



The Gulf Economies

The Gulf Cooperation Council: Arab Spring Yet to Usher in Reform

Real growth in gross domestic product (GDP) of close to 5% is projected for the six member states of the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE) – in 2011, and slightly higher than that next year, assuming that crude oil prices continue to trade at close to current levels of about \$100 a barrel (bbl). Economic growth this year has largely been powered by the first-quarter surge in crude prices, against the backdrop of popular uprisings in the Middle East and North Africa (MENA) region, and a civil war in oil exporter Libya in particular, that caused significant volume and price disruption in international oil markets in the first half. An improvement in private credit and broad money growth, in addition to higher government expenditure, has provided further support for the economies of the Persian Gulf.

Middle Eastern countries as a result of the impact of the violent uprisings in Bahrain, Egypt, Libya, Tunisia, Syria and Yemen, and, to a lesser extent, Oman.

United Arab Emirates: Abu Dhabi to Lower Growth Forecasts as Confidence Slumps

While the United Arab Emirates has managed to escape political contagion from the popular uprisings in much of the region in 2011, the country has been unable to avoid completely its economic consequences. This has been most clearly visible in the decision of the government of Abu Dhabi, the wealthiest of the emirates, to delay new development projects and contract awards, and the dismissal of staff at government bodies and state firms. Responding to market fears that government spending was spiralling out of control, Abu Dhabi is now enforcing greater fiscal discipline.

Since 2005, state expenditure has more than tripled from \$22bn to a peak of \$72bn in 2009, before declining to \$67bn last year. The fall reflects, at least in part, a drop in average oil export prices received, from \$96/bbl in 2008, to \$63/bbl in 2009. Combined with lower oil production, this meant that Abu Dhabi's oil revenues plummeted by more than half to \$39bn, from a 2008 peak level of \$82bn, resulting in a \$32bn deficit, equal to 82% of revenues. Last year saw a small improvement with revenues recovering slightly, but at \$51bn they were still almost 38% lower when compared with 2008, resulting in a \$16bn deficit.

At the same time, Abu Dhabi's debt stock has also risen, to \$104bn, equal to 54.8% of GDP, according to the IMF, not far short of the \$113bn debt pile of Dubai, but given the smaller size of Dubai's GDP, its debt is equal to a much higher 81.2% of GDP. Similar to Dubai, most of the financial problems now being encountered by Abu Dhabi can be traced to the rapid growth of several government-related entities (GREs), whose combined debts are equal to \$92.4bn, or 48.6% of Abu Dhabi's GDP.

Among the GREs with the largest debts are Abu Dhabi Water & Electricity Authority, which includes Abu Dhabi National Energy Company, which holds \$20bn of debt; International Petroleum Investment Company, with \$10bn; and Mubadala Development Company with \$17bn, each of which has continued to raise their debt load by continuing to plough investment into new projects over the past two years. The additional debt has been taken on even as Abu Dhabi's private sector has reduced investment. These contract awards have underpinned the construction industry following the heavy losses incurred by contracting companies when

International Monetary Fund GDP Growth Forecasts for MENA Region

	Growth forecast published in Oct 2010	Growth forecast published in April 2011
Bahrain	4.5	3.1
Egypt	5.5	1.0
Jordan	4.2	3.3
Kuwait	4.4	5.3
Morocco	4.3	3.9
Oman	4.7	4.4
Qatar	18.6	20.0
Saudi Arabia	4.5	7.5
UAE	3.2	3.3

Source: Middle East Economic Digest

Economic hardship and the lack of employment opportunities have featured prominently among the key grievances of the Arab Spring protestors. Whereas as recently as two years ago, Gulf governments were contemplating the scaling back of generous subsidies that is now firmly off the policy agenda and price controls have been imposed on some items in an attempt to quell further outbreaks of unrest. With most recent activity data and confidence surveys indicating that global economic prospects are now deteriorating, GDP growth forecasts for the MENA region are being revised down, while the International Monetary Fund (IMF) had already reduced its growth forecasts in April for most

Dubai's grandiose property projects came to a stuttering halt in the closing months of 2008, leading to the declaration of a six-month debt standstill by Dubai, raising fears of a default by the emirate. Recent project spending has been unable to encourage the private sector to invest in Abu Dhabi in the same way it did prior to 2008, when the widely held view was that real estate prices would only ever rise.

Since then, several projects that were scheduled for construction have been cancelled as the downturn in property prices has accelerated. That, in turn, has had the effect of casting doubt on Abu Dhabi's ambitious economic growth forecasts and population projections contained in the government's Economic Vision 2030, a blueprint for development prepared in 2007. In response, it is widely expected that Abu Dhabi will shortly revise down its growth assumptions and attempt to exert greater financial discipline. Already, the unwillingness to commit to new deals has brought the project market to a virtual standstill.

