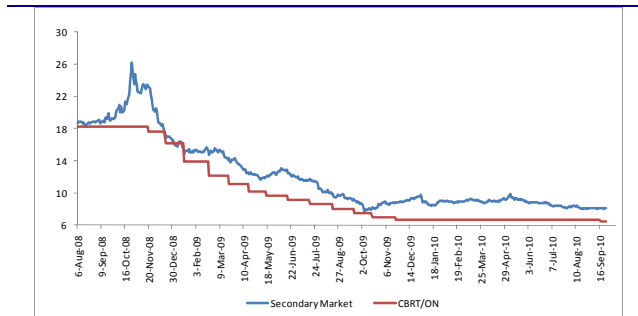


Turkey Weekly Macro Comment

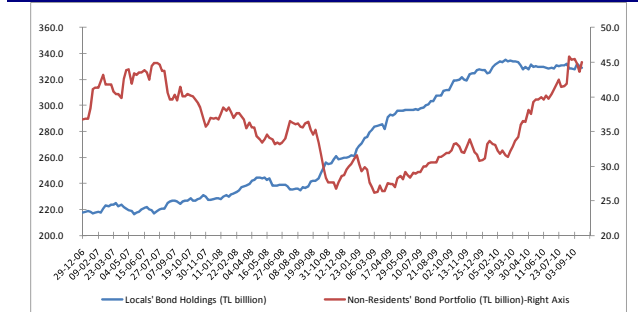
11 October 2010

Bond Rates vs O/N



Source: Central Bank of Turkey, YK Economic Research

Domestic & Foreign Bond Portfolios



Source: Central Bank of Turkey, YK Economic Research

True Change Takes Place When You Do Not Feel It Much

- Younger generations will probably be looking back into the agenda items of the last few years and will not help but wonder what the whole fuss had been about. Pace of normalization is borderline mind-boggling here but most seem to miss the feeling.
- The referendum result overwhelmingly in favor of “change” is simply being translated into daily life in myriad ways; that is the synopsis of what is taking place here nowadays.
- Anxiously awaited Medium Term Plan (MTP) and Medium Term Fiscal Plan were announced over the weekend and the numbers look quite reasonable and targets not ambitious at levels that would make us think the preparing body had gotten carried away.
- IP growth in August at 11.0% yoy came very much in line with our forecast of 10.7% which was significantly above market consensus around 7%.
- The first expectations survey of the month held by the CBRT hardly has any surprise info in it.

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1.1 General Outlook

Younger generations will probably be looking back into the agenda items of the last few years and will not help but wonder what the whole fuss had been about. Just consider what had taken place last week shortly after the historical referendum in which “change imposed its policies” on Turkey, on those in power and in opposition, not sparing a single soul.

After a student wearing a headscarf (or another head-covering ornament as headscarf is not allowed(?)) was expelled from class in Istanbul University, Higher Education Board Head Prof. Ozcan reportedly sent a letter to the University and reminded them of the fact that they were indeed assigned no such authority on any student. He further stated that the controversial ban on headscarf could be resolved through existing laws and no constitutional amendments were needed. Guess what happened next. Nothing. Or rather, other universities reportedly started allowing students with headscarves as if that had been their routine practice for ages. Yet close followers of political events here very well know that the headscarf issue has been a political hell-raiser here for so long and until as recently as a few weeks ago.

Leader of the main opposition party CHP, Kilicdaroglu, kept his silence for a while which simply signaled that he was indeed facing significant objections and possible spirituous debacles given the staunchly secular state of mind in his party. He broke his silence over the weekend and opined that headscarf would not be allowed in primary and secondary education institutions and in the public sphere (intending to state that service providers in the public sector would not be allowed to wear headscarves unlike service receivers), timidly accepting that there could indeed be no justifiable legislation regarding proper attire in higher education institutions. The idea of headscarf wearing female students in universities is a spooky idea for the staunch seculars and is presumably giving shivers to hardcore CHP deputies and constituency but we do not hear their loud voices the way we used to just a few months ago. So what exactly is happening here? As we tried to discuss in our previous Weekly, social dynamics usually assumes a life of its own when a policy maker simply initiates the process leading to a change in social norms and/or perceptions. The process need not be controlled by the initiator from that point onward. It may even be better if it is not, and maybe even more so if the initiator itself feels a bit desperate and out of the loop. The end result is change that is organic and not induced (not fully that is). The referendum result overwhelmingly in favor of “change” is simply being translated into daily life in myriad ways; that is the synopsis of what is taking place here nowadays.

Consider another piece of news that hardly found itself any space in daily press. The ancient Armenian Church Akdamar in the eastern province of Van had been made available for a mass a few weeks ago and it was greeted with enthusiasm by all advocates of normalization. It created a very pleasant atmosphere of mutual empathy and closeness on both sides of the

border but there were doubters and categorical rejecters on both sides as expected. Their voices were hardly heard though, as the aura of normalization has started to sink in even for those who have been rejecting the inevitable normalization for long. Doubters of the gesture by the AKP Government had hinted at the absence of a cross in the church in the Akdamar mass and had tried to interpret this as a sign of the insincerity of the AKP officials and of the intolerance they had against a most fundamental religious symbol of another religion. Guess what happened on October 2 which again not surprisingly did not make the headlines in the mainstream media? A cross commissioned by the Armenian Patriarchate of Turkey was installed on the Church in Akdamar. Had it made the news, the silence or the indifference would not have been much different.

No mass allowed, a mass with the cross missing, next mass with all symbols of prayer properly in place. I am sometimes asked what I mean by normalization and I have certain anecdotes which I believe serve as the best definition of “normalization”. I may have added just one more, particularly given what follows below in addition to what I have provided above.

Take an incident deemed more headline-worthy by the mainstream media. When leader of nationalist opposition party MHP Bahçeli, frustrated by the whole Akdamar event, decided to reciprocate and express his disillusionment by praying in a converted mosque (from an Armenian church not surprisingly) in the province of Kars,¹ the scene looked awkward to a large majority of Turks and Bahçeli may very well have accelerated the erosion in his voter base. MHP leadership, presumably disappointed by the lack of approval for or even interest in their endeavor by the public at large, chose to claim that no reciprocity was indeed intended. Moral of the story is that jingoism sells much less on this land than it did as recently as a few months ago. We have been arguing for years, to the dismay of some, that political normalization on this land is accelerating and that the once revolutionary AKP could fall behind the demands and aspirations of its own constituency. They seem to have done away with that (for them) unpleasant prospect for the time being and are once again leading the normalization process here. What is striking this time around is that dogged resistance forces of the past are either accommodating this process or are desperately shutting up as their lines and obsolete rhetoric are not selling any more.

