot of intellectual havoc last week. *The decision to cut lending rate by 1 percentage point and the borrowing rate by 50 bps took all market participants by surprise who were only expecting a 50 bps cut in the lending rate. The move was mostly labeled premature, counterproductive, borderline irresponsible, etc...The ultimate gauge will be the change in market rates and inflation*

expectations, and the fact that it was unexpected could render the move much more effective provided it was indeed a prudent one.

Let us try to make some sense out of the move which would be tantamount to second-guessing the MPC. The Council overplayed the decline in oil prices, the reduction in the pass-through parameter, and the slowdown taking place globally and at home. One can not object to the relevance of any of these factors, maybe with the exception of the pass-through parameter which did indeed come down yet in a period dominated by YTL appreciation. Asymmetry is a crucial feature of pass-through and the Council's comfort in the reduction is thus only partially justified. *What was most important in criticisms that followed was that no one disputed the relevance of these factors. The disagreement pertained to the strength of these factors but not to their existence.*

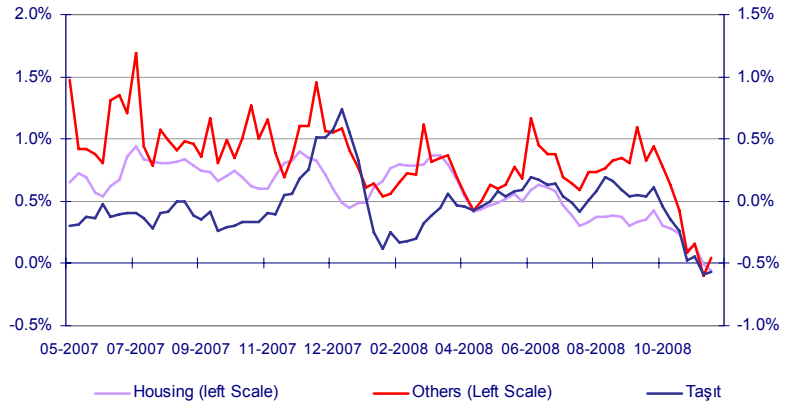
What may the Council have contemplated? It must by now be a given that disinflation efforts overwhelmingly based on appreciation of local currency are de facto fragile. That we learned from the experience of the last 6 years but from the 2006 crisis in particular. Hence, the Council may have figured out that most of the damage the de-leveraging is supposed to inflict on Turkey is presumably over. Do not fear significant outflows and depreciation any more then. Even if the exchange rate moves up a bit, or somewhat, pass-through is weaker and impact on inflation will be limited. That is a plus. Secondly, more cuts are likely to come which will signal that monetary policy loosening in a serious slowdown environment. The reduction in lending rate could lead to some appetite on the part of banks, but that is also ok as it would put downward pressure on deposit rates and bond rates although limiting banks' capacity to increase their loan portfolios. Normalization and some stability could increase non-bank appetite for bonds as well, as it did even through the dire straits we have been traveling, and banks could seek the opportunity for a re-switch, more of a medium term issue anyway. A higher exchange rate and a lower interest rate mix would then be the initial start-up point for the new disinflation effort, and rate hikes if necessary would be less problematic and the level of the exchange rate rather than that of the interest rates could provide the motive for inflows. *The setting is as conducive as it could get for such a policy choice in the sense that risks are at a minimum for the selected policy at hand (outflow, pass-through, aggregate demand pick ups are all less likely or dangerous than they could have been in a more "normal" setting).* Appreciation of YTL would then make its usual impact of helping disinflation and the interest rate spread would not have to be as high as it used to be given that appreciation will not be as gallop-pace as it used to be in the past.

