

Weekly Economic Commentary – December 11, 2011

Markets

Stock markets were in an upbeat mood waiting for some breakthrough from the EU Summit. But the press conference by ECB President Draghi spooked the enchantment by reminding that many banks remain unable to sell their debt into the market and face a large refinancing hump next year. Draghi also asserted that no large scale debt monetization will take place over the foreseeable future in the Eurozone. The conclusion of the EU Summit reiterated this orthodox stance. Structural reforms are the priority. Regional markets are likely to open higher this week, if Saudi market reaction to the EU Summit is taken as a proxy – Saudi markets rose to the highest level since August yesterday. The euro rose against the dollar post-EU Summit and commodities were generally lower, with both oil and gold prices down – the latter by almost 2% from the previous week.

Global Developments

Americas:

- Initial jobless claims in the US fell 23k to 381k in the week ended Dec 3, to a nine-month low.
- The US ISM non-manufacturing headline index declined 0.9 point in Nov to 52.0. The composition of the report was mixed: new orders and the business activity indexes increased (by 0.6 point to 53.0 and by 2.4 points to 56.2, respectively).
- October factory orders in the US fell 0.4% mom, on a 17% dip in orders for commercial aircraft, following Sep's 0.1% drop. Core capital goods fell 0.8%, also showing

weakness in investment plans for the future.

- Brazil GDP Q3 growth was flat qoq and 2.5% yoy, versus a 0.8% qoq and 3.1% yoy in Q2. Another large emerging market ends up in the doldrums.

Europe:

- The EU Summit turned out to be another step in the crisis resolution process, not the “do or die” moment portrayed by media. A closer fiscal union along the German inspired fiscal discipline will be enshrined in a Treaty envisaging substantial penalties for non-compliers. An isolated UK withdrew from the new framework. The EU will finance the IMF with EUR 200bn of new ammunition to cope with emergencies in Italy and Spain if needed.
- Standard & Poor’s put 15 EU countries under negative watch, including the AAA rated ones. As a consequence, the EFSF is at risk of losing its top rating.
- The ECB cut interest rates by 25 bps to 1%. More importantly it announced non-standard measures to support banks which are shut out of the money market. The central bank’s list of accepted collateral was also widened, with ratings thresholds reduced and loans to small- and medium-sized enterprises made acceptable for the first time.
- Retail sales in the Eurozone rose 0.4% mom in Oct, with German and French sales rising 0.7% and 0.8% respectively while Spain and Portugal sales continued to fall. Potential austerity measures are likely to result in lower spending in the coming months.
- EU provisional GDP data reported growth of 0.2% qoq in Q3, the same as Q2, as a rise in consumption and exports offset the decline in inventories.
- German industrial orders surprised with a sharp 5.2% rebound after Sep fall of 4.6%. Despite this strong figure the trend points down: orders for Sep-Oct

combined were 2.7% lower than the previous two months.

- Industrial production in Germany was up 0.8% mom in Oct as production in the manufacturing sector grew 0.8% after declining 2.8% in Sep as capital goods grew 2.2% while consumer goods remained flat.

Asia and Pacific:

- A host of data was released in China last week – inflation was at its slowest pace in 14 months, with price rise at 4.2% in Nov (Oct: 5.5%); Chinese retail sales for the first 11 months of the year grew 11% to CNY 16.35 trillion; manufacturing rose 12.4% yoy in Nov, the slowest pace since Aug 09 (Oct: 13.2%), following contraction in the PMI data last week – pointing to the risks of a hard landing.
- China's foreign trade growth slowed and surplus narrowed in Nov as external demand slowed – especially given the crisis in Europe. Trade was up 17.6% yoy to USD 334.4bn in Nov (Oct: 21.6%) while exports grew 13.8% to USD 174.5bn – the slowest growth since Feb this year.
- Machinery orders in Japan unexpectedly fell in Oct, with bookings declining 6.9% mom, signalling that companies are postponing business investments given the slowing global economy and strong yen.
- Reform is on the back burner in India: a key new law allowing foreign investment in the retail sector was put on hold due to protests only few days after the Prime Minister had announced it; a major setback.
- Central banks that met last week left policy rates on hold, given the uncertainty in the Eurozone: Indonesia and South Korea left rates unchanged at 6% and 3.25% respectively. South Korea's central bank revised GDP numbers: the economy is forecast to expand 3.7% growth in 2012 and 4.2% in 2013, compared to 3.8% this year.

