GCC bond yields pick up on US rate hike expectations

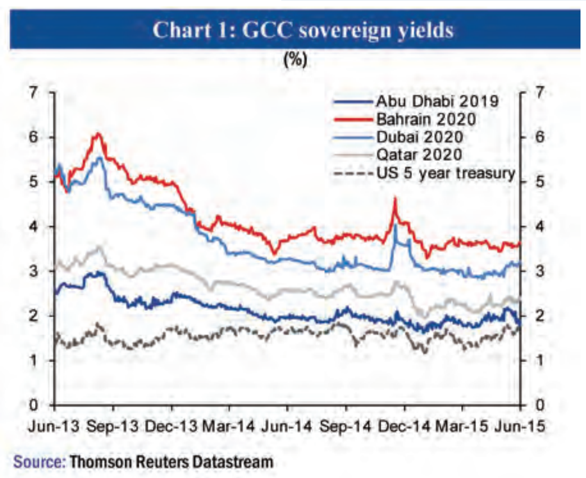
NBK ECONOMIC REPORT

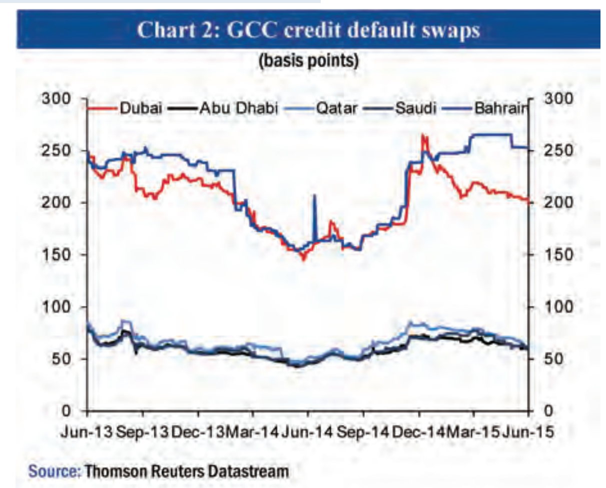
KUWAIT: Increased expectations of a US rate hike has seen GCC bond yields pick up, while CDS rates continued to ease as sentiment improved during 2Q15.Yields appear to have shrugged off earlier concerns about fiscal vulnerabilities in the GCC; instead, yields are now being driven by the prospects of at least one increase in the US policy rate before the end of this year thanks to indications of a steady recovery in the US. Meanwhile, the stock of outstanding debt was flat, led by the financial sector in its compliance with new capital regulations. A robust economic outlook will likely see debt activity pick up this year.

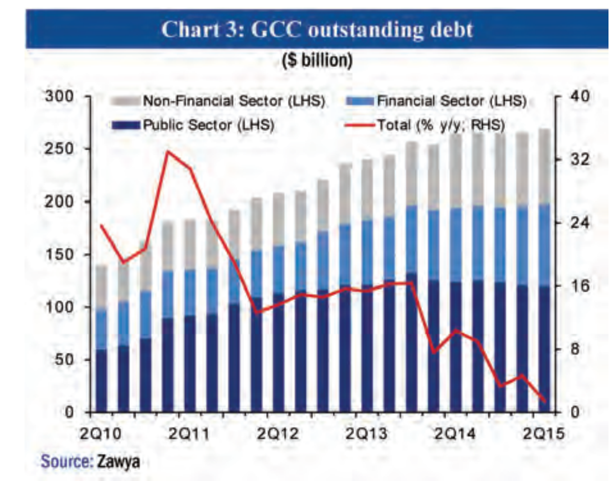
With fears of sharp slowdowns in GCC economic growth diminished, the increased prospects of a US rate hike before the end of the year is pushing GCC rates higher. Intentions to maintain healthy government spending levels despite lower oil prices, coupled with a robust economic outlook have helped assuage fears, bringing GCC rates down at the start of the second quarter of 2015. Yields climbed, however, in the latter part of the second quarter as a slew of positive US economic data increased the chances that the Federal Reserve will move to increase its key policy rate before the end of 2015. Sovereign yields on five year paper stood at 1.88percent, 3.65percent, 3.23percent, and 2.38percent, for Abu Dhabi, Bahrain, Dubai, and Qatar, respectively, by end 2Q15.

