

Weekly Economic Commentary – Jul 13, 2014

Markets

Stock markets started the week on the back foot after the fireworks of the 4th of July; the correction was not very deep in the US and Japan. The S&P 500 wobbled off its all-time high and emerging markets fell amid a movement to safer assets and the wait for the coming reporting season, that will set the tone for the rest of the year. However, in Europe, where Espirito Santo's woes rattled investors, stock indices sank. The news from Portugal, although not a game-changer in and of itself, is a reminder that the economic situation remains precarious. Regional markets appeared insulated from global sentiment, as most closed higher for the week, Qatar's gauge leading by far. On **currency** markets trading has been directionless. **Energy futures declined sharply** as uncertainty around Middle East oil supply eased. Furthermore the prospect of a normalization of relations with Iran could add 1.5 million barrel per day to global supply this year. **Gold** spiked amid renewed concerns in Europe but eased toward the week end when it appeared the crisis will remain contained.

Global Developments

US/Americas:

- According to the **FOMC June minutes** the US **Fed will end its QE** programme October with a purchase of USD 15bn if the US economy remains on track to recovery. Furthermore "many" Fed officials advocate reinvesting income into their asset purchases until at or after the time that interest rates rise. That would be a change to the current strategy of stopping reinvestment before raising rates.

- US **initial jobless claims dropped** by a more-than-expected 11,000 last week to 304,000 sa. The less volatile four-week moving average fell by 3,500 to 311,500.

Europe:

- **ECB** President Draghi surprised markets by calling for new rules at the European level to ensure that euro zone members **enact deep reforms** to make their economies more competitive: "it would have been useful to establish, alongside existing convergence criteria, a set of **structural criteria** that had to be met to enter the euro area and then respected once inside." he stated.
- The **Eurozone Sentix business confidence index rose** to 10.1 points in Jul, from 8.5 in Jun. Investors' assessments of the current situation climbed to 2.3 from 0.3, while six-month expectations improved to 18.3 points from 17.0.
- **German industrial production unexpectedly plunged** -1.8% mom in May – the sharpest drop in two years – which follows a downwardly revised -0.3% mom drop in Apr and suggests a weaker Q2 for the Eurozone. In **France** output also fell by -1.7% mom and **Spain** saw a -0.7% contraction in production. Italy's production was down 1.8% yoy
- The majority stakeholder of **Portuguese** largest bank **Banco Espirito Santo** declared insolvency pushing up Portugal's sovereign bond yields and sinking the shares of European banks. The bank itself issued a note asserting that it is well capitalized and solvent.

Asia and Pacific:

- At its regular policy meeting the **People's Bank of China** reiterated that it would continue to **pursue its steady monetary strategy**, flexibly using a mix of policy instruments, and keep liquidity tight. The downward

pressure on the economy was not eliminated, and the inflation was still low. In May, the Chinese foreign exchange reserves increased by just 361 million, indicating that market intervention is subsiding.

- **China CPI slowed** to 2.3% yoy in Jun from 2.5% in May, leaving more room for government policy activism.
- **China exports rose by a less-than-expected** 7.2% yoy in Jun after rising 10.4% yoy in May. Imports rose 5.5% yoy.
- **Japan core machinery orders collapsed** by -19.5% mom in May, the sharpest fall since 2005, after a drop of -9.1% mom in Apr confirming that the Q1 firework in GDP growth, will be followed by a dark outlook.
- **India's budget** targets a 4.1% deficit for 2014, **largely unrealistic**, as it is based on optimistic tax revenues. Hopes of deep structural reforms were dashed as the law contains only promises to raise foreign investment limits in defence and insurance, remove India's USD 43bn subsidy regime, and streamline its parlous tax system. Some of the low hanging fruits have been missed out, including clarity on the retroactive tax, general anti-avoidance rules (GAAR) and a pass-through status for all categories of alternative investment funds.

Bottom line: The **central banks in the US, China and the EU were the focus of attention in the macro sphere.** The first two reiterated that they will stay within the course of action set earlier prefiguring a broadly supportive monetary stance. The third is pushing for effective reforms in Euroland in exchange for its lax monetary policy and liquidity provisions to banks. The introduction of explicit targets would exert pressure on policy makers who have been stubbornly refusing to alter significantly the status quo, thereby prolonging a crisis, now one month away from its 7th birthday.

Regional Developments

- **Egypt's Gross Domestic Debt** reached EGP 1.6 trillion at

end Mar (78.9% of GDP), compared to EGP 1.5trn at end of Dec 2013 (75.9% of GDP). However, Egypt's Gross External Debt declined to USD 45.3 bn at end of Mar 2014 (15.5% of GDP) compared to USD 45.8bn at the end of Dec 2013 (15.5% of GDP) thanks to external GCC assistance.

- **Urban consumer inflation in Egypt** remained **steady** at 8.2% in June, though the fuel price hike is likely to be reflected in the upcoming months. Fuel prices were raised by upto 78% amidst a cut in gas subsidies and alongside last week's hike in sales tax on alcohol and cigarettes.
- **Saudi Arabia** was the **largest recipient of Egypt's exports in Jan-May** 2014, receiving goods worth EGP 6.4bn, followed by Italy, Turkey and the US – according to a report by the Egyptian General Supervisory Authority. Building material, electronic engineering goods and food topped the list of exported items from Egypt to Saudi Arabia.
- **FDI into Egypt increased** to USD 1.84bn at the end of Q3 FY13/14 against USD 1.602bn at the end of Q2, reported the Central Bank of Egypt. Meanwhile, there was a decline in investment flows abroad to USD 1.232bn (Q2: USD 1.252bn).
- A recent UN/ **ESCWA** report estimates that a **drop of 1 percentage point of growth in Iraq** would lead to a drop of 0.88 or 0.9 percentage point in each of the three countries Lebanon, Jordan and Syria.
- **Total Omani crude oil exports** was **down** 5.1% during Jan-May in spite of a rise in total oil production by 1.3% during the same period; sharp declines in exports to Taiwan (down 23.6%), Japan (down 32.4%), Singapore (less 63.6%), Thailand (down 19.6%) and India (lower by 16%) offset the 21.4% rise in exports to China.
- **Oman's budget** clocked in a total **surplus** of OMR 551.2mn during Jan-May, vis-a-vis a deficit of OMR 71.6mn during the same period a year ago. Public revenues were up 0.5% yoy to OMR 6.04bn though net oil revenues were down 2.6%

to OMR 4.3bn while corporate income tax was up 15.6% to OMR 362.1mn.

