Weekly Economic Commentary – July 8, 2012

Markets
The aftermath of the **EU agreement** failed to further impress the markets. Worse, after the sequence of monetary easing from China to Europe, stock markets fell sharply partly because Draghi stated that downside risks have materialized and partly because markets were expecting stronger monetary measures. The spreads between sovereign debts in core and peripheral Eurozone countries widened to pre-summit levels. Investors are awaiting the next round of negotiation due to start at the **Eurogroup** tomorrow. Regional markets were mixed, though earnings season began on a positive note in Saudi markets. The euro retrenched with the dollar rising to a 10-month high, while gold remained broadly stable. Oil prices were lifted by a strike at Norwegian Statoil.
Global Developments
Americas:

- **Non-farm payrolls** disappointed again, growing only 80k in June (May: 77k) though the **ADP** report was encouraging with the private sector adding 176k jobs; **unemployment rate** held steady at 8.2%.
- The **ISM** in June plunged 3.8 points to 49.7, its first sub-50 reading of the recovery. The forward-looking components weakened, with both new orders and new export orders coming in below 50 as global developments appear to have sharply hit the industrial sector. The only positives were the employment index, little changed, and the inventory measures, which signal that the overbuilding of stockpiles is not an imminent concern.
- **Factory orders** for May increased by 0.7% mom (Apr: -0.7%), with durable goods orders up 1.3% and non-durables up by 0.2%. Capital goods orders, excluding

military equipment and aircraft, grew 2.1% (-1.5%).

- An increase in investment in residential and federal government projects lifted May US **construction spending** by 0.9% mom to USD 830bn – a record high since Dec 09.
- **Brazilian** Industrial Production in May contracted by -5.7% yoy sa after -3.4% in Apr, the ninth consecutive monthly drop, showing that recession is not sparing the BRIC, in this case due to a loss of competitiveness following last year's monetary tightening and resulting currency appreciation.
- **Argentinian** authorities forbade converting pesos into dollars, a new confiscatory measure that pushes the country closer to economic collapse.

Europe:

- Policy rates were cut 25bps to 0.75% at the **ECB** meeting, and Draghi warned that the outlook is worrisome.
- The French Budget does little to reform a bloated public sector and introduces higher taxes on the rich and big firms, hardly a recipe for growth. The Cour des comptes (France's official audit) chief Didier Migaud said France needs an "unprecedented brake on spending."
- The unemployment rate in the euro zone rose to 11.1% in May from 11% in the previous month, while Italian youth unemployment recorded the highest since 1992, at 36.2%.
    - **Russia**'s GDP rose 4.9% yoy after 4.8% growth in Q4 2011 thanks to oil prices and a fiscal stimulus. Robust domestic demand will maintain the economy in high gear in the coming months.
    - The Bank of **England** left rates unchanged at 0.5% but decided to inject GBP 50bn more in a new round of QE, as expected.
    - Eurozone's Composite **PMI** was revised up to 46.4 in June from the initial estimate of 46.0, though employment still remains a concern as the sub-component index fell to 48.3 (May: 48.5). German

services PMI moved to “contraction” territory, falling to 49.9 from an initial estimate of 50.3.
- Diverse May industrial production (**IP**) data: in **Germany**, IP grew 1.6% mom (Apr: -2.1%) on consumer goods and construction while **Spain**’s IP fell 6.1% yoy, for the consecutive ninth month, following Apr’s decline of 8.3%. Meanwhile, **German factory orders** unexpectedly picked up by 0.6% mom in May (Apr: -1.4%) on demand from the Euro area.
- A week after the Euro Summit, and while details are awaited, **Finland** announced its intention to block ESM secondary market bond buying, with **Netherlands** also opposing the idea.

Asia and Pacific:

- Unexpectedly, the **Chinese** central bank cut its benchmark interest rate by 0.25% and lowered its one-year lending rate by 0.31% aiming to boost bank lending to counter a lower than forecast real growth rate.
- **South Korea** recorded a trade surplus of USD 4.96bn in Jun (May: USD 2.3bn), the highest since Oct 2010, as exports grew 1.3% yoy against a decline in imports by 5.4%. Total trade surplus for H1 2012 was at USD 10.7bn, while exports to US recorded an impressive 10.5% yoy growth, on the back of a FTA signed in Mar.
- **Hong Kong** retail sales declined to 8.8% yoy growth in May, down from April’s 11.1%, dragged down by a slowdown in Chinese demand.
- Business sentiment in **Japan**, captured by the BoJ Tankan survey, improved in Q2 to -1 from -4 in the previous quarter. Leading indicators index increased to 95.9 in May (Apr: 95.6) while the coincident indicator, which tracks current activity, fell to 95.8 (97.0).

Bottom line: The drop in global manufacturing has intensified in the past couple of months: from southern Euroland contagion has spread to China and now to the US and South America. The global manufacturing PMI index from Markit/JP Morgan fell almost 2 points from May, to 48.9 in June, i.e. recession territory. The focus has shifted from the euro crisis towards **global growth weakness**: the response of the central bank essentially is buying time to allow another round of political squabbling in the hope that some decision emerges on how to reignite the growth engine through structural reforms rather than fiscal profligacy.