The appreciation of YTL and the reduction in benchmark rates today seem to have proven the move defensible at least for this very short ex-post assessment. The problem seems to lie more in the malfunctioning channels of transmission mechanism and not in (inflation generating) results of a loosening move had the mechanism been working properly in a more "normal" environment. *Hence, if a different route as described above is to be tried, one could hardly spot more opportune times. That is not to be disputed, but the prudence of the move itself is still open to question. Only time and data will tell, and up to a certain point only; the ever so present problem of the counterfactual.*

1.3 Weekly Data

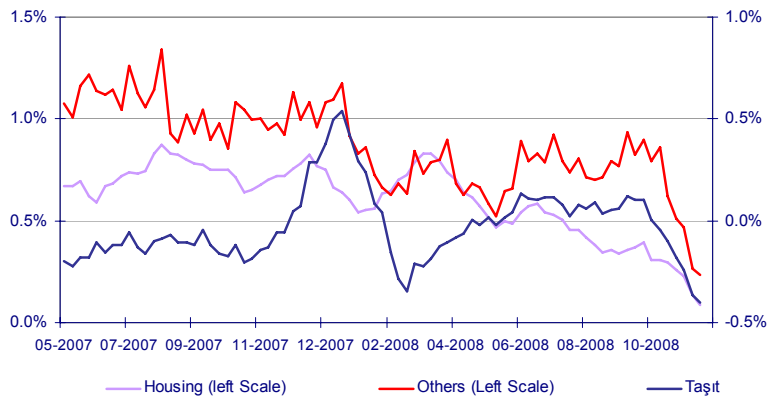
Nothing of interest beyond what we mentioned last week which was interesting enough anyway. Suffice it to say that all consumer credit categories registered reductions in volume size for the second week in a row, a first as far as I can remember. All trend indicators continue to head south, and it does not look like a reversal is anywhere soon.

Figure 2. Consumer Credit Volume (*)

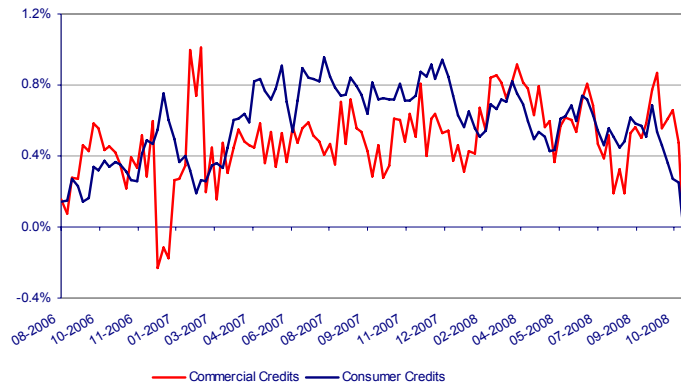


Source: Central Bank of Turkey, Yapı Kredi
 (*)Weekly % change of 4W moving average

Figure 3. Consumer Credit Volume (*)



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

Figure 4. Commercial & Consumer Credit Volume (*)

Source: Central Bank of Turkey, Yapı Kredi
 (*)Weekly % change of 6W moving average

Nothing new on the bond portfolios front as foreigners continue to shy away from the market and banks and non-bank take care of the resulting slack. FX deposits were up for the second week in a row for a change following huge switches from FX to YTL denominated deposits and bonds. That is likely to reverse again in the upcoming data.

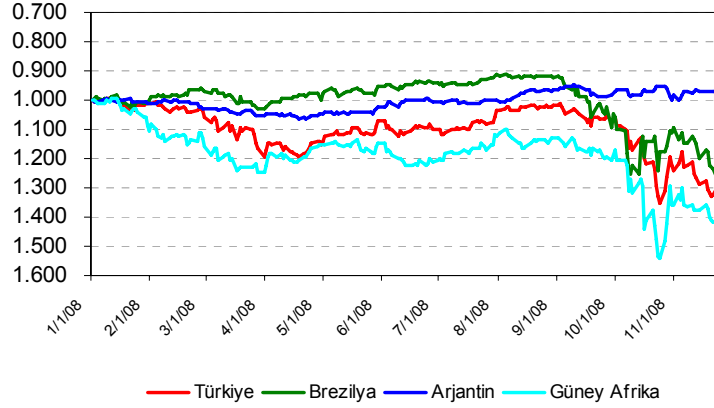
1.4 Markets

IMF deal announcement is imminent, but that does not mean that the announcement is likely to come as early as this week or the next. There should be significant differences between the two parties and it would be a significant shock if the AKP acquiesces this easily and accepts the Fund's target or estimate figures for most variables of interest. A precautionary stand-by is only a second best, and I am not very sure if the market also sees it as such. Relief in global markets will bring relief at home, but that is still more of a tail event given the global outlook. There could be another minor rally if a bona fide stand-by is announced, but the fundamental dynamics will have to take over at some point again.

