Standard Chartered

Standard Chartered sees a resilient Asia, Middle East and Africa in 2012

Bahrain, 24 January, 2012 - Standard Chartered sees 2012 as a year of a two-speed global economy. The Bank, which recently topped a ranking of 354 global firms for the accuracy of its economic forecasts over the past two years, sees a slowing global economy in 2012, with a fragile West and a resilient Asia, Africa, Middle East and Latin America.

The mounting crisis in the advanced economies is expected to cause the euro area (-1.5%) and the UK (-1.3%) to fall back into recession and US growth (+1.7%) to remain below-trend.

The world economy grew strongly in 2010, expanding 4.3%, before cooling in 2011, when it grew by around 3.0%. In 2012, Standard Chartered expects a significant slowdown in the first half of the year because of the crisis in the West, slowing global growth to 2.2% for the full-year.

Gerard Lyons, Chief Economist and Group Head of Global Research, said: "This points to the continuation of a two-speed world where a fragile West contrasts with a resilient East. It is a divided and disconnected world economy facing major policy dilemmas. Yet, no region is fully decoupled from events elsewhere. During the first half of 2012, problems in Europe and the West will weigh on global growth. By the second half, stronger growth across China and other emerging economies should pull up worldwide activity. It will be a recovery made in the East and felt in the West. If ever one needed to illustrate the shift in the balance of power, this is it."

In its annual Global Focus report, the bank forecasts that Asia's gross domestic product (GDP) growth will slow to a still-robust 6.5% in 2012 from 7.3% in 2011. China is expected to cool significantly in the first few months of 2012 before rebounding, helped by a major policy boost. As a result, China's growth will decelerate from 9.2% to 8.1% in 2012.

Growth in India, Asia's third-largest economy, is expected to accelerate mildly to 7.4% in the fiscal year starting 1 April, 2012, from 7.0% in 2011. Indonesia, South East Asia's largest economy, is forecast to slow to 5.8% from 6.5%.

There are significant underlying growth drivers across the emerging world, including a rapidly expanding middle class, rising infrastructure investment and growing business ties along the `New Trade Corridors' linking Asia, Africa, the Middle East and Latin America.

These factors are likely to become more pronounced as Europe contracts and US consumers deleverage.

The Bank sees similar resilience in Africa, where growth in the two largest economies – South Africa and Nigeria – is likely to slow marginally to 3.1% and 6.9%, respectively, in 2012, from 3.2% and 7.2% this year. In Latin America, Brazil's growth is likely to slow to 2.5% from 3.0%.

Differentiation remains the key issue in the Middle East, where the resource-rich economies are expected to show resilience, with growth decelerating only moderately in 2012. Asset bubbles in the region have already burst and unsustainable credit booms are long over, providing a stable base for growth. Elevated oil prices bode well for government finances, enabling authorities to adopt counter-cyclical fiscal policies to stimulate growth as the West decelerates.

As Lyons says, "The outlook depends on the interaction between the fundamentals, policy and confidence. The policy challenges will be very apparent in 2012. Emerging economies will use fiscal and monetary policy to boost growth in the first half of the year. But, by the second half of the year, the combination of further quantitative easing in the West and firm commodity prices may cause inflation risks to re-emerge during the latter part of the year. From an investment standpoint, this also raises the potential for a shift back towards macro-prudential measures, including stricter capital controls."

For the foreign exchange markets, this points to a strengthening US dollar (USD) in the very near term as the US currency performs well in an environment of risk aversion. But on a multi-year basis, this implies a weakening USD, reflecting the significant debt overhang for the US economy and continued, gradual diversification away from the USD by governments and other international investors. The euro is also expected to weaken sharply in the first quarter of 2012 and enter a longer-term downtrend as the euro-area authorities fail to deliver a co-ordinated and credible strategy to solve the region's problems. The weaker longer-term outlook for the world's two largest reserve currencies signals the continuation of the multi-year shift into emerging-market economies and currencies, reflecting both their rising role in the global economy and their significant role in global trade. The broader trend of investing in liquid, investment-grade emerging-market currencies is expected to continue.

