

Weekly Economic Commentary – July 17, 2011

Markets

The contagion of the EU fiscal crisis reached Italy, the third largest sovereign bond market in the world. Stock markets are shaky and risk aversion rising. Regional markets were not immune to global events: all markets were down from a week ago. The euro dropped to a four-month low against the US\$, before stabilising later. Oil prices remained volatile last week while gold surged on the US sovereign rating warnings.

Global Developments

Americas:

- Moody's warned that it has placed the US sovereign under review for possible downgrade. S&P warned of a 50% chance of a US downgrade within 3 months if the current congressional impasse is not overcome.
- May trade deficit rose 15% yoy to USD 50.2bn, highest since Oct08, with oil imports the main contributor.
- June US retail sales rose by 0.1% mom to USD 387.8bn (May: -0.1%), as weakness in jobs growth continues to constrain disposable income and spending.
- Producers' Price Index declined by a seasonally adjusted 0.4% mom in June, following May's 0.2% gain, on a 2.8% drop in energy costs, the biggest decline in nearly two years. The core PPI was up 0.3%.
- Overall CPI inflation fell 0.2% mom in June, while core inflation was up 0.3%.
- Industrial production in the US grew modestly by 0.2% mom in June (May: -0.1%), largely due to a 0.9% rise in the utilities as manufacturing remained flat and motor

vehicle production was down 16.4%.

- Initial jobless claims fell 22k to 405k for the week ending July 8.

Europe:

- The EU Council emergency meeting called to tackle the run on Italy sovereigns ended without results. The ECB however was able to stem the wave of sales by intervening in the secondary market.
- Irish 10Y yields surged to a euro-era record after Moody's downgrade to Ba1, in practice junk status.
- Eurozone bank stress tests revealed that only eight of 90 banks failed but 16 are in the danger zone, with Spanish banks faring the worst – raising doubts as to the how rigorous the tests were.
- Eurozone industrial output increased only 0.1% mom (4.0% yoy) in May, raising fresh doubts on the strength of the currency area's recovery. Eurozone inflation remained unchanged from a month ago, at 2.7% yoy in June – the rise coming from higher fuel and electricity costs.

Asia and Pacific:

- China's Q2 GDP grew 9.5% yoy, the slowest pace since Q3 '09. Domestic demand continues to support, with final consumption contributing 4.6% to H1 growth and retail sales expanding 16.8% yoy in H1. Industrial production growth remained quite steady at 15.1% yoy in June.
- Chinese inflation touched 6.4% yoy in June, a 3-year high, with non-food inflation reaching 3% (the highest since records began in 2002).
- China M2 growth in June came in at 15.9% yoy (May: 15.1%, consensus: 15.3%). Despite the rebound in the amount of new loans extended, M2 growth fell on both yoy and sequential terms. Foreign exchange reserves increased to USD 3.2 trn at end June, up from USD 3.04

trn in Q1.

- China's trade surplus rose 10.3% yoy, widening to USD 22.7bn in June, taking H1 surplus to USD 44.9bn. Import growth slowed to a 20-month low of 19.3% (May: 28.4%) while exports grew 17.9%.
- India's industrial production was at a 9-month low in May, growing 5.6% yoy, after Apr's growth was revised down to 5.8% from 6.3% announced previously.
- The Bank of Thailand raised its benchmark one-day repo rate by 25bps to 3.25% joining other Asian central banks stepping up fight against inflation. Indonesia and South Korea left rates unchanged.
- Singapore Q2 GDP grew 0.5% yoy (Q1: 9.3%), though the economy contracted 7.8% qoq (Q1: 27.2%), with manufacturing sector registering the biggest contraction of 5.5% yoy. Consensus forecasts were pointing at zero qoq growth.

Bottom Line:

World growth is increasingly unbalanced. Data show that the economy is firing on one cylinder, China (& parts of Asia) but looking ahead even the dragon is not as powerful as in 2010. In mature economies where the tremors of the fiscal crisis are intensifying no harbinger of perkier growth is in sight. Investors are trying to find solace in the Q2 reporting season just underway. In Q1 corporate profits held up well especially in the US despite a sluggish recovery. Analysts foresee another spate of buoyant results. If this scenario is confirmed by actual numbers, the camp of those who perceive the soft patch to be temporary will strengthen. If the corporate sector falters and bank profits sink, then new stimulus packages and QE3 will become familiar themes.

Regional Developments

- World oil demand growth will accelerate in 2012, adding

to the pressure on supplies, according to the International Energy Agency whose outlook was more bullish than OPEC's. The IEA estimates oil use would grow by 1.47 million barrels per day (bpd) to 91 million bpd. The agency however trimmed its estimate of demand growth for 2011 to 1.20 million bpd.

- Saudi Arabia raised its oil production by 700k bpd to reach 9.7mn bpd last month in an attempt to meet rising consumer demand for oil, as per the latest estimates from the IEA.
- Saudi Arabia's non-oil exports rose 10.3% yoy in May to SAR 13.9bn, with China as the largest importer and exporter of goods. While UAE, Singapore, India and Turkey were the next biggest importers, the exporters list comprised US, Germany, South Korea, and Japan.
- The Central Bank of Iraq has granted licenses to four new banks, each with a capital of 250bn Iraqi dinars, bringing the total number of private banks doing business in Iraq to 35.
- Mercer's Cost of Living survey 2011 places Abu Dhabi and Dubai as being more costly, much above regional counterparts, at 67 and 81 respectively, with Doha ranked one of the least expensive in the group at 167.
- The Gulf Organization for Industrial Consulting released statistics on the GCC chemical industry for 2010. Saudi Arabia ranked first in terms of contribution to the industry, followed by Qatar, Kuwait and Oman.

UAE Focus

- Dubai's non-oil trade increased by 30% yoy in Q1 2011 to AED 235bn, with import growth of close to 45% while India remained its largest trade partner, clocking in AED 75bn in total bilateral trade.
- S&P announced that they were undertaking a market review for UAE, Qatar and Jordan for a potential upgrade to emerging markets status. Though the consultation process

concludes on Aug 26, any such move would be announced and will come into effect only in Q1 2012.

- Tourists from other GCC nations visiting Dubai rose by 79% yoy for the weeks June 15 to July 2, which coincides with the first half of the Dubai Summer Surprises shopping festival.
- The Crown Prince of Dubai has approved DEWA's decision to introduce a fuel surcharge that will fluctuate in line with the global prices; this variable surcharge would be measured in comparison with the fuel price in 2010. This increase will likely lead to an uptick in inflation in the coming months.
- Abu Dhabi consumer price index increased by 2.4% yoy in June, according to the Statistics Centre Abu Dhabi, with cost of food and non-alcoholic beverages rising 7.9% and communications group up 12.4%.
- The value of returned cheques in the UAE dropped 9% mom to AED 4.5bn in June (May: 22.9%).
- The Vice-President and Prime Minister of UAE, in his capacity as Ruler of Dubai, issued a decree waiving certain percentages of the amount if the borrower repaid a home loan granted by the Mohammed Bin Rashid Housing Establishment before its maturity date. The details of calculating the waiver is listed in the annexure to the decree.
- The UAE is the only Arab nation to be among the top 30 goods markets worldwide. According to the Inter-Arab Investment Guarantee Corporation, which cites WTO data, the UAE is the 25th largest global importer and 19th largest exporter of goods in 2010.