For 2011 as a whole, the UAE economy is projected to grow by between 3% and 3.5%, following estimated GDP growth of 2.4% last year, before the pace of expansion quickens slightly to between 3.5% and 4% in 2012. Although runaway inflation, which reached an annualised rate of 13% in early 2008, has been brought to an end by the local property-market slump and the consequent fall in rents, the IMF, in April, said it expects inflation to accelerate this year, to 4.5%, compared to last year's estimated 0.9% rate. The single most important factor curbing domestic inflation pressures currently is falling housing costs, which account for 39% of the basket of goods and services used to measure the cost of living. Both sales prices and rents have been falling sharply since the end of 2008, the result of a large oversupply of new housing during the boom years leading up to the global credit crisis. Property rentals are now estimated to be only half their level in early 2009. With rents expected to ease again this year, inflation should remain contained.

State-imposed price controls are also helping contain inflation, while excess capacity in most leading economic sectors is also preventing inflation's resurgence. Sensitive to political tensions in the region currently, the monetary authorities are not passing the full impact of food and fuel-price increases on to domestic consumers, with the government's subsidies programme being extended to include food, including bread and rice, to the end of this year. It has also meant that the cost of the official fuel subsidy has risen to the extent that ADNOC, the national oil company, says it makes no profit on fuel sales in Abu Dhabi and the smaller northern emirates.

Qatar: An Oasis of Calm in a Troubled Region

Qatar, which has recorded the world's highest economic growth rates in recent years, is on track for another year of double-digit expansion in GDP, close to 20%, in 2011. It is one of only a handful of countries in the MENA region not to have witnessed protests, reflecting the high standard of living enjoyed by Qataris, with a per capita income of \$65,495, the highest in the world, a population of only 1.7 million and a 2010 GDP of \$130bn, the same as Egypt,

which has a population of over 80 million. Unemployment is officially reported to be just 1%, suggesting that the economy is operating at maximum capacity.

Last year, the World Economic Forum's Global Competitiveness Report 2010-2011, which covers 139 countries, ranked Qatar as the Middle East's most competitive economy, and 17th globally, highlighting the country's strong institutional framework and stable macroeconomic environment. In May 2011, the non-profit Sydney-based Institute for Economics and Peace ranked Qatar in first place among MENA region countries in its Global Peace Index 2011 and in 12th place globally among the 153 countries included in the index, describing it as a model for other countries.

Qatar GDP by Economic Sector in 2010

Sector	% Share of GDP
Mining & quarrying (including hydrocarbons)	56
Other Services	11
Finance, insurance & real estate	9
Manufacturing	7
Trade, restaurants & hotels	6
Transport & communications	6
Construction	5

Source: Middle East Economic Digest, June 2011

Today's economic prosperity is the result of heavy investment in energy export infrastructure, to exploit the world's third-largest gas reserves and 15 billion barrels of oil, to become the world's largest exporter of liquefied natural gas (LNG) in partnership with a number of international oil companies. Last year, annual LNG export capacity reached 77 million tonnes, with the state securing long-term supply contracts with Asian and European countries, to ensure revenue streams. Rapid industrialisation has also seen Qatar create large-scale aluminium and steel production capacity, but a small domestic market means that metal producers need to look overseas for growth opportunities. Qatar's high dependence on hydrocarbons for export earnings and government revenues means that the economy is vulnerable to sharp swings in energy prices. Gas makes up a much larger component of hydrocarbon revenue than in other GCC states.

While the Al-Thani family has ruled Qatar since the 19th century, and the emir of Qatar, Sheikh Hamad bin Khalifa al-Thani, has absolute control over the country, the prime minister, Hamad bin Jassim bin Jaber al-Thani, heads the Council of Ministers, which in turn manages the administrative, financial, legal and regulatory infrastructure. Further reinforcing political stability, Qatar's constitution guarantees the rights to private property and economic freedom, in addition to state ownership of hydrocarbon reserves.

Kuwait: Surge in Oil Output to Drive Doubling of GDP Growth

Kuwait's economy is expected to grow by between 5% and 5.5% this year and next year, following growth of 2.3% in 2010, underpinned by buoyant oil prices and increased government spending.

Already one of the world's leading oil producers, the country is significantly boosting output this year, with current daily production estimated to be at a 37-year peak of about 2.7 million barrels, up from 2.3 million barrels at the beginning of 2011. Most Kuwaiti crude oil is shipped to Asian markets.

A recent mid-year production estimate from the International Energy Agency (IEA) put Kuwait's daily oil output at 2.5 million barrels, though the IEA warned that state-owned Kuwait Petroleum Corporation (KPC) is producing at close to capacity of 2.54 million barrels a day. Industry officials, however, claim that KPC is now in a position to produce more than the IEA's maximum capacity estimate, helped by the easing of an export bottleneck at the Mina al-Ahmadi oil terminal, which has allowed for extra output from the Burgan oil field, the second largest in the world measured by production. Kuwait is now believed to be able to raise daily output above the recent peak daily level of 2.6 million barrels set in mid-2008, and boost it to a 38-year high. Kuwaiti production reached an all-time peak of 3.3 million barrels in 1972.

