



MACROECONOMIC OVERVIEW

April 2008

Koç Holding

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Political and Economic Agenda

Political worries added another dimension to our universe of uncertainties

As if the worries in regards to the global markets were easy to grasp in forecasting the potential economic scenario for Turkey, the Turkish Constitutional Court's decision to go forward with the closure case against the ruling party added another dimension to our universe of uncertainties. The signals from the global markets continued to be mixed although the prompt actions of the global central banks, led by the US FED, have averted the likelihood of an immediate meltdown in the world markets. The IMF has recently estimated total potential losses related to the U.S. sub-prime crisis to reach up to US\$1,000bn, of which around US\$500bn was attributed to the bank losses. While this figure itself is a large number, it is still a relatively small share of GDP (only around 3% of the total of the EU and the U.S. GDPs), compared to the prior global crisis such as the Asian crisis back in 1998 (when the losses reached up to 35% of GDP) and the Japan banking crisis back in the beginning of 1990s.

A global economic slowdown is now well underway

A global economic slowdown is now well underway, reflected both in growth forecasts and also in world trade. The IMF, for the first time, adjusted their growth estimates four times in a row during the last one year, reducing their growth expectation for the world economy from 5.2% in July 2007 to 3.8% in April 2008 and, more dramatically, from 2.8% to 0.6%, respectively, for the U.S. economy. Regardless of different expectations in terms of the full impact of the turmoil, the economic fall-out is expected to persist for many months.

Higher resilience of the Turkish economy against negative externalities lead market players to be more optimistic about the long-term scenario despite shorter-term volatilities

While the sustainability of the positive growth and disinflationary trends in the Turkish economy have been challenged both through internal and external shocks (including the supply side shocks), the increased resilience of the economy against such short-term turmoil has been supporting the comfort zone of the investor and business community. We have not yet seen very significant capital flights either in the bond or in the equity markets from Turkey and the appetite for both new portfolio and FDI investments appear to be continuing. This comfort zone leads most of the policymakers to stick with their base case scenario in their long-term forecasts, which mainly suggest short-term volatility in the markets and some deceleration in growth rates in 2008, followed by more sustainable and higher growth dynamics in the upcoming years. As the attainment of a final verdict in the political scenario will take some more time, we should expect the continuation of the political uncertainties at least until the local elections, which will take place in March 2009. Until then, it will be important for the AKP government not to deviate their focus from economic targets and structural reforms. What we observed until now is that the Government seems to be willing to even accelerate the process to attract higher voter support and is expected to come up with a five year fiscal program shortly to prove their commitment to the fiscal austerity and structural adjustment process.

Macroeconomic Indicators

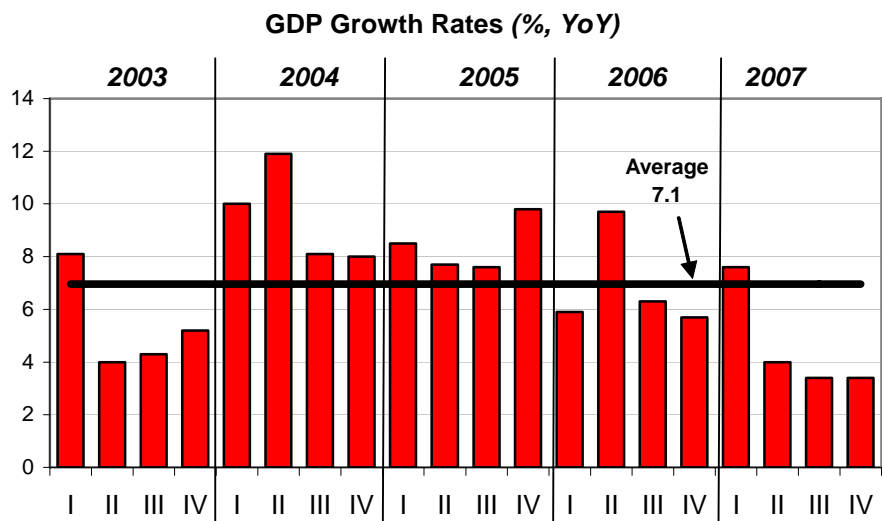
Economic Growth

GDP growth decelerated to 4.5% last year

The GDP figures revealed that the growth rate in 2007 was limited to 4.5%, remarkably lower compared to the 6.9% growth performance obtained in 2006, signalling an economic slow-down. It should also be noted that this is the lowest GDP growth rate since 2001. The GDP, based on the new calculation method reached YTL856.4 billion, or US\$658.8 billion in 2007, while the GDP per capita was US\$9,333.