¹ The exact location of the Church is the Armenian city of Ani which had served as the capital for the Armenian empires of Bagratli dynasty from 961 to 1045.

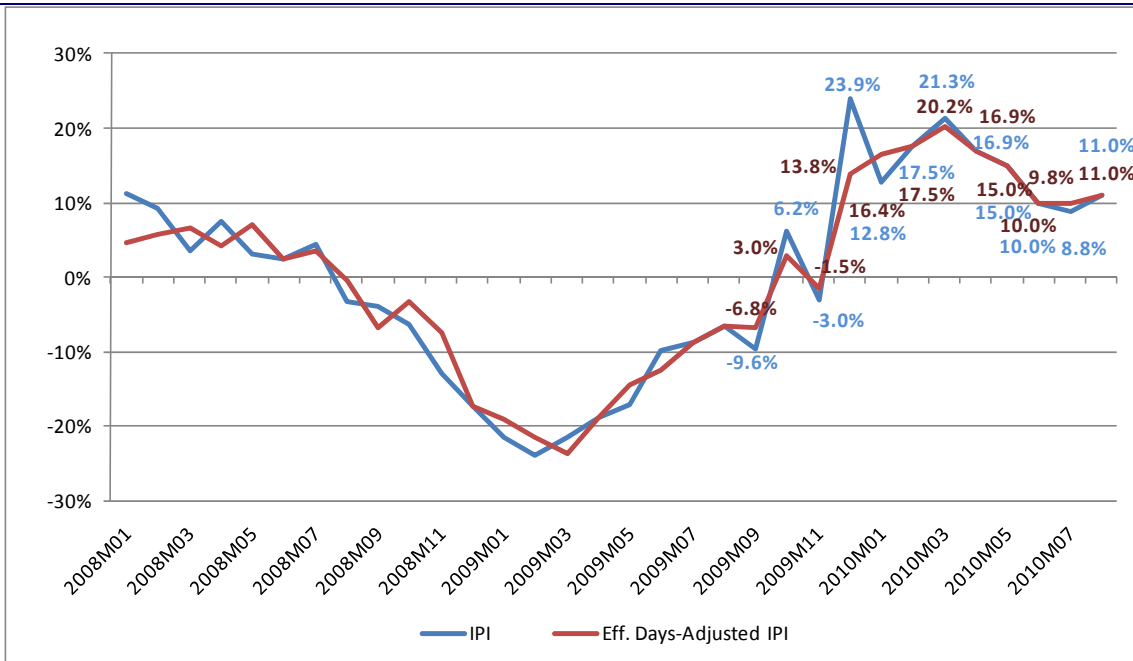
1.2 Macro Data

Anxiously awaited Medium Term Plan (MTP) and Medium Term Fiscal Plan were announced over the weekend and the numbers look quite reasonable and targets not ambitious at levels that would make us think the preparing body had gotten carried away. The reduction in growth from 6.8% this year to 4.5% next year and then to the 5% plateau is very much in line with the estimated figures that we have produced barring decimal point differences. Inflation expectations are quite optimistic on that other hand, with 2011 forecast standing at 5.3%, 2012 at 5%, and 2013 at 4.9%. We share the direction of movement without any exceptions it seems, but the magnitudes do differ a bit. Nevertheless, assuming that market participants are likely to produce direction-wise identical forecasts, level spreads will be easier to manage on the inflation front and growth forecasts will converge with data piling up in quarters.

	MTP			
	2010	2011	2012	2013
GDP Growth Rate	6.8	4.5	5.0	5.5
Inflation	7.5	5.3	5.0	4.9
Budget Balance (billion TL)	-44.2	-33.5	-32.3	-24.4
Budget Deficit (as % of GDP)	-4.0	-2.8	-2.4	-1.6
EU Defined Nominal Debt Stock (as % of GDP)	42.3	40.6	38.8	36.8
Current Account (as % of GDP)	-5.4	-5.4	-5.3	-5.2

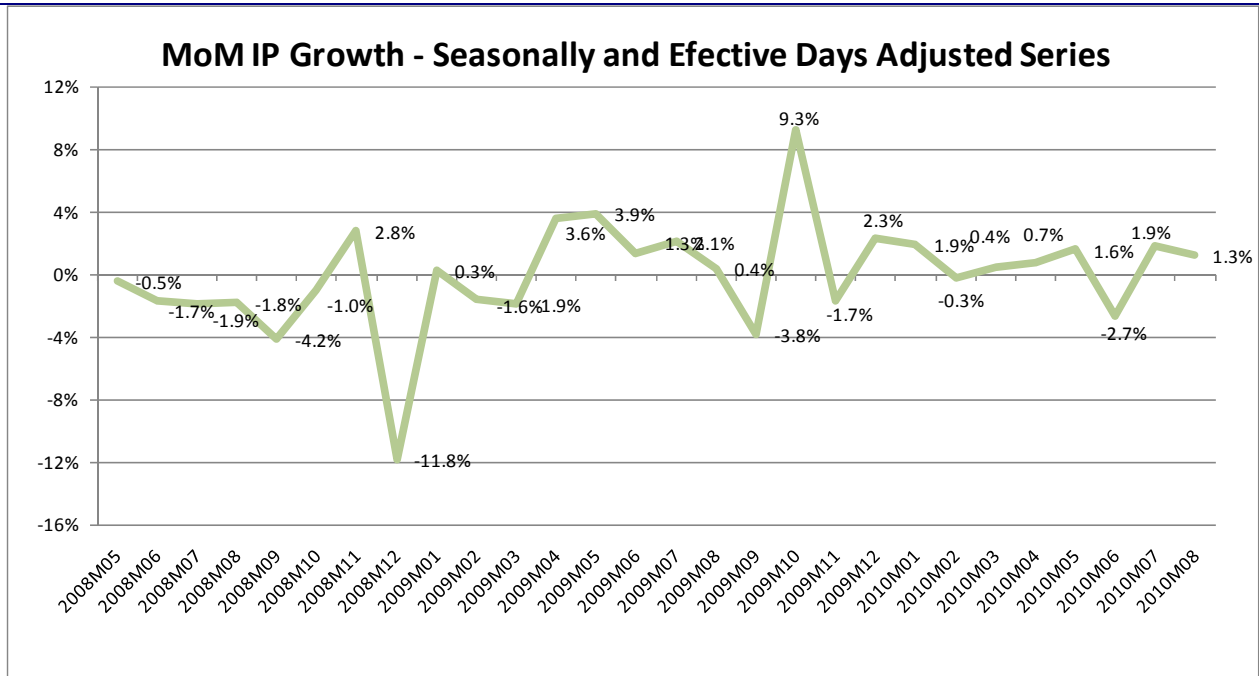
IP growth in August at 11.0% yoy came very much in line with our forecast of 10.7% which was significantly above market consensus around 7%. Given that the next highest forecast was 8.5% while some analysts (for reasons totally beyond us) were expecting 5% and lower (one was 3%!), this is truly a positive shock to the market ex-ourselves. Would it have any repercussions policy expectations-wise? We think not, as the market believes that IP data is very volatile and that forecast errors are mostly random. Mom growth at 1.3% on top of the 1.9% in the previous month is commendable, but prospects of overheating as some have been claiming for some time are still not there we believe.

