Weekly Economic Commentary – December 18, 2011

Markets

Markets were mostly down from a week ago, as Eurozone sovereign debt fears continue to play out, with ratings downgrades and warnings of potential downgrades by rating agencies. Regionally, the failed MSCI reclassification bid by UAE and Qatar dampened spirits and led to a decline in markets. Downgrade fears and decline in risk appetites led the dollar to its highest level in 11 months, boosting its status as a safe haven. As the dollar stature gained, commodity prices dropped: gold was down to the lowest level in 3 months.

Global Developments

Americas:

- US retail sales edged up by 0.2% mom in Nov (Oct: 0.6%), recording the least growth in the past five months and following the strong rise during Thanksgiving. Even stronger auto sales were not sufficient to salvage retail growth as spending on food and beverages plunged.
- In the last meeting of the year, the FOMC maintained its current policy rates at 0.25% and did not mention any timing for QE3.
- Initial jobless claims fell to the lowest since May 2008 – falling 19k to 366k in the week ended Dec 10. This news came while Obama pushed for Congress to pass his stalled $447 billion Jobs Bill, in the welcome speech for troops returning from Iraq.
- US industrial production unexpectedly fell in Nov – declining by 0.2% mom (Oct: +0.7%) while factory production, which accounts for three-quarters of the

total, decreased 0.4%. Meanwhile, capacity utilisation fell marginally to 77.8% from 78% in Oct.

- CPI was unchanged in Nov (3.4% yoy), as energy prices declined for the second month in a row, offsetting the rise in food prices; core inflation was up 0.2% mom and 2.2% yoy. PPI rose 0.3% mom in Nov (Oct: -0.3%); core PPI edged up 0.1% after being flat in Oct.

Europe:

- EU Industrial production fell 0.1% mom in Oct (Sep: -2%) for the second consecutive month; Germany posted a 0.8% mom growth, after a -2.9% in the previous month, France's output was unchanged and Ireland recorded a 6.6% mom gain while Italy and Spain output declined.
- The composite EU PMI consisting of services and manufacturing output rose to 47.9 in Dec (Nov: 47) still below 50, indicating a contraction for the fourth month now. European inflation held steady at a three year high of 3% yoy in Nov while core inflation remained steady at 1.6%.
- German investor confidence measured by the ZEW increased to -53.8 in Dec after a three year low of -55.2 in Nov. Rise in industrial production and manufacturing orders along with a decline in unemployment further indicate that Germany may avoid a recession.
- Belgium's credit rating was cut by two notches to Aa3 from Aa1 by Moody's, citing "fragile sentiment" in the Eurozone. Meanwhile, Fitch affirmed France's ratings but put it on negative watch, while warning that it could downgrade Italy, Spain, Ireland, Belgium, Slovenia and Cyprus.

Asia and Pacific:

- Industrial production in India fell 5.1% yoy in Oct (Sep: +2.0%), contracting for the first time since Mar

09. While the decline was registered across the board, capital goods output declined by 25.5%, implying weak corporate investments. Production of durables and consumer durables declined together for the first time since Feb ‘09, an indicator of weak consumer demand.

- M2 in China rose by 12.7% yoy in Nov (Oct: 12.9%), the least since May ‘11. The decrease in lender’s reserve requirements would support an increase in lending in the coming months to combat economic growth and exports weakness.
- Business confidence, recorded by BoJ Tankan, fell to a worse-than-expected “minus four” in Dec from positive “two” in Sep as stronger yen and weakened global recovery hurt Japanese businesses and sentiment.
- India’s central bank left policy rates unchanged, with the Governor indicating upcoming policy shift: “from this point on, monetary policy actions are likely to reverse the cycle, responding to the risks to growth”.

Bottom line:

Fitch’s downgrade of the world’s largest banks including Barclays, BNP Paribas and BoA, due to “structural weakness in their funding, earnings, and leverage” highlighted once again the perverse enmeshing of banks’ and governments’ balance sheets. Commerzbank is widely indicated as the next beneficiary of a government bailout. The euro area agreement of last week on hardened fiscal discipline has left the markets skeptical and with the Old Continent heading for a recession, the year-end mood is sour. Further confirmation of a slowdown came from Japan and India, while the US job market continues to gain strength.

