

# Weekly Economic Commentary – October 30, 2011

## Markets

Agreement to avoid a Greek default & boost the EFSF was hailed by stock markets all over the world. The Standard & Poor's 500 Index jumped extending the biggest monthly rally on record since 1974 pushed also by encouraging US GDP figures. On Friday, however, concern that the post-EU euphoria went too far, drove indices down. When details of the agreement are clear, enthusiasm will give rise to a more nuanced assessment. Regional markets followed the global trend and recorded gains as progress in the EU boosted risk appetite. Major currencies gained against the USD with yen reaching a record high of JPY 75.64. Oil price was positively affected, with WTI picking up faster than Brent and gold prices were up 6.0% on a lower dollar.

## Global Developments

### Americas:

- US Q3 GDP expanded at a 2.5% yoy, the fastest pace in a year (Q2: 1.3%). The GDP surpassed its pre-recession level after 15 quarters, three times longer than the average for 10 previous recoveries since World War II. Corporate investment in equipment and software was the main driver with a 17.4% jump. Private consumption growth was also perky at 2.4%. Inventories were down subtracting 1.1% to the growth rate.
- The housing market painted a varied picture: the S&P/Case-Shiller index fell in Aug by more than expected to 3.8% yoy while pending home sales recorded an unexpected 4.6% mom decline in Sep (Aug: -1.2%) as lower

prices and borrowing costs failed to support demand. Meanwhile, new home sales rose 5.7% in Sep (-0.3%), for the first time in five months, to 313k (sa) as discounted prices attracted buyers.

- US durable goods orders excluding airplanes and automobiles, were up 1.7% mom in Sep though total bookings were down by 0.8% (Aug: -0.1%), owing to a 26% decline in demand for aircraft (+25%).
- First-time jobless claims decreased by 2k to 402k in the week ended Oct. 22. The number of people collecting unemployment benefits fell in the previous week by 96k to 3.65mn, the fewest since Sep 2008.

## Europe:

- EU leaders agreed on a deal to force a 50% “voluntary” haircut on Greek institutional bondholders and to leverage the EFSF up to 4 times. Details on the rules defining the conditions against which financial support will be granted to member states have not surfaced, but will directly affect pricing of Italian & Spanish risk.
- Italian government presented a letter of intent to the EU partners on drastic measures to be taken to assure continuous support from the ECB, but it failed to convince the markets. Spread with German bunds widened again after a brief spell of euphoria.
- An across-the-board AAA rating was confirmed for the EFSF on the basis of amendments (decided in July) that took effect on Oct 18, taking the lending capacity of the Fund to EUR 440bn, with a guarantee commitment of EUR 780bn. However guarantees means markets will want details of conditions applying.
- Eurozone composite PMI dropped further to 47.2 in Oct, below the 50 mark, after dropping to 49.1 in Sep, just before the European Summit agreed on the way out of the debt crisis.

## Asia and Pacific:

- China's PMI rebounded to 51.1 in Oct (Sep: 49.9) with the manufacturing output sub-index rising to 51.7 (50.3) – a six-month high.
- The Reserve Bank of India raised repo rates by 25bps to 8.25% – for the 12th time in 18 months – as inflationary pressures weighed in more than growth concerns. Food inflation rose to the highest level in more than six months, rising to 11.43% in the week ended Oct. 15.
- A slower growth in electronics and pharmaceuticals led to a decline in Singapore industrial production in Sep: 12.8% yoy after a revised 22.8% increase in Aug. Meanwhile, inflation rose to a high 5.5% in Sep (Aug: 5.7%) on housing and transportation costs.
- Korean GDP growth slowed further to 0.7% in Q3 from 0.9% in Q2, led by consumption and facility and inventory investment, while exports were steady. The figure indicates that the global slowdown is slowly extending to Asia.

## Bottom line:

The most important achievement of the EU deal was the removal of the uncertainty over the fate of Greek bondholders. With this obstacle out of the way now the main issues come into sharper focus: the recapitalization of the European banks and the governance of the EFSF which at this point will be the incubator of a European Debt Agency and, hopefully, the stepping stone towards a common fiscal framework. In the meantime the surprise GDP performance in the US has allayed fears of an imminent synchronized recession in mature economies and with profits for companies in S&P 500 up 16% on average in Q3, based on results reported so far, stock markets could be entering a less volatile period. However it is too early to call a turning point as the Korean GDP figures remind us: slowing advanced economy growth is impacting EMEs.

