

Weekly Economic Commentary – December 26, 2010

Markets

Markets were in pre-festive mood and trading was drifting in low volumes – even US macro data signaling move towards recovery failed to excite markets. In Europe there were mixed effects stemming from the support by the Chinese authorities and the downgrade of Portugal. KSA hit a 7-month peak after the 2011 budget was announced. The euro fell for a third-straight week against the USD and the yen on the rating downgrades. Oil closed at \$90 on Fri – the highest in more than two years due to cold weather, sharply lower US inventories and the OPEC's decision to keep oil output unchanged, while gold continued its rally.

Global Developments

Americas:

- PCE index rose 0.1% after being flat for four straight months.
- Existing home sales was up 5.6% mom in Nov, but 27.9% below Nov '09 levels. New home sales showed a notable increase of 5.5% in Nov to an annual rate of 290k on new home sales in the West (+37.3%).
- US home prices fell 3.4% yoy as sales of foreclosed properties dragged down values.
- Consumer spending rose for a fifth straight month in Nov, rising 0.4% mom (Oct: 0.7%), supported by a 0.3% increase in incomes (Oct: 0.4%). However GDP revision disappointed: against expectation of a 3.0% increase the figure was only 2.6% almost unchanged from the early estimate of 2.5%.

- US Durable goods orders fell 1.3% mom mostly due to lower aircraft bookings.
- Analyst Meredith Whitney warned about hundreds billion USD defaults on municipal bonds in 2011.
- Continuing claims dropped by -103k to 4.064 million vs. a median forecast 4.105 million.

Europe:

- The EU and EFSF are mulling to issue bonds up to €13 bn in early Jan to fund the Irish bailout. Expectations are for EUR 5bn with 5-10 year maturity, followed by an EFSF bond of up to EU 8bn with a 3-year maturity.
- Chinese Vice Premier Wang Qishan said his government took “concrete action” to support indebted EU countries, essentially confirming that Chinese authorities are investing in Euroland government bonds.
- For the year-to-date, Greek government bonds have lost 19%, Ireland -12%, Portugal -7.6%, and Spain -5.2%. Italian government bonds are nearly flat on the year. This contrasts with a 6.69% total return from UK gilts, a 6.07% gain in German bunds, a 5.58% total return in US Treasuries, and a 1.80% return from JGBs.
- Spanish banks reported their highest bad loan ratios in 15 years: 5.66% of total lending in Oct (Sep: 5.49%).
- Fitch cut Portugal’s rating by one notch to A+, citing concerns of “deteriorating near-term economic outlook” and a “much more difficult financing environment” for government and banks.
- Fitch also downgraded Hungary by one notch to BBB-, the lowest investment grade.

Asia and Pacific:

- China’s central bank raised interest rates on Sat – benchmark lending and deposit rates by 25 bps to 5.81% and 2.75% – for the second time in two months to rein in

- inflation – at a 28-month high of 5.1% in Nov.
- Hong Kong's central bank has set up a CNY 20bn fund to ensure supply of yuan for cross-border trade. HK banks can access this fund from Jan in case HK clearing bank run out of yuan liquidity.
 - Japan's export growth accelerated to 9.2% yoy in Nov in volume, from 5.3% in Oct, while in value it rose by 9.1%, from 7.8%. But the trade surplus was only Y163 bn versus forecasts of Y450 bn because imports also grew strongly. Trade surplus halved over a year ago. With this figure Q4 GDP is poised to be rather weak.
 - Singapore's Nov CPI rose 0.3% mom and 3.8% yoy on higher costs of housing and transport.
 - South Korea announced a levy on banks' foreign exchange borrowings, following the Oct implementation of FX forward position limits and a maximum 100% hedge ratio for corporates.

Bottom Line:

In the US signs of recovery are mixed at best, with the real estate far from having bottomed out, the labor market improving slightly and consumption holding up. The fiscal crisis remains the focus in Euroland with markets unconvinced by the European Union approach to tackle the impending defaults, while downgrades are testing nerves. In Asia a tightening monetary cycle is in full swing to offset inflation and stabilize growth.

Regional Developments

- GCC Secretary General Al Attiya stated that the Gulf Currency Union is "around the corner". Separately the GCC Monetary Council announced the completion of the institutional framework draft and the organizational structure of the Central Bank also approving its operating budget for the current fiscal year.

- Saudi Arabia announced a record 2011 budget with expenditure of USD 155 bn with most of the funds directed towards infrastructure. The magnitude of the stimulus will generate powerful effect throughout the GCC. Education and training account for 26% of outlays, in an effort to boost the local workforce's human capital.
- Saudi Arabia's annual inflation was flat from the previous month at 5.8% in Nov.
- Bahrain has released four British citizens held in the country without charges for 18 months. They worked at banks involved in the row between Maan Al Sanea business and the AlGosaibi family.
- Qatar will be able to mitigate the impact of any sharp fall in hydrocarbon prices by pursuing fiscal consolidation in the medium term, according Prasad Ananthakrishnan, IMF Mission Chief.
- The joint venture between Mubadala and GE is buying a stake in Oman's United Power.
- A new SR1.1 bn industrial city is to be built in Riyadh in line with the Kingdom's strategy to involve the private sector to strengthen its industries and achieve economic development.
- The Islamic Development Bank, said in a statement its Mega Islamic Bank created to provide "liquidity management solutions to create an Islamic interbank market" will have an initial paid-up capital of USD \$1 bn. The bank will also originate and finance large projects across Muslim countries.
- Saudi Electricity plans to invest USD 80 bn to upgrade capacity to at least 70,000 megawatts by 2020 from the current 50,000 MW to meet demand rising at 8% per year.
- Kuwait bourse mulls the launch of an OTC market for troubled firm whose share trade below 100 fils.
- Fitch affirmed Bahrain's long-term foreign and local currency Issuer Default Ratings (IDRs) at 'A' and 'A+' respectively, underscoring the country's stable economic

performance and robust growth outlook.

- Qatar Airways is planning to launch an initial public offering in early 2012 after three consecutive years of profit, according to the CEO Akbar Al Baker.

UAE Focus

- Dubai International Capital will replace its CEO, Anand Krishnan with CIO Officer David Smoot as major lenders agree to the investment company's plans to restructure USD 2.6bn of debt. The core committee of lenders agreed to the offer of 2% interest and repayment over six years on a USD 1.25bn syndicated loan that was due in June.
- Borse Dubai denied reports that it is planning to sell its stake in the London Stock Exchange.
- UAE inflation was unchanged mom in Nov after a 0.6% mom increasing Oct. due to falling housing and transportation costs, while food and goods and services prices rose. In the Emirate of Abu Dhabi inflation rose 4.13% yoy, as housing rents and energy costs continued to push inflation to new highs
- DP World announced the sale of 75% of its Australian port interests to an infrastructure fund managed by Citigroup Inc. for around AUD 1.5bn as part of the plan to reduce its debt exposure.
- A new resolution by the UAE Minister of Labor, says that from Jan 1 a new employment permit will be granted immediately after a work contract expiration eliminating (if the contract ends amicably) the six-month period mandated so far.
- The Emirates Securities and Commodities Authority recommended a merger of UAE stock exchanges to boost liquidity, later clarifying that their Board of directors were still undecided about this merger.
- A Dubai tribunal has halted an attempt by Nakheel to raise AED 41mn (USD 11.2mn) in extra fees in a landmark ruling with implications for a dozen buyers on the

offshore World development