

Weekly Economic Commentary – December 22, 2013

Markets

Stock markets were calm after the **announcement of the QE tapering by the US Fed**, if nothing else because the planned reduction in purchases was minimal and markets had already priced the policy change. The final GDP reading came in higher than initially estimated, lending support to the Fed's decision and a boost to equities. Asian markets were mixed, with the Japanese gauge rising on a weaker yen and Chinese stocks plummeting as money market rates hit a six month high while European stocks advanced. In the **region**, most markets gained, led by Dubai and Abu Dhabi while Qatar's index dipped. The **dollar** gained some ground, the **yen** fell to a five-year low and the **euro** weakened on an S&P EU downgrade of its sovereign default intervention mechanism ESM. **Oil** prices rose on stronger than expected US GDP, supporting a sustained economic recovery, and **gold** plummeted on the back of the Fed's decision to taper.

Global Developments

US/Americas:

- The **US Fed** announced that in February it will **reduce** the **monthly purchases of fixed income** securities by USD 10bn to USD 75bn, as widely expected and priced by markets. It represents a token measure which is unlikely to be of any practical relevance. The real test will come when the Fed will have to start offloading the USD 4 trillion assets that it has accumulated. For now it has only slowed the pace of further accumulation.
- Markit's **US flash manufacturing PMI slipped** to 54.4 in Dec from 54.7 in Nov, signaling stable business

conditions.

- **US GDP grew** 4.1% qoq ann. in Q3 (+2.5% in Q2) according to the third estimate, much higher than the initial 3.2%. Personal consumption growth surged to 2.0% from the previous 1.4% estimate but inventory accounted for 1.7% of GDP growth.
- **US industrial production rose** 1.1% mom sa in Nov marking the largest jump in a year and surpassing its pre-recession peak. The volatile mining and utilities component added the most to growth. Manufacturing output expanded for the fourth consecutive month, rising 0.6%.
- **US consumer prices remained flat** Nov after dipping -0.1% in Oct but rose at a faster pace on an annual basis to 1.2% yoy in Nov from 1% yoy in Oct. Core inflation which excludes energy and food rose 0.2% mom (0.1% in Oct) leaving the annual rate stable at 1.7% yoy.
- The NAHB/Wells Fargo Housing Market Index showed **US builder confidence increased** for the sixth month straight in Nov adding 4 points to 58 – a gain larger than expected. All index components improved with the current sales conditions sub-index reaching its highest level in 8 years.
- **US housing starts surged** 22.7% mom in Nov to a six-year high of 1.09mn units annually sa. This follows a modest rise of 1.8% mom in Oct. **Building permits** dropped by a less than expected -3.1% mom to an annual rate of 990k, weighed by as drop in approvals for multi-family homes.
- **Initial jobless claims increased** for the second consecutive week, by 10k to 379k. The four-week moving average rose from 330,250 to 343,500. Continuing claims rose 94k to 2.884 mn. Claims are volatile this time of year so are not a solid indicator of the job market strength.
- **US residential construction** in Nov shows that the **recovery continues**. Privately owned housing starts came at 1.1mn annualized units, increasing 22.7% mom and 29.6% yoy. Permits grew at a more moderate rate but

still show a steady increase.

Europe:

- EU finance ministers agreed on a **plan to wind down failed banks** and related cost sharing procedures, easing the deadlock in **banking union negotiations**. The so-called Single Resolution Mechanism (SRM) will be backed by an agency with the power to methodically wind down failed banks and will be funded by a EUR 55bn levy on the financial sector accumulated over a ten year period. Additional funds if needed will be provided by national governments of the ailing nations. The Economic Stability Mechanism (ESM) will not play a role unless ailing nations exhaust their access to the SRM and apply for a bailout loan.
- **Moody's downgraded the long-term rating of the European Stability Mechanism** (ESM) to Aa1 from Aaa, maintaining a negative outlook. Moody's also downgraded the provisional long-term rating for the Issuer Rating and debt issuance programme of the European Financial Stability Facility (EFSF) to (P)Aa1 from P(Aaa), also with a negative outlook.
- **Markit's euro zone flash manufacturing PMI increased** more than expected to 52.7 in Dec from 51.6 in Nov. In Germany, the preliminary manufacturing PMI jumped to its highest level since Jun 2011 at 54.2 from 52.7, and in France the gauge unexpected fell to 47.1 from 48.4. The **flash euro zone composite PMI** rose 0.4 points to 52.1 while the divide between growing Germany and shrinking France worsened.
- The **ZEW German economic sentiment index higher** a more-than-expected 7.4 points to 62 in Dec – the highest level since Apr 2006. Economic sentiment in the **eurozone** also improved, the gauge rising 8.1 points to 68.3, while the current conditions index rose 7.2 points to -54.4.

