

*Alison Adams, PhD*

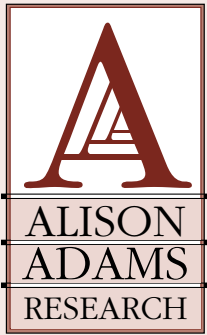
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**Week 37: September 16, 2010**

**Turkey:** *The referendum was only one of 3 victories this week. The surprisingly strong GDP print from domestic demand was another. And perhaps most importantly for PM Erdogan and the run up to parliamentary elections next spring, the MHP opposition seems to be imploding. Comments from the IMF and the OECD about the fiscal rule and financial reforms will be ignored perhaps until after the elections. The budget is far behind schedule, with targets and projections from various ministries still outstanding, and government will be working hard to submit it by mid-October.*

*Putting off the fiscal rule is a win-win for Erdogan:* There might be very good arguments for the fiscal rule that would cap government spending and ensure budget discipline. But those arguments are from economists. PM Erdogan has his eye on the next elections. Growth is moderating and external demand from the EU is weak. Erdogan has every reason to keep his spending as it is now. One has to ask if Turkey's commitment to fiscal discipline is any more questionable than certain European member countries' at the moment? Turkey skeptics argue that the lira is already overvalued. Well Turkish exporters would surely agree. From Erdogan's perspective, foot-dragging with the IMF/OECD has two advantages: He can grandstand on political autonomy from the IMF and its rules for his political base and he can help stave off the inevitable appreciation the lira might suffer if he did implement the fiscal rule.



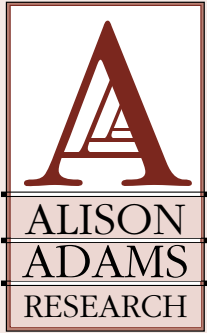
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*The implosion of the opposition party MHP:* The MHP, while smaller than the staunchly anti-AK CHP, is an important opposition party in Parliament that has been able to be reelected and exceed the mandatory voting threshold, even during the AK party asset. But the political base of the MHP has called for the resignation of the party leadership, who alienated their base and parliamentary representatives by coming out against the referendum. The MHP might have little in common with the AK party, but their voters do share a suspicion of the military and its judicial and political prerogatives. The MHP voters were at odds with their leadership and voted for the referendum on the basis that it made the military more accountable to civilian courts and government. The divide inside the MHP should benefit the AK with a weaker opposition. The relief rally in the markets in Turkey seems to be largely psychological. Rather than the referendum having any specific legislation that would directly benefit the investors of the economy, the referendum victory seems to have allayed a host of fears, most of which were unlikely to have ever materialized.

1. Reduced reoccurrence of high-tension challenges from the high courts. The referendum itself reduces the chances of further clashes between the judiciary and the executive. The AK party will not be under threat of dissolution (though I never thought this was a real threat).
2. Continuity of government has been confirmed. The AK is popular no matter how you look at it. And the rumors of its demise were greatly exaggerated so I am not sure why



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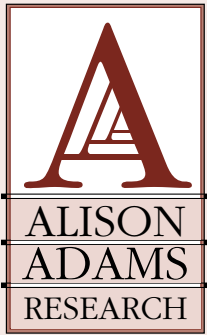
some pundits seem to think that this is a confirmation of their future victory at the polls. No one else stood a chance of winning. Even a coalition government seemed unlikely. But that would have been fine. The AK served its first years under such conditions and survived. The AK party machine was able to get the vote out in spite of bad weather. The voting is definitely geographical, with the western coastal districts voting against the referendum and the interior voting for the changes.

3. Risk of popular demonstrations and clashes has been reduced. Perhaps there was a fear of further confrontation and demonstration if the referendum failed.

4. The AK party still has an active popular support base in spite of economic difficulties.

The AK party is very sophisticated when it comes to polls and has weekly polling data on everything. They would never have sent the referendum to the vote if they did not believe they would win. A 77% voter turnout means that the AK party still has a serious political machine.

*Challenges ahead:* The IMF has yet to resolve its budget problems and the IMF is worried. The 2011 budget and the pre-budget reports and targets have not been completed. These were due in Parliament last June and need to be approved by mid-October. The election will demand more spending and will actually distract the government. Though the referendum has made the army more accountable to civilian authorities and courts, the high profile arrests and trials of generals



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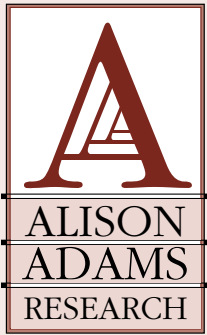
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and their cadres are still ongoing. The referendum gives government workers the right to strike, which is not necessarily a good thing in the long run.