For commodity markets, although the fragile global backdrop may be similar to that at the start of 2009, tight supply in several raw materials as a result of the sharp drop in investment in new projects during the 2008 financial crisis is likely to put a firm floor under commodity prices, even if global demand declines significantly in the first quarter of 2012.

MENA

The Middle East and North Africa (MENA) is as economically diverse as a region could be, with the oil-rich Gulf Cooperation Council (GCC) countries facing very different economic dynamics than countries without rich resource endowments. The region is also relatively open and is therefore subject, to varying degrees, to global economic trends. But it is local factors that will ultimately determine economic performance in 2012.

Marios Maratheftis, Head of Research, Europe, Middle East, Africa and Americas, Standard Chartered said "The economic and market implications of Europe's debt problems bring back memories of 2009. However, parts of MENA are in a significantly stronger position now. This is particularly true for the GCC economies, which we expect to show resilience, with growth decelerating only moderately in 2012. Asset bubbles in the GCC have already burst, and unsustainable credit booms are long over. Base effects have become more favourable. Tight credit conditions are set to persist, with Saudi Arabia perhaps being the main exception. While tighter credit will not help growth, it will not be as big a drag as it was in 2009, when credit growth in the region went from an uncontrollable pace to a complete halt."

We expect oil prices to remain elevated in 2012. This bodes well for the government finances of oil-exporting countries, and it should enable counter-cyclical fiscal responses. Fiscal policy in Saudi Arabia is already on an expansionary trajectory and should continue to drive growth in 2012.

Abu Dhabi and Qatar adopted a more conservative approach to government expenditure in 2011. Their project pipelines are full, though, and while we do not anticipate a boom in government spending, any increase will help to pick up the slack in the economy. Stable oil prices provide governments in the region with ample fiscal space.

Non-oil-producing countries, which are also dependent on net capital inflows, will face a more challenging 2012. Growth in Jordan and Egypt will be fragile, and both countries will need to attract foreign inflows to boost their reserves and fund their current account and fiscal deficits. Jordan is attracting inflows from the GCC, and its prospects for joining the bloc are

still on the table, although nothing is final. In Egypt, political stability will be the key factor, as it is necessary to attract both investment and tourism. The country's presidential elections in June 2012 will be widely watched.

Commenting on policies, Maratheftis said:"GCC countries have the fiscal space to shift to more expansionary policy. Policy in Saudi Arabia is already expansionary, and this is set to continue in 2012. We also anticipate higher spending in Qatar and, to some extent, Abu Dhabi. In Egypt and Jordan, fiscal headroom is limited and the focus will be on financing the funding gap rather than on growth"

Monetary policy in the GCC will continue to be tied to US policy, as the region's currency pegs face no pressure for either revaluation or devaluation.

Bahrain:

Bahrain's economy is recovering from a sudden slowdown in the first half of 2011. The economy slowly recovered, growing 1.1% year on year in the second quarter of the year and 2.4% year on year in the third quarter. Owing to the oil-driven economy, we expect real GDP growth to accelerate to 3.5% in 2012 from 1.9% in 2011. Growth in 2012 will be driven by strong oil production and a highly favourable base effect. Bahrain's growth story is driven by hydrocarbons. The non-oil economy was still witnessing contraction in the third quarter of 2011. Bahrain has a large banking sector, by far the largest relative to the size of the economy among GCC countries (retail banks‟ assets are equal to 300% of GDP, and wholesale banks assets are an additional 700% of GDP). The wholesale banking system contracted by around 14% in Q1-2011 but remained broadly stable in Q2 and Q3.

Jordan:

Jordan's recovery from the 2008-09 financial crisis has been hit by a decline in tourism and investment inflows. We expect real GDP growth to remain weak at 2.5% in 2012, little changed from 2.4% in 2011. Unemployment rose to 13.1% in September 2011 from 11.8% at the end of 2010.

