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WEEKLY REPORT

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Making sense of global markets,
information and analysis for an informed investment

This is the fourth issue in a new series of TeleTRADE Armenia weekly reports offering insightful analysis of international market trends and financial & economic developments, with a focus on Armenia but also covering global market trends and developments in the US, Europe and Asia.

Highlights

- Investor confidence in US markets was shaken by concern over a weaker fourth quarter, confirmed by a decline in business investment and weaker consumer spending, and from political conflict over a looming fiscal crisis. But there were some positive signs, as overall business activity increased in November for the first time in three months;

- Pessimism over the European economy mounted as investors became concerned over the possibility of a recession in Germany, bolstered by a decrease in retail sales, exports, manufacturing and industrial production, as well as the highest unemployment in two decades. Markets responded positively to the European release of a new 34.4 billion euro ($44.7 billion) loan installment for Greece. Elsewhere, market uncertainty in the UK was triggered by Bank of England's warning that British banks may not have sufficient capital and by a possible reversal of economic activity for the fourth quarter;

- Asian stocks gained for a second week as investor confidence was bolstered by optimism for economic recovery in the US and China, from market gains in Hong Kong, Singapore and South Korea, and due to optimism over a possible economic recovery in China. The Chinese economy is now projected to expand by at least 7.8 percent in the fourth quarter, after the slowest growth in three years;

- Global oil prices rose by almost $2 a barrel, driven by market speculation, and gold suffered a more than $30 per ounce decrease.

Investor Confidence in US Markets Shaken

Despite an ***unexpected increase in US economic growth***, as GDP increased by 2.7 percent for the third quarter, up from initial estimates of a 2.0 percent increase, ***investor confidence was shaken by signs of longer term weakness*** in the fundamental drivers of that growth. More specifically, investors are now concerned over a weaker fourth quarter, confirmed by a 2.7 percent decline in business investment and a weaker than expected 1.4 percent rise in consumer spending. And with consumer spending now accounting for some 70 percent of the overall US economy, that factor is especially important. Investor confidence has also declined due to the ongoing ***political fight over the so-called "fiscal cliff***," with an automatic $600 billion in spending cuts and tax increases set for the start of next year, and triggering a downward revision to estimates for fourth quarter GDP growth, now projected at between one and two percent. But there were some positive signs, as overall business activity increased in November for the first time in three months.

Negotiations between Republicans in Congress and President Obama over the "fiscal cliff" were complicated by a dispute over taxes, leading President Obama to challenge the Republicans by publicly warning of "prolonged negotiations." The ***White House has adopted an aggressive post-election political posture*** and is pressuring Republicans in Congress to extend tax cuts for middle-income Americans, while the Republicans are opposed, arguing that any tax increase on small business will threaten economic growth. The president's plan calls for $1.6 trillion in tax increases on the wealthiest Americans, $600 billion spending cuts, including cuts of $350 billion in health programs, and about $50 billion in stimulus spending for this fiscal year.

Developments in Europe

Pessimism over the European economy mounted as investors became concerned over the ***possibility of a recession in Germany***, Europe's largest economy, for the first time in over three years. Despite the success of the latest European bailout for the Greek economy, investors are worried that with German elections next year, domestic pressure from three years of German support for weaker euro-zone states will challenge further aid to Spain and possible Italy, adding a new degree of market instability. This fear was bolstered by a recent 2.8 percent decrease in German retail sales, the largest fall in nearly four years, and by declines in German exports, manufacturing and industrial production, as well as the highest unemployment in two decades.

However, the ***markets responded positively*** to the European move to cut the interest rates and extend the deadline for the ***financial aid package to Greece***, although European investors were ***worried over the outlook for Spain***. Most significantly, after a fourth crisis meeting aimed at managing the crisis in Greece, European finance ministers finally reassured the International Monetary Fund (IMF) and freed a ***new 34.4 billion euro ($44.7 billion) loan installment for Greece***.

Elsewhere in Europe, ***market uncertainty in the UK*** was triggered by the announcement late last week by the Bank of England warning that ***British banks may not have sufficient capital*** on hand to absorb future losses. Although the UK central bank noted that the shortfall in capital requirements was "manageable," it also warned of larger problems, as the British economy's success in emerging from recession in the third quarter, largely due to spending on the London Olympics, may be threatened by a ***possible reversal of economic activity*** for the fourth quarter of 2012. The Central Bank is set to take over responsibility for much tighter regulation of UK banks from the Financial Services Authority (FSA) next year, and will be led by a new chairman, the head of the Canadian central bank governor, Mark Carney.