Agriculture & construction pulled down the headline growth

On the production side, agricultural production fell by 9.7% YoY in the last quarter of 2007, which brought the contraction for the whole year to 7.3%. Manufacturing sector, which has the largest share in total GDP with 24%, also declined annually to 5.4% in 2007 from 8.4% a year earlier. The slowdown in the construction sector was only 0.5% YoY in Q4 and 5.0% YoY over the full year, compared to 18.5% YoY expansion recorded in 2006. The wholesale and retail trade sector that has 13% share in total GDP grew by 5.5% YoY in 2007 against 6.3% a year earlier.



The sharp increase observed in domestic demand post elections decelerated in 4Q07

On the demand side, private consumption continued to grow, although at a much lower pace, and grew by 2.9% Q407 compared to 8.2% in 3Q07. Public consumption is rather more moderate but there is a significant increase in public investment to machinery & equipment (24.6% and 17.7% in Q3 and Q4, respectively). This trend is expected to continue in 2008 as part of the government’s program in the run up to the local elections in March 2009. Meanwhile, private sector’s investment in machinery & equipment is significantly low, posting only 0.7% YoY growth in 2007.

Public sector's investment and private sector's construction growth (20.3% and 6.3% in Q3 and Q4, respectively) were the main contributors to the investment growth. The contribution of net exports is again negative in 2007. While export expansion lowered to 2.5% in Q4, imports posted a robust 15.7% growth that was the highest since 2Q04.

The global drought, weaker domestic demand and the widening trade deficit determined the pace of GDP in 2007

A combination of factors including the global drought, weaker domestic demand and the widening external trade deficit determined the pace of economic growth in 2007. Accordingly, GDP growth was limited to 4.5% YoY, against the government's growth target of 5.0% YoY for 2007.

% YoY	Annual		2007			
	2006	2007	Q1	Q2	Q3	Q4
GDP	6.9	4.5	7.6	4.0	3.4	3.4
Supply Side						
Agriculture	1.3	-7.3	-6.9	-2.3	-8.2	-9.7
Industry	8.4	5.4	10.2	3.9	4.3	3.6
<i>Construction</i>	18.5	5.0	8.8	7.5	4.0	0.5
<i>Trade</i>	6.3	5.5	6.3	2.4	6.7	6.6
Demand Side						
Private Consumption	4.6	4.6	5.6	1.6	8.2	2.9
<i>Food</i>	3.9	3.5	-12.1	11.8	10.8	-8.0
<i>Furnishing, Household Equip.</i>	5.3	1.5	-0.9	-0.8	1.7	2.9
<i>Clothing</i>	-3.9	-3.9	-0.9	-0.8	1.7	2.9
Public Consumption	8.4	2.8	4.7	2.1	3.3	1.6
Public Investment	-18.5	16.5	-3.4	10.8	24.6	17.7
Private Investment	12.0	1.0	-3.2	-3.7	-1.6	11.9
Exports	6.6	6.7	12.5	9.3	4.2	2.5
Imports	6.9	11.1	8.6	5.6	14.4	15.7

Industrial Production

Industrial output grew by 7.5% YoY in February

While the industrial production (IP) grew by 7.5% YoY in February, IP increased by 9.4% YoY over the January-February period on top of last year's 11.4% growth. In annual terms, however, IP growth remained at 5.2%, quite below last year's level of 7.5%.

