

# Weekly Economic Commentary – May 20, 2012

## Markets

It was a dismal week for **equity** investors with all regions affected by the ongoing Greek drama and Spain sub-plot as even the Facebook IPO received only a muted response. **Regional** markets were not spared either, with Tadawul closing near a 3-month low on Saturday. While the **euro** continued to be battered, the Indian **rupee** continues to slide to record lows given its burgeoning current account and fiscal deficits alongside withdrawals by foreign funds. Among commodities, **gold** was one of the gainers, posting its biggest weekly gain in a month, while crude **oil** prices slipped.

## Global Developments

### Americas:

- **Industrial production** in Apr recorded an uptick of 1.1% mom (Mar: -0.6%), above market consensus, with manufacturing rising by 0.6%. Motor vehicle production, at 3.9% (Mar: 1.2%), accounted for much of the rise; factory output excluding this segment recorded only 0.3% hike. Capacity utilisation increased to 79.2% (78.4%) – the highest since Apr '08.
- **Retail sales** grew at the slowest pace this year by 0.1% mom in Apr (Mar: 0.7%), weighed down by building materials (-1.8%) and clothing (-0.7%).
- **Housing starts** increased 2.6% mom to 717k (sa) in Apr, though building permits fell to 715k (sa) from a 3.5 year high largely owing to a 23% drop in the volatile apartments segment.
- **CPI** for Apr was 2.3% yoy and remained unchanged mom (Mar: 0.3%) while core CPI, which excludes food and energy costs, picked up 0.2% mom.
- **Initial jobless claims** remained flat at 370k in the week

ended May 12, taking the four-week average to 375k from 379,750 previously.

- **US tax rules** that require reporting of Americans' overseas bank accounts has resulted in some Asian banks turning away US customers while an official from BlackRock stated that "foreign investors may choose not to invest in funds that include US securities because they could be penalised if they work with a foreign broker who isn't compliant".

## Europe:

- With no coalition government in **Greece**, the country goes into another election, scheduled for June as the speculation that Greece could leave the euro continues to spook markets. *It was also reported that about USD 894mn was withdrawn from Greek banks on Monday alone, leading to a potential bank run .*
- The Bank of **Spain** disclosed that **bad bank loans** had risen to EUR 148bn at end-Mar, the highest since Aug '94, accounting for about 8.4% of the sector's entire loan portfolio. **Moody's**, meanwhile, downgraded 16 Spanish banks, citing "recession, reduced funding access for lenders and deterioration in loan quality.
- Q1 **GDP** data was released for the **Euro area** along with a clear divergence pattern emerging in growth numbers of Germany, France, Italy and Spain. Euro area growth was unchanged from the previous quarter (Q4: -0.3%), avoiding a recession headline helped by Germany, which reported a strong 0.5% qoq pick-up helped by exports (Q4: -0.2%). France's growth dissipated in Q1 (Q4: +0.1%) while growth in Italy was down by 0.8% (Q4: -0.7%).
- EU **industrial production** fell 0.3% mom and 2.2% yoy in Mar (Feb: +0.8%), as energy production declined by a whopping 8.5% (+8.7%). Production increased in Germany by 1.3% while most other nations reported declines:

Netherlands (9%), Spain (1.8%), Greece (1%).

- German **ZEW** registered a decline by 12.6 points to 10.8 in May: as per the report, “the outcome of the elections in Greece and France has made it more doubtful that European governments will resolutely fight the sovereign debt crisis”, resulting in lower investor confidence.
- 26 Italian banks, including UniCredit SpA and Intesa Sanpaolo SpA, were **downgraded** by **Moody's** last week citing “the banks’ vulnerability to mounting loan defaults and potential funding problems”.