Industrial Production YoY Growth



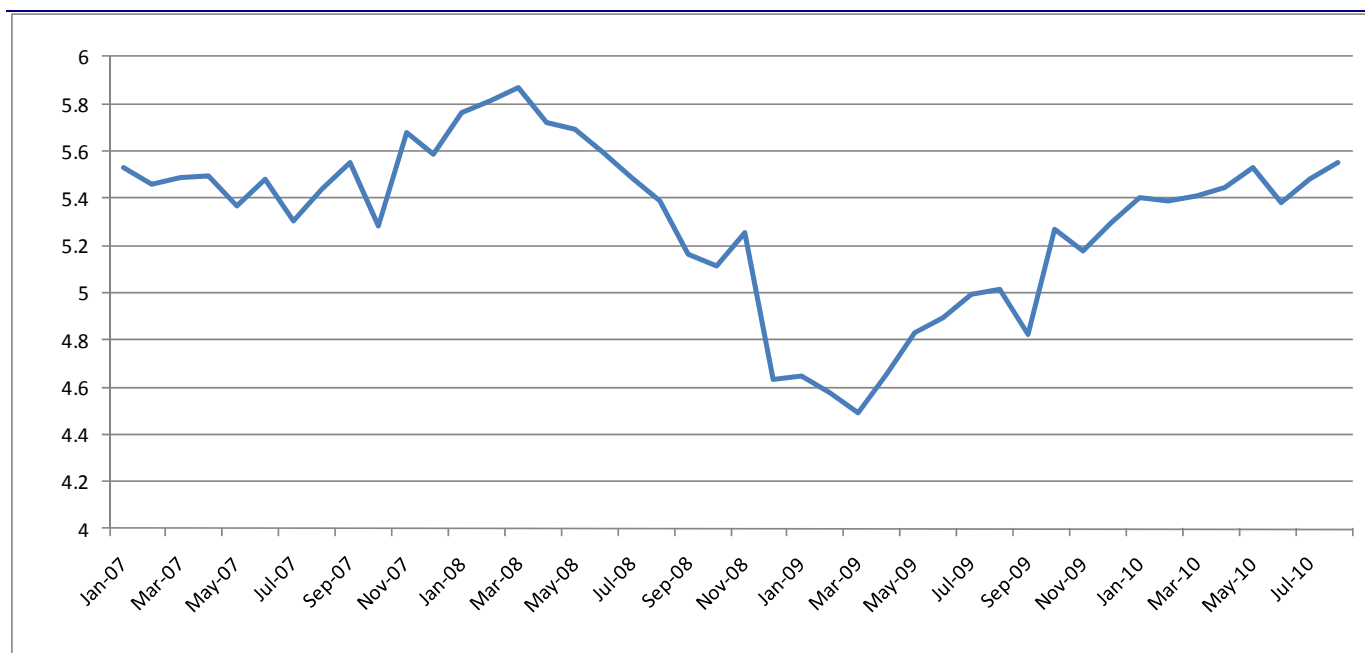
Source: Turkstat, YK Economic Research

Industrial Production-Effective Days & Seasonally Adjusted Series MoM Growth



Source: Turkstat, YK Economic Research

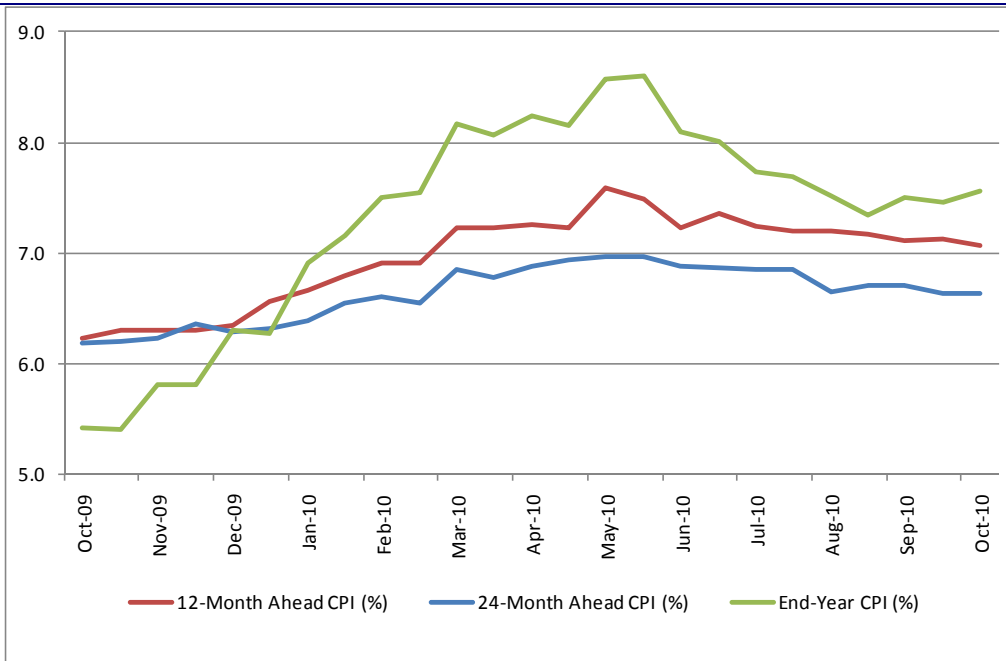
Industrial Production Level (Seasonal and Effective Days Adjusted Series)