Production of motor vehicles is the leader of IP thanks to export demand

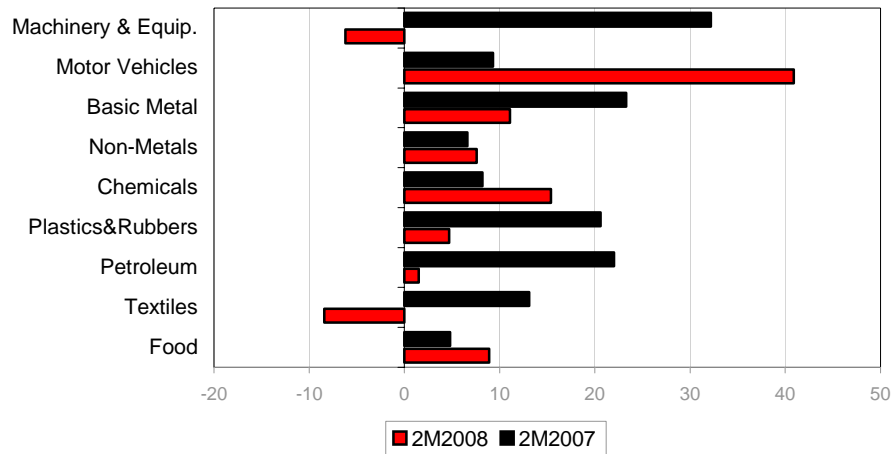
Despite the low domestic demand, IP performed quite well, thanks to strong exports. Given the rising uncertainty and the drop in consumer confidence due to the global markets and domestic politics, performance of IP will continue to rely on external demand conditions. In other words, the main concern going forward is a possible slow down in the EU zone as the main trade partner of Turkey.

Sub-details of the manufacturing industry are in line with the foreign trade figures in which observing the strength of certain sectors,

Continuation of the export strength is vital

namely metals and motor vehicles, are already being observed. So far the figures are in line with Turkey's export driven growth strategy.

Sectoral breakdown of IP shows that most of the sectors posted positive growth annually. Best performers were chemicals, plastic & rubber, basic metals, electrical machinery and motor vehicles, while textile, machinery and radio-TV posted a negative growth.



Automotive sector registered the highest CUR in March

Capacity Utilization Rate (CUR) in the manufacturing industry declined to 81.2% in March, from 82% a year ago. As it was the case in previous months, manufacturers said the main reason for not working at full capacity was low domestic demand. On a sectoral basis, export-oriented automotive sector's CUR was a high of 90.9% and basic metals, another outperformer sub-group reported 88.3% CUR.

% YoY	February	Jan - Feb		Weight in the index (%)
	2008	2007	2008	
IP	7.5	11.4	9.4	100.0
Manufacturing Industry	6.6	11.8	9.0	86.9
Food	7.8	4.8	8.9	10.6
Textiles	-12.8	13.1	-8.4	10.9
Petroleum	-5.3	22.0	1.5	14.5
Plastics	-1.5	20.6	4.7	3.4
Chemicals	11.5	8.2	15.4	10.3
Non-Metals	10.1	6.6	7.6	6.9
Basic Metal	10.1	23.3	11.1	8.9
Motor Vehicles	35.8	9.3	40.9	6.3
Machinery & Equipment	-4.5	32.2	-6.2	5.8

Central Government Budget

First monthly primary deficit occurred in March

According to the central government budget realizations, there was a budget deficit of YTL4.9 billion in March, carrying the YtD level to a YTL4.4 billion deficit. Meanwhile there was a limited primary deficit of YTL117 million in March. On the back of the monthly figure, the primary surplus in the first three months of the year reached YTL9.4 billion, representing 25% of the full year target.

The March figures were visibly worse than the levels prevailing a year ago, mainly due to the inflated figure of last year due to the privatization revenues. The early payment of agricultural subsidiaries (106% increase in nominal terms) also contributed to the annual deterioration. However, the cumulative primary surplus in 1Q08 is still higher than a year ago, somewhat relieving concerns with regard to a deterioration in budget performance.

<i>Billion YTL January-March</i>	2007	2008	% Change	% Real Change	% of 2008 Target	2008 Target
Revenues	46.1	47.2	2	-5.9	23	204.6
Tax Revenues	33.9	40.3	19	9.0	24	171.2
Expenditures	49.4	51.6	4	-4.2	23	222.6
Interest Expenditures	16.0	13.8	-14	-20.9	25	56.0
Non-Interest Exp.	33.5	37.8	13	3.8	23	166.6
<i>Social Security Ins.</i>	8.5	8.9	5	-3.5	24	37.0
Budget Balance	-3.3	-4.4	31	20.6	24	-18.0
Primary Surplus	12.6	9.4	-26	-31.8	25	38.0

Deceleration of economic activity had a negative impact on revenues

On the revenues side, there is evidently weakness in both tax and non tax revenues in March. Total revenues in the first quarter were 5.9% lower YoY in real terms. Real increase in VAT and special tax revenues were limited to 0.7% YoY in the same period. One item which continues to post high increases (13.7% in real terms) is the import duties, indicating higher imports this year.

