Weekly Economic Commentary – March 18, 2012

Markets

Markets have been choppy in the absence of major macro news and a catalyst which could guide expectations. Even the **bank stress tests** that were negative for Citigroup and other large US banks had limited impact. Regional markets, except **KSA**(where the trend points upwards), are caught in the erratic swings. Meanwhile, **US Treasury yields** moved up on better economic data and a reversal of flight-to-safety flows. Asian currencies were weak against the dollar; however, the higher than expected US inflation data towards end of the week led to a slight decline in the greenback. Tensions regarding Iran continue to impact **oil** prices; **gold** is mostly weak, leading to increased buying from central banks.

Global Developments

Americas:

- The US **current account deficit** for the fourth quarter of 2011 widened to USD 124.1bn (Q3: USD 107.6bn), on account of rising oil prices. The deficit for 2011 stood at 3.1% of GDP.
- **Retail sales** advanced 1.1% mom in Feb (Jan: +0.6%), the largest in five months. Auto and clothing sales contributed largely to rise, although increases were seen across the board, in 11 out of 13 categories.
- **Business inventories** in the US climbed 0.7% mom in Jan (Dec: 0.6%), maintaining a ratio to sales of 1.27. Motor vehicle inventories rose 2.6% in Jan.
- Initial **jobless claims** fell by 14k to 351k in the week ended Mar 10, the lowest in 4 years; continuing claims

dropped by 81k.

- US **inflation** in Feb rose 0.4% mom and 2.9% yoy (Jan: 0.2% mom) led by rising energy costs (3.2% mom). The food index remained unchanged from a year ago, while core inflation, excluding food and energy, rose 0.1%. **Producer price index**also increased by 0.4% mom in Feb (Jan: 0.1%).
- Feb **industrial production** came in flat from Jan, owing to a slowdown in mining (-1.2%), while Jan's IP was revised up to 0.4% (Initial: 0.0%). Feb capacity utilization slipped to 78.7% (Jan: 78.8%).
- US **federal budget deficit** was revised upwards to USD 1.2 trn for 2012 (2011: USD 1.3 trn), resulting from the 2%-pt cut in Social Security taxes for the rest of 2012 while health care costs were likely to cost about USD 50bn less than anticipated.

Europe:

- **Industrial production** (IP) in the eurozone inched higher by 0.2% mom in Jan (Dec: -1.1%) but dropped 1.2% yoy (Dec: -1.8%). Divergent economic performances persist: German IP rose 1.5% mom, while in Spain and Italy it dropped 0.2% and a walloping 2.5% mom, respectively.
- **Eurozone inflation** saw an uptick of 2.7% yoy in Feb, unchanged from a revised Jan figure. The rise was led by a spike in energy prices of 9.5% yoy. German and French inflation came in at 2.5% (Jan: 2.3% and 2.6%, respectively), with lower rates in Greece (1.7%) and Spain (1.9%).
- The **German ZEW survey** surged to a 21-month high of 22.3 points in March (Feb: 5.4) as investors took solace from the recent agreement reached in the sovereign debt crisis.
- **UK's goods trade deficit** widened in Jan to GBP 7.53bn (Dec: GBP 7.18bn), as import growth, driven by high oil prices, outpaced exports at 2.6% and 2% mom,

respectively. Meanwhile, exports to non-European countries rose to the highest level ever.

- **UK unemployment** recorded its highest level since 1995, coming in at 8.4% in the three months through January. Unemployment benefits claims in Feb increased by 7.2k from Jan (7k).