Credit default swaps (CDS) for all GCC countries continued their decline, reflecting the ongoing improvement in investor sentiment. The Dubai CDS benefitted the most from the resurging confidence, shaving off 21 points over the quarter, thanks to Dubai's steady fundamentals and fiscal prospects. Bahrain's CDS, which had seen its rate rise in 1Q15,experienced a decline of 12 basis points; still, the rate remains high due to a still vulnerable fiscal position. Abu Dhabi, Saudi, and Qatar each saw CDS rates drop by 10, 16, and 18 basis points, respectively. GCC debt issuance was flat in 2Q15 compared to the previous quarter, slowing net growth in the stock of debt to 1.48percent year-on-year (y/y).Outstanding debt saw a net increase of only $4 billion to $269billion.The issuance of fresh debt remains weaker than a year ago, at $9.1 billion; once again, weaker issuance by the non-financial sector was part of the reason. The financial sector continued to lead issuance activity in 2Q15 as more banks are complying with new capital regulations. Meanwhile, public sector issuance was led by Oman.

GCC debt issuance is still expected to recover this year, with borrowing needs likely to rise. In the current environment of lower oil prices, governments are expected to issue debt to finance rising fiscal deficits. The region's robust economic outlook and substantial capital spending plans, means private borrowing needs are expected to remain large.







ATHENS: A woman walks past a closed pharmacy in central Athens yesterday during a 24-hour public sector worker and pharmacist's strike. Greece gears up for a crucial parliamentary vote on draconian reforms demanded by euro-zone creditors in exchange for a huge new bailout, in what could be Prime Minister Alexis Tsipras's toughest political test yet. — AFP

US producer inflation rising; factory activity picking up

WASHINGTON: US producer prices rose more than expected in June as the cost of gasoline and a range of other goods rose, indicating the recent oil-driven downward spiral in prices was abating.

Other data yesterday showed a rebound in factory activity in New York state this month. The signs of stabilizing manufacturing and firming inflation came as Federal Reserve Chair Janet Yellen said the US central bank remained on track to raise interest rates this year. The Labor Department said its producer price index for final demand increased 0.4 percent last month after increasing 0.5 percent in May. It was the second straight month of increase in producer prices.

A 0.7 percent increase in goods prices accounted for nearly two-thirds of the increase in the PPI last month. In the 12 months through June, the PPI fell 0.7 percent after declining 1.1 percent in May. It was the fifth straight 12-month decrease in the index. Economists polled by Reuters had forecast the PPI rising 0.2 percent last month and falling 0.9 percent from a year ago. In testimony prepared for the US House of Representatives Financial Services Committee, Yellen affirmed the view of a central bank prepared to gradually raise rates after more than six years at a near-zero level.

"If the economy evolves as we expect, economic conditions likely would make it appropriate at some point this year to raise the federal funds rate," Yellen said.

The dollar rose against the euro, while prices for US Treasury debt fell. A plunge in crude oil prices and a resurgent dollar have subdued producer inflation and dampened overall domestic price pressures. Inflation is stabilizing as oil prices steadily rise, but a strong dollar suggests any increase will be gradual. A report on Tuesday showed broad weakness in import prices in June, underscoring the impact of the dollar's 11.6 percent appreciation against the currencies of the United States' main trading partners since June 2014. In a separate report, the New York Fed said its Empire State general business conditions index rose to 3.86 in July from -1.98 in June, which was its lowest level since January 2013.

A reading above zero indicates expansion. Manufacturing has been hammered by the strong dollar and investment spending cuts in the energy sector in response to the tumble in oil prices. There are signs, however, that the spending cuts in the energy sector are diminishing as oil prices rise. The New York Fed survey's index on future business conditions climbed to 27.04 from June's 25.84, which was the weakest since February. A measure of new orders, however, contracted for a second month. Last month, gasoline prices increased 4.3 percent after surging 17 percent in May. Food prices rose 0.6 percent in June following a 0.8 percent increase the prior month.

A shortage of eggs after an outbreak of bird flu, which led to the culling of millions of chickens, continues to pressure food prices. Wholesale egg prices soared a record 84.5 percent last month after surging 56.4 percent in May.

Higher gasoline and food prices are likely to filter through to the June consumer price index. June consumer price data will be published on Friday. The volatile trade services component, which mostly reflects profit margins at retailers and wholesalers, rose 0.2 percent in June after increasing 0.6 percent in the prior month. A key measure of underlying producer price pressures that excludes food, energy and trade services increased 0.3 percent last month after dipping 0.1 percent in May. The so-called core PPI was up 0.7 percent in the 12 months through June. — Reuters

What relief? Greek economy on its knees despite bailout deal

ATHENS: Greece has a tentative rescue deal, but relief that it is not falling out of the euro is unlikely to last long: its economy has taken a huge hit. Months of political brinkmanship, uncertainty and bank closures have hurt companies and brought everyday business to a standstill. And new economic measures meant to secure the bailout are forecast to put the country, which emerged last year from six years of economic decline, through more misery.