Source: Turkstat, YK Economic Research

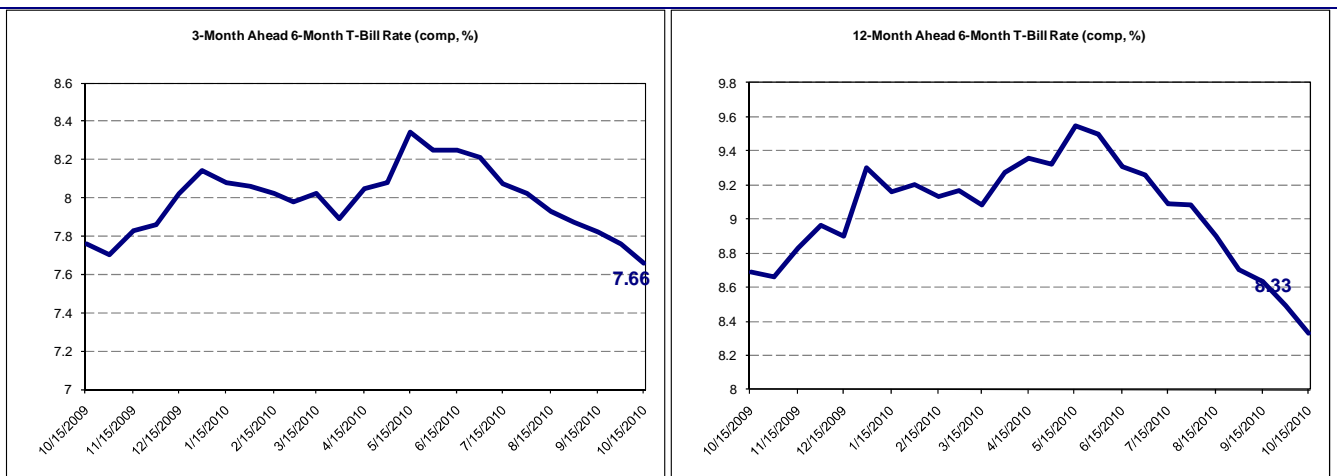
The first expectations survey of the month held by the CBRT hardly has any surprise info in it. Year-end CPI inflation expectation is 10 bps higher at 7.56% and 12-month ahead expectation is slightly lower at 7.06% compared to 7.12% a survey ago. 3-month ahead and 12-month ahead expectations of both short and long tenor bonds continue to come down and this must be thrilling news for the CBRT who would love to keep rates “low for longer”. Maintained expectation reductions, slow but steady ones, would make the CBRT euphoric and postpone hikes to periods beyond the 1Q2011. That is not our working scenario at the moment and we believe that the CBRT will most presumably start to hike at the end of 1Q 2011 or in the beginning of 2Q.

Inflation Expectations



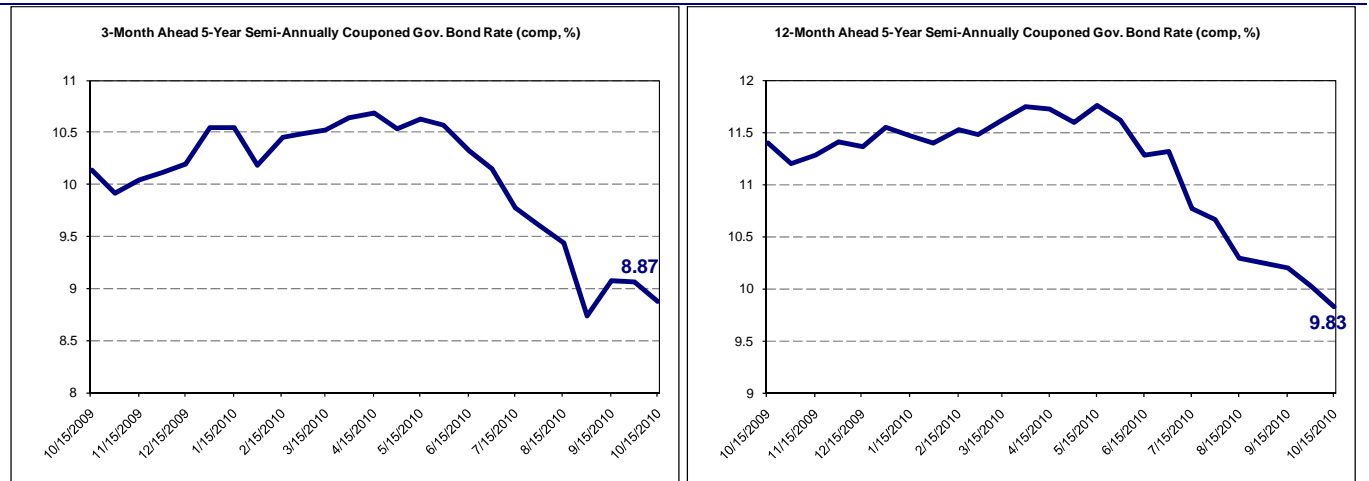
Source: Expectations Survey, Central Bank of Turkey

Interest Rate Expectations



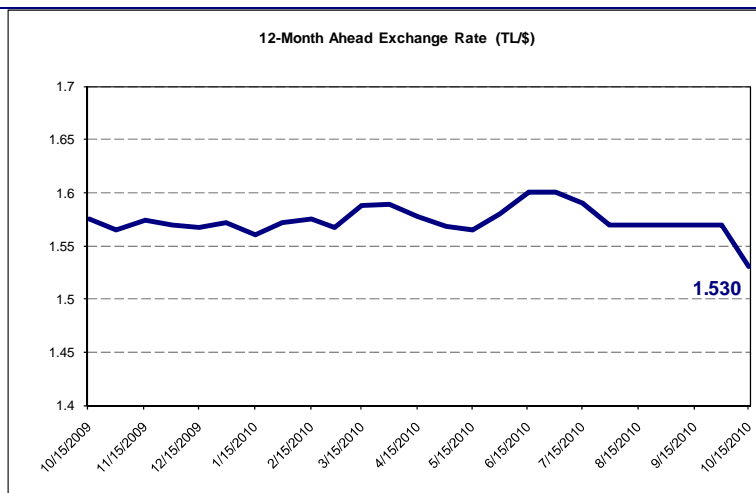
Source: Expectations Survey, Central Bank of Turkey

Interest Rate Expectations



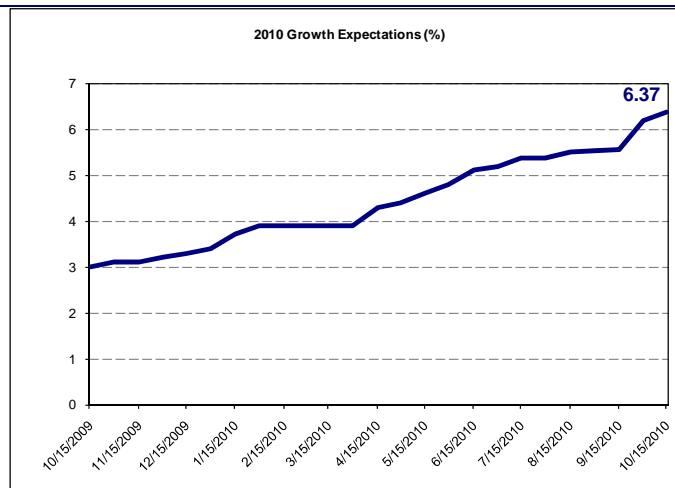
Source: Expectations Survey, Central Bank of Turkey