Agricultural subsidies put pressure on expenditures

On the expenditures side, primary expenditures rose by 12.9% YoY while during the same period, interest expenditures have declined. We will closely follow the government spending in the coming months, especially through local administrations in the run up to the local elections that will take place in March 2009.

All in all, weak domestic demand as well as tight global credit conditions started to cast a shadow over budget performance. On the expenditures side, room for manoeuvre is already very limited. We expect the continuation of the relationship with the IMF, through a new program.

Headline CPI and PPI are shockingly high in March

Inflation

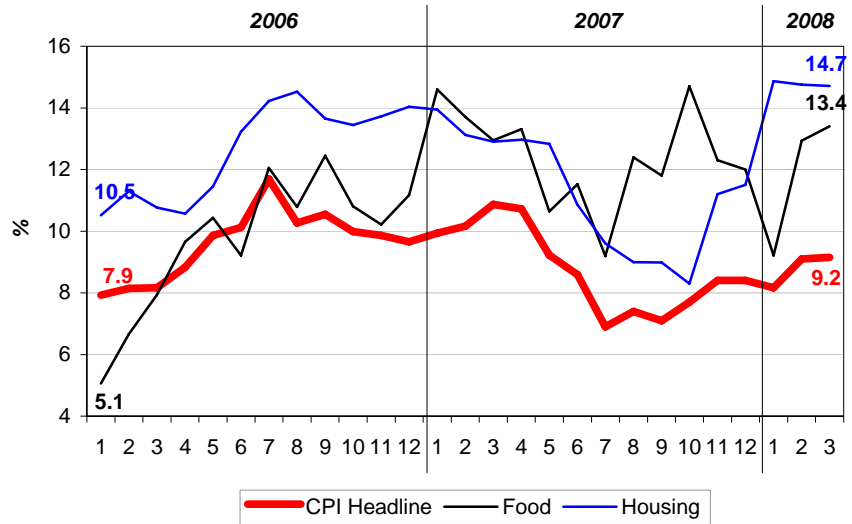
CPI increased by 0.96% in March, higher than the market consensus of 0.66%. Meanwhile, PPI surged by 3.17%, significantly above the market consensus of 1.23%. With the March inflation figures, annual CPI inflation increased to 9.15% from 9.10%, whereas annual PPI inflation soared to 10.50% from 8.15%.

Annual CPI rose to 9.15% from 9.1%

Most of the sub-sectors in both CPI and PPI were on an upward move as the local currency weakened, and the food, energy and commodity prices soared. The CB is target was to reach annual CPI of 7.1% with upper and lower limits of 9.1% and 5.1%, respectively at the end of

the first quarter, however annual inflation surpassed the upper band of the target for March.

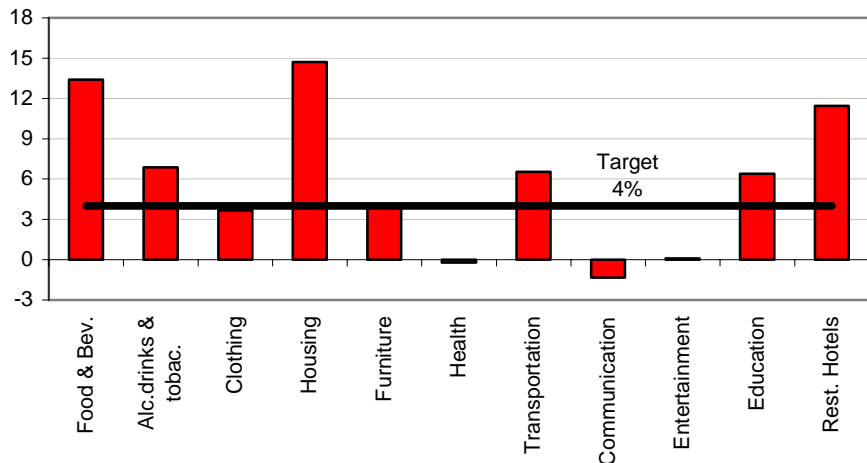
Thus, CB is obliged to send a letter to the government and the IMF, explaining the reasons for the divergence from the quarterly target. The government’s CPI inflation target for this year is 4%, which is already a very aggressive target to achieve.