### **Asia and Pacific:**

- **Japan's machinery orders** declined by 2.8% mom in Mar (Feb: +2.8%), largely from the volatile chemical sector which dipped followed a rise the month before. However, inspite of the decrease, orders for Q1 remained positive at 0.9% qoq.
- Domestic demand and exports rebounded in Q1, enabling **Japan's GDP** to expand by 1.0% qoq, from Q4's unchanged reading. In yoy terms, growth was up 2.7%, the first yoy rise in 5 quarters.
- **Singapore's** non-oil domestic exports (**NODX**) rose by 8.3% yoy in Apr (Mar: -4.3%) with strong performance from both electronic (+1.0%, Mar: +2.8%) and non-electronic (12%, -7.8%) segments. While NODX to US and Europe declined, the top three countries expanding were Japan, Hong Kong and South Korea.
- **Singapore GDP** grew 10% qoq and 1.6% yoy in Q1, a tad higher than initial projections, compared to 2.5% qoq contraction and 3.6% yoy growth recorded in Q4 2011. Growth forecast for this year has been maintained in the range of 1-3%, amidst uncertain global outlook.
- **Unemployment rate** in **Korea** held steady at 3.4% in April, while total employment was up 1.9% yoy to 24.76mn. Meanwhile, the UN's Social and Economic Survey of Asia and the Pacific forecast youth unemployment in the

region to remain unchanged at 10.2% this year.

**Bottom line:** Even as **Greece** dominates headlines and heads to another round of elections in June, the G8 leaders have sent out a statement that “we reaffirm our interest in Greece remaining in the euro zone while respecting its commitments”. The **balance of power between Germany and France** is likely to come into the forefront again, if the G8 meeting (where France’s growth-oriented strategy found some acceptance) is anything to go by. Till the question of Greece’s “will it or won’t it” leave the Eurozone is answered, market volatility can be expected, irrespective of data releases.

### **Regional Developments**

- **Saudi Arabia’s** Arriyadh Development Authority started accepting business proposals for the projects related to the construction of **metro** in Riyadh, which is expected to be completed in 4 years. Metro construction is one of the infrastructural projects included in SAR 690bn budget for 2012.
- Revenues of **Oman LNG**, primary liquified natural gas producer in the Sultanate, was 26.5% yoy higher totalling USD 3.96bn in 2011, according to the company’s report cited by Oman Daily Observer.
- According to the Chairman of the Saudi Commission for Tourism and Antiquities, the share of **tourism** in **Saudi Arabia’s** 2011 GDP was estimated at 7.2%, while the sector employed around 9% of workforce, of whom more than 26% are locals.
- **Jordan’s** government discussed measures aimed at **fiscal** consolidation, that would allow reduce public agencies’ operational expenditure by 15%, and capital expenditure by 10%.
- Revenues from **tourism** sector in **Jordan** in Jan-Apr 2012 reached JOD 776.7mn, demonstrating 10.5% growth over the same period of the previous year, according to data released by the Central Bank of Jordan.

- **Net foreign assets** of the **GCC** area increased by USD 456bn to reach USD 1,605bn by the end of the last year, and high hydrocarbon prices would allow the region to increase its foreign assets by another USD 300bn in 2012, and USD 234bn in 2013, according to the estimates of the IIF.
- According to the law recently approved by the President of **Turkey**, the amount of land that can be purchased by foreigners has been increased from 25 to 300 thousand square meters.
- **Unemployment** rate in **Turkey** was estimated to decrease from 11.5% in Q1 2011 to 10.4% in Q1 2012, according to the survey conducted by the country's statistical agency.

### **UAE Focus**

- **IMF**, in its concluding statement of the Article IV consultation for the UAE, estimated growth at 4.9% in 2011 and a lower 2.9% in 2012. Government related entities are expected to pay close to \$30bn this year, with "a significant amount of debt falling due in 2014–15". *(More details in the Addendum)*
- The Dubai Economic Council's Chief Economist has projected **Dubai's** real **GDP** growth in 2012 at the level of 4-5%, higher than last year's 3%. These estimates, supported by the results of Q1 2012, and revised growth projections for the region by the IMF, are based on the assumption of strong performance of emirate's key sectors, including trade, tourism, and industry.
- The UAE's proposed new **banking law** is expected to establish a new regulator for financial services, giving the country a **twin regulator** model – "a prudential regulator and a conduct-of-business regulator". The Central Bank will remain the prudential regulator and the new entity will control consumer protection in addition to its role of managing the day-to-day running

of the financial system.

