

# Weekly Economic Commentary – July 05, 2009

## Markets

Global financial markets completed a second quarter that showed changes wholly consistent with an upturn in the global cycle: the S&P rose 22%, the MSCI EM index was up 51%. U.S. 10-year yields rose 63bp; and the spread of EM bonds narrowed by 239bp. Oil and other commodities have rebounded strongly. Investors are divided over the prospect that Q3 will see stabilization or a further jump up. On currency the role of the US dollar has been questioned and the green back is generally down compared to Q1 also because of fears over long term fiscal sustainability. But People's Bank of China Governor Zhou emphasized that dollar stability was the right policy for now. A significant development came from the IMF board which approved last week a large issuance of bonds to members. The main buyers will be emerging market countries (especially in Asia) looking to diversify (slightly) away from USD.

## Global Developments

**USA:** Consumer Confidence fell to 49.8 in the month of June, following two months of recovery, with insight into some labour market deterioration (respondents stated that jobs were harder to get). The pace of job losses quickened in June, with unemployment rising to 9.5% in June (May: 9.4%) as 467,000 jobs were lost in June (more than 100,000 worse than expected). Some good news came from PMI rose to 44.8 (42.4 in May), with the production component rising to 52.3, its strongest reading since Jan08.

**Europe:** The European Commission reported that its eurozone “economic sentiment indicator” rose substantially in June.

Optimism rose among consumers, in the service sector and somewhat less in industry. The predictive power of these surveys is under scrutiny, as “hard” data are still weak. Euro area unemployment rate for May was up two ticks to 9.5%. Inflation in June was negative for the first time since records started, highlighting the risk of prolonged Japanese style deflation. The ECB remained on hold, but Trichet hinted to possible new rate cuts. The Riksbank cut rates 25bp, to 0.25%.

**Asia and Pacific:** Data are generally more upbeat: Japanese industrial production was strong in May, up 5.9%mom for the second straight month. The revised manufacturing production estimate for June also posted a 3.1%m/m gain. Assuming this holds, production would end up 40%qoq, sa in Q2 (having been down 38%, saar, and 63%, saar, in the previous two quarters). Korean IP rose another 1.6% mom, sa, in May. Production has now climbed 19% since December (not annualized) with exports in June up 17% mom. PMI indices from China are above the 50 mark, confirming the return to global growth as the mature markets struggle.

**Bottom line:** Three elements will drive the global economy in the second half of 2009: a) the slow healing of Western financial institutions (with some problems likely to resurface in Europe); b) the lagged reaction of the real economy to the credit crunch, in terms of unemployment, defaults and restructuring; c) the long term reconfiguration of the economic landscape with the baricenter shifting to Emerging Markets. Last week’s data essentially confirm these trends (and our long held view) that growth will strengthen in EM especially Asia leading the rebound.

## Regional Developments

- UAE banks have “significant” exposure to Saudi groups Saad and Al Gosaibi, the UAE central bank governor said, adding that the issue of frozen accounts should be resolved in a transparent way. According to UAE banks

involved in the deals, the total exposure is more than \$3 bn. The vicissitudes could raise fears by international lenders on exposures to Saudi Arabia and the Middle East.

- Bahrain has endorsed a law to treat GCC nationals as citizens in running their own businesses, to attract investment and improve the business climate. Gulf nationals will be treated on par with Bahrainis in business privileges, rights and fees payments.
- Qatar's 1Q09 GDP shrank 17.5% y/y at current prices in the first quarter, soon after Oman reported a similar decline last week.
- Among GCC countries, UAE topped the Worldwide Governance Indicators (WGI) in government effectiveness; it was in the 80-90 percentile for the control of corruption, but came in low, next to Saudi Arabia on the voice and accountability parameter.
- June's GCC Investor Confidence Index, by Shuaa Capital, showed that confidence in UAE jumped by 15.7% mom. Looking forward, investors see Saudi Arabia, Qatar and the UAE as the economies most likely to improve over the next six months.

## **Market Intelligence on the UAE:**

- Dubai leadership has launched a plan culminating in the bid for the 2020 Olympic Games and the World Expo.
- Abu Dhabi has been selected to host IRENA the UN agency for renewable energies which could spur a growth of alternative energy sector in the UAE and foster a market for carbon trading in the GCC.
- Dubai's inflation rate slowed to 5.4% in the first five months of 2009, compared to 8.7% a year earlier, the head of Dubai Statistics Center (DCS) was quoted as saying.
- A federal law guaranteeing the bond sales of local banks has been passed by the Federal National Council; this

would allow financial institutions to tap cheaper funds, improve investor confidence in new issuances and help develop the bond market.

- Standard & Poor's revised down the credit ratings of DP World and Jebel Ali Free Zone by two levels to BBB+ while Dubai Multi Commodities Centre rating was cut to BB, two levels below investment grade. Similarly Moody's announced that "The Baa1 rating of Emaar was placed on review for downgrade," while Dubai Holding was revised down to A3 from A2. Standard & Poor's (on Mon) revised the CreditWatch implications for 'BBB+' long-term credit ratings on Emaar to 'developing' from 'negative' following the merger talks with Dubai Holding's property subsidiaries.
- Abu Dhabi's International Petroleum Investment Company (Ipic) has signed a USD5 bn syndicated loan, increased from a launch amount of \$3.5bn, banking sources revealed. It is the first major new loan in the Gulf this year. Also Abu Dhabi based developer Tourism Development & Investment Company's \$ 1bn bond issue was oversubscribed 6 times over. Both news highlight the global appetite for regional issuances, the confidence of investors and the need to speed up the creation of a debt market in Dubai.
- With the exit of private shareholders from Emirates Industrial Bank the way is open for the merger with Emirates Real Estate Bank (EREB) to create Emirates Development Bank (EDB), with a capital of Dh10 billion. Approval of the draft bill on EDB's establishment however has been stalled by the Federal National Council which asked to conduct more studies.
- Emirates NBD has announced the conclusion of the issuance of AED 4bn Tier 1 debt securities (sole investor: Investment corporation of Dubai), enabling the bank's Tier 1 capital adequacy ratio to exceed 11% and the overall capital ratio to exceed 17%. As per the UAE Central Bank, overall capital adequacy ratio of the UAE

banking system was 16.2% as of Mar09.

- **Bottom line:** The authorities are putting in place safeguards to allay fears in the financial markets while starting a process of consolidation and restructuring in key economic areas, which is entirely justified by the downgrades of key companies in Dubai.