Asia and Pacific:

- **Japanese core machinery orders** rose 3.4% mom in Jan (Dec: -7.1%) and 5.7% yoy (Dec: +6.3%). The Bank of Japan left policy rates unchanged.
- Despite high interest rates, **industrial production in India** surged ahead at the fastest pace in seven months, at 6.8% yoy in Jan (Dec: +2.5%). Manufacturing, which contributes to 75% of the index, rose by 8.5%.
- India's Feb **wholesale price inflation** accelerated by 6.95% yoy (Jan: 6.55%), the first rise in five months. Primary food prices rose 6.1% (-0.5%), while non-food manufactured products prices eased to 5.7% (6.7%) while fuel prices saw a smaller rise in Feb of 12.8% (14.2%).
- The **Reserve Bank of India** left policy rates unchanged, with the repo rate at 8.5% and the reverse-repo at 7.5%, following the surprise 75bps cut in the cash reserve ratio last week.
- The **Indian budget** for the next fiscal year (Apr 2012 – Mar 2013) is focused on reducing the budget deficit to 5.1% of GDP by capping subsidies to under 2% of GDP. The deficit for the current fiscal year came in at 5.9%, much higher than the 4.6% target.
- **Industrial production in Malaysia** saw a mild increase of 0.2% yoy in Jan (Dec: 2.9%) owing to increases in manufacturing (1.2%) and electricity (2.7%) production.

Bottom line:

Surprises did not come from the trickle of macro data last week, but from the **political front**. In China the ousting of conservative leader Bo Xilai, as Communist Party Secretary of Chongqing (he conducted a crackdown on entrepreneurs), paves the way for a victory of the "reformist" camp at the next Congress in October and the subsequent change of government leadership next year. In the financial markets, the wind of liberalization blows stronger with new provisions in fixed income and capital account liberalization. Meanwhile in **Europe** Sarkozy's campaign is closing the gap with Hollande and in the **US** the Republican primaries have not produced yet a clear winner while internecine divisions blow tailwinds in the sails of Obama's re-election.

Regional Developments

- According to the **SWF Institute**, assets under management by SWFs globally amounted to USD 5 trillion, an increase of 9% over the last 12 months. UAE's Abu Dhabi Investment Authority tops the list of richest SWFs, holding assets worth USD 627bn.
- **McKinsey** estimates an opportunity worth USD 15bn for the region's banks, over the next 5 years, should they choose to serve around 11mn SMEs (~50% of total) that are currently not being catered to.
- A report from **AT Kearney** states that **GCC banks** will return to their pre-crisis profitability levels this year, while suggesting that banks need to "invest in retail banking infrastructure and capabilities, address untapped opportunities in wholesale banking and redefine priorities for external growth and international expansion" for more opportunities.
- Sources at the GCC Secretariat revealed that the **GCC Common Currency's** name and denominations were being actively discussed, in anticipation of its 2015 launch, and its printing expected mid-2013.
- **Kuwait** posted a budget surplus for the first 10 months of the fiscal year at KWD 14.38bn. Oil revenues

contributed up to KWD 22.83bn, comprising 95% of total budget revenues.

- Moody's affirmed the long term rating of **Oman's** government local and foreign currency bonds at A1. Financial stance of the country is strong as measured by high fiscal and external surpluses, solid foreign international reserves and low external debt.
- Inflation in **Egypt** rose to 9.2% yoy in Feb (Jan: 8.6%) on the back of rising food prices and a weaker Egyptian pound, brought about by political instability.
- **Turkey** ran a current account deficit of USD 5.99bn in Jan (Dec: USD 6.56bn), a 0.41% yoy drop.
- Monetary aggregate M2 increased in **Oman** by 13.1% yoy to reach OMR 9.97bn in the end of Jan 2012. The growth was mostly driven by the expansion of savings and time deposits, including deposits in foreign currencies, which grew by 17.9% yoy, while M1 (currency in circulation and local currency demand deposits) increased by only 3.6% yoy.
- Overall price level in **Qatar** increased 1.2% yoy in the end of Feb 2012 despite the decrease in house rents by 6.1%, as food prices grew at a higher pace.
- The **World Travel and Tourism Council** expects the direct contribution of tourism and travel sectors towards Qatar's GDP to reach USD 1.1bn in 2012 from USD 800mn in 2009 due to growing investment in material infrastructure. Qatar is investing USD 20bn into tourism infrastructure in preparation for the 2022 World Cup, with a majority of this investment being directed towards the building of new hotels.
- **Libya**n authorities approved USD 52.4bn state budget for 2012, with the major part of budgetary expenditure, USD 20bn, to be allocated for public sector employees' salaries.
- **Turkey** revised down its 8% target economic growth for 2012 to 4%, according to the Turkish Deputy PM. The revision was aimed at signalling economic sustainability