Gulf Cooperation Council (GCC) states have provided critical financial support to Jordan's economy in 2011, including grants of USD 1.4bn (5.2% of GDP) from Saudi Arabia. Jordan could become a GCC member, which would give it preferential trade access to the bloc's bigger markets and open up new avenues for investment. This move is a potential game-changer for Jordan's economy and would boost growth over the medium term.

Lebanon:

We estimate GDP growth at 1.5% in 2011 and expect it to accelerate to 3.75% in 2012. The central bank's coincident indicator – a sector weighted reflection of economic activity – attests to this slackening, especially in consumption.

Barring a substantial further deterioration in the regional political environment, we expect a steady return to the previous real GDP growth trend. Lebanon continues to benefit from a strong services sector, robust domestic consumption (correlated to improved sentiment), and protracted pent-up reconstruction development needs following the war years. The comfortable primary surplus in 2010 allowed the government to adopt an accommodative fiscal policy during the 2011 downturn, while managing to maintain a modest surplus. We expect this prudent macroeconomic policy to continue in 2012.

Oman:

Growth will be sustained by Oman's eighth five-year plan, which began in 2011 and is part of a longer-term goal of diversifying away from oil. The bulk of spending under the plan will go to infrastructure (approximately 70% of the total), followed by social spending, which includes education and health care. Oman's 2012 budget envisages a 25% year on year rise in expenditure. Spending on current consumption (mainly via higher wages) will need to be balanced by spending on infrastructure, in line with the five-year plan. This would help to generate longer-term growth. Spending will continue to be buoyed by higher oil prices, which we expect to average above USD 100/bbl in 2012. Oman's greatest vulnerability stems from its over-reliance on oil revenue (which, together with gas, makes up 80% of government revenue). The breakeven price required to balance the budget has risen: the 2012 budget sees a breakeven oil price of USD 75/bbl, up from USD 58/bbl in 2011.We expect the budget deficit to turn to a surplus in 2012 on the back of higher than budgeted oil revenue. We also expect Oman to post a fiscal surplus for 2011 due to higher oil prices.

Qatar:

2012 marks a significant inflection point for Qatar. We forecast that the emirate's real GDP growth will moderate to 5.9% in 2012, from an estimated 16.9% in 2011. Qatar is likely to meet its target level for liquefied natural gas (LNG) output around year-end 2011, leaving little room for LNG to remain the key driver of super-charged economic growth rates (as it has been for the last seven years) in 2012. Even though growth is likely to slow, the real economy will probably play a much more important role. 2012 should mark the next phase of

Qatar's growth, marked by higher-quality growth driven by activity in the non-oil and gas sectors.

In 2012, LNG infrastructure will allow production of close to 77mt/year, making Qatar the world's largest exporter of LNG. Global consumption of LNG increased to 3.2trn cubic feet in 2010 from 2.4trn cubic feet in 2000, according to the BP Statistical Review of Energy; this points to bright export prospects. Increasingly, Qatar's gas customers are from Asia (Asia's demand for gas has almost doubled over the last decade).>

We expect investment in the non-oil and gas sectors to pick up significantly in 2012 as the country gears up to host the FIFA 2022 World Cup. We estimate that close to USD 107bn of projects are in the pipeline as Qatar begins to prepare for the World Cup. Most of the investments are infrastructure-related. The transport sector will receive close to USD 44bn of spending (USD 25bn for a fully integrated rail system), and about USD 12bn will be invested in accommodation facilities. The 12 stadiums that will host the games will be built at an estimated cost of USD 4bn.

