Weekly Economic Commentary – July 15, 2012

Markets

The Eurogroup made some progress on the Spanish bank deal lifting up the stock markets in developed countries, but the summer rally seems to have ended; the flurry of data from China suggesting no hard landing with GDP growth at 7.6% and slowing inflation, did however help Asian markets recover from their losing streak. Regional markets were mostly down, though the Qatar government's Sukuk sale led to a positive impact. The euro was at its weakest level in two years, while the yen continued to rise against the greenback for a third consecutive week. The end of the strike at Norwegian Statoil pushed down the oil price, but it crossed the $100 mark on fresh Iran sanctions; gold prices gained on Fri erasing losses suffered earlier in the week.

Global Developments

Americas:

- US May **trade** deficit narrowed by 3.8% mom to USD 48.7bn (Apr: USD 50.6bn) as imports declined by 0.7% (lower demand for oil) alongside a slight increase of 0.2% in exports (food and capital equipment).
- Federal **budget deficit** was reported at USD 59.7bn in June, taking deficit to a total USD 904.2bn in the first nine months of the budget year – revenues were up 5.2% and spending down 0.9%. The CBO estimates full year deficit to be around USD 1.17 trillion (2011: USD 1.3trillion).
- Producer Price Index (**PPI**) for May rose by 0.1% mom (Apr: -1.0% mom), with the 0.5% increase in food prices offset by a 0.9% drop in energy prices. Core PPI,

meanwhile, was up 0.2% (0.2%).

- Initial **jobless claims** dropped to a 4-year low, falling 26k to 350k – also recording the biggest drop since Jan. The four-week moving average fell 9,750 to 376,500.
- **Brazil**'s central bank slashed interest rates for an eighth consecutive time, reducing the Selic rate to an all-time low of 8%.

Europe:

- Euro-area **industrial production** rebounded unexpectedly in May (+0.6%) as growth in Germany more than offset a decline in France (-2.1%). German industrial output rose 1.5% mom in May (April: -2%) while Italy and Spain reported monthly gains of 0.8% and 0.9%, respectively.
- **Italian** borrowing costs fell at an auction hours after Moody's Investors Service downgraded its bond rating by two levels to Baa2 from A3, citing the worsening political and economic outlook. Italy sold EUR 3.5bn (USD 4.3bn) of three-year bonds, and later sold EUR 1.75bn of three longer-dated securities. Treasury sold the 2015 bond at 4.65%, down from the 5.3% on a similar-maturity bond sold on June 14. Investors bid for 1.73 times the amount offered, up from 1.59 times last month.
- **Inflation** data for June were released in key EU countries including Germany and France: **German** inflation was at a 17-month low of 2% yoy (May: 2.2%) on lower oil prices while in **France**, inflation held steady at 2.3% yoy despite cheaper energy prices. **Hungary**'s inflation meanwhile was the fastest growing in the EU – prices were up 5.6% yoy in June (May: 5.3%).

Asia and Pacific:

- **China** has permitted the entry of foreign hedge funds to its markets, its latest move to open its capital account.
- **China** released a slew of data last week: Q2 **GDP** grew

1.8% qoq and 7.6% yoy (Q1: 8.1% yoy), but stories of "hard landing" were fewer as **fixed-asset investment** grew 20.4% yoy to CNY 15.07trillion; its growth rate moderated by 0.5pp qoq, and was down 5.2pp yoy. **IP** was up 9.5% in June, hence taking the H1 figure to 10.5% (Q1: 11.6%) while **retail sales** grew 13.7% in June, buoyed by purchases of furniture and electronics (14.4% in H1, 14.8% in Q1).

- **Inflation** in **China** fell for the 5th consecutive month in June to a two-year low of 2.2% (May: 3%) while broad money growth **M2** was up 13.6% (13.2%) and new Yuan **loans** totalled CNY 919.8bn in June (May: CNY 793.2bn).
- **Trade** data for June in India and China were released last week: **China** recorded a trade surplus of USD 31.7bn, as imports grew only 6.7% yoy (May: 12.7%) on lower domestic demand, while exports grew 11.3% (15.3%). As Europe slows, China reported that US had replaced Europe as its largest exporting market in H1. Provisional data revealed **India**'s trade deficit narrowed to USD 10.3bn as exports declined by 5.5% and imports fell 13.5%.
- **India**'s May industrial production (**IP**) was up 2.4% yoy (Apr: -0.9%), recording the biggest pick-up since Feb, but the reading of a fall in capital goods production by 7.7% raises concern.
- **Japan**'s current account surplus, at JPY 215.1bn in May, was the smallest since 1985 while machinery orders fell 14.8% mom (Apr: +5.7%) – the biggest fall since 2001.
- In Asian central bank meetings last week, both **Japan** and **Indonesia** kept policy rates on hold, while **South Korea**'s BoK unexpectedly cut rates by 25bps to 3% and reduced its economic growth forecasts for 2012 to 3% from 3.5% announced previously in April.
- **Singapore**'s Q2 GDP contracted by an annualised 1.1% qoq (Q1: + 9.4%), with manufacturing dragging growth down. This sector shrank 6% qoq, reversing the 20.9% gain registered in Q1 while services and construction sectors were up 0.4% and 0.3% respectively.

