

VAKIFBANK GLOBAL ECONOMY WEEKLY

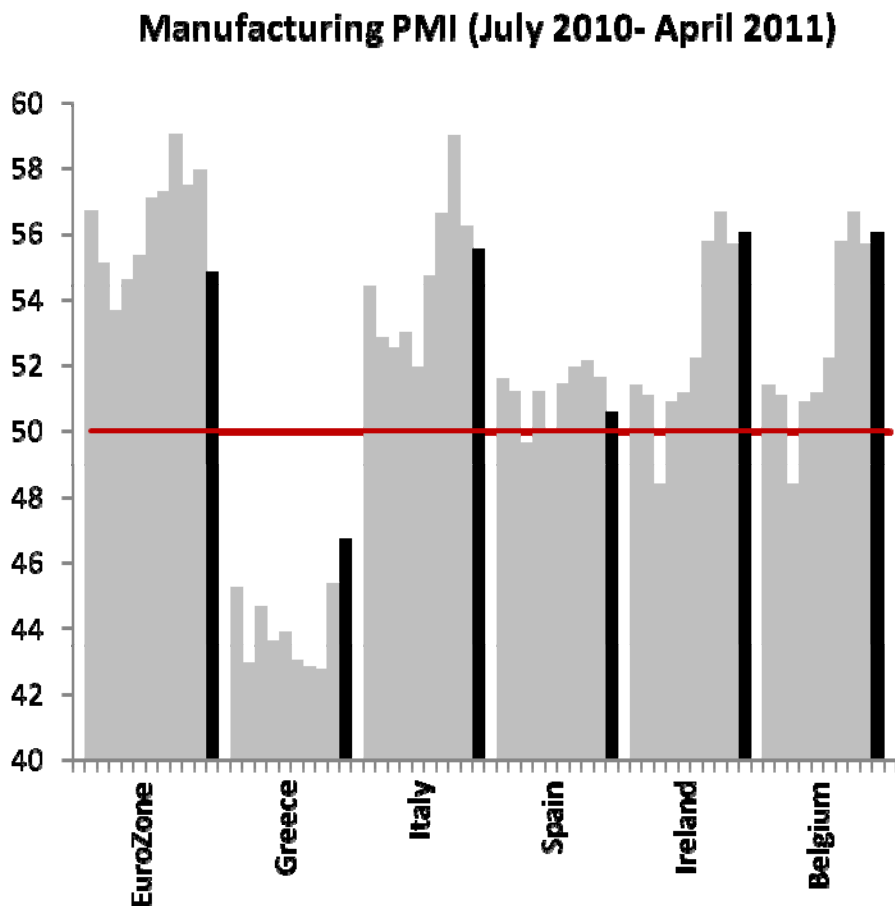
Problems in Eurozone
continues...



T. Vakıflar Bankası T.A.O



Last release of PMI signals negative outlook for the growth...



Source: Bloomberg

- ✓ In May 2011, Eurozone manufacturing PMI declined to its lowest level since December of 2010. This increases the concerns of lower growth in the Q2.
- ✓ Composite PMI which has a higher correlation with the growth, felt in May.
- ✓ In the light of these developments, Eurozone is expected to grow by 0.7% qoq which is lower than Q1. This exhibits a negative outlook for the EuroZone.
- ✓ In April, PMI continued to decline in countries such as Italy and Spain.
- ✓ Despite an increase in the index for two months in Greece, it continues to remain below the critical level of 50.
- ✓ Growth concerns may be important for the ECB decision in the coming months.

Changes in credit ratings of the Euro countries...

	Moody's		Standart & Poors		Fitch	
	Credit Rating	Outlook	Credit Rating	Outlook	Credit Rating	Outlook
Spain	Aa2 ↓ (10.03.2011)	Negative ↓ (10.03.2011)	AA ↔	Negative ↔	AA+ ↔	Negative ↓ (04.03.2011)
Italy	Aa2 ↔	Stable ↔	A+ ↔	Negative ↓ (04.03.2011)	AA- ↔	Stable ↔
Greece	B1 ↓ (09.05.2011)	Negative ↓ (09.05.2011)	B ↓ (09.05.2011)	Negative ↔	B+ ↓ (14.01.2011)	Negative ↓ (20.05.2011)