Bottom Line:

Political developments overshadow economic data, but contagion is spreading and the slowdown is involving the large emerging economies as well more notably Brazil and India (where the prime minister after the fiasco on the retail law is approaching the last stop of his political career). Signs of life come from the US labour market and German manufacturing. The German leadership in Europe is solidifying with France compelled to follow: more fiscal discipline via a new Treaty, not much monetary amphetamine from the ECB, no Eurobond opium, more work to define clearly the functions of the European Stability Mechanism (ESM).

Regional Developments

- Egypt's new cabinet was sworn in before the head of the ruling army council, while electoral results keep pouring in from remote areas. Islamist candidates were taking the majority of seats.
- IMF Chief calls for inclusive growth in the Middle East, also mentioning that "macroeconomic stability and inclusive growth can – and indeed must – go hand in hand".
- The Arab Spring has severely affected foreign direct investment in the Middle East and North Africa (Mena) region, according to a new report by the World Bank's Multilateral Investment Guarantee Agency (MIGA).
- Mercer's 2011 total remuneration survey results shows nearly every company surveyed in three key markets – Saudi Arabia, UAE and Qatar – plan to give pay rises between 5 and 6% and hire more people in 2012.
- Moody's downgraded to A3/Prime-2 from A2/Prime-1 the global local currency deposit and foreign currency deposit ratings of Burgan Bank of Kuwait.
- AT Kearney reports that revenue of around USD 700k is lost for every megawatt-hour of power not supplied to

key industries in the GCC.

- Almost 600k Saudis have applied for housing loans from the Real Estate Development Fund which is expected to give individual loans of up to SAR 500k.
- Saudi Ministry of Labour announced that close to 6 million expatriates were employed in the private sector while close to a million Saudis remained unemployed. Official unemployment rate is at 10.5%, with female unemployment higher at 26.6%.
- The International Air Transport Association reduced its forecast for profits of the Middle East airlines by half to USD 400mn as higher fuel costs are expected to lower profit margins.

UAE Focus

- After Moody's reported that Dubai's companies face "execution risk" in meeting repayments coming due next year, Sheikh Ahmad clarified that there is no intention to restructure part of debts in 2012, but that the government may look into refinancing part of the financial obligations if the need arises. The statement from Moody's needs to be put in the right context – given on-going global sovereign risk developments, credit rating agencies (CRA) are trying to be more active by revising their ratings at close intervals. The Dubai report should be read as a part of such a global initiative.
- Fitch in a note on UAE banking sector underlines that a significant increase in renegotiated private sector loans is symptomatic of the true extent of the banks' asset quality problems. Fundamental credit issues remain unresolved, and may re-emerge as non-performing loans. Ultimately, the success of the various restructuring and renegotiating plans accepted by the banks depends on recovery in both UAE and globally.
- A draft Companies Law was approved by Sheikh Mohammad,

which will allow flexibility in the setting up of companies and in line with the MSCI's "foreign ownership limits" criteria.

- The UAE Ministry of Finance (MoF) is studying the set-up of an organisation aimed towards keeping records on mortgages of capital assets – this will ease SMEs to obtain funding, according to the MoF undersecretary Younis Al Khouri.
- Nakheel has paid USD 7.3bn to the creditors so far and is expected to issue AED 1bn of Sukuk before the year-end, as part of the AED 59bn restructuring deal.
- UAE's PMI, compiled by HSBC, dropped to 52.5 in Nov from 53.4 in Oct as new export orders also rose at a weaker pace, with growth at a ten-month low.
- UAE's central bank data places total credit growth this year till Oct at 4.1% (AED 1.073 trillion) while deposit growth was slower at 1.3% (AED 1.67 trillion).