

Weekly Economic Commentary – July 10, 2011

Markets

The fluctuations driven by the negotiation over Greek rescue program have abated. With the dust settled, the attention has turned to the macroeconomic fundamentals, the lack of momentum, and the other fiscal crises in the US and Eurozone. Hence the new drop in stock markets after the end-June mini rally. Regional markets are in summer mood with minimal volumes, with investors remaining cautious ahead of Q2 earnings. A weaker dollar led to safe haven demand for commodities, including gold.

Global Developments

Americas:

- US non-farm payroll figures were downbeat: 18k new jobs were added in June, the smallest number of new jobs in nine months, and are insufficient to inject any confidence in the strength of the recovery.
- Private sector payrolls reported an addition of 157k new jobs in June, more than four times May number.
- Factory orders rose by 0.8% mom in May (Apr: -0.9%) to USD 445.3bn, with capital goods orders excluding aircraft and military equipment, rising 1.6% after a decline of 0.4% in April.
- June's ISM non-manufacturing index declined to 53.3 (Apr: 54.6), as new orders fell to 53.6 (56.8) and business activity dropped by 0.2 points; however employment index registered a slight uptick of 0.1 pt.
- Initial jobless claims hit a seven-week low of 418k in the week ended July 2.

Europe:

- The ECB raised its rate by 25bps to 1.5%, with Trichet hinting that more were in the offing.
- The ECB will continue to accept Greek sovereign bonds as collateral for its liquidity operations unless all 4 ratings agencies it relies on (the three major plus Canada's DBRS) will declare Greek bonds in default.
- The IMF approved a EUR 3.2bn euro payment to Greece (5th tranche) under a joint loan with the European Union, making the IMF rescue package to Greece the second-highest in the fund's history.
- The Swedish Riksbank raised its rates by 25bps, the seventh increase in a row, to 2.0%.
- Moody's downgraded Portugal's sovereign debt rating by four notches from Baa1 to Ba2. The other two major agencies still list Portugal as BBB.
- June's PMI Composite and PMI Services slowed down reaching a level of 53.3 (May: 53.6) and 53.7 (54.2) respectively. This decrease mimics the drop in the PMI manufacturing reported last week.
- Retail sales in the Eurozone disappointed in May, dropping 1.1% mom, after having registered an increase in Apr (+0.9%), with even Germany reporting a fall of 2.8%.
- German May industrial production was up 1.2% mom (Apr: -0.8%) as capital goods production increased 2.5%, output of basic goods rose 0.7% while Apr's numbers were revised down further.

Asia and Pacific:

- China raised interest rates a third time this year: 1-year lending rate and benchmark one-year deposit rate were hiked by 25bps to 6.56% and 3.5% respectively – following a 34-month high inflation rate in May.
- Moody's warned that Chinese banks' loans to local

governments are about CNY 3.5trn more than the national auditor's estimates, lamenting the "apparent absence of a clear master plan to deal with this issue". If real estate credit is added, non-performing loans could reach up to 12% of total credit.

- Japan's government proposed a JPY 2trn package for rebuilding the areas hit by the cataclysm in March.
- Malaysian Central Bank unexpectedly left policy rates unchanged at 3.00%, but raised the statutory reserve requirement ratio to 4% from 3% effective July 16. Earlier in the week, the government had announced plans to sell state companies, improve public finances and relax foreign ownership rules.
- June inflation in Philippines reached a 26 month high of 5.2% yoy as utility and transport costs rose.
- Japan's machinery orders gained 3.0% mom in May (Apr: -3.3%), as reconstruction demand led to a 42% increase in orders from the construction sector for machinery to be used in the quake-affected northeast.

Bottom line:

Last week's data highlighted three main novelties: a) a sharp rebound in Japan manufacturing which could attenuate the global slowdown; b) China becoming another hot-spot of the fiscal crises with local governments unable to repay bank loans; c) Labour market in the US dismal. Overall Q2 has disappointed and Q3 is not particularly promising. Meanwhile the credit tightening in China is producing perverse effects. The banking system is inadequate to provide loans to small companies for lack of effective creditworthiness assessment procedures. Another credit stream goes to high end real estate which then fuels a frenzy of flipping. Redirecting credit away from the public sector and real estate towards manufacturing and services is the key to the continuation of China's buoyant growth.

Regional Developments

- Saudi inflation rose at 4.7% annual rate in June 2011, led by an increase in rental prices.
- Claim on the private sector rose 7.7% at annual rate to SAR 811bn in May 2011 in Saudi Arabia, while banks deposit rose 15% to reach SAR 1.06trn.
- Oman's oil production rose 2.3% in the first five months in 2011 while gas production increased by 5%.
- Oman's inflation rate recorded an increase of 4.9% in the period Jan-May 2011, led by surge in food prices.

UAE Focus

- The Dubai government announced plans to invest AED 28.8bn in expanding airspace and airport capacity at the Dubai International Airport over a 10-year period.
- Nakheel has received 100% restructuring approval from all its bank creditors, "received acceptance from 100 percent of the banks and the required majority of its trade creditors giving their consent to the Nakheel restructuring plan" it said in a statement.
- Dubai World announced on Wednesday that it had signed agreements setting out the terms to separate its property units Nakheel and Limitless in order to transfer them to the Dubai Government as part of the restructuring process.
- UAE and Kenya have signed a double taxation avoidance treaty agreement.
- The Islamic Development Bank is going to establish a regional office for the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) in the UAE.
- Total loans given by the UAE banking sector rose 2.7% at annual rate to reach AED 1048.7bn in May with NPLs standing at 4.5%, while deposit rose strongly by 15.7% in the same period.

- Dubai duty-free sales rose 16.6% at an annual rate to reach AED 2.5bn in H1 2011.
- UAE insurance sector's written premium increased 10% yoy to touch AED 22bn in 2010, as per the Annual Report of the UAE Insurance Authority.