- The **German Ifo business climate index higher** to 109.5 in Nov from 109.3 in Oct. The Expectations index rose more than expected to 107.4 from 106.4 while the current assessment index slipped to 111.6 from 112.2.
- **Italy's new industrial orders fell** -2.5% mom in Oct , after a jump of 1.7% in Sep.
- **UK unemployment rate** unexpectedly **fell** to 7.4% in the three months to Oct as against 7.7% in the three months to Jul effectively signaling that the economy has regained strength. Also **U.K. retail sales** rebounded in Nov by 0.3% mom and 2% yoy on a more cheerful pre-holidays mood.

Asia and Pacific:

- The Reserve Bank of **India** unexpectedly kept its benchmark **interest rates steady** despite having stated that inflation is "too high".
- **Indian WPI** ticked **up** to 7.5% yoy in Nov from 7% in Oct. Food price inflation and core inflation both accelerated over the month.
- The **flash Markit/HSBC China manufacturing PMI fell** a marginal 0.3 points to 50.5 in Dec. New orders and exports orders rose at a faster pace while employment declined.

Bottom line: The **US economy has left the doldrums**, thanks to two factors: a re-leveraging of households (the Fed data showed in Q3 the first increase in US household debt since before the financial crisis) and a massive increase in business inventories. Whether the second element is a positive or negative factor will be seen in 2014. In Europe the so-called **banking union is hardly a decisive step in the build up of a more robust EU institutional framework**, but at least is a step ahead. Skepticism and doubts around the process of reforming the EU governance were further highlighted by the downgrade of the ESM and the EFSF. In the meantime the dichotomy in economic outlook between core and periphery

widened. The new German government was hailed by a jump in the ZEW index, but the agreement signed between CDU CSU and SPD is definitely not business friendly with a higher minimum wage, lower pension age, an embarrassing confusion over energy policy and more regulation. China's reform drive could prompt a "Dubai moment" according to Thomson Reuters, halting government financial support for public companies (and the implicit state guarantees) which is not sustainable. A market driven financial system requires a clear boundary between public and private lending.

Regional Developments

- **Bahrain's economic growth slowed** in Q3 to 4.5% yoy, slowing from 5.3% the previous quarter. No further details were revealed other than the fact that the oil sector contributed about 45% of output growth, given higher crude oil prices.
- **Egypt posted a current account surplus** of USD 757mn in Jul-Sep, thanks to the rise in official transfers (to USD 4.27bn from USD 40mn a year ago) via aid from the GCC. This compares to a current account deficit of USD 1.26bn in the same period a year ago. FDI into Egypt rose to USD 1.246bn in Jul-Sep, up from USD 1.164bn last year.
- The **Egyptian pound took a beating** for the second day at a foreign exchange auction on Thursday. The central bank sold USD 37.2mn to banks at the auction on Thursday, with a cutoff price of 6.8972 EGP to the USD, weaker than the 6.8869 at Wednesday's sale.
- **Egypt's** finance minister revealed that about EGP 30bn would be spent as per the **second stimulus package** to be launched in Jan. The Minister stated that this would be financed using the money received from the Gulf, also clarifying that those funds were not used in the first stimulus package of EGP 30bn implemented in Aug this year. Separately, voting on the Constitution is set for

Jan 14-15.