Exchange Rate Expectations



Source: Expectations Survey, Central Bank of Turkey

Growth Expectations

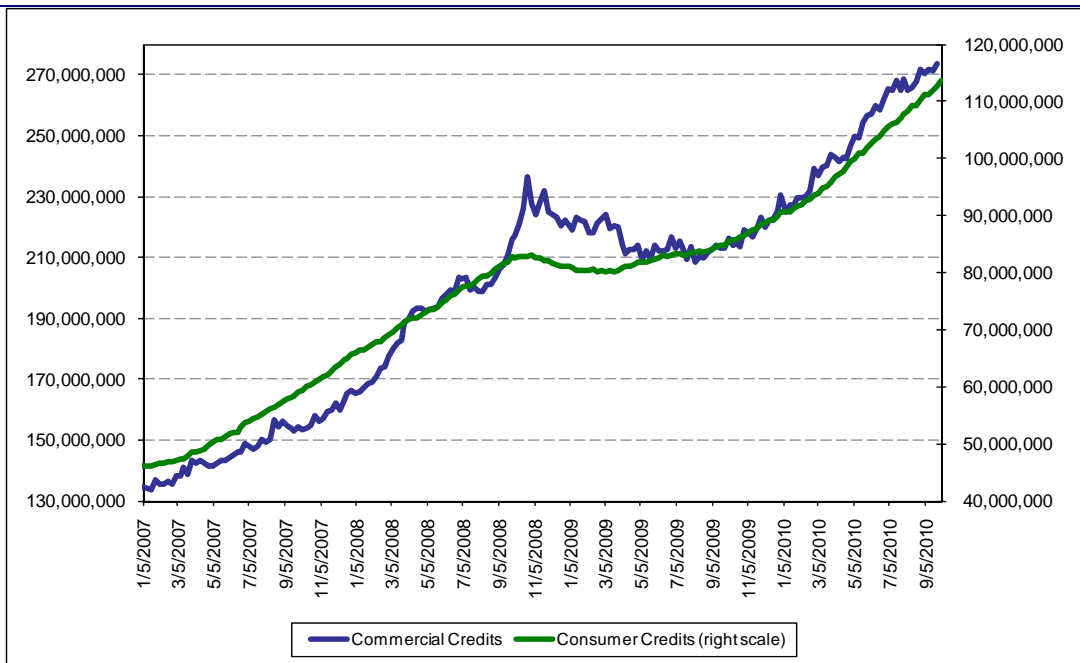


Source: Expectations Survey, Central Bank of Turkey

1.3 Weekly Data (all weekly data terminate on September 24, 2010 while consumer credits are one extra week updated)

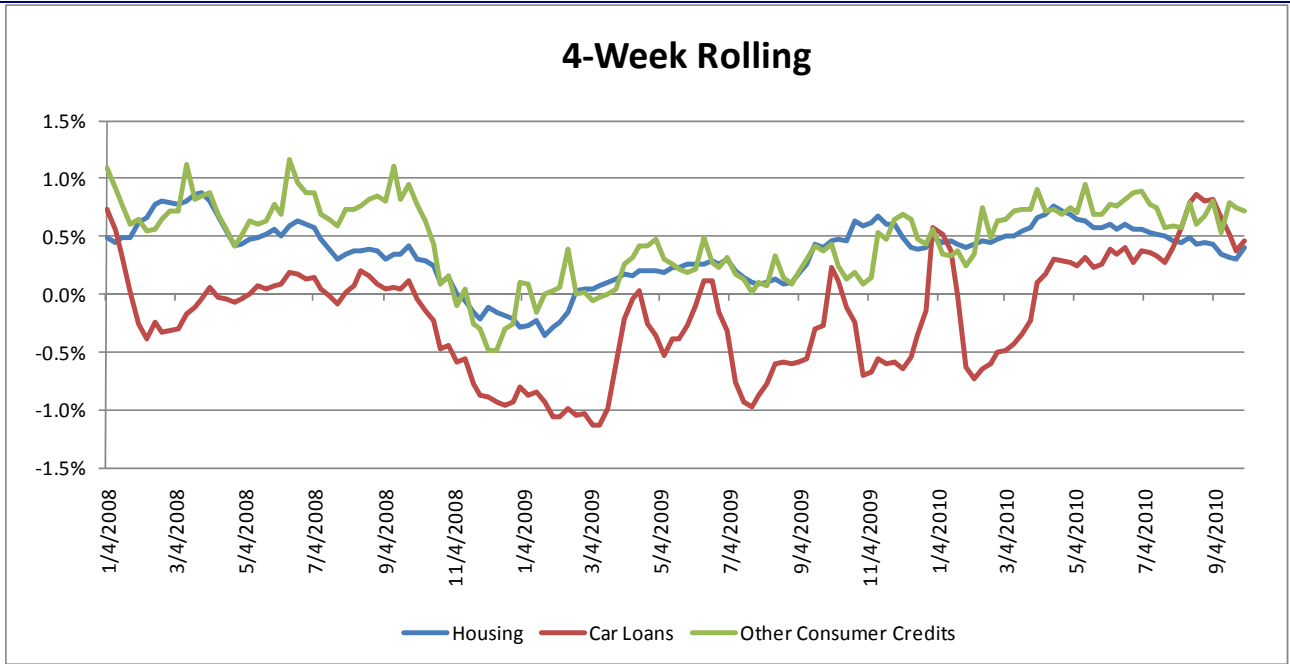
Consumer credits had a stronger showing than the previous week when they had registered respectable volume increases in all categories. Housing and auto loans both picked up percentage-wise and we are likely to see robust credit growth going forward given growth prospects and the normalized rate environment.