## Regional Developments

- IMF in its Regional Economic Outlook for the MENA region have placed the region's growth at 3.9% this year, down from 4.9% in 2010, with increased divergence among the oil exporters and importers, expected to grow at 4.9% and 2.0% respectively in 2012 pointing to growing fiscal vulnerability in the oil exporters as a result of growing expenditures and higher budgetary break-even oil prices. In 2011, the oil exporters' combined external current account surplus is expected to increase to USD 334bn from USD 202bn (excluding Libya) and to USD 279bn from USD 163bn for the GCC. Rising oil prices have helped the oil exporters to intensify spending on investments and social programmes, with GCC fiscal surplus rising to 9.7% of GDP in 2011 compared to 6.1% last year. However, fiscal vulnerability is increasing with the unprecedented rise in breakeven oil prices – with UAE requiring oil price to be close to USD 80 a barrel.
- Separately, the IIF has reported that “The projected breakeven Brent oil prices for 2012 are as follows: Kuwait, \$55/b; Saudi Arabia and the UAE, around \$90/b; Iraq, \$102/b; Algeria, \$105/b; and Russia, \$114/b”
- Higher oil prices and production led Oman to post a budget surplus of OMR 736.5bn (+77% yoy) in the first eight months. Current expenditure was up 11.3% while capital spending was a tad higher at 14.8%. A recent Moody's report states that Oman is likely to record a budget surplus of 10% of GDP in spite of the increased social spending following the protests earlier this year.
- Qatar is planning almost USD 150bn in infrastructure development in the coming five years, according to the Minister of Economy and Finance, with most of the spending (between USD 120-140 bn) focused on the non-oil sector.

- The D&B business optimism index for Q4 2011 recorded an improvement as the Composite Index for the non-hydrocarbon sector rose to 45, helped by a strong economy and government stimulus measures.
- UN's "World Population Prospects" report places GCC youth at close to 30% of total population, with only one-third of them in the labour force compared to 50% globally. Female labour force participation was more dismal – at half of that of males in the region and the lowest in the world at 22%.
- Qatar's fall in investment income by 33% and a government decision to cut tax led to declines in revenues during the fiscal year 2010-11; but, this was partially offset by a surge in oil and gas revenue due to higher crude prices and an increase in the Gulf country's LNG exports.
- Tourism in Saudi Arabia generated close to SAR 5bn in revenue in the summer months, with about 9.3mn visitors of which 3.3mn were tourists and shopping accounting for almost 40% of the total revenue.

## **UAE Focus**

- The Investment Corporation of Dubai and Brookfield have signed an MoU to form a \$1bn investment fund to focus on Dubai's real estate sector, with \$100mn each from both entities and the rest from "a select group of local, regional and international investors".
- Inflation in the UAE rose 1.17% in the first three quarters of 2011, as higher prices for beverages and tobacco, education and food outweighed the slight decline in cost for housing and medical care.
- UAE's total non-oil trade increased by 22% yoy to AED 445bn in H1 2011, as imports and exports grew 20% and 51.9% respectively to AED 285bn and AED 54.7bn. India, China, US, Germany & Japan topped the list of trading partners, with Saudi Arabia as the top ranking among

GCC trading partners (AED 13.5bn), followed by Kuwait. Gold ranked first among the UAE's imports (a major item of re-exports to India), followed by diamonds, cars and jewellery.

- UAE's budget deficit touched AED 1.2bn at the end of Sep this year and is expected to be lower by the end of this year, according to the Minister of State for Financial Affairs. He also ruled out the possibility of imposing any taxes or fees to finance the budget deficit.
- Dubai airports recorded a 6.2% yoy growth in passenger traffic in Sep to 4.24mn, in spite of contraction in traffic on Middle Eastern routes, taking the year-to-date traffic at 37.5mn (+7.8%) while air freight volumes dropped 5.5% to 177,128 tonnes.
- The volume of trade between US and the UAE amounted to AED 18.9bn in Jan-May 2011, according to the Ministry of Foreign Trade.