as the main priority for the Turkish government amid global economic uncertainty. Lower growth poses risks for the central government budget, which recorded a TL 2.6bn deficit in Feb 2012, compared to surplus TL 0.99bn in Feb 2011.

- Inflation projections for **Saudi Arabia** demonstrate certain level of divergence. While Global Investment House expects inflation slowdown to 4.3-4.6% in 2012 from 5.2% last year, some experts, cited by the Saudi Gazette, consider price growth acceleration to 7% this year due to supply shortage in the housing market. Extensive growth of money supply observed in the last years creates strong potential for high inflation in the medium term. This calls for tighter fiscal policy, as existing monetary policy framework does not provide effective instruments to tackle inflation.

UAE Focus

- A statement released at the conclusion of the IMF Mission's Article IV visit to UAE stated **real GDP growth** for the UAE at 4.9% in 2011 due to higher oil output and an expansion in the non-hydrocarbon sector. The 2012 projection is lower at 2.3%, although the non-oil sector, encompassing trade, tourism and manufacturing, is expected to remain strong.
- The **UAE Minister of Finance** stated that the UAE was unlikely to issue its first ever sovereign bond this year, on the sidelines of an exhibition. He also mentioned that the GREs were in a good shape.
- An EIU report has ranked **Dubai as the most competitive city** in the Middle East and 40th worldwide, closely followed by Abu Dhabi (41st), based on its ability to attract capital, business, talent and tourists.
- Reports about the possible **merger between Aldar and Sorouh** has led to higher share prices and is likely to lead to further consolidation in the real estate sector,

should this merger go through. S&P announced that their ratings for Aldar remained unchanged given that the merger talks are in very early stages.

- Dubai’s **credit risk** has dropped to a seven-month low, as the cost to insure its debt fell 100bps to 345.
- **Total provisions** set aside by the **UAE** banks showed the highest monthly average – allocating almost AED 2.1bn – in Dec 2011. This boosted total provisions to AED 11bn in 2011, slightly lower than 2010’s AED 11.7bn and 2009’s peak of AED 12.9bn.
- Rising food prices led to an uptick in **Abu Dhabi’s** Feb **inflation** by 0.6% yoy. The increase of 2.6% in food and 7.4% in beverages, also translated indirectly into higher prices for restaurants and hotels group – 9.7%. In mom terms, prices decreased 1.2%.
- UAE firms listed on the local exchanges showed remarkable **profits growth by 104% last year**, which was not supported by the corresponding growth of stock indices, according to the Kuwait Financial Center. Two issues are worth to be mentioned in this regard: (i) Strong growth of stock indices on the UAE exchanges in the last 2 months and beginning of March may partly reflect better financial stance of local companies as measured by the financial statements for the last year; (ii) Ex-post evaluation of stock prices may indicate shortages in the existing practices of information disclosure and assessment on the local stock exchanges.
- The **Federal National Council** has requested that the ceiling for housing loans offered by the Zayed Housing Program be increased to AED 850k from AED 500k at present.
- UAE’s proven **oil reserves** are likely to decline by about 5.8bn barrels to around 91bn barrels by 2016, according to the latest report by Business Monitor International. Oil production is expected to rise to over 3.2 mn bpd by 2016 and about 3.5 mn bpd by 2021.
- The World Travel & Tourism Council stated that the

contribution of travel and tourism to GDP, though strong, has declined by about half a percent, compared to 2009. In 2012, travel and tourism is expected to add USD 19.9bn to the UAE’s GDP (6.1%) compared to USD 16.6bn (6.6%) in 2009.