Inflation, which is estimated to have risen to about 6% this year, due to government subsidies and grants, is expected to slow to 2.7% next year, well below the economy's long-term average growth rate of about 4%. Kuwait's fiscal and current-account surpluses are estimated to remain the highest among the GCC states this year, at 23% and 37% of GDP, respectively, and hold around those levels next year. Recent comments from Kuwait's central bank governor, in July, highlighted the key problems facing the Kuwaiti economy, namely an overly dominant public sector, a state budget that remains excessively reliant on oil income receipts and increasing government expenditure, which are combining to create economic imbalances. Political turmoil has only compounded the economic problems, with the government, in April, forced to resign amid fractious relations with parliament.

Kuwait's Capital Market Authority (CMA) is planning to open up the country's stock exchange (KSE) with a view to attracting greater investor interest, but it is too early to gauge the likely impact of the new CMA Law, implementation of which has been postponed to next March, instead of September this year. Meanwhile, concerns about proposals to privatise the KSE, a half share of which will be offered to Kuwaiti citizens, have been voiced; the remaining 50% will be distributed in 5% stakes to 10 of the country's listed companies. Since the 2008 global financial crisis, the KSE has fallen from favour, with investors deterred by the dominance of the finance sector. Eight of the country's 10 largest listed companies are financials.

Oman: Stability Hinges on Implementation of Key Reforms

In response to the protests in Oman in the first quarter of this year, part of the broader uprisings in the Arab world, the country's ruler, Sultan Qaboos bin Said al-Said, in power since 1970, when he came to power in a British-backed coup, recently announced a

number of significant political and economic reforms to quell the unrest. Several cabinet reshuffles occurred, involving the dismissal of more than a dozen ministers, including the National Economy Minister Ahmed Macki and the closure of the ministry. Although Sultan Qaboos enjoys strong popular support at home, and has weathered the political turmoil remarkably well, the fact that any protests took place at all in the traditionally conservative sultanate came as a rude awakening for the elite, posing the first direct challenge to their rule. Oman is an absolute monarchy where the Sultan is both head of state and the government, as well as prime minister and head of a number of government ministries, including defence, foreign affairs and finance.

Unlike much of the MENA region, however, Oman's popular uprising had more to do with economic, rather than political, issues and regime change, with popular demands for higher wages, improved employment opportunities and an end to government corruption, with much of the trouble occurring in the port of Sohar, 220 kilometres northwest of the capital, Muscat, and the centre of the country's industrial sector. It is much too soon to know whether the measures announced by the Sultan will be sufficient to appease the protestors, but effective implementation will be key to their success and, on this crucial point, the jury remains out. Moreover, the cabinet reshuffles have created additional short-term challenges, with a worrying lack of experience among the new leadership of many government ministries, which has already impacted decision-making and resulted in delays to some infrastructure projects.

Among a number of key reforms announced by the Sultan is the creation of a committee responsible for giving lawmaking powers to the Council of Oman, which is made up of elected representatives from the Shura Council and from the State Council, whose members are appointed by the Sultan. Currently, only the Sultan and his cabinet can legislate. With parliamentary elections, held at four-year intervals, scheduled for October, this has added importance for political stability. Among a number of social measures introduced by the Sultan in response to the unrest is the creation of almost 41,000 new jobs in defence, security and civil ministries, at an estimated cost of OR444mn, equal to 1.75% of Oman's projected GDP of OR25.4bn (\$66bn) in 2011, a minimum monthly wage of OR200 and a monthly unemployment benefit of OR150.

Further compounding the uncertainty, the first quarter's political unrest has raised concern about the lack of a named successor to Sultan Qaboos, who has no heirs. Recent heightened political uncertainty in the wake of the protests has exacerbated concerns about the succession, and has the potential to undermine Oman's economic prosperity, with doubts about a future successor's commitment to continuing with economic liberalisation a key concern among foreign investors. The re-emergence of protests in Sohar in early July has only served to emphasise further the need for swift implementation of reforms.

Omani Government's Projected Spending under the 2011-2015 Five-Year Development Plan

Project	Value US\$bn
Roads, airports and ports	15.0
Regional municipalities, environment and wastewater	6.0
Health, education and vocational training	3.6
Housing, including 12,000 low-cost units	2.3
Electricity, water and recharging dams	2.4
Information, culture and youth centres	1.2
Agriculture and fisheries	0.6
Tourism	0.3
Other production and service sectors	0.1

Source: Middle East Economic Digest, August 2011

Meantime, as part of the sultanate's plans for economic diversification, Oman is planning to boost