Weekly Economic Commentary – December 12, 2010

Markets

Markets are giving a warm reception to the US tax deal and made gains globally, although EM were on a softer tone. Regional markets were up, with Qatar benefitting the most after winning the World Cup bid. Higher US Treasury yields supported the dollar, while both oil and gold weakened.

Global Developments

Americas:

The US approved a substantial fiscal package, financed by additional borrowing. The plan extends tax cuts, and unemployment benefits, while cutting a payroll tax and the estate taxes (with exemption below USD 5 mn). With some details still hanging it looks like fiscal policy in 2011 might be neutral to mildly expansionary, but fuels concerns on long term debt sustainability, which in fact impacted sharply the bond markets.
The Mexican Central Bank governor stated that the adoption of QE2 in the US has not resulted in sizeable capital inflow into emerging markets, because the policy had already been discounted by markets.
US initial jobless claims declined to 421k in the week ending Nov 27, from a revised 438k the week before. The four-week moving average fell to 427,500, the lowest since August 2008.

Europe:

- The Euro Group (i.e. Finance Ministers) did not increase the size of the EFSF (rescue fund) nor considered the

introduction of (mutually guaranteed) “EU bonds” managed by a common debt office.

- German manufacturing output grew strongly in Oct by 3.2% which translates into a quarterly rate of 21.1%, annualized. German manufacturing orders increased 1.6% mom in Oct, led by domestic orders.
- German industrial production (IP) rose by 2.9% mom in Oct (Sep: -1.0%), the strongest monthly increase since May, while French and Italian IP fell, declining 0.8% and 0.1% mom respectively. The data again underscore the divergence between an expanding Germany and an ailing rest of the Eurozone.
- Moody’s cut the sovereign rating of Hungary by two notches to Baa3, one notch above junk status, with the outlook remaining negative.
- Hosting the World Cup could be negative for Russia’s sovereign debt due to large expenses envisaged.

Asia and Pacific:

- The highlight from China is the 50bp hike in reserve requirement to 18.5% for its largest banks, taking the total hike this year to 300bp in all.
- China’s trade surplus was USD 23.9bn in Nov (exports: 34.9% yoy and imports 37.7% yoy) while broad money growth quickened to 19.5% in Nov, alongside new lending at CNY 564bn.
- Oct industrial production was up in India and China. Indian IP increased 10.8% yoy, the fastest pace in 3 months while Chinese IP rose 13.1% yoy. But inflationary pressures are mounting – Chinese CPI grew in Nov by 5.1% yoy, the fastest pace in two years, while Indian WPI inflation ran close to 9% yoy in Nov.
- The Indian government is expecting that Parliament, after three years of stalemate, will soon relax FDI limits in the insurance and retail sector, from the current level of 24% to 49%.

- South Korea's central bank left the policy rate unchanged at 2.5%, even though inflation touched 4.1% in Oct – the top end of the CB's 2-4% comfort zone.

Bottom line:

The fiscal policy deal in the US is the typical compromise reached by a bi-partisan consensus at the expense of fiscal stability, but which fail to address the reforms necessary to jump start growth. With QE2 essentially switching long term public debt for short term liabilities, the US government bond market looks dangerously vulnerable to a shock. Meanwhile in Europe the bolder proposals to deal with the current and future fiscal crises in the Eurozone are mired in a quarrel between Germany and the more profligate members of the monetary union. In emerging Asia, with inflationary pressures building, the authorities are forced to follow the Chinese lead and reduce bank credit, which will have an impact on global liquidity and take out some support for stock markets.

Regional Developments

- E&Y Q3 report indicated that capital markets raised USD 177 mn in the MENA region – a 79.7% yoy and 70% qoq decline – taking the total IPO value for 2010 to date to USD 1.2bn.
- Kuwait Finance House made an early payment of US$250 mn on debt due in March 2011, a rare occurrence in the current market environment.
- A consortium of large SWFs including ADIA has invested USD $1.8bn in new capital into the independent Brazilian investment bank BTG Pactual. The deal marks a new step in the "new financial order", because it is the SWFs' first big move into Latin America bypassing the traditional financial centers and institutions.
- National companies will be allowed to open branches in any GCC state treating them on par with local firms, in

the latest move towards a Gulf Common Market. This will lead to increased intra-region trade and investment.

- Oman’s 2011 budget has assumed an oil price at $58 a barrel, compared to $50 in the 2010 budget. Total revenues have been budgeted at OMR 7.28bn and spending at OMR 8.13bn, projecting a deficit OMR 850mn for 2011.
- According to the Saudi newspaper Okaz, SAMA has proposed the postponement of the approval of the mortgage law following a surge in inflation to 6% in October.
- The Aluminum Bahrain (Alba) IPO, was fully subscribed with around 75% coming from institutions and the remainder from retail investors, including employees. Alba is majority owned by the SWF Mumtalakat.

UAE Focus

- Government officials confirmed that the validity of the labor card for all workers and employees in the UAE private sector will be reduced to two years from the current three.
- Bank of America Merrill Lynch wrote in a report that Aldar Properties is expected to re-finance AED 3 bn of debt by year-end. The AD government has likely injected cash into banks’ deposits in view of this operation.
- The law creating a federal credit bureau to assess the credit worthiness of bank clients was approved last week. This will significantly improve the legal framework relating to credit data and bank risk in the UAE.
- Dubai will increase electricity and water tariffs by close to 15%, from 2011, due to higher fuel prices.
- UAE PMI for Nov slipped to 52.9 from Oct’s peak of 53.8 as strong competition forced non-oil private sector firms to absorb input price inflation; employment grew at the weakest pace in the survey’s 16-month history.
- The UAE Central Bank Governor announced that the UAE has no plans to rejoin the Gulf monetary union or depeg its

currency from the dollar.

- Axiom’s proposed IPO, which was priced at between $0.80 and $1.15, was withdrawn from the market citing “widespread concerns about market conditions and liquidity”.
- Dubai’s non-oil trade increased 19% yoy in Q3, recording a new high of AED 425bn. At the end of Q3, imports recorded a 14% increase to AED 268bn while re-exports grew 22% to AED 106bn. India had the biggest share of non-oil trade transactions with Dubai, followed by China and the US.