Core CPI inflation soared in March to its highest level in the last 8 months

Developments in core inflation in March were not encouraging either. Core index D, which excludes energy and unprocessed foods increased from 7.18% to 7.56% and CB’s most favorite H, which excludes alcoholic drinks & tobacco and gold from D, went up from 6.50% to 7.36%, the highest level since July 2007.

Components of Annual CPI (%)



On the production front high commodity and energy prices created a significant pressure

On the producer prices’ front, prices rose by 3.17% mainly due to price hikes in the manufacturing industry, which is very sensitive to currency movements. Agricultural prices increased by 0.82% MoM and manufacturing prices jumped by 3.99% MoM in March, signifying strong inflationary pressures. The increase in commodity prices, especially in metal industry and oil prices are the main reasons

behind the headline increase. This indicates that cost-push inflation pass-through to consumer prices might take place in the coming months, which will lift CPI inflation higher.

%	2007			2008		
	Oct	Nov	Dec	Jan	Feb	Mar
CPI (MoM)	1.81	1.95	0.22	0.80	1.29	0.96
CPI (YoY)	7.7	8.4	8.4	8.2	9.1	9.2
Core-H type (YoY)	6.0	6.4	6.6	6.4	6.5	7.4

* H-type ind.: Excluding unprocessed food products, energy, alch.bev. tobac.prod. & gold

The 1.7% MoM increase in CPI was quite above the market consensus forecast of 1.3% in April. The latest figures soared the annual inflation rate to 9.66%, even exceeding the Central Bank's revised year-end target, which is 9.3%.

External Balances

Despite robust exports, trade deficit continues to increase

The foreign trade deficit widened by 37.2% YoY to US\$10.6 billion in the first two months of the year. In Jan-Feb, exports increased by 52.2% YoY to US\$21.6 billion, while imports registered a 46.9% YoY rise to US\$32.3 billion. Annualized export and import rose to US\$114.6 billion and US\$180.4 billion, respectively, pointing at a total deficit of US\$65.7 billion (19.4% higher YoY)

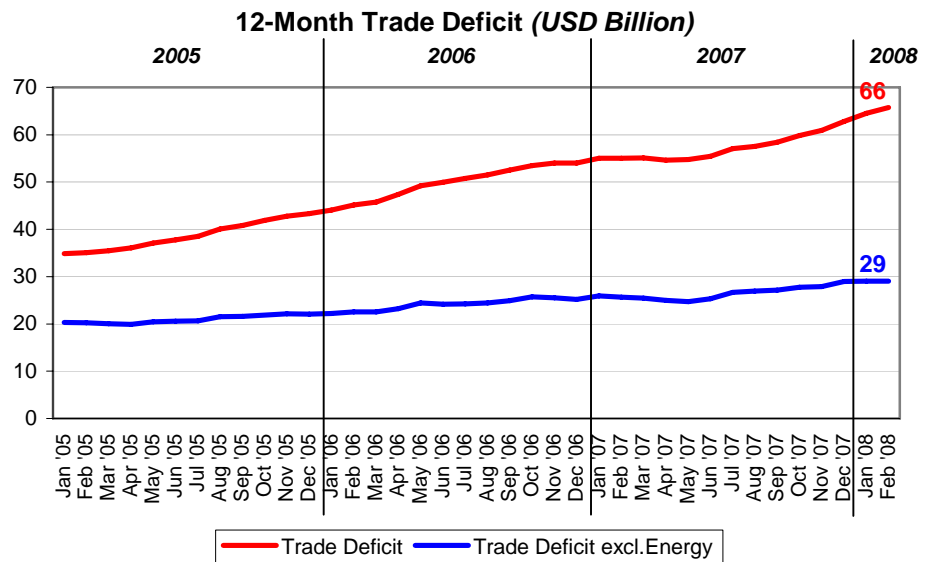
Foreign trade gap widens to 37.2% YoY in Jan-Feb

Strong export performance continues, as formerly suggested by the preliminary data of the Turkish Exporters' Assembly (TIM). Exports increased by 22.86% YoY to US\$10.95 billion in March while 12-month exports reached US\$114.3 billion, representing a 26.6% increase. As the domestic currency depreciates further, one might expect a performance improvement on the exports front, however we expect this improvement to be limited as the global demand conditions are also getting tighter.