- **Iraq's** Oil Ministry data show that **oil exports increased** to about 71.4mn barrels in Nov despite bad weather, and with the average selling price at USD 102.577 per barrel, revenues would have touched about USD 7.324bn. Exports from Iraq's southern terminals have averaged 2.01mn barrels per day (bpd) so far in Dec, according to Reuters tracked shipping data, down slightly from Nov's average of 2.07mn bpd.
- **Infrastructure budget** in **Iraq** is estimated to be USD 516mn in 2014, nearly a third of the total planned expenditure, according to an information adviser at the ministry.
- **Kuwait** "may adopt proposals to **extend the current corporate income tax** to include Kuwaiti firms besides the foreign firms", according to the country's Finance Minister, reported by Bloomberg.
- **Kuwait** is expected to secure USD 1.43bn in financing from a consortium of banks for the The Az-Zour North Power and Desalination project, which is the country's first **public-private partnership** project. This is part of a KWD 30bn development plan announced in 2010, which also includes a refinery, new airport and major causeway.
- **Lebanon's** sovereign foreign currency long-term **credit rating was revised downwards** to negative from stable by **Fitch Ratings**, citing political risks, deteriorating public debt dynamics and weak economic growth prospects. The credit rating was affirmed at B, five notches below investment grade.
- **Oman** expects USD 110 billion to be injected into its **hydrocarbon sector** in the next 10 years. Its oil ministry under secretary revealed that 53 projects worth around USD 64bn had already been identified in the hydrocarbon sector, of which 15 projects were to be presented to the private sector soon. The investments are likely to expand the hydrocarbon sector's

contribution to GDP from 18 to 32% by 2020 and create 10-15k jobs.

- **Oman** is expanding expenditures on new and existing **road network** by nearly OMR 2.1bn as part of an enhanced overall infrastructure development programme.
- BP won a gas project approval in **Oman**, allowing it to bring America's shale gas techniques to the USD 16bn investment in Oman's Khazzan field. It is expected that BP will drill 300 wells to produce 1bn cubic feet of gas per day, equal to 1/3rd of Oman's current gas supplies.
- The **Qatar** Financial Markets Authority, without disclosing details, stated it had received two requests for new listings and five for **launching IPOs**.
- **Qatar's** Ministry of Development Planning and Statistics released a more **optimistic growth scenario** for the country in 2013, raising the growth forecast to 6.0% from the previous estimate of 5.3% released in June this year.
- **Saudi Arabia's** Labour Minister revealed that the Nitaqat program had increased **Saudization** by 15% since the beginning of 2013, also adding that demand for work visas had decreased by a quarter over the past two years.
- The volume of the **industrial output** in **Saudi** grew 10.9% yoy to SAR 279.5bn in 2012 and the number of employees reached 768k, with non-metallic mineral industries (18%), food industries (15%) and metal formation (12%) accounting for bulk of the labour force.
- **Saudi** Hollandi Bank privately placed a SAR 2.5bn tier 2 **Sukuk**, with a tenor of 10 years and a half yearly profit of six-month Saudi Interbank Offered Rate plus 1.55%, according to a bourse statement.
- The head of the National Committee for Cement Companies in **Saudi Arabia** stated that the labour crackdown and the consequent shortage has led to a 30% decline in cement sales.

- A single **GCC visa**, modeled on the Schengen visa, is likely to be launched by mid-2014, as the GCC interior ministers are working on the details of the project. This will boost both trade and tourism in the region as a whole, by easing the movement of people across borders.

UAE Focus

- The Vice-President and Prime Minister of the UAE and Ruler of Dubai has issued a decree on **rent hike caps** while renewing tenancy contracts. Applicable across the board – public, private sector owned and even within free zones – the new rental slab will not allow landlords to raise rents on renewals if the current lease is only 10% lower than the average rent of a similar property.
- **Istithmar World**, a part of Dubai World, announced that it had sold its 50% stake in Miami Beach's Fontainebleau hotel to south Florida developer Turnberry, as part of its divestment programme following a USD 25bn debt restructuring. While the asset's selling price was not immediately known, the 50% stake in the property was acquired at USD 375mn in 2008.
- **Moody's** expects UAE's real **non-oil GDP** to grow by 4.8% in 2014 aided by increased investment in infrastructure and real estate sectors, boosted by the Expo 2020 bid win. It also affirmed UAE's Aa2 government bond rating with stable outlook.
- Italian builder Salini Impregilo announced it had won a contract worth EUR 168mn to build part of a highway between Abu Dhabi and Dubai.
- Yet another global report, this time by the UK-based Global Property Guide, placed **Dubai** as the world's **fastest growing real estate market**, with prices up 6.48% qoq in Q3 while the increase was 21.37% yoy.

