

Japan and Middle East crises pull down the markets...**Global markets faced with strong sell-off...**

Global markets experienced an extraordinary month in March. Investors headed towards safe ground with high sell-offs in the global markets after civil upheaval in the Middle East and North Africa shifted to a new dimension with the United Nations having authorized air attacks on Libya, combined with the earthquake, tsunami and nuclear dilemma in Japan.

The Monetary Policy Committee kept the policy rate (1-week repo rate) unchanged at 6.25%. The committee also held O/N borrowing rate, lending rate and repo rate for primary dealers constant at 1.5%, 9.0% and 8.0% respectively. This was in line with the market consensus. However, the CBRT shocked the market when it hiked the reserve requirement ratios (RRR), as most market players had not been anticipating an increase.

RRR was increased surprisingly by CBRT...

The new regulation on reserve requirement ratios is expected to withdraw TRY 19.1bn from the market on April 15 as per the central bank's announcement. According to the new regulation, the reserve requirement ratio (RRR) on demand deposits was raised by 300 bps to 15.0%, time deposits with a maturity up to one month deposits was raised by 500 bps to 15.0%, time deposits with a maturity up to three month deposits was raised by 400 bps to 13.0%, time deposits with a maturity up to six month deposits was raised by 200 bps to 9.0%, liabilities other than deposits was raised by 400 bps to 13%. The RRR for time deposits with a maturity up to 1 year, and more than 1 year were kept unchanged at 5% and 6% respectively.

The RRR move is negative for bonds and stocks in the short-run, because market players will likely be in an ambiguous environment as the CBRT shocked the market. On the other hand, it will have a positive impact on the current account deficit and inflation in the medium term, hence affecting the stocks and bonds positively after the initial shock.

Despite the global markets having followed a bearish trend on the back of the MENA crisis and disaster in Japan, the ISE decoupled itself and recovered due to the expectation that the CBRT would hold the interest rate and RRRs at same level at its March 23rd meeting. However, the CBRT hiked reserve requirements aggressively by 300-500bps and the stock market was faced with panicked sales, especially in the banking sector.

Our portfolio recommendations for April 2011...

We believe that markets will closely monitor developments in the credit markets following the recent RRR increase and the MPC meeting to be held on April 21. Moreover, developments in the MENA region i.e. any possible spill-over effects to other oil exporting countries (such as Saudi Arabia) and the oil's upside risk should not be ruled out. In light of the abovementioned expectations, the markets may follow a fluctuating course in April, however, we believe that expectations regarding the results of the general elections in June might start to be priced-in and this will limit the retreat.

We maintain our portfolio coverage of 40% in government securities, 20% in FX and 40% in equities.