**The New IMF and the new internationalism of globalization:** *Between the G20, Germany, the U.S., and China, the IMF will be nearly unrecognizable in the next couple of years. It will have a voting board comprising emerging markets with blocking votes and a new SDR basket of currencies that will include EM currencies. (If China has its way, and I think it will.) These changes will be a significant support for the continuation of global growth and the ascent of the “Next 11” and Frontier Markets.*

If you doubt that the IMF has had a change of heart, then just look to its friendly and cooperative stance in the most recent International Labor Organization’s conference in Oslo. This meeting was part of the original G20 prospectus from Pittsburgh. Perhaps some might want to consider this international political theater. But the role of the IMF as the G20’s think tank and policy advisor should not be underestimated. The IMF has committed to cooperate with the ILO to focus on economic policies that foster job creation within a sustainable policy framework. And although such research might normally be limited to the likes of the World Bank, the IMF will also apply its technical expertise to modeling optimal strategies for the social protection of vulnerable groups. Normally such research is external to the IMF’s technical focus and has been left outside its serious policy recommendations. The IMF has responded to the G20 requests and has tackled banking reform, financial sector taxes, and energy subsidies over the past year and a



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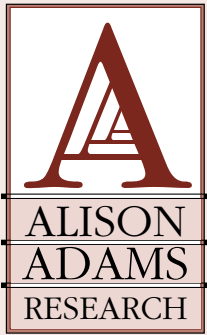
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half. The addition of job creation to their purview will be interesting to see. Certainly, the IMF is concerned with reducing global imbalances and their drivers. Could the IMF become an advocate of higher wages in Asian tigers as a way of addressing these imbalances?

But the IMF Board needs to be rebalanced as well. The current rules for a supermajority vote of 85% for major decisions have given the U.S. a blocking vote. There are smaller IMF board members who could lose their seats entirely to emerging market countries as part of the G20 commitment to rebalancing the IMF board and governance rules. Since the economic crisis began, countries like China and Brazil have been pushing for more IMF votes and control. China is particularly interested in advancing its interests. The current SDR-blended basket of global currencies does not include the yuan. There are China experts who argue that China views the SDR basket reweighting as part of its strategy to liberalize the yuan. A larger voting share on the board and a reduced voting majority rule would help China move for inclusion of the yuan and other EM currencies into the SDR basket.

**Rebased CPI baskets in Egypt and India, while in Russia price caps for food are**

**considered:** *Both India and Egypt will have monetary policy meetings tomorrow. In both cases, but for different reasons, their central banks should stay on hold. The Kremlin is considering price caps for certain foods to help stem inflation. With a heavy borrowing schedule ahead, the government is particularly worried about inflation and local rates.*



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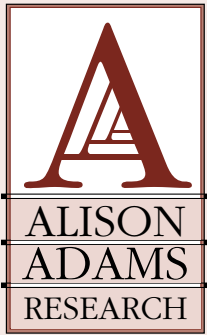
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In India the new WPI basket includes many more goods—including precious metals and white goods—to better capture middle class spending (the new basket includes 241 more items).

According to the new rebalanced WPI, overall inflation fell in August. The old series would have printed higher inflation that might have warranted further interest rate hikes. The Planning Commission is expecting inflation to fall to perhaps 6% by year's end. Better growth, more exports, and lower inflation might mean that India deserves such a high market premium.

*Egypt has a rebased CPI as well.* But even with the new inflation measures, core inflation is running higher than the stated comfort zone of 6–8 percent. Core inflation was up in August to 8.2% over July's print of 7.1%. Recent wage increases for government workers ahead of the parliamentary elections in October and the Ramadan effect could have pushed prices higher. From a political perspective, the central bank has little reason to tighten. Egypt has a presidential election next year and the government might want to keep spending even as oil and gas FDI has been falling. FDI in the oil and gas sector has fallen from \$8bn in 2009 to \$6.8bn in 2010.

A recent decision from the Ministry of Finance has given a massive tax break to property owners with a tax holiday for 2010. The tourist-oriented property sector might also enjoy a tax break. It seems that the government is disposed to help the vote with windfalls of higher wages and tax holidays. Higher interest rates from the central bank might be delayed until after October's elections.



