Weekly Economic Commentary – August 14, 2011

Markets

Volatility is king and mood swings have produced a roller-coaster of most stock markets indices. The US downgrade has been largely discounted in asset prices and no longer the critical factor; rather, recession fears predominate and drive investor strategies. Heightened risk aversion is the dominant factor and is not going to disappear for a while. Regional markets weremostly subdued and oil followed the gyrations of stocks, but has been mostly weak on expectation of an impending double-diprecession. The Swiss franc had been rallying amidst volatile markets, but fell on speculation that the Swiss National Bank might take further measures to weaken its currency. Gold price touched $1800 per oz last week, though retreated following a short rally in equities on Friday.

Global Developments

Americas:

- The Fed statement depicted a downbeat economic outlook highlighting downside growth propects. Despite three dissents (the largest number since 1992, which by Fed's standards is almost a revolt) the FOMC advocated an easier policy stance than expected: first, rates will stay at 0.25% "at least through mid-2013." Second, additional easing steps are anticipated, i.e. QE3 is in the cards, possibly extended to corporate bonds.
- US nonfarm productivity fell -0.3% qoq in Q2, a smaller decline than anticipated which translated into unit labour cost (ULC), rising 2.2% qoq.

- July retail sales increased by 0.5% mom (June: +0.3%), with the main drivers of this positive growth being electronics stores (+ 1.4%), gasoline stations (+ 1.6%) and non-store retailers (+ 0.9%).
- The positive trend undertaken by Initial Jobless Claims the last week of July was confirmed also the first week of August when the claims unexpectedly dropped, reaching a four-month low at 395k.
- June US trade deficit widened to USD 53.1bn, its highest levels since Oct08 as exports slowed in spite of the weaker dollar.

Europe:

- The ECB started to purchase Italian and Spanish ten year bonds on the secondary markets stemming for the moment the rout that threatened to end up with a major sovereign default.
- Eurozone industrial production recorded a negative growth in June (-0.7% mom) performing worse than expected, with only five countries showing positive growth in the EU 27 area; UK IP growth remained flat.
- Spain, France and Italy maintained stable levels of inflation in July. The EU Harmonized CPI remained 3.0% yoy for Spain and 2.1% yoy for the other two EU countries.

Asia and Pacific:

- Chinese exports growth accelerated to 20.4% yoy in July (consensus: 17.0%; Jun: 17.9%). Import growth strengthened to 22.9% (22.0%, 19.3%) while trade surplus rose to USD 31.5bn (June: USD 22.3bn).
- China’s July IP registered a 14.0% yoy growth (consensus: 14.6%, Jun: 15.1%). This implies a sequential growth of 2.1% mom s.a. ann. in July (Jun: 19.0% mom s.a. ann.), which is not exactly cheerful.

- Nominal retail sales growth dropped to 17.2% yoy in July (Jun: 17.7%) in China, despite slightly higher consumer inflation and a low base from last year while real retail sales growth fell to 10.7% (Jun: 11.2%).
- China's July CPI inflation rose to 6.5% yoy (June: 6.4%), with food price inflation rising to 14.8% (14.4%) and interestingly a slight decline in non-food price inflation to 2.9% (3.0%). PPI inflation rose to 7.5% yoy in July, up from 7.1% in June.
- Singapore's final estimate for Q2 real GDP showed an increase of 0.9% yoy, slowing from the 9.3% growth (revised from 8.3%) in Q1. Exports growth, a good proxy of global expansion, slowed to 1.8%.
- Japan's machinery orders increased 7.7% mom in June, as companies increased spending; however, overseas orders fell 5.9%, continuing the slump in foreign demand for Japanese machinery.
- India's industrial production grew 8.8% yoy in June (May: 5.9%) in spite of the recent tightening measures.
- Hong Kong's Q2 GDP growth slowed: rising only 5.1% yoy compared to Q1's 7.5% (revised), as exports recorded minimal growth given slower demand in key overseas markets and production disruptions.