USD Billion	2007	2008	YoY Change
12-Month Exports	88.6	114.6	29%
12-Month Imports	143.6	180.4	26%
Foreign Trade Balance	-55.0	-65.7	19%

There is no significant improvement on the foreign trade front

The burden of high energy prices is clearly evident on the imports. When energy is excluded from the YtD figures, the growth in the import of raw materials is limited to 39.5%, down from 45.6%. Due to the slow down in the global economy, a further weakness in the import of consumption and investment goods is expected in the period ahead. However this does not lead to any expectations of a significant improvement on the annual foreign trade deficit.



C/A Deficit continued to soar

The current account (C/A) deficit widened by 23.7% YoY to US\$7.7 billion in Jan-February. On the back of the monthly realizations, 12-month C/A deficit stands unchanged at US\$38.9 billion. Although the annualized C/A deficit stayed stable compared to the previous months, we do not expect a significant improvement in this figure in 2008. High energy prices were the main factor behind the C/A deficit.

US\$ Billion	2006	2007	2008
	Annual	Annual	Feb. Trailing
C/A Deficit	-32.2	-37.4	-38.9
Net Errors&Omis.	-0.1	1.0	0.5
T.Financial Need (1+2+3)	-32.3	-36.4	-38.4
Capital Flows (1) net	53.3	51.9	46.7
FDI	19.0	19.9	14.3
Portfolio Inv.	7.4	0.7	-5.1
IMF Credits (2)	-4.5	-3.9	-2.1
Reserve Chg.(3)	-16.4	-11.5	-6.2

On the financing front, FDI inflows financed 36% of the C/A deficit as of February

Despite the unfavorable global economy, so far, Turkey has financed the deficit without difficulty. The foreign direct investment (FDI) and real sector borrowing have remained strong. The net annual FDI inflow stood at US\$14.3bn, financing 36% of the C/A deficit as of February. Meanwhile, net portfolio investments continue to be weak, standing at US\$395 million. In an annualized basis, we observe a net outflow of US\$5.4 billion. Despite uncertainty in the global credit conditions, real sector continued to borrow without difficulty. Moreover, bank and non-bank sector borrowings were mainly long-term. Considering the financing needs of Turkey's C/A deficit, privatizations, M&A activities and FDI will continue to be key issues in 2008.

Interest Rates and FX Markets

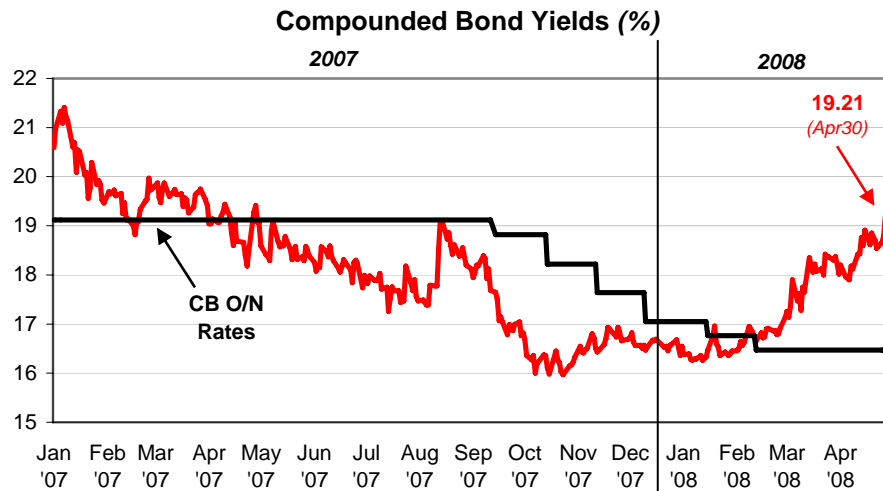
Global markets are still suffering from uncertainty and related volatility

Financial results of banks are being closely watched

While the financial turmoil originated in a relatively small segment of the US financial market -the sub-prime mortgages-, it spread quickly across the world, inflicting damage on the global markets.

Credit market strains have intensified since then, with a broadening range of markets coming under pressure. With rising estimates of bank losses and continuing worries regarding counterparty risk, there were increasing concerns about contagion to other often seemingly unrelated markets.