Bottom line: Contrasting views among developed and emerging market central banks were evident with Korea being the latest to lower policy rates. Global inflation-adjusted real policy rates are all in negative territory. With FOMC minutes indicating that more monetary stimulus will not be injected, corporate earnings, Bernanke's Congress testimony and the Eurogroup finance ministers meeting on 20 July are likely to determine investor sentiment this week.

Regional Developments

- Investor appetite and demand was obvious in the USD 4bn Sukuk sale undertaken by **Qatar**'s government last week. The largest dollar-denominated Sukuk ever, at USD 4bn (2 five- and ten- year tranches of USD 2bn each), was priced cheaper than a conventional bond and attracted close to USD 24bn in orders, 6 times over-subscribed.
- The Governor of Mumtalakat, the sovereign wealth fund of **Bahrain**, announced net consolidated loss of BHD 270.6mn (USD 718mn) for the year 2011, mainly driven by the financial problems at the state-run carrier Gulf Air reportedly suffering from local and regional turmoil and high fuel prices.
- **Iran**'s **oil output** was at a 20-year low on impact of the sanctions from US and Europe. According to OPEC estimates, production fell 188,500 barrels per day (bpd) in June to 2.96mn bpd while it has fallen 570k bpd since sanctions were imposed in the beginning of the year.
- The Central Bank of **Jordan** has released a few macro statistics: inflation stabilized at 3.9% by end of Jun, unemployment decreased to 11.5%, and bank credit grew 7% yoy. The Department of Statistics meanwhile issued GDP data: growth was 3% yoy in Q1 2012, compared to 2.3% for the same period a year ago.
- Budget surplus in **Oman** amounted OMR 1.6bn in Jan-May 2012. Public expenditure reached OMR 4.5bn, growing at a faster pace (+38%) than revenues (+34%), which totalled

OMR 6.1bn. The latter was mostly due to the substantial increase in crude oil prices, implying a higher non-oil fiscal deficit in the current year.

- Available data indicate overall trend for **inflation slowdown** across the **GCC** region, partly supported by lower food prices growth, however it is not yet clear whether this trend is sustainable. In particular, inflation in Saudi Arabia reduced to 4.9% yoy in Jun (May: 5.1%), in Oman – to 2.2% yoy in May (the lowest level since Feb 2010) from 2.9% in Apr, and in Kuwait – to 2.8% yoy in May (Apr: 3.3%).
- Government **subsidies** remain a big concern for the **MENA** economies: the government of Jordan plans to improve subsidy targeting of low-income groups of population to tackle corruption, according to the Minister of Industry and Trade; **Lebanese** authorities have reached USD 360mn agreement to lease Turkish electricity-generating equipment to cover power shortages, and reduce high cost of electricity which have led to excessive subsidies to the state-owned Électricité du Liban, which reached record level of USD 1.2bn in 2011, according to the Daily Star citing country’s officials.
- Issuance of conventional **bonds** in the **MENA** region in Q2 2012 increased by 17% qoq to USD 12.4bn, while the number of issues was higher by 25%, according to the quarterly Zawya Bonds Monitor.
- MENA **M&A** activity demonstrated strong growth in H1 2012: total value of deals increased by 137% yoy to USD 14.3bn, an estimate reported by Thomson Reuters.

UAE Focus

- 1.5 million-bpd Abu Dhabi **Habshan- Fujairah 370-kilometre crude oil pipeline**, costing $3.3bn, will be inaugurated on Sunday (according to Gulf News), provides direct access to Indian Ocean and bypasses Straits of Hormuz.

- **Dubai Group**'s USD 10bn restructuring talks ran into trouble last week with the withdrawal of three banks – RBS, Commerzbank and Standard Bank Group – from the negotiation table. While the trigger may have been the delay to reach a consensus, with talks ongoing for almost 18 months, the ongoing crisis in Europe would have added additional pressure on the banks' loan books.
- Dubai **Drydocks** received a thumbs-up from almost 97% of its creditors for the USD 2.2bn restructuring deal. The property group **Limitless** announced it is nearing the completion of a restructuring deal for its USD1.2bn debt, with prospects looking up with the passing of the mortgage law in Saudi Arabia last week: one of the biggest projects stalled had been Al Wasl, a USD 12bn development on the outskirts of Riyadh.
- **Inflation** in Dubai was up 0.8% yoy in June on food and transportation costs; H1 inflation clocked a drop of 1.5% as declines in housing, electricity and fuel (-6.0%) more than offset the rise in food prices (+3.8%), transportation (1.9%), furnishing (2.2%), and education (1.8%) among others. In contrast, inflation in Abu Dhabi was up 1.3% in H1, with food prices accounting for almost two-thirds of the rise.
- A Central Bank official stated that the UAE **Mortgage Law** would be issued by end of this year. The Law, which differentiates between mortgage-to-own and mortgage-to-invest, will help boost the real estate sector through secure financing.
- Dubai **Duty Free** announced that it raised USD 1.75bn through a 6-year syndicated loan, after having an initial target of raising USD 1.1bn.
- Data released by UNCTAD showed that **FDI** inflows into the UAE advanced by almost 40% to USD 7.6bn in 2011 while flows into the Arab region were down by about 35%. However, UAE remained most affected by cancellation of ongoing/ announced projects, worth USD 958bn.