Consumer/Commercial Credits - Levels



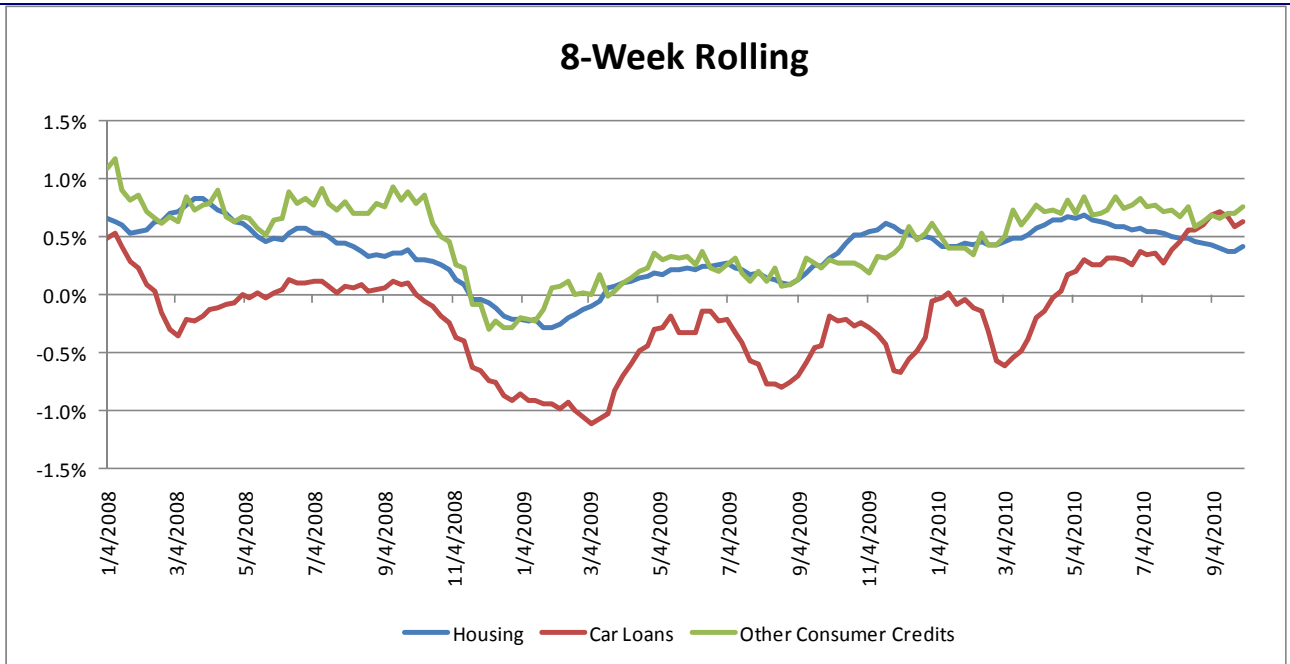
Source: Central Bank of Turkey, Yapı Kredi Economic Research

Consumer Credit Volume (*)



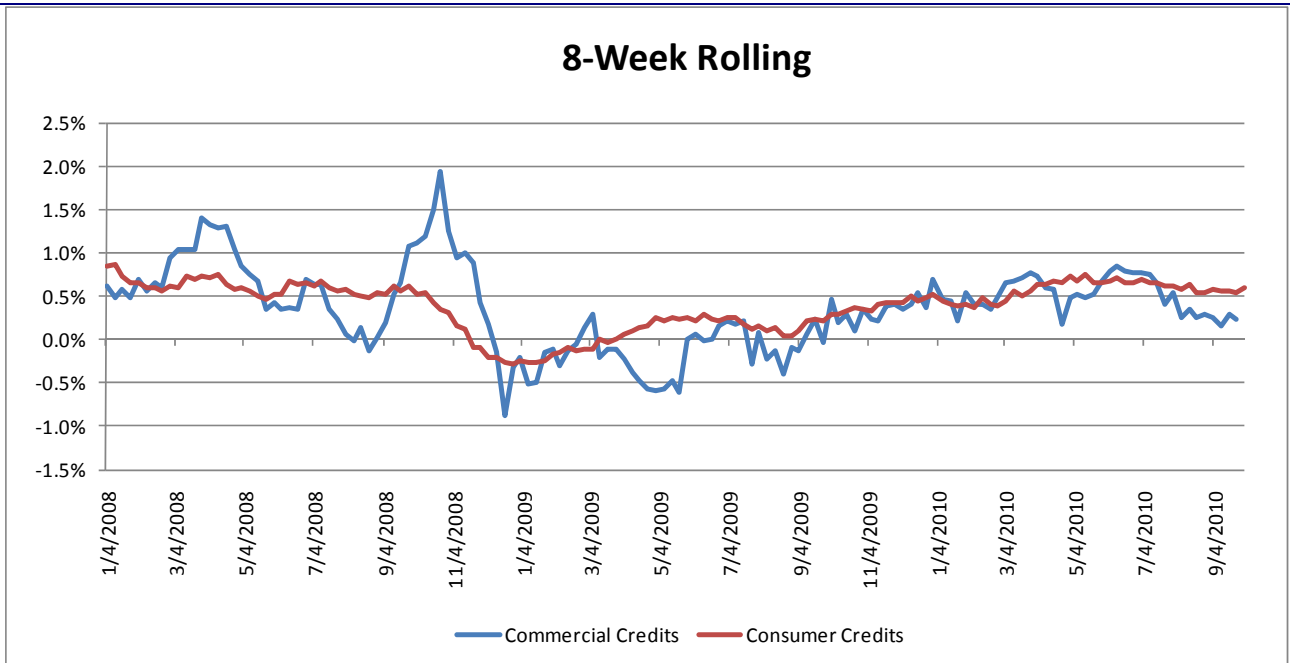
Source: Central Bank of Turkey, Yapı Kredi Economic Research
 (*)Weekly % change of 4W rolling

Consumer Credit Volume (*)