Saudi Arabia:

The economy boomed in 2011 on increased hydrocarbon output (to compensate for loss of output from Libya) and higher government spending after new social spending packages announced in the first quarter of 2011. We expect growth in 2012 to moderate to a lower but still healthy level of 2.9%, with the key driver of growth being the robust pace of government spending. However, lower oil output in 2012 will detract from growth. The commitment to spend close to USD 128bn on social subsidies (boosting social security) and projects (building 500,000 housing units) will continue to drive headline growth in 2012 and into 2013. This is in addition to budgeted spending commitments in 2012, which are expected to continue moving ahead at the strong pace seen in Saudi budgets since 2008. Housing supply will be a key challenge for policy makers in 2012 and beyond, though steps are being taken to address this challenge. Saudi Arabia is well placed to deal with oil-market outages, as it did in 2011 when it raised production to compensate for output shortages from Libya.

We estimate that Saudi Arabia‟s oil output reached 9.29mbd in 2011, against our 2010 estimate of 8.28mbd – an 11% increase. We estimate that 2012 output will fall to 8.42mbd as Libya gradually raises output to 1.06mbd from 0.45mbd in 2011. Government expenditure will continue to be an important driver of economic growth in 2012. We estimate that a total of USD 159bn worth of projects will be awarded in 2012 by the government and, to a lesser

extent, the private sector. Infrastructure and construction projects will dominate, at USD 44.6bn and USD 39bn, respectively. Saudi Arabia plans to award projects worth about USD 67bn related to the construction of 500,000 housing units (this is part of the USD 128bn worth of social spending announced in 2011).

Tunisia:

After GDP contracted by 8% quarter to quarter in the first quarter of 2011, the economy slowly recovered. Growth resumed in the third quarter of 2011 (1.5% y/y) following the gradual normalisation of the day-to-day business environment after disruptions caused by the Q1 change of regime. We nevertheless expect a slight (0.5%) contraction in real GDP for 2011. We forecast a rebound to positive growth of 4% in 2012 owing to a return of confidence and a very favourable base effect. We see the current account deficit widening to 7.0% in 2011 and narrowing to 4.5% in 2012, which would still be off the recent trend of below 3%.

Egypt:

Egypt's economy is being shaped by the political landscape. Political events dominate 2012 (ending June 2012). Election results for the lower house of parliament are expected to be finalised in January; this will be followed by elections for the upper house by end-January and presidential elections at end of June 2012. Economic growth was hampered in early 2011 at the height of the political turmoil; the economy contracted 4.2% year on year in the first quarter- 2011 (January-March 2011), and returned to barely positive growth of 0.4% in the April-June quarter. We expect a stronger performance in the second half of 2012 (January-June 2012) on a low base effect. We forecast that full year growth will tick up slightly to 2.0% in 2012 from 1.8% in 2011 as manufacturing (Egypt's largest sector, which contributed 26% of 2011 GDP) moves into expansion mode. Manufacturing was likely affected by numerous strikes and factory shutdowns in early 2011.

We expect public and social services to be major drivers of growth in 2012, given the high expectations of the population during Egypt's time of transition. These sectors contributed 7.8% and 4.6% of 2011 GDP and grew by 4.5% and 2.8%, respectively. We also expect higher public spending to widen the budget deficit as a percentage of GDP. Suez Canal receipts, calculated as a component of GDP, grew by a strong 11.5% y/y. The deteriorating global outlook in 2012 is likely to detract from this growth.

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Pakistan:

Election years are characterised by populist measures to support growth, and we expect this to be the case in 2012. We forecast GDP growth at 4% in 2012 (ends 30 June 2012), up from 2.4% in 2011, when flood damage reduced growth. The combination of higher government spending and accommodative monetary policy will boost growth. Visible improvements in the security environment are also supportive of the growth outlook. Reforms that are critical to reducing the build-up of debt and containing inflation – including tax measures and a reduction in energy subsidies – will be stalled or even scaled back in some cases. The government is in no mood to hold back in the run-up to the elections, and record spending is expected to result in a fiscal deficit of 6.5% of GDP in 2012, against the budget target of 4%. This will support growth but will also add to inflationary pressures.

Downside risks remain high in 2012 due to slowing export growth, weak private credit growth and the risk of higher inflation. Investment is still declining as the country's uncertain political and security environment and growing energy crisis deter both foreign and domestic investors.

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