There has been some success in alleviating pressures and liquidity strains in financial markets have moderated as a result of coordinated actions by major central banks, including the provision of large-scale liquidity support and tough policy interest rate cuts by the Fed and the other big central banks.



* Average compounded yield of all traded bonds and T-bills in the secondary market

Due to the weakness in the US economy and the decreasing likelihood of the ECB cutting rates, the dollar has fallen down to about 1.59 against the euro

There is still risk that the financial market turmoil could intensify further, however, some market participants believe the bottom has already been reached, and from this point on the markets will start to recover. Financial results of banks are being closely watched, while non-bank sector earning performance also started to attract more attention, as the slowdown in the US and Eurozone economies are expected to take a toll on the profitability of real sector companies.

	CBT Rates			Devaluation (%)	
	Apr-08	Mar-08	Dec-07	MoM	YTD
USD	1.2849	1.3064	1.1593	-1.7	10.8
Euro	1.9994	2.0643	1.7060	-3.1	17.2
Currency Basket	2.8244	2.8959	2.4729	-2.5	14.2
REER *	167.8	176.1	190.3	4.7	11.8

* Real Effective Exchange Rate(The base year 1995=100).

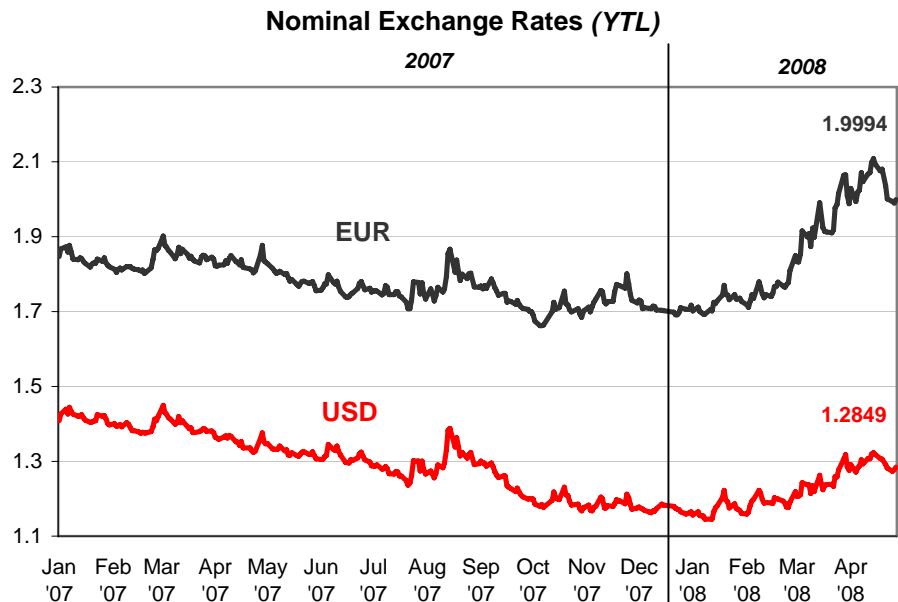
IMF lowered global growth forecast

Many economies are now showing strains of the financial market volatility, although some signs of bottoming out are emerging. On April 2, the IMF lowered its 2008 global GDP growth forecast to 3.7% from 4.1% in January and 4.9% in April 2007, pointing out to a significant global slow down.

In this environment, the interest rates floated within a broad range of 16.4%- 18.6% in the first quarter of 2008 with an increasing trend. It is apparent that 18.02% level has been a downside limit for interest rates in April, reflecting the increased risk perceptions of investors, as well as expectations about the continuation of higher short-term interest rates of the CB.

The basket exchange rate rose by 17.1% in 1Q08 in the domestic FX market

In the FX market, the euro appreciated by 7.38% against the dollar, ending the first quarter at 1.58 level. The basket exchange rate rose by 17.1% in 1Q08, while YTL/\$ and YTL/€ rates increased by 12.7% and 21.0%, respectively. The YTL/\$ floated in the range of 1.29-1.32, while the YTL/€ ranged between 1.99-2.10, reflecting the extent of volatility in FX market.