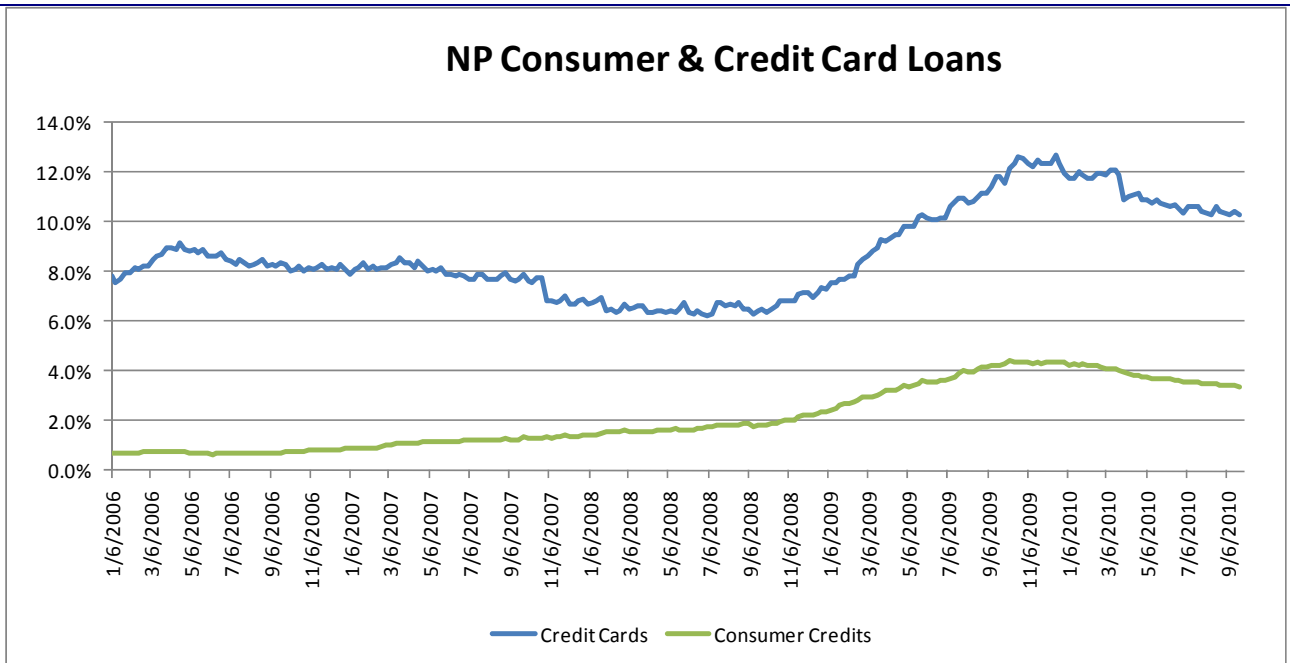
Source: Central Bank of Turkey, Yapı Kredi Economic Research
 (*)Weekly % change of 8W rolling

Commercial & Consumer Credit Volume (*)



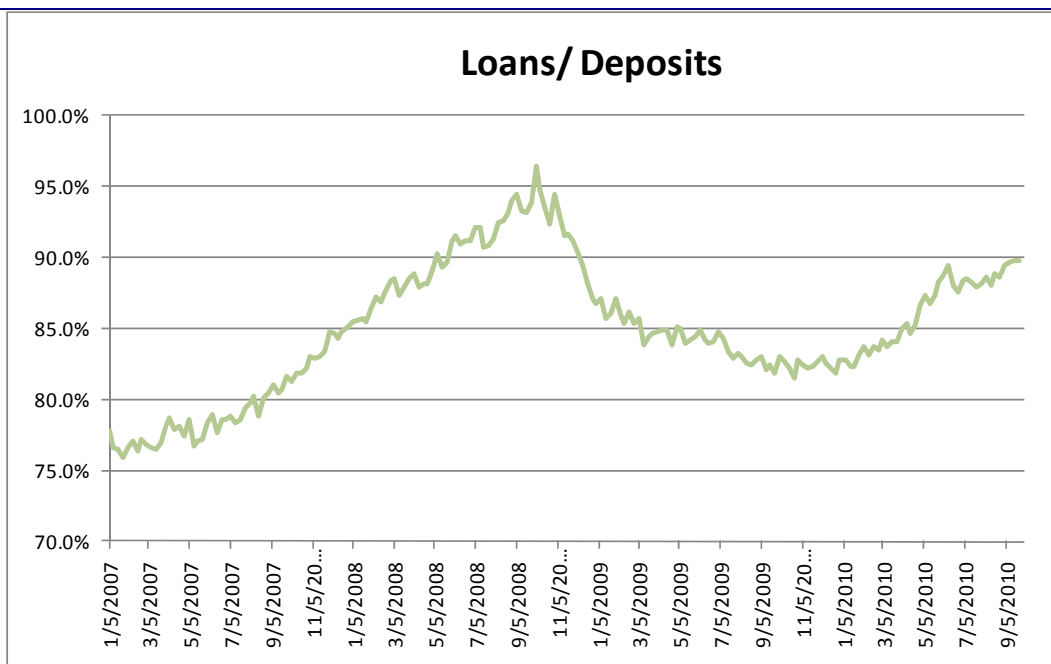
Source: Central Bank of Turkey, Yapı Kredi Economic Research
 (*)Weekly % change of 8W rolling

NPL



Source: Central Bank of Turkey, Yapı Kredi Economic Research

Credit/Deposits Ratio



Source: Central Bank of Turkey, Yapı Kredi Economic Research

The regulatory body BRSA finally agreeing to allow the banking sector to issue bonds will both diversify and reduce the cost of funding on the liability side for the sector. An extremely fruitful by-product of this latest decision of the BRSA will be witnessed on inflation/interest rate front. It goes without saying that there is need for a stronger lobby for a low inflation/low interest rate environment in this until very recently high and chronic inflation economy. The recently blossoming corporate bond sector will prove to be the most potent member of that group. It is thus an extremely positive move forward to allow commercial banks to issue corporate bonds while staying on top of things with respect to due regulation.

FX deposits in the system reached the equivalent of USD 103.3 billion but the appreciation of the Euro against the USD had a lot to do with the surge from USD 99.3 billion just two weeks ago.