- **Inflation rate in Oman rose** to 1.48% yoy and 0.22% mom in May, with education and health costs up 6.3% and 6.0% respectively in yoy terms while food and non-alcoholic beverages grew by 2.7% yoy.
- **Qatar Holding (QH) slashed its 15% stake in the London Stock Exchange** group by almost a third, as part of “routine portfolio management”, reported *The Telegraph*, citing sources familiar with the deal. This happened ahead of the British group’s USD 1.6bn rights issue to help it buy the US indexes group Frank Russell and QH was to use the sale proceeds to maintain its 10% stake in LSE, without having to contribute additional cash for the expected rights issue.
- **Saudi Arabia’s imports fell** for the seventh month in a row, falling 5% in May, while non-oil exports also fell by 5.1% – the first fall since Mar 2013. Exports declined largely due to lower exports of petrochemicals and plastic, which together accounted for 65% of total non-oil exports since the start of the year.
- **June PMI** clocked in a **strong reading** of 59.2 in **Saudi Arabia**, the highest since Jan and up from 57 in May. The pace of output growth quickened to a 26-month high while record-high buying activity was also recorded.
- According to a report by **Moody’s**, the **GCC insurance sector** tripled during the period 2006 to 2013, with insurance premiums rising to USD 18.4bn from USD 6.4bn. Several regulatory changes are being proposed – including mandatory insurance covers and takaful-specific regulations – and this is likely to boost the credit profile of the insurance market. Separately, **Swiss Re** reported that **insurance premiums in 12 Arab markets** grew 7.5% yoy to USD 28.6bn last year.
- Among the GCC nations, **Qatar** (at 4.1%) registered the **highest rise in housing costs** during the first 5 months of this year, followed by Saudi Arabia (1.8%) and the

UAE.

UAE Focus

- UAE's planned **DFM-ADX merger** has been **shelved**, reported *Reuters*, citing sources familiar with the situation, missing an important financial reform opportunity. Agreement was not reached on multiple counts including valuations, the location of the merged entity's headquarters, and the board's composition among others. It is not confirmed whether merger plans were permanently on hold or whether they would be revived later.
- **UAE's Securities and Commodities Exchange** introduced **two classifications for brokerage firms** – “those which engage in trading only while the clearance and settlement operations are conducted through clearance members” and “those which engage in trading clearance and settlement operations for their clients” – in an effort to reduce capital requirements. The approved draft regulations, if signed into law, would mean that trading brokerages require a paid-up capital of AED 3mn, whereas trading and clearance brokerages will need AED 10mn.
- **Djibouti launched arbitration proceedings** in London against DP World, seeking to rescind the latter's concession on the grounds that the agreement “unfairly favoured” the port operator. DP World owns one-third of Djibouti's Doraleh Container Terminal, Africa's largest.
- **Dubai's residency visas** were **up** 30% yoy to 570,917 new cases in H1 2014; it was also revealed that during this period, there was an 8.14% increase to 21.9mn passengers entering and exiting the country.
- **DMCC announced a 30% increase in number of member companies during H1 2014**, registering 1027 new companies during this period, bringing the total to more than 8865 companies.

- **Jebel Ali Free Zone**'s Fitch rating was **upgraded** to BB- from B+ previously, on improved liquidity, reduced leverage metrics, and better-than-expected operating performance.
- **Emirates NBD** Investment Bank arranged 10 USD sukuk issuances aggregating to USD 5.4bn during Jan-June 2014, as per Bloomberg's league tables, making it the **highest number of USD sukuk issuances led by any arranger during this period**.
- **Dubai** jumped two places up to **5th in the annual MasterCard Global Destination Cities Index**, which surveys 132 cities and topped by London, followed by Bangkok, Paris and Singapore. Visitors spent USD 10.9bn in Dubai, making it the fifth highest market in terms of visitor spending while Abu Dhabi ranked fifth in the Middle East and Africa in international overnight visitor spending at USD 1.9bn.

Media Review

The rise and fall of Arabtec ...

http://www.zawya.com/story/Ambition_investor_greed_fuel_rise_and_fall_of_Dubais_Arabtec-TR20140708nL6N0PA08NX2/

... and the rebound of Emaar

<http://www.emirates247.com/business/robust-realty-tourism-boom-will-lift-emaar-moody-s-2014-07-08-1.555875>

<http://on.ft.com/VUYwcW>

GCC governments to invest AED 550 billion in education

http://www.zawya.com/story/GCC_education_sector_to_see_AED550bn_investments_Report-ZAWYA20140703041509/

Deflating China's property bubble will have dire consequences

<http://www.ft.com/intl/cms/s/0/71a9e156-fafe-11e3-8959-00144fab7de.html?>

Temasek performance suffers from exposure to banks

<http://www.bloomberg.com/news/2014-07-06/temasek-set-to-show-slower-asset-growth-on-banks-southeast-asia.html>

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