- Total **loans** increased by 0.2% mom in Mar to AED 1.074 trillion while **deposits** were up 3.3% to AED 1.146 trillion, taking total growth in loans and deposits to 0.3% and 7.1% respectively in Q1, according to latest data released by the UAE Central Bank. **Broad money** grew 2.8% mom to AED 880.4bn in Mar.
- **UAE inflation** touched a nine-month high of 0.9% yoy in Apr, while rising by 0.1% from March. Prices in Dubai were up 1.5% yoy and 0.2% mom while in Abu Dhabi the increase was a tad higher in comparison – at 1.8% yoy and 0.2% mom.
- UAE **unemployment** among the local population was reported to be 14.4% by Alrooya newspaper, citing a committee at the Federal National Council.
- **Dubai Summer Surprises** 2011 recorded total spending of about AED 8.8mn (AED 5.9mn by regional and international visitors, AED 2.9mn by residents) from the close to 1 million visitors in addition to the 3mn residents, as per data released by Dubai Events and Promotions Establishment.
- The UAE **Insolvency Law** is expected to be issued by end of this year, as per the UAE Minister of Justice on the sidelines of a conference on the issue of bankruptcy and insolvency.
- **UAE and South Korea** signed a customs cooperation agreement, with an aim to “facilitate the movement of trade and enhancing cooperation” between the two countries.
- Bilateral trade between **UAE and Italy** trade was close to USD 5.0bn in 2011, further increasing by 20% in Q1 2012. An official at Italy’s Embassy in Abu Dhabi also announced that there were about 50,000 Italian professionals in UAE and close to 170 Italian companies operating out of free zones.
- **Dubai Investments** net profit increased 6% yoy to AED 107mn in Q1 2012, while total assets reached AED 13.5bn,

according to its financial statements.

**Addendum: IMF released UAE's Article IV report for 2012 on May 18, 2012**

The IMF estimates that the UAE grew a healthy 4.9% in 2011, owing to its perception as a "safe haven" in the region amidst regional turmoil. Growth in hydrocarbon sector was high at 9.2% in 2011, largely supported by higher oil prices and increased production in response to disruptions in Libya. But as economic diversification increased, non-hydrocarbon sector grew at 2.7%, supported by trade, logistics, and tourism sectors while the real estate sector continued to be a drag. In 2012, the IMF forecasts real GDP growth slightly lower at 2.3%, with no real growth in the hydrocarbon sector (given limited potential for further increases in oil production) alongside a recovery in non-oil sector growth to 3.5% (thanks to stronger trade, tourism, logistics, and manufacturing). Inflation remained subdued at 0.9% in 2011, largely as a result of declining housing rents and is estimated at a tad higher 1.5% in 2012.

Fiscal policy remained expansionary and thanks to higher oil prices the consolidated overall balance improved from a deficit of 2.1% of GDP in 2010 to an estimated surplus of 2.9% of GDP in 2011. Fiscal consolidation is on the books in 2012, with the IMF revealing that "the federal and emirate budgets imply a modest consolidation of the fiscal stance by 0.5% of non-hydrocarbon GDP". According to the IMF, estimated total GRE debt had declined to 51% of 2011 GDP as of March 2012, from 61% of 2010 GDP. While the IMF lauded better availability of information on GRE debt (especially with Abu Dhabi's debt management office), it underscored the fact that the "passage of the draft Public Debt Law would help to further strengthen the monitoring of GRE debt". While Dubai's debt-to-GDP is on a declining path (baseline scenario), a simulation showed that GREs could pose fiscal risk: assuming a constant primary balance at 2011 levels (1.6% of GDP) and augmenting government

debt by 20% of GRE debt would raise the debt-to-GDP ratio by about 26 percentage points by 2017 compared to the baseline. The banking sector remained well-capitalised and profitable, in spite of a rise in NPLs and higher provisioning, and lending to the private sector has been sluggish. Meanwhile, stress tests undertaken by the IMF showed that the domestic banking system could absorb a significant increase in nonperforming loans. Given the rise in exposure of the banking system to government and public institutions by 3.5% of GDP (roughly 2.6% of banking system assets), the IMF warned that it would be “important to avoid channeling bank funding to non-viable GREs” given strains in external financing. The IMF, in its Staff Appraisal, stated that developing the domestic fixed income market would support banks’ liquidity management, an argument that has long been proposed by the DIFC.