1.5 Appendix

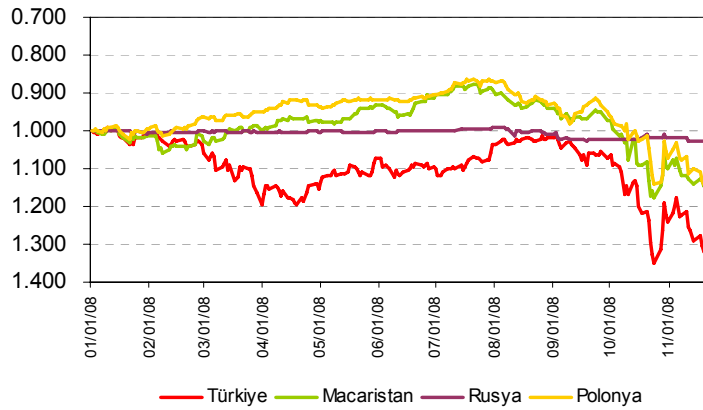
Currency Performances

Figure 13. Turkey, South Africa, Latin America 1/Jan/2008=1.00 (*)



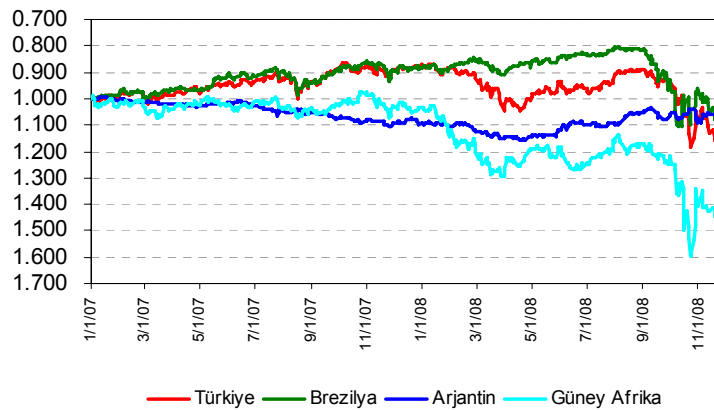
Source: Reuters, Yapı Kredi

Figure 14. Turkey, Eastern Europe 1/Jan/2008=1.00 (*)



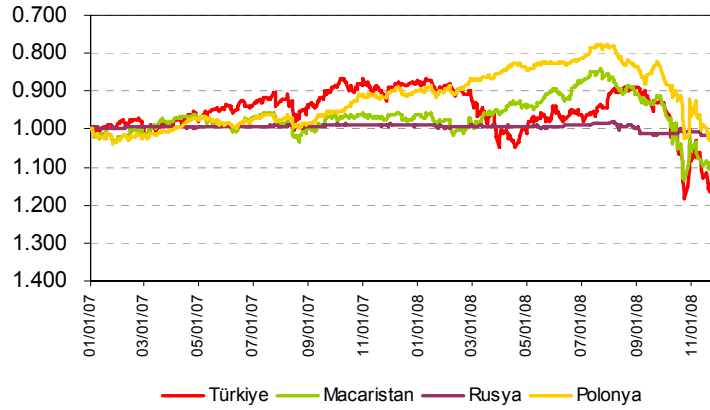
Source: Reuters, Yapı Kredi

Figure 15. Turkey, South Africa, Latin America 1/Jan/2007=1.00 (*)



Source: Reuters, Yapı Kredi

Figure 16. Turkey, Eastern Europe 1/Jan/2007=1.00 (*)

