

Weekly Economic Commentary – July 23, 2009

Markets

Global stock markets continued to rally in the second half of this month after broadly positive corporate earnings reports dominated the scene: of 107 companies in the S&P500, 78% are now beating earnings expectations; 7% meeting the expectations; and only 16% falling short. The few macroeconomic data releases broadly confirmed the inception of an economic stabilization phase. Regional markets continued to gain: the Dubai Financial Market index lifted after news that the UAE central bank may subscribe to the second bond issue by the government of Dubai, but from last Tuesday it has lost some ground. A positive response is expected to the announcement of the creation of the “Dubai Financial Support Fund”.

The dollar weakened after news of strong Chinese growth and positive earnings surprises boosted risk appetite, pushing investors away from greenback and into riskier assets. The weakness of the dollar also led to a rise in gold and oil prices.

Global Developments

USA: Retail sales rose and producer prices were up in June, with the- transportation sector being the biggest driver. The budget deficit in June was \$94 billion and year-to-date, the deficit is \$1.086 trillion, with outlays up 20.5% and receipts down 17.9%. It will take several years to make up for this kind of fiscal laxity.

Europe: Eurozone industrial production increased mildly in May, the first expansion in industrial activity since Aug08, largely from a rebound in capital goods production. The ZEW

financial markets indicator rose strongly in May indicating a better outlook for the second half of 2009, while the assessment of the current situation remained broadly unchanged.

Asia and Pacific: More positive news from Emerging Asia. China grew at an annual rate of 7.9% in 2Q09 from 6.1% in 1Q09, fuelled by the stimulus program. Government-led infrastructure investment projects continue to be a main driver of the acceleration of fixed asset investment (in China), which accelerated 35.2% in June. Advance GDP growth estimates for 2Q09 in Singapore declined less-than-expected, at -3.7% yoy (largely contributed by the rise in biomedical manufacturing output and electronics inventory restocking), compared to the 9.6% drop in the previous quarter.

Bottom line: The last few months have been dominated by the stabilization in the global economic cycle and reduction in systemic risk through massive government intervention. We continue to take the view that global economic recovery depends on recovery in Asia and particularly China. The positive news on Chinese growth confirms our view. We are looking for signs over the next few months to confirm sustainability of the recovery. But until hard data become available in 2 to 4 months the horizon will remain clouded with expectations likely to shift quite wildly. The summer holiday over the next few weeks is expected to bring some lull in the markets, although one should remember that major crises (Russia, Thailand, Mexico, invasion of Kuwait) tend to erupt in August and September.

Regional Developments

- Oman's slow progress on diversification was underscored in the Central Bank of Oman's Annual Report, given brisk activities in the petroleum sector and improvement in its GDP share to 51.3% in 2008 from an average 46.3% share in the previous four years.
- Negotiations are expected to resume between the GCC and

European Union over the next few months to discuss the free trade agreement and other issues. Given that the EU is a top trade partner for the GCC, a successful agreement would be a win-win for both regions.

- Abdullah Sadiq Dahlan, Saudi Arabia's representative to the International Labour Organisation, was quoted in the Arab News paper suggesting that the country should reform the citizenship system to open the way for long-term legal residents to acquire naturalisation.

Market Intelligence on the UAE:

- The United Arab Emirates central bank may buy into the second tranche of Dubai's \$20 bn bond programme and "start trading these bonds very soon" if the Board so decides, according to the UAE Central Bank Governor Sultan Nasser al-Suweidi (as told to Bloomberg). He also mentioned that he was reassured about the dollar by U.S. Treasury Secretary Timothy Geithner and hence "we emphasise that we will continue to peg the dirham to the U.S. dollar".
- According to a report by the Samba Financial Group, potential investors in the new UAE sovereign bond issue could include UAE's sovereign wealth funds (SWFs), since this would potentially open up a new source of long-term corporate finance; also meaning that the region's SWFs could potentially depart from its long-standing tradition and begin investing in the local market.
- A report by CB Richard Ellis placed Dubai as the second most expensive office market in the Europe, Middle East and Africa region, but expected rents to fall further when more supply hits the market. The report also mentioned that occupiers of older office buildings were withdrawing from commitments to move into premium office space due to economic uncertainties in Abu Dhabi, while weakened demand from the banking sector was affecting demand for office space in Bahrain.