The CB left the O/N rates unchanged, and signaled its cautious stance

The CB's Monetary Policy Committee (MPC) has kept short term interest rates steady at 15.25%, in line with the forecasts. In their meeting on April 17, the MPC also signaled a possible rate increase in the coming months. Developments in the global markets, domestic demand and fiscal policy implementations will continue to shape the monetary decision of the CB.

Expectations

Pressure over inflation mostly stems from the supply side

Inflation

Although we expect the disinflation trend to continue in the medium term, the current outlook is cloudy due to the risk factors and supply shocks. We find four main risk factors which could create an obstacle to the declining in the rate of headline inflation until at least the first half of 2009:

1. Pass through effect from currency: The recent depreciation will have an impact on the rate of headline inflation.
2. Backward pricing habits: The failure to meet the official inflation targets for two years in a row casts some doubts over the credibility of the CB. The wide credibility gap may provokes an old pricing habit.
3. Secondary effects of high commodity prices: Since this trend has been evident for some time, it is clear to spread to other segments.
4. Cost-push inflation: As the pricing pressure has been lasting long, pass through effect to the CPI front is inevitable.

We expect global conditions and domestic political uncertainties to shadow markets for the rest of the year with rising volatility. Hence, we revised our year-end CPI expectation from 7.2% to 9.0%.

Global markets will shape the direction and pace of CB's actions

Interest and FX Rates

The pressure on the level of inflation together with the slow down on the economic front leave almost no room for manoeuvre on the monetary front. We believe the Central Bank's room for manoeuvre on interest rates is likely to be limited in 2008 even if global markets normalize.

Although we were previously expecting some monetary easing through the last quarter of the year, the latest developments and increasing uncertainties make us believe that there will be no room for monetary easing and even some tightening might be needed.

GDP growth is likely to slow down to 3.9%

Economic Growth

The early indicators for 1Q08 suggest the continuation of the growth dynamics despite the pressure due to external shocks. We are downsizing our growth estimate for the full year to 3.9% due to the expected continuation of political as well as global uncertainties. We believe the long-term investments will continue to support the Turkish growth even in the short-term spectrum.

Macroeconomic Indicators

		2005	2006	2007	2008 Koç Estimate *	2008 Gov. Program
Economic Growth						
Growth Rate	%	8.4	6.9	4.5	3.9	5.5
GDP	US\$ bn	481	526	659	753	685
GDP per capita	US \$	6,864	7,478	9,333	10,633	9,582
Inflation						
CPI	%	7.7	9.7	8.4	9.0	4.0
PPI	%	2.7	11.6	5.9		
Foreign Currency						
YTL / USD (Year-end)		1.34	1.41	1.16	1.33	
YTL / USD (Average)		1.35	1.43	1.30	1.28	1.38
YTL / EUR (Year-end)		1.59	1.85	1.71	2.06	
YTL / USD	%	0	5	-18	15	
YTL / EUR	%	-13	17	-8	21	
Interest Rates						
Nominal Interest Rate (Avg)	%	16.3	18.1	18.1	17.5	
Real Interest Rate (Ex-ante)	%	8.7	10.1	11.1		
Consolidated Budget						
Primary Balance / GDP (Cons. Bud.)	%	6.0	5.4	4.1		3.3
Primary Balance / GDP (Pub. Sec.)	%	5.1	4.6	3.4		3.5
Tax Revenues / Total Revenues	%	77.5	79.3	80.6		
Interest Expenses/ Total Expenditures	%	31.2	25.8	25.8		
Privatization Revenues	US\$ bn	8.2	8.1	4.2		8.2
Balance of Payments						
Exports	US\$ bn	73.5	85.1	107.2		117.0
Imports	US\$ bn	116.8	137.0	170.1		182.0
Foreign Direct Investment (Net)	US\$ bn	10.0	19.9	22.0		18.5
FDI / CA Deficit	%	45.2	62.4	58.8		
Current Account Balance	US\$ bn	-22.1	-31.9	-37.4	-45.2	-50.0
Current Account / GDP	%	-4.6	-6.1	-5.7	-6.0	-7.3
FX reserves excluding gold	US\$ bn	50.5	60.0	71.3		
FX reserves / Imports	Month	5.2	5.3	5.0		
Debt Stock						
Net Public Debt	YTL bn	270.6	259.5	249.0		
Net Public Debt / GDP	%	41.7	34.2	29.1		

* Estimation