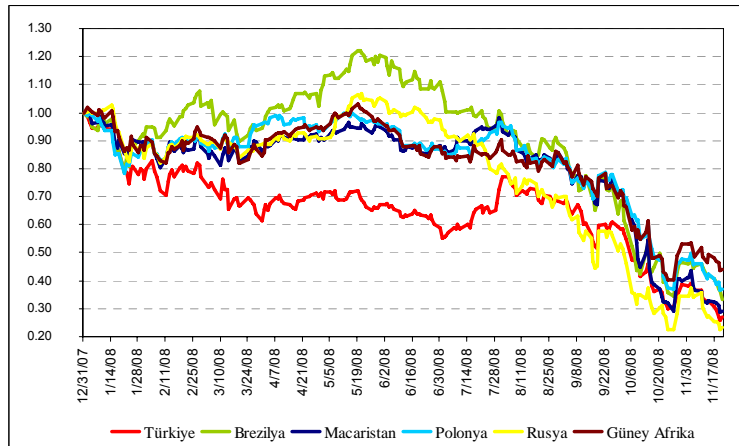


Source: Reuters, Yapı Kredi

(*) 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

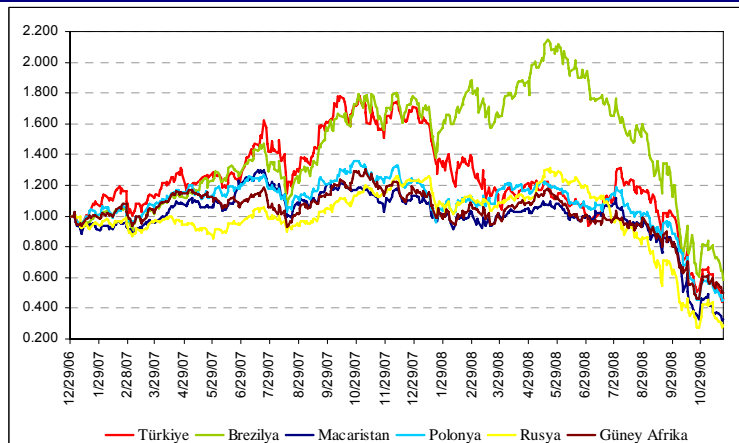
MSCI

Figure 17. MSCI Turkey versus Other Selected Emerging Markets (12/31/2007=1.00)



Source: Reuters, Yapı Kredi

Figure 18. MSCI Turkey versus Other Selected Emerging Markets (12/31/2006=1.00)