Source: Bloomberg

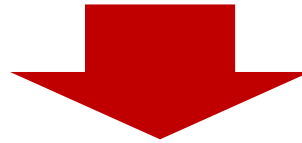
- ✔ Euro debt crisis, which has started in Greece, affects the sovereign credit notes of other countries.
- ✔ Bankruptcy risk of Greece, banking sector problems in Spain and Italy's weak growth prospects and rising debts are underlying problems of the sovereign credit rating cuts.
- ✔ Standard & Poor's cut rating outlook of Italy to negative from stable, due to weak growth prospects and increased risks related to the high debt stock. However, under the current conditions, Moody's and Fitch do not consider any rating change in Italy's credit rating.
- ✔ Concerns about the growth after the implementation of austerity policies in Spain are shown as a reason of the rating cuts.
- ✔ The last rating cut of S&P puts the rating of Greece at the same level with Belarus which is the Europe's lowest-rated country.
- ✔ Fall in Belgium's credit outlook due to concerns for the capacity to accelerate the fiscal consolidation has kept the risks in Eurozone.

Social effects of debt crisis in Eurozone...

- ✔ Ongoing economic crisis in Eurozone has affected the union countries by socially. There has been experienced social explosions in notably Greece, Spain and Italy which have strict austerity policies to deal with the debt crisis.
- ✔ High tax rates which have been applied with the strict austerity policies in Greece led to civil commotions. Nowadays, expectations of the increase in the austerity policies has led to concerns of restarting of civil commotions.
- ✔ Italian 10-year spreads over German bunds have risen to 1.8% and Spanish spreads to 2.52% have drawn attention.
- ✔ S&P's downgrade warning for Italy and lower growth performance of Italy in 2011 Q1 have indicated the continuing economic instability in the country.
- ✔ Besides, downward revise on GDP and upward revise on public debt expectation for the following years in Italy have enforced the expectations which indicates that the exit of economic crisis can be long. This increases the risks towards contiguous effects of debt problems to other eurozone economies.