Bottom line:

With politics in a stalemate in the US, the burden of devising measures to avoid another deep recession fell on the Fed, which does not need Congressional approval for its policies. Unfortunately the cookbook is not particularly original and the recipes have already proved insufficient to spur sustainable growth. But as predicted a few weeks ago in this Commentary QE3 is the latest fashion in DC. In Europe, London is burning, Paris is sinking, and Rome is crying. In Berlin the ruling coalition is divided over support to indebted countries. In such conditions growth in Q3 will be flattish, in the best of circumstances. As usual the spate of relatively good news came from China where inflation is ebbing, foreign trade is strong and consumption is holding up well, although industrial production seems to be in vacation mood. The policy mix is poised to become less restrictive with recessionary winds getting stronger. However, China unlike other major economies has room for easing monetary policy. It could start for example by relaxing quantitative controls and maybe lowering reserve requirements. However, controlling inflation will be the predominant policy objective.

Regional Developments

- Bahrain approved extra budget spending of BHD 325mn to cover an increase in public sector salaries in financial years 2010 and 2011.
- Qatar Central Bank cut its policy rates – overnight Deposit Facility by 0.25% and overnight Lending Facility and Repo rate by 0.5% – on Aug 11 to boost lending.
- Kuwait’s government intends to include corporate taxes in the upcoming budget, as per a report in Al-Watan newspaper.
- Kuwait’s budget surplus narrowed about 38% in the fiscal year 2010-2011 from preliminary estimates to KWD 5.3bn – public expenditure was KWD 16.2bn while revenues stood at KWD 21.5bn.
- Oman’s total revenues in Q1 2011 increased 15.6% yoy to OMR 2.308bn (Q1 2010: OMR 1.996bn). Total public spending rose by 9.1% to OMR 1.718bn during the same period.
- Saudi Arabia’s non-oil exports rose 26% at annual rate in June 2011 to reach SAR 14bn while imports rose 5% to SAR 36bn for the same period.
- Saudi’s inflation rate rose at a 4.7% annual rate in June 2011, led by a surge in rent (7.1%) and food prices (5.5%).
- Oman’s government signed an Exploration and Production Sharing Agreement with Canadian-based international oil

firm, Allied Petroleum Exploration.

- Saudi Arabia’s Ministry of Finance has awarded contracts worth more than SAR 84bn in H1 2011.
- Profits of the 41 listed companies in Doha Securities Market rose 25% at annual rate to QAR 14.8bn in 1H2011. Meanwhile, profits of the 135 listed companies in Tadawul rose at a 26%annual rate to reach SAR 47.5bn in 1H2011.

UAE Focus

- Nakheel has finalised Aug 25 as the date for issuing the AED 4.8bn Sukuk, which had been expected to be issued in H1 2011, as part of the debt restructuring plan.
- After years of speculation on the revised UAE Company Law, a Ministry of Economy official announced last week that the draft was complete and that the Law would “allow foreign investors to have a varied percentage of ownership in some projects, depending on the type of investment and size of the project”.
- Provisions for non-performing loans have declined in Q2, as per banks’ results: loan loss provisions of Emirates NBD fell 28% qoq (18% yoy), ADCB recorded a 28% yoy decline in provisions while Mashreq and Commercial Bank of Dubai reported a 29% and 9% decline respectively.
- The Investment Corporation of Dubai has announced that it will be repaying a USD 4.0bn debt facility maturing Aug. 21 in full, also mentioning that the debt is being “repaid from internal sources derived principally from cash dividends received from ICD’s operating subsidiaries”.
- Limitless received a fifth extension on a loan of USD 1.2bn as the real estate developer controlled by state-owned Dubai World works on a restructuring plan, according to two bankers familiar with the plan.
- Average daily volumes for Oman Crude on Dubai Mercantile Exchange stood at 4,427 contracts in July (equivalent to

4.4mn barrels per day), with a record 88,539 contracts traded which was a 35% yoy increase in trading levels on the exchange.