Regional Developments

- An economic advisor to **Egypt**ian President Mohammed Mursi has stated that the country is not opposed to resuming talks with the IMF once the president's economic team is in place for $3.2 bn funding.
- **Egypt** will spend around USD 850mn on infrastructure projects in the new cities, according to the country's New Urban Communities Authority referring to the 2012-2013 fiscal year budget.
- Three **Bahrain**i financial institutions, Capivest, Elaf Bank and Capital Management House, are expected to **merge** conditional on the approval of the Central Bank and Ministry of Industry and Commerce. Total assets of the new entity may exceed USD 400mn, while shareholders' equity is estimated at almost USD 350mn, according to the statements made by the institutions' executives.
- Re-offer yield on the recent 10Y **Bahrain**i government bonds for USD 1.5bn was 6.14% – 4.4ppts higher than the US 10Y mid-swap rate. Majority of investors were asset managers and hedge funds (38%), with local banks comprising 35%. By geographical breakdown, 29% of investors were Middle Eastern, 16% each from the UK and Europe, followed by US (14%), Asia (11%) and local Bahraini investors (14%).
- **Kuwait** is expected to provide USD 1.25bn financial assistance to **Jordan** within the next 2 months, according to Jordan's Finance Minister. Part of the USD 5bn Gulf Fund package agreed to by KSA, UAE, Qatar and Kuwait,

the resources will be spent in 5 years on development projects.

- Fitch has affirmed **Lebanon**'s ratings at 'B' level, pointing to adequate foreign exchange reserves, lower debt levels, and positive trends in financial and budgetary sectors.
- **Libya** went to elections after four decades yesterday to elect a 200-seat interim legislature that will appoint the PM. Almost 142 parties and 3700 individual candidates were running for these seats and the preliminary results are expected on Mon or Tues.
- **Oman**'s social security and welfare government expenditure surged by 123.7% yoy to OMR 702.8mn in 2011. Subsidies and other current transfers more than tripled to OMR 666.7mn, while total wage expenditure (including Pension Fund contributions), rose 12.3% to OMR 1.9bn.
- **Qatar**'s GDP growth was 6.9% yoy in Q1, unchanged on Q4, but down sharply from an overall rate of 12% for 2011 reflecting the expected levelling off in the expansion of LNG production.
- Foreign assets at the **Saudi Arabian Monetary Agency** increased to SAR 2239.9bn (USD 597bn) as of end of May 2012 to set another record, while profits of Saudi commercial banks reached SAR 15.4bn in Jan-May 2012, according to official statistics.
- The **Saudi** Ministry of Housing and Ministry of Finance are drafting a law to reform the real estate finance based on four pillars (1) Create real estate financing market; (2) Promote house ownership among Saudis; (3) Ensure transparency of real estate financing; (4) Creation of a Real Estate Development Fund in support of mortgage financing.
- **Saudi Arabia** has issued a package of **new financial law**s, comprising of the Execution/Enforcement Law, the Finance Lease Law, the Real Estate Mortgage Law, the Real Estate Finance Law, and the Law on Supervision of Finance Companies. The new regulations will enter in force 90

days after publication in the Official Gazette; the copies of the laws are not yet available.

- **Algerian** foreign currency reserves, comprising mostly of USD and European sovereign bonds, reached USD 182bn as of end of the last year.
- **Turkey**'s public debt is expected to decrease to 37% of GDP from 40% of GDP currently by end-2012, as per the Central Bank governor.
- Consumer prices in **Turkey** declined by 0.9% in Jun'12, more than market expectations at 0.4%, while annual inflation reached 8.9% yoy.
- **Turkey**'s real GDP increased by 3.2% yoy in Q1 2012, demonstrating economic growth slowdown, according to official data from the Statistical Institute; seasonally adjusted data indicate 2.3% yoy growth.
- **GCC** witnessed a strong quarter for IPOs, with four IPOs raising about USD 1.1bn in regional exchanges; average IPO value, at USD 276mn, was higher than Q1's USD 39mn and Q2 2011's USD 113mn.
- S&P, in a recent report, stated that it does not expect a strong adverse effect of the Euro zone turmoil on banks in the **Gulf** region, which remain adequately capitalized with positive trends in asset quality as measured by loan loss provisions.

UAE Focus

- UAE **non-oil foreign trade** grew by almost 23% to AED 927.6bn in 2011, as per National Bureau of Statistics, with Dubai accounting for the majority share of non-oil trade: AED 7004.4bn or 76% followed by Abu Dhabi (AED 139.4bn, 15%) and Sharjah (AED 68.3bn, 7%).
- UAE **PMI**, compiled by HSBC, fell to a 3-month low of 53.2 in June (May: 53.8) but numbers on the employment front were encouraging – expansion was the steepest since last July as companies hired more workers to meet the increasing workload.

- **Abu Dhabi**’s nominal GDP grew almost 30% yoy to AED 806bn in 2011, helped by higher oil prices, while non-oil GDP grew by about 7%.
- In a year when there was a “freeze” on school fees, cost of **education** was up by an average 4.5%, according to Dubai’s Knowledge and Human Development Authority. This implies a further spike in inflation this year, when schools were permitted to raise fees. Meanwhile, the Ministry of Economy announced that the price of 27 staple **food** items would be made cheaper by almost 30% in the month of Ramadan.
- The Habshan-Fujairah **pipeline,** which was expected to be commissioned by June, is only “approaching the phase of continuous operation” and will be operational (“have regular flow of oil”) by Aug, as announced by a senior ADNOC official.
- The World Travel and Tourism Council estimates that UAE **tourism** will grow by 6.5% annually until 2021, with the report highlighting that almost three-quarters of the spending was on leisure activities. Furthermore, the news that **India and UAE** are progressing towards the signing of a **MoU** for tourism only adds to this forecast, with one of the aims of the MoU being to double tourist flows by 2015.
- About 4.4mn **passenger**s passed through Dubai **airport**s in May, taking year-to-date number to about 23.2mn (+13.2% yoy). **Etihad**, operating out of Abu Dhabi, posted record Q2 revenues (+30% yoy to USD 1.25bn) on higher passenger growth (Q2: +34% yoy to 2.55mn; H1: 4.89).

A **TRA** official was quoted stating that UAE might get new telecom operators after 2015 as per the official commitment by the government to the WTO.