

Weekly Economic Commentary – November 07, 2010

Markets

Equities markets have been driven by the reaction to the QE2 announced by the Fed. Regional markets were mostly up except Oman and the UAE, whose indices were weighed down by property stocks; the DFM index dropped almost 2.5% after hitting a six-month high on Monday. Commodities, primarily oil and gold, have rallied since the Fed's announcement alongside a weak dollar, which hovers around its lowest level of the year.

Global Developments

Americas:

- S&P estimated the gross cost of US financial reform legislation for top 8 US banks would be \$19.5-22 bn. US core personal consumption expenditure index was unexpectedly flat mom in Sep (Aug: 0.1%). The ISM composite index of the manufacturing sector rose to 56.9 in Oct, the highest since May 2010 as new orders and production posted strong increases. The non-manufacturing index rose to 54.3 (Sep: 53.2). New orders by US factories rose 2.1% mom in Sep, posting their largest gain in eight months. Initial jobless claims rose by 20k to 457k. The four-week moving average rose slightly to 456k from 454k for the prior week offsetting the positive jump recorded last week, confirming a weak labour market. Non-farm payrolls added 151k units in Oct as the private-sector added 159k jobs. The unemployment rate remained at 9.6, as non-farm productivity grew faster than expected in Q3, increasing at an annual rate of 1.9% (Q2: -1.8%) while non-farm output grew at a 3.0%

in Q3, accelerating from 1.6% in Q2. Brazil's new President Rousseff elected with 55% of the vote is expected continue the current model of free-market policies and social programs which constituted the main planks of her predecessor's policies.

Europe:

- The Portuguese Parliament approved the 2011 budget, thanks to abstentions by the opposition Social Democrats. However the 2010 deficit is still out of control, hence analysts are holding judgment until the austerity measures actually reduce the deficit. The final estimates for EU PMI data showed an increase to 54.6 in Oct (Sep: 53.7), as manufacturing output and new orders rose for the fifteenth successive month. The ECB left policy rates unchanged, with Trichet being more hawkish than last month. Eurozone Sep retail sales slowed, falling 0.2% mom, adding concerns as to the region's economic prospects.

Asia and Pacific:

- The Australian central bank surprised the market with a 25bps hike in interest rates, resulting in the AUD striking a 27-year high against its US counterpart.
- The Reserve Bank of India (for the 6th time this year) increased repo and reverse repo rates by 25bps to 6.25% and 5.25% in an attempt to stem rising inflation, while signaling a near-term pause in rate action.
- China's central bank reported that the value of trade settlements in yuan increased 160% qoq in Q3 to 127 bn yuan (\$19 bn) exceeding expectations. However, Yuan settlements are equal to just 2.4% of total trade.
- Manufacturing PMI data for both China and India rose sharply in Oct – growth fuelled by rising consumer demand. Chinese PMI moved up to 54.8 (Sep: 52.9) while

India's registered a 2.1 point rise to 57.2.

- South Korea registered a surprisingly higher than expected USD 6.9bn trade surplus for October, causing a sharp rise in the KRW against the dollar on Monday.

Bottom line:

QE2 implies \$600 bn of Treasuries purchases through June. This adds to acquisition of agency debt and MBS paydowns bringing the total program to \$850-900 bn. Given the severe blow suffered by President Obama in the midterm elections this measure is the only significant policy for months to come, but utterly inadequate (and potentially damaging) to stimulate growth and likely to lead to asset bubbles in emerging markets. Stock markets celebrated the new injection of liquidity, but the prospects for the real economy are hardly rosier. In a week where G3 central banks left policy rates unchanged, Asian and peripheral nations were busy tightening, confirming once again the gap in growth rates between mature and emerging economies, which is likely to widen in 2011.

Regional Developments

- IIF underscored that further strengthening of banks' balance sheets is a key precondition for a recovery in GCC credit growth. The sooner banks recognize losses and raise additional capital, the sooner they will be able to rebuild their loan portfolios and resume normal credit conditions.
- The Egyptian government is considering issuing 100-year bonds worth \$500 mn, media sources reported and the foreign minister confirmed without specifying the amount.
- Qatar has announced the initiative of Enterprise Qatar Capitas Group International, to help SME owners gain access to capital, and take on policy initiatives on their behalf.

- The Doing Business 2011 report places most GCC nations lower than previous year rankings, except Saudi which improved to 11 (2010: 12) while Oman retained its position at 52. UAE stands at 40 (37) alongside Bahrain slipping to 28 (25), Qatar to 50 (39) and Kuwait to 74 (69). The pace of reforms has not been maintained.
- Saudi Arabia's PMI rose to 59.9 in Oct from Sep's 58.4, as strengthening domestic demand led to rising optimism in business conditions. Meanwhile, the UAE's PMI report hit a series high of 53.8, from Sep's 52.6, with output and new orders registering accelerated growth.
- Saudi Arabia's annual inflation rate slowed slightly to 5.8% in October, but monthly inflation stayed at 0.5% for the third month in a row. The weakness of the US dollar will maintain pressure on GCC inflation rates.

UAE Focus

- Tamweel, a home finance institution that had been on the brink of insolvency, announced that it was starting its activities again, after being recapitalized by Dubai Islamic Bank.
- The total value of foreign direct investment through UAE free zones has touched Dh268 billion according to Shaikha Lubna Al Qasimi, UAE's Minister of Foreign Trade.
- Inflation hit a 16-month high in Sep, at 1.2%, after staying at 0.9% for four consecutive months. The rise was attributed to the increase in the cost of food (2.7%) and transport (1.6%).
- DP World ratings has been upgraded to positive from stable by Moody's, citing solid performance and the company's deleveraging process.