"No one is producing. No one is buying. Everyone is scared," said 59-year-old Dimitris Farmakis, who has a cloth-making firm in Athens. On top of a slump in demand, Farmakis' business is hit hard by a government limit on money transfers that makes it impossible to buy supplies from overseas. He's cut down on production and given his staff time off.

"In a few weeks we won't be producing due to these shortages," Farmakis said. Farmakis' woes are commonplace in an economy that analysts estimate will contract by about 4 percent this year.

That's a big reverse from just six months ago, when it had emerged from one of the most savage recessions the developed world has seen in modern history. Its public finances were also healing and the country was even considering financing itself once again on international bond markets.

Rip up that script. Greece fell back into recession in the spring amid growing uncertainty over the country's future in the euro in the wake of the election triumph of the radical left Syriza party in January. As the bailout talks dragged on, concerns became more acute and the recession deepened, evidence suggests. The government's decision over two weeks ago to shutter all banks, impose limits on cash withdrawals at ATMs for Greeks, and restrict electronic transfers abroad dealt a huge blow to an economy that was already reeling.

Bankruptcies are on the rise: bad loans on banks' books are expected to surge to account for 40-45 percent of all loans, from 35 percent in December, according to Moody's credit rating agency. Money has been pulled out in droves from the country over the past months of uncertainty. Deposits hit an 11-year low in May and analysts say it will take time for investors to find the courage to plow money back into the country, even if it has a rescue deal. The public debt load is unsustainable at around 180 percent of GDP - or 320 billion euros - and forecast to rise over the next two years as the economy weakens, the International Monetary Fund warned this week.

Meanwhile, the budget savings the government will have to make to get the financial bailout from its European creditors will hurt economic growth. They include, among other things, tax increases that are likely to dent spending. "Greece has already gone through (a) depression," said Megan Greene, chief economist at Manulife Asset Management. "This ensures they'll go through three more years of recession if it's implemented."

The Greek government, and many experts, say the bailout deal is needed to avoid the even worse scenario of a complete collapse in Greece's banks, which would push the country out of the euro. Economists estimate that if Greece falls out of the currency union, its economy could shrink by another 10 or 20 percent. The government also notes that the bailout deal will ensure the country's funding for three years and includes a promise to lighten its debt burden.

In the short-term, it is needed to help the banks reopen, a priority for the economy to start breathing again. Imports in Greece have been hammered by the limits on money transfers that the government imposed two weeks ago to prevent a bank run. Business owners are warning there could be shortages of basic goods such as food if the situation isn't resolved and banks aren't reopened.

Exporters are also experiencing problems as many are unable to buy raw materials from abroad, while others say they cannot pay for agricultural products.

"It's a huge problem, we're now only receiving from abroad the products that have already been imported and paid for," said Natassa Voudouri, owner of Contlift, which transports goods from shipping containers around Greece. "From here on, things get harder ... The reason is that no money transfer can be sent abroad from Greece. At the moment we're taking delivery of the last goods, which is food. All the rest is frozen and we're expecting product shortages."

Pantelis Kourbelas, owner of fashion company Ioanna Kourbela, which exports to 25 countries, is being creative as he tries to import thread and material from Italy and France.

"If we can't buy raw materials because we can't send money abroad we will have a problem," said Kourbelas, 62, who is also on the board of the Athens Traders' Association. "We're thinking of opening a bank account in another European country and all our transactions with clients who buy from us to be done through that account. That's the only way we can ensure the continuation of production."

While a rescue deal could allow Greece to ease its money controls somewhat, the country is unlikely to be able to undo them completely - the last euro-zone nation to impose such controls, Cyprus, took two years to lift them fully.—AP

Turkish Airlines seeks up to $3bn in loans

DUBAI: Turkish Airlines is in talks with banks to raise up to $3 billion in loans for financing the purchase of Airbus and Boeing aircraft to be delivered in 2016, according to three sources. The Airbus aircraft financing will be 85 percent guaranteed by the European Export Credit Agency (EECA), while the financing for the Boeing aircraft and a General Electric spare engine will have a 85 percent guarantee from the Export-Import Bank of the United States, the sources said.

Turkish Airlines is seeking funds in tranches with a maturity of 12 years and a minimum 5 year lifespan. It will be accepting bids in multi-currencies and with floating and fixed interest rate offers, the sources said. The state carrier said it was open to other financing options such as commercial loans, Islamic financing and others.

The airline is due to take delivery of 17 Airbus planes in 2016: 10 A321-200s, five A330-300s and two A330-200Fs. Boeing is due to deliver 26 aircraft: 20 B737-800s, six B777-300ERs. The funding request also includes a spare GE engine. The loan facilities will not have any sovereign guarantee and the prices of the aircraft mentioned in the document were approximate, the sources said. Turkish Airline has asked banks to submit proposals by July 27, the sources said. —Reuters