Focus on Asia

Asian stocks gained for a second week as the regional benchmark index rose to its highest level since May. The market increase was matched by a greater degree of investor confidence, bolstered by ***optimism for economic recovery in the US and China***, and from ***market gains in Hong Kong, Singapore and South Korea***.

Although Japanese stocks posted a more marginal increase, ***investor confidence in Japan was strengthened*** by the Japanese government's adoption of an 880 billion yen ($10.7 billion) stimulus package. And with elections set for December 16, the Japanese Nikkei posted an overall 9 percent increase since November 14, as many observers expect the opposition to win the election and introduce a "more aggressive" easing of monetary policy and focus on boosting exports. But concern over the structural weakness of the Japanese economy is reflected by projections for a looming economic recession in the three months ending December, after two consecutive quarters of contraction. Japanese GDP is set to decline by 0.4 percent for the fourth quarter, after a 3.5 percent reduction for the third quarter.

More importantly, the rise in Asian markets last week was also due to a new sense of ***optimism over a possible economic recovery in China***. After nearly two years of an economic slowdown, the Chinese manufacturing index rose to its highest level in seven months, driven by higher export demand and rising factory orders. ***Institutional investors also expressed higher confidence*** in an improved investment climate in China and now expect no cuts in Chinese interest rates. Based on the recent improvement, the ***Chinese economy is now projected to expand by at least 7.8 percent*** in the fourth quarter, following a 7.4 percent rate of growth for the past three months, representing the slowest growth in three years. But there is lingering ***concern over the new Chinese leadership's commitment to reform***, with little expectation for greater efficiency among the country's powerful larger state-run enterprises.

That concern and worry over the performance of the recently installed Chinese leadership was also reflected in new research by the International Monetary Fund (IMF) that criticized policymakers for their ***over-reliance on state investment to boost China's economic growth***. The IMF found that in order to prevent the vulnerability from such state intervention, the Chinese government needs to reduce total investment by about 10 percent of GDP. Since the start of the economic downturn, the ***Chinese state has actually increased its investment*** and spending in an attempt to maintain economic growth. The practice has resulted in a dangerous trend of ***easy and unchecked state credit for large state-owned enterprises, hurting smaller businesses and weakening domestic competition***.

Commodities

After stabilizing last week, global ***oil prices rose by almost $2 a barrel***, driven by market speculation due to greater expected demand after positive economic news from the US. After a more than ***$30 per ounce decrease in the price of gold*** last week, gold sustained a partial market recovery, closing at $1725. ***Uncertainty in gold mining operations*** were compounded by several months of strikes and labor unrest in South Africa, leading the ***world's fourth largest gold producer***, Gold Fields, to announce a serious ***reorganization of its mining assets in South Africa***. The move follows a similar reconsideration of mining operations in South Africa by Anglo-Gold Ashanti and Anglo American Platinum.

Spotlight on Armenia

According to new statistics released last week by the Armenian government, the ***national poverty rate in Armenia*** declined to 35 percent of the population for 2011, a ***slight improvement*** from the 2010 level of 36 percent. Despite the improvement, the statistics confirm that more than 1 out of every 3 Armenians still lives in poverty. Although the country is experiencing an economic recovery, with ***GDP expected to post an increase of 7 percent*** this year and is projected to expand by another ***6.2 percent next year***, neither the recovery nor the recent 10 percent increase in social spending by the government are expected to do much to reduce poverty.

Armenian Energy and Natural Resources Minister Armen Movsisian announced a significant 10 percent ***increase in the aggregate output of the mining sector***, to a level of 150 billion drams ($370 million) for the first nine months of 2012. Despite a fall in global prices for key metals, including copper, molybdenum and other base metals, the volume of Armenian exports of metals and metal ore concentrates, which now account for the country's main export item, also increased by 36 percent for the same period. But the government also confirmed a serious 27 percent ***decrease in the level of tax payments by mining firms***, to a total of 16.7 billion drams ($41.2 million) from January-September 2012.

The Armenian government reiterated its ***refusal to join a Russian-led customs union***, explaining that ***current negotiations with the European Union*** (EU) for a Deep and Comprehensive and Comprehensive Free Trade Agreement (DCFTA) are a ***larger "priority" for Armenia***. In addition to the limits of the customs union, which comprises Russia, Belarus and Kazakhstan, Prime Minister Tigran Sarkisian also rejected the more recent Russian project to form a new "Eurasian Union," noting that such a project would not be practical for Armenia, especially because the country does not border Russia.