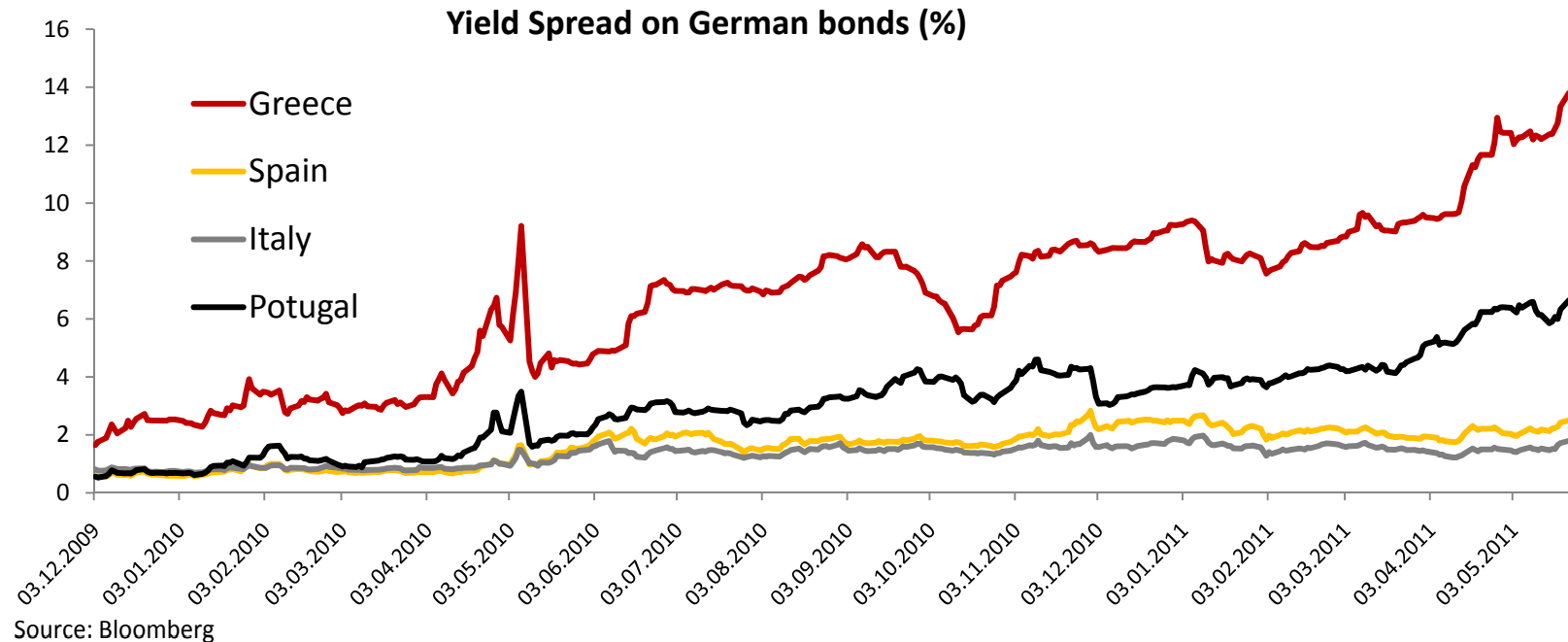


Social effects of debt crisis in Eurozone...



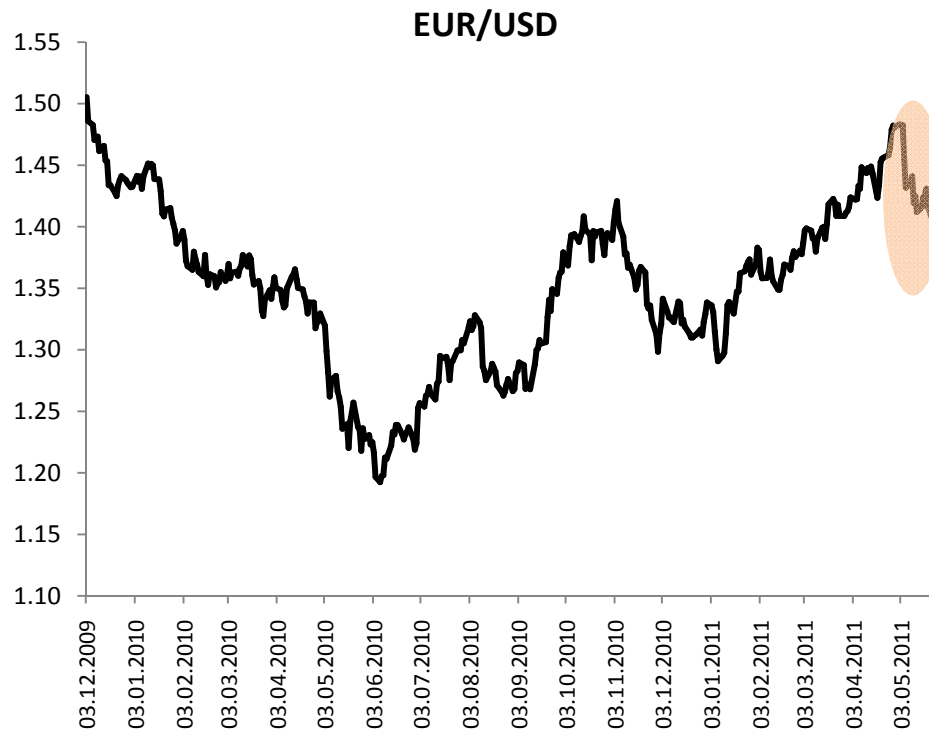
- On the other hand, besides the strict austerity policies in Spain, the high unemployment rates especially in young population has led to the most crowded civil commotion since 2008 crisis.
- The increase in unemployment rate of under 25-year-old to 44.6% in Spain which has a 21.2% unemployment rate in 2011 Q1 has explained why the majority of the protesters has been young people.
- Since the prime minister of Spain, Jose Luis Rodriguez Zapatero, announced that the austerity policies would continue with more tax rate, the young people who react against the unemployment has voted firstly in this election affected the results of election.

The yield spread reached a record high...






- ✔ The yield spread between ten-year Greek government bonds and German government bonds reached a record high. Therefore, the yield differential reached 1,341 basis points.
- ✔ The extra yield demanded by investors to hold 10-year Portuguese bonds instead of German bonds widened due to the rising risks on government debt. Political turmoil in Portugal has added extra risk appetite.
- ✔ Despite, yield spread between ten-year Spanish bonds on German bonds is relatively low. However, political uncertainties would cause increasing in yield spread in the short term.

Recent developments in Eurozone have affected EUR/USD...



Source: Bloomberg

-  Policy rate hike of ECB led to strengthening of EUR against USD in the first quarter of the 2011.
-  EUR/USD parity fell to 1.4050 from 1.4830 because of Greek debt restructuring worries.
-  Recently, since China reported to buy bailout bonds for Portugal, EUR rose to a week high versus the USD.

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