Weekly Economic Commentary – October 09, 2011

Markets

After a week spent in an upbeat mood, the release of labour market data in the US had stock markets was about to seal the week on a positive note till Fitch's downgrade of Italy and Spain spoiled the sentiment for global equities and debt markets. In the region, markets were down with the Eurozone debt crisis weighing in on investor sentiment. Dollar dropped after the jobs data release giving the GBP a boost – up 2.1% compared to a week ago. In the commodities market, the biggest gainer was copper – which surged off 14 month lows while oil also recovered (Brent recovered from below $100 gaining almost 3%).

Global Developments

Americas:

- Non-farm payrolls edged up by 103k in Sep but the unemployment rate stayed steady at 9.1%, while the ADP report showed an expansion in private sector workers by 91k in Sep (Aug: 89k).
- Initial jobless claims rose by 6k to 401k in the week ended Oct 1, following the previous week's sharp decline of 33k
- US ISM survey showed varied sentiment: while the manufacturing index was unexpectedly positive, rising to 51.6 in Sep (Aug: 50.6), the services index expanded at a slower pace to 53.0 (53.3) though the measure of new orders increased to a four-month high of 56.5 (52.8).
- Factory orders in the US dipped 0.2% mom, on lower demand for cars, consumer goods and construction

materials; orders excluding transportation also registering a decline of 0.2% – for the first time in six months, though increased investment in capital equipment (+0.9%) was the sole positive sign.

Europe:

- Fitch downgraded Italy's sovereign credit rate from AA- to A+ on Friday while keeping its negative outlook, reflecting "the intensification of the Eurozone crisis that constitutes a significant financial and economic shock which has weakened Italy's sovereign risk profile".
- Fitch downgraded Spain by two notches to AA- citing high budget deficit and a fragile economic recovery which exposes the country to external shocks.
- Greece's government says it will miss its deficit targets this year, but moves ahead with a controversial plan to slash thousands of public sector jobs to meet the demands of its international creditors. Greece confirms its economy is expected to contract by an annual pace of 2.5% in 2012, its fourth consecutive year of contraction, sending the country's jobless rate higher, according to its 2012 draft budget.
- Depressing data from the Eurozone continues: the composite PMI fell to 49.1 in Sep (Aug: 50.7), signalling first contraction in private sector activity since July 2009 with the services PMI dipping to 48.8 (51.5) and below the flash reading of 49.1.Retail sales fell 0.3% mom in Aug (Jul: 0.2%) as non-food product sales dipped 0.6% and Germany recorded the biggest fall of 2.9%.
- The ECB held interest rates unchanged at 1.5%. Meanwhile, the Bank of England unexpectedly expanded its bond-purchase program to GBP 275bn from GBP 200bn after its key rate was left at a record low of 0.5%.
- German industrial production dipped 1% mom in Aug (Jul:

3.9%) as production of consumer goods slumped 4.9% and construction activity declined 1.2%; but production of investment goods was the saving grace, rising by 0.2%.

Asia and Pacific:

- South Korea's inflation moderated from a three-year high to 4.3% in Sep (Aug: 5.3%) as food prices weakened but the weaker won will add to the worries since it will lead to a rising import bill. Inflation in Indonesia slowed to 4.6% in Sep (Aug: 4.79%) in spite of higher costs of red chilli, gold jewellery and cigarettes while core inflation slowed to 4.93% (5.15%).
- Thailand's inflation was down marginally at 4.03% in Sep, while the core rate rose to 2.92%. The Bank of Thailand and the Finance Ministry have announced the revision of inflation targeting method – by using headline inflation instead of core inflation. The central bank will set a headline-inflation target at 3% and plus or minus 1.5 percentage points annually.

Bottom line:

The data flow showed a dichotomy between the US and Europe where recessionary forces are more intense due to tighter credit conditions and extremely low liquidity. All eyes are kept on the emergency measures of various natures, from increasing the size of the EFSF allowing it to intervene by purchases of sovereign bonds to recapitalization of banks. In Asia inflation is ebbing, leaving room for central banks to reduce rates if activity deteriorates.

Regional Developments

- Saudi Arabia may be recording a budget deficit in 2011 due to additional social programs in particular a $130 billion plan to create jobs and build homes and a break-even oil price level of USD87. Officials haven't said whether they'll sell debt or draw on reserves, as they did two years ago.

- Under Oman's new capital market law, which is expected to be passed soon, family businesses may be allowed an exemption to offer a 25% stake through initial public offerings as opposed to the 40% stake currently, according to the Muscat Securities Market.
- Qatar's nominal GDP rose by 42% yoy to QAR 153.7bn on higher energy prices and increased production of LNG; the mining and quarrying sector's contribution was hence substantial – rising 68% to QAR 89.49bn while manufacturing rose 39% to QAR 16.93bn.
- Private equity funds in MENA are under pressure to produce returns for investors. They face difficulties because of a dearth of exit options. The preferred route, an IPO is blocked in the region as bourses like Dubai have not seen an IPO in over three years.
- Total project finance transactions in the Middle East fell by more than half to USD13.3bn in the first nine months of 2011 from USD 29.5bn in the equivalent period a year ago.
- According to Abraaj Capital, SMEs in MENA employ close to 70% of the workforce, with contribution to GDP at only 30%. Furthermore SMEs' share of bank loans is only 8% in the MENA and an even lower 2% in the GCC region.
- The USD 30bn GCC rail project will start its construction phase in 2013, with nearly four years estimated for completion, according to Abdullah Al Shubaili, assistant undersecretary for economic affairs in the GCC Secretariat.
- UAE and Oman linked their power grids, making more efficient the management of their installed and future capacity.
- The Arab Spring is expected to result in a fall in FDI by 17% to USD 55.1bn in 2011, according to the Arab Investment and Export Credit Guarantee Corp. report. However, 7 nations included in the report, among which

Saudi Arabia and Iraq are forecast to record a rise in FDI inflows.

- Apicorp estimates that an investment of over USD 58bn in the next five years will be required to increase power generation capacity in the GCC; this USD 58bn investment accounts for nearly 46% of the total capital required for electricity development projects in the MENA region.

UAE Focus

- UAE PMI rose by just over one point to 52.1 in Sept, with new orders (57.0) and new export orders (55.9) still showing relatively robust expansion. The overall output component, which was flirting with recession in Aug (at 50.0), regained some altitude at 51.6.
- Deposits fell 3.2% mom in Aug to AED 1078.4bn, hence reducing the gap with loans which grew by 0.5% to AED 1056.8bn. Provisions for NPLs continued to rise: to AED 49.2bn in Aug compared to AED 32.6bn last year.
- India continues to be the top trading partner for Dubai, with bilateral trade up 49.8% yoy to AED 87.2bn in the period Jan-May 2011 as per Dubai Customs data.
- Dubai’s Al Jalila oilfield is on track to begin operations before the end of 2011 according to the Chairman of the Energy Committee.
- Emirates Airlines, is pushing Boeing to press ahead with improvements to its 777, even as it finishes work on an all-new airplane and updated designs for two others.
- Taqa, Abu Dhabi’s National Energy Company, is expected to issue MYR 3.4bn in an attempt to diversify its financing base – following the steps of NBAD a few months ago.