Banking Sector - Highlights of the BRSA's Weekly Data						Change (%)			
Funding - TRY mn	2009	Jul-10	Aug-10	24-Sep-10	1-Oct-10	Chg.WoW 01-Oct / 24-Sep	Chg.MoM Sep-10 / Aug-10	Chg.QoQ 3Q10 / 2Q10	Chg.YTD 1-Oct-10 / Dec-09
1) Deposits	504,776	558,373	561,017	565,106	561,896	-0.6%	0.7%	3.3%	11.3%
<i>- Deposit Breakdown</i>									
i) TL Deposits	331,345	381,955	383,163	384,626	381,444	-0.8%	0.4%	2.8%	15.1%
- TL Demand Deposits	47,871	54,372	53,938	51,745	53,055	2.5%	-4.1%	4.6%	10.8%
- TL Time Deposits	283,474	327,583	329,225	332,881	328,389	-1.3%	1.1%	2.5%	15.8%
ii) FX Deposits (US\$ mn)	116,608	117,260	117,372	122,061	125,401	2.7%	4.0%	11.0%	7.5%
- FX Demand Deposits (US\$ mn)	20,387	21,326	20,578	22,690	22,199	-2.2%	10.3%	19.4%	8.9%
- FX Time Deposits (US\$ mn)	96,221	95,934	96,794	99,371	103,202	3.9%	2.7%	9.3%	7.3%
2) Funds from Domestic Banks	4,005	3,631	3,705	3,778	3,835	1.5%	2.0%	-10.6%	-4.2%
3) Funds from Foreign Banks	71,137	78,740	76,424	78,259	77,704	-0.7%	2.4%	0.5%	9.2%
4) Shareholders Equity	110,350	119,732	119,528	120,881	121,645	0.6%	1.1%	3.4%	10.2%
Total Liab. and Shrs. Equity*	800,386	863,144	867,128	883,228	879,842	-0.4%	1.9%	1.3%	9.9%
<i>*Weekly "Total Liab. and Shrs. Equity" figures are Strategic Planning and Research estimates</i>									
Placements - TRY mn	2009	Jul-10	Aug-10	24-Sep-10	1-Oct-10	Change (%)			
						Chg.WoW 1-Oct / 24-Sep	Chg.MoM Sep-10 / Aug-10	Chg.QoQ 3Q10 / 2Q10	Chg.YTD 1-Oct-10 / Dec-09
1) Liquid Assets	50,543	37,785	35,778	35,557	38,126	7.2%	-0.6%	-20.9%	-24.6%
2) Due from Banks	33,093	34,874	33,485	29,163	29,720	1.9%	-12.9%	-0.3%	-10.2%
3) Loans	373,295	435,275	441,198	446,249	450,955	1.1%	1.1%	5.2%	20.8%
<i>- Loan Breakdown</i>									
TL Loans	268,321	314,054	318,939	322,763	328,107	1.7%	1.2%	6.6%	22.3%
FX Loans (US\$ mn)	70,580	80,572	80,683	83,515	85,364	2.2%	3.5%	8.4%	20.9%
4) Non-Performing Loans (Net)	3,160	2,839	2,793	2,798	2,901	3.7%	0.2%	-3.6%	-8.2%
5) Securities Portfolio	261,824	273,049	270,337	269,886	271,584	0.6%	-0.2%	-1.7%	3.7%
- TL Securities	212,266	224,747	222,712	226,806	229,640	1.2%	1.8%	0.9%	8.2%
- FX Securities (US\$ mn)	33,321	32,105	31,429	29,136	29,148	0.0%	-7.3%	-7.9%	-12.5%
6) Other Assets	78,471	79,322	83,537	99,575	86,556	-13.1%	19.2%	3.9%	10.3%
Total Assets*	800,386	863,144	867,128	883,228	879,842	-0.4%	1.9%	1.3%	9.9%
<i>*Weekly "Total Assets" figures are Strategic Planning and Research estimates</i>									
Other Indicators - TRY mn	2009	Jul-10	Aug-10	24-Sep-10	1-Oct-10	Change (%)			
						Chg.WoW 1-Oct / 24-Sep	Chg.MoM Sep-10 / Aug-10	Chg.QoQ 3Q10 / 2Q10	Chg.YTD 1-Oct-10 / Dec-09
FX Pos. - Balance Sht.-(US\$ mn)	-12,788	-10,855	-10,039	-15,120	-17,553	16.1%	50.6%	37.8%	37.3%
Foreign Exchange Net General Position (US\$ mn)	374	1,190	1,330	1,546	1,890	22.3%	16.3%	151.6%	405.6%
Securities Held Under Custody (Nominal)	95,660	99,396	103,153	101,940	101,653	-0.3%	-1.2%	4.7%	6.3%
- Residents (Nominal)	70,566	65,224	65,885	65,678	65,482	-0.3%	-0.3%	-0.6%	-7.2%
- Non-Residents (Nominal)	25,094	34,174	37,270	36,262	36,171	-0.3%	-2.7%	16.0%	44.1%
TRY/US\$ rate - (period-end)	1.4873	1.5045	1.5153	1.4786	1.4390	-2.7%	-2.4%	-6.1%	-3.2%
Ratios	2009	Jul-10	Aug-10	24-Sep-10	1-Oct-10	Change			
						Chg.WoW 01-Oct / 24-Sep	Chg.MoM Sep-10 / Aug-10	Chg.QoQ 3Q10 / 2Q10	Chg.YTD 1-Oct-10 / Dec-09
Loan Structure									
TL Loans/Total Loans	71.9%	72.2%	72.3%	72.3%	72.8%	0.4	0.0	0.9	0.9
Consumer Loans/Total Loans	24.3%	24.8%	25.1%	25.3%	25.3%	0.0	0.2	0.5	0.9
Home Loans/Consumer Loans	47.0%	46.4%	46.2%	45.8%	45.7%	-0.1	-0.4	-0.8	-1.2
Auto Loans/Consumer Loans	4.6%	3.9%	4.0%	3.9%	3.9%	0.0	0.0	0.0	-0.7
Personal Need Loans/Consumer Loans	48.4%	49.6%	49.8%	50.3%	50.3%	0.0	0.4	0.8	1.9
Credit Card Loans/Total Loans	9.8%	9.3%	9.2%	9.2%	9.3%	0.1	0.1	0.0	-0.5
Commercial Installment Loans/Total Loans	9.8%	9.9%	9.9%	9.9%	10.0%	0.1	0.0	0.1	0.2
Corporate & Commercial Loans/Total Loans	56.0%	55.9%	55.8%	55.5%	55.4%	-0.1	-0.3	-0.6	-0.6
Asset Quality									
NPL Ratio	5.2%	4.3%	4.3%	4.2%	4.2%	-0.1	0.0	-0.2	-1.0
NPL Provision Rate	84.5%	85.6%	85.8%	85.9%	85.3%	-0.6	0.0	0.4	0.8
Consumer Loan NPL Rate	4.2%	3.4%	3.3%	3.2%	3.1%	-0.1	-0.1	-0.2	-1.0
Credit Card NPL Rate	10.3%	9.1%	9.1%	9.0%	8.7%	-0.3	-0.1	-0.2	-1.6
Commercial Installment Loans NPL Rate	8.6%	7.2%	6.8%	6.6%	6.5%	-0.1	-0.1	-0.6	-2.1
Corporate / Commercial Loans NPL Rate	4.0%	3.4%	3.4%	3.4%	3.4%	0.0	0.0	-0.2	-0.6
Other Key Ratios									
Off-balance Sheet Liab./Total Assets	67.5%	91.9%	93.1%	94.3%	95.3%	0.9	1.3	9.5	27.8
FX Balan. Sheet Pos./Shrs. Equity	-17.2%	-13.6%	-12.7%	-18.5%	-20.8%	-2.3	-5.8	-3.7	-3.5
Sec. Under Custody (Residents)/Sec. Under Custody (Total)	73.8%	65.6%	63.9%	64.4%	64.4%	0.0	0.6	-3.4	-9.4

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