Source: Reuters, Yapı Kredi

Banking Sector - Highlights of the BRSA's Weekly Data					Change (%)			
Funding - TRY mn	4Q07	Oct-08	7-Nov-08	14-Nov-08	Chg.WoW	Chg.MoM	Chg.QoQ	Chg.YtD
					14-Nov / 7-Nov	Oct-08 / Sep-08	Sep'08 / Jun'08	14-Nov-08 / 4Q07
1) Deposits	350,608	425,502	423,954	433,517	2.3%	3.0%	3.5%	23.6%
<i>Deposit Breakdown</i>								
i) TL Deposits	227,473	274,469	273,039	277,554	1.7%	0.7%	6.8%	22.0%
- TL Demand Deposits	33,223	34,946	31,770	34,910	9.9%	-13.9%	6.1%	5.1%
- TL Time Deposits	194,250	239,523	241,269	242,644	0.6%	3.3%	6.9%	24.9%
ii) FX Deposits (US\$ mn)	105,723	96,797	98,201	95,912	-2.3%	-15.2%	-2.8%	-9.3%
- FX Demand Deposits (US\$ mn)	20,264	15,930	15,931	14,804	-7.1%	-15.4%	-12.6%	-26.9%
- FX Time Deposits (US\$ mn)	85,459	80,868	82,270	81,108	-1.4%	-15.1%	-0.6%	-5.1%
2) Funds from Domestic Banks	3,735	4,181	4,565	4,992	9.4%	-8.3%	4.6%	33.7%
3) Funds from Foreign Banks	57,250	83,685	84,428	86,245	2.2%	17.8%	6.1%	50.6%
4) Shareholders Equity	73,040	84,888	84,876	85,161	0.3%	1.4%	7.0%	16.6%
Total Liab. and Shrs. Equity*	561,947	687,994	687,496	701,402	2.0%	4.8%	3.6%	24.8%
Placements - TRY mn	4Q07	Oct-08	7-Nov-08	14-Nov-08	Chg.WoW	Chg.MoM	Chg.QoQ	Chg.YtD
					14-Nov / 7-Nov	Oct-08 / Sep-08	Sep'08 / Jun'08	14-Nov-08 / 4Q07
1) Liquid Assets	30,051	44,121	38,784	45,098	16.3%	10.1%	21.7%	50.1%
2) Due from Banks	21,001	25,882	26,975	27,324	1.3%	9.2%	-7.2%	30.1%
3) Loans	271,865	360,005	356,049	360,600	1.3%	3.8%	6.5%	32.6%
TL Loans	190,116	233,612	231,660	231,234	-0.2%	-1.8%	6.7%	21.6%
FX Loans (US\$ mn)	59,388	68,776	68,779	68,034	-1.1%	-6.6%	4.2%	14.6%
4) Non-Performing Loans (Net)	1,107	2,053	2,207	2,133	-3.4%	5.8%	27.9%	92.7%
5) Securities Portfolio	164,104	187,263	187,952	191,208	1.7%	5.0%	3.4%	16.5%
- TL Securities	121,054	139,911	140,975	141,383	0.3%	2.0%	3.8%	16.8%
- FX Securities (US\$ mn)	36,962	30,348	30,568	30,641	0.2%	-9.4%	1.2%	-17.1%
6) Other Assets	73,819	68,670	75,529	75,039	-0.6%	5.3%	-13.2%	1.7%
Total Assets*	561,947	687,994	687,496	701,402	2.0%	4.8%	3.6%	24.8%
<i>*Weekly "Total Assets" figures are Strategic Planning and Research estimates</i>								
Other Indicators - TRY mn	4Q07	Oct-08	7-Nov-08	14-Nov-08	Chg.WoW	Chg.MoM	Chg.QoQ	Chg.YtD
					14-Nov / 7-Nov	Oct-08 / Sep-08	Sep'08 / Jun'08	14-Nov-08 / 4Q07
FX Pos. - Balance Sht.-(US\$ mn)	-10,558	-5,187	-5,754	-4,266	-25.9%	-47.6%	-29.7%	-59.6%
Foreign Exchange Net General Position-(US\$ mn)	-300	-1,236	-893	-498	-44.2%	95.5%	-633.8%	66.2%
Securities Held Under Custody (Nominal)	103,738	104,286	103,912	104,561	0.6%	-0.5%	0.4%	0.8%
- Residents (Nominal)	66,560	76,173	76,307	77,124	1.1%	7.2%	0.2%	15.9%
- Non-Residents (Nominal)	37,177	28,113	27,606	27,436	-0.6%	-16.8%	1.0%	-26.2%
TRY/US\$ rate - (period-end)	1.1647	1.5603	1.5368	1.6261	5.8%	26.7%	0.6%	39.6%
Ratios	4Q07	Oct-08	7-Nov-08	14-Nov-08				
Loan Structure								
TL Loans/Total Loans	69.9%	64.9%	65.1%	64.1%				
Consumer Loans/Total Loans	24.2%	23.2%	23.3%	23.0%				
Home Loans/Consumer Loans	46.9%	46.0%	46.0%	46.0%				
Auto Loans/Consumer Loans	9.0%	7.0%	6.9%	6.9%				
Other Consumer Loans/Consumer Loans	44.0%	47.1%	47.1%	47.1%				
Credit Card Loans/Total Loans	9.6%	9.0%	9.1%	9.1%				
Asset Quality								
NPL Ratio	3.5%	3.0%	3.1%	3.1%				
NPL Provision Rate	88.7%	81.7%	80.8%	81.5%				
Consumer Loan NPL Rate	1.3%	1.9%	1.9%	2.0%				
Credit Card NPL Rate	6.2%	6.2%	6.2%	6.2%				
Other Key Ratios								
Off-balance Sheet Liab./Total Assets	69.7%	71.8%	70.6%	70.6%				
FX Balan. Sheet Pos./Shrs. Equity	-16.8%	-9.5%	-10.4%	-8.1%				
Sec. Under Custody (Residents)/Total Assets	11.8%	11.1%	11.1%	11.0%				

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