YapıKredi Invest

DAILY MARKET COMMENT

02 February 2012

Reflation, Stagflation, Fragility

"The ECB's new term repo (LTRO) window offers another example of how sovereign debt sustainability concerns can affect financial stability. This new window offers banks three-year money at the repo rate to encourage them to use that money to lend to sovereigns, taking advantage of the arbitrage opportunity. But this financial engineering is a fragile and potentially problematic arrangement. Banks will need to post additional collateral with ECB if the bonds they offered fall in value or suffer a credit downgrade. For precisely the same reasons – fall in value and credit downgrade – banks will need to provide additional capital against monies they have lent to sovereigns. This could put banks on a collateral spiral and erode overall financial stability….(see next page)

Murat Berk

MARKET SUMMARY

Stock Market	Close	Day Chg.	2011 Chg.
ISE-100	59,216	4.0%	-10.3%
ISE-100 ($)	3.37	5.7%	-21.6%
	01/02	**31/01**	**2011 Avg.**
Turnover ($mn)	1,370	1,677	1,393

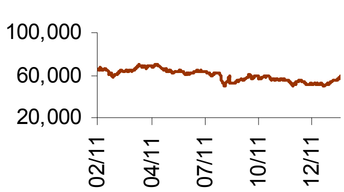
Indicators *	Close	Day Chg.	2011 Chg.
$/TRY	1.7550	-1.4%	13.5%
€/$	1.3170	0.9%	-1.0%
$/JPY	76.15	-0.1%	-6.3%
Gold ($)	1,747.84	0.7%	23.1%
Brent Oil ($)	112.77	1.5%	19.7%
US 10-Yr Bond(%)	1.84	1.9%	-44.2%

**priced as of 6:30 CET this morning*

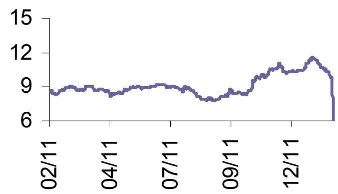
Fixed Income	Maturity	31/01	01/02
Local bond	4/12/13	9.4%	0.0%
Eurobond	15/01/30	160.125	160.375
Repo-simple	10.09%	Repo-comp	10.62%

Blue Chip Tracker	Price (TRY)	Chg (%)	Mcap ($ mn)
Akbank	7.08	6.0%	16,095
Garanti Bank	6.70	4.4%	15,992
Isbank	3.86	4.0%	9,871
Yapi Kredi Bank	3.42	3.6%	8,449
Koc Holding	7.14	3.2%	9,800
Sabanci Holding	6.82	0.3%	7,908
Turk Telekom	8.30	4.5%	16,509
Erdemir	4.13	6.2%	5,046
Tupras	42.20	4.2%	6,006
Turkcell	9.32	2.2%	11,653
Turkcell-NYSE	**$**	**Chg**	**TRY**
Turkcell-ADR	13.12	1.78%	9.21

ISE National



Bond Yield (%)



CALENDAR OF EVENTS

DATE	DATA
Feb 2	France and Spain Bond Auction
Feb 2	US - Nonfarm Productivity
Feb 2	US - Initial Jobless Claims

The most obvious route for sovereign debt concerns impinging on price stability is through the monetization of government debt. Central banks do, of course, resort to open market operations (OMOs) – buying and selling government paper – for purposes of liquidity management. But if the motivation for the OMO is to help out a fiscally vulnerable sovereign or to reduce the cost of borrowing for the sovereign, central banks could end up holding price stability hostage to sovereign debt concerns."

Duvvuri Subbarao: "Price stability, financial stability and sovereign debt sustainability policy challenges from the New Trilemma". Inaugural speech by Dr Duvvuri Subbarao, Governor of the Reserve Bank of India, at the Second International Research Conference of the Reserve Bank of India, Mumbai,1 February 2012.

One has to wonder whether some short-sighted policies in Europe may paradoxically increase systematic risk by further increasing the links between sovereign and financial sector balance sheets. Attempts to win confidence, prop up markets and growth by reflating alone are unlikely increase real wealth, but they will cause further distortions to some economies that are already out-of-sync and have issues of competitiveness and the FX framework. As the latest loan surveys and monetary aggregates suggest, the newly created funds may not flow to companies, real investments and job creation but rather hard assets (i.e. commodities and gold) and carry trades (in its various forms).

Reflationary policies are generally thought in a closed, narrow, linear and short sighted framework. However, in the real world it doesn't work that way and there are usually side effects. In a natural state of things, growth is a wonderful product of productivity but simply reflating to generate positive GDP numbers is not the way to generate a healthy economy.

Also, to say that commodities are not affected by reflation would be wrong. And we should not underestimate side effects of commodities on growth and inflation. Just the cost of oil itself, (setting aside refining, its derivative products) is estimated at around 5% of global GDP.

Thus, higher prices of oil have a definite impact. As we've said before, ultra loose monetary policies and a race to the bottom in major currencies could become a key driver of the price of commodities and then emit a stagflationary impulse as in 2008, or in the 1970s. This is a scenario which is probably not priced in any major asset class right know.