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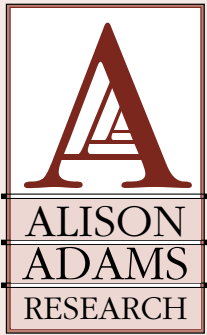
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*Russia's record drought is pushing food prices higher.* The Deputy Minister of Industry and Trade indicated that the government was considering price caps for basic foodstuffs as a result of the drought. Although certain members of government, including Medvedev's economic advisor, will be against such measures, the Kremlin might consider such actions pertinent. Local investment banks are raising their year-end inflation targets above the governments. Higher local rates will hurt recovery and cost Russian corporate more money to issue bonds. The state development bank VEB is planning a ruble-denominated offering as part of its capital-raising plans. Higher oil prices might help offset the troubles caused by the drought. But higher interest rates will have little impact on food prices in the medium term. MoF Kudrin indicated that while the government's fiscal deficit will continue to fall over the next few years, the Kremlin would be borrowing "heavily" to meet budget shortfalls.

**Nigeria, the Petroleum Law, and elections:** *President Goodluck Jonathan aims to have a Petroleum Law ahead of January's presidential election. But he is facing challenges from within his own party for the nomination.*

AAR wrote several months back that the Petroleum Law would be part of President Jonathan's reelection strategy. He nominated his Oil Minister and tasked her with the specific task of bringing the reform law into being. The law will almost certainly mean higher taxes and royalties for the oil companies that are currently operating in Nigeria, though there should be some tax incentives for future deep water projects and capital spending. The oil companies ought to be



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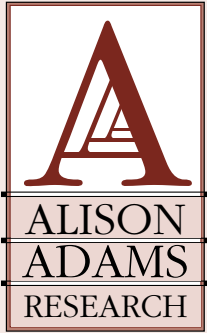
more supportive of the new law as part of its revenue will be used to finance the transfer of 10% percent of the revenues from the oil industry to the rebellious coastal populations. But time is running out and now the vote of the new law is scheduled for mid-October.

And President Jonathan, who has been working behind the scenes to have his nomination and reelection confirmed by the political elites is now in an open contest. The head of the Nigerian Governors Forum, Governor Saraki, has announced his candidacy. There are now 3 candidates for the party nomination. The Petroleum Law and the Energy Reform Law could become casualties in the political horse-trading. Former military president, General Ibrahim Babangida is the third candidate. Early polls show that the state delegates are confirmed for the nomination and reelection of Jonathan.

**China: PM Wen wants more political reform and openness:** *If we see a Wen presidency, will China look more like a democracy? Wen's recent speeches seem to point in that direction.*

At the summer Davos conference in Taijin, PM Wen indicated that China would continue to move towards more openness and reform in the economy and in politics. The state mouthpiece *Xinhua* gave a different translation of speech than the independent newspapers, which included his references to political reform and openness. After a series of low key meetings with Larry Summers and members of the U.S. government, Wen's specific comments regarding a serious commitment to intellectual property rights and openness for foreign businesses seem like a nod





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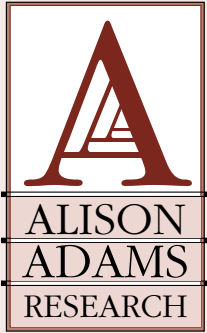
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to the U.S. and its demands. But from Wen, after his “shocking” speech in Shanghai, which included references to political openness, it is possible that if Wen is able to succeed Hu to the presidency, we could see further political reform from China. *Caijing’s* translation of Wen’s speech: “China’s development and progress would not have been possible without reform and opening up. . . . And to achieve the modernization goal of building a prosperous, democratic, and culturally advanced and harmonious country, we still need to rely on reform and opening up.”

**Mutual Assessment Process (MAP), the EU, and the G20:** *The EU is not the only political body interested in using the MAP process for fiscal sustainability. The G20 is also working with the IMF to institute a peer review process of its own.*

The euro’s zone’s Stability Pact will see its language and authority increased to formalize the semester process by which European member countries submit their budgets ahead of implementation for peer review and fiscal sustainability. The members of the EC indicated that sanctions or penalties would be part of the new robustness for the semester process. Of course France was quick to indicate that agricultural subsidies could not be part of the sanctions. Spain worried about regional funds. But there seems to be a political consensus building that mutual assessment is part of new international relations and the management of fiscal risks.

The IMF was asked to begin a sort of MAP process for the G20, which compiled and reviewed member country budgets at face value. From this, the IMF constructed its base-case scenario and



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an optimal outcome scenario based on cooperation and reform. It turns out that the G20 liked the optimal scenario, which emphasized the economic benefits of cooperation and coordination. The IMF's best-case scenario showed that countries working together could boost global GDP by 2.5%. I would not be at all surprised if this kind of MAP process and policy coordination continued as part of the G20's best practices in the future.

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