Regional Developments

- An official’s comment about the possible inclusion of Egypt into the GCC was denied by several key officials.

It was also mentioned that the invitation for Jordan and Morocco, issued in May, would not include “membership”, but will “boost distinguished relations and strategic ties”.

- A report from Citibank placed the total value of new projects in the MENA region from Jan-Oct 2011 at USD 82bn, with Saudi Arabia accounting for almost a third of it, at over USD28bn. Iraq has awarded close to USD 17bn in projects, while UAE, Kuwait and Qatar recorded declines or remained flat compared to the previous year.
- An annual report titled “Paying Taxes 2012” placed all 6 GCC nations within the top 15 with Qatar 2nd and UAE at 6th, in terms of ease of paying taxes. The near absence of and limited number of taxes levied in the Middle East region is obviously a critical factor.
- The World Economic Forum’s Financial Development Report 2012, which tracks financial system development and financial stability, placed Saudi Arabia at 23, ahead of its GCC counterparts UAE and Bahrain (25 and 24 respectively).
- SAMA’s annual report expects real GDP to grow 5.1% in 2011; this follows a GDP growth of 18.8% yoy to SAR 1.7 trillion in current prices and an increase by 4.1% to SAR 871.6bn at constant prices for 2010. The report was released amidst rumours of a potential Riyal-denominated Sukuk issuance by Saudi Arabia, according to banking sources.
- Moody’s expects higher oil prices and production to help Saudi Arabia reduce public debt levels, in spite of the increased budgetary spending. The report expects “net foreign assets to reach 95% of GDP as of year-end 2011, with debt levels dropping to around 8% of GDP”.
- A Reuters report suggested that Saudi Arabia is expected to make a limited expansion of its stock markets. The Capital Market Authority and Tadawul have disclosed a detailed plan to market participants and according to sources, total direct ownership of each stock would not

be allowed to exceed 20% of the issued share capital. If implemented, this would increase volumes and bring in institutional investors, also improving transparency and market efficiency.

- Oman has received close to USD 74mn, from the US Department of State, between 2007 and 2011. This year, the nation pocketed USD 11.8mn, with the request for 2012 stating that the funds would be utilised for ‘stabilisation operations and security sector reforms.’
- Almost 2000 low-cost homes have been provided to the Omanis as per a Ministry grant of OMR 40mn in 2011. The Undersecretary of the Ministry of Housing also stated that another OMR 40mn has been allocated for the same and OMR 7mn as interest-free loans for next year.
- Inflation in Oman ticked up to 3.75% in Oct, following Sep’s 3.7%, due to a hike in education services – seen mostly as a one-off effect.

UAE Focus

- The UAE and Qatar failed in their bid to be reclassified as an emerging market by the MSCI for the third time last week. Though there was positive feedback about the DvP model, implemented in May this year, the MSCI stated that “investors continue to stress significant concerns over the effectiveness of the new framework to fully ensure the safeguarding of their assets under certain circumstances, particularly for failed trades where a forced sale of assets, without the owner’s consent, remains a possibility”.
- About 1.19mn tourists from the neighbouring GCC countries visited Dubai in the first 10 months of this year, according to the Executive Director of Tourism at the Dubai Department of Tourism and Commerce Marketing.
- Total credit fell to AED 1073.3bn in Oct, after the surge to AED 1075.2bn in Sep, according to the UAE Central Bank’s latest data. In spite of the decline in

overall credit, personal loans increased to AED 252.6bn (Sep: AED 249.8bn).

- Inflation in Abu Dhabi was recorded at 1.9% yoy for the period Jan-Nov 2011 while Nov inflation fell to a 23-month low of 0.6% (Oct: 0.9%). Dubai’s inflation, meanwhile, came in at 0.2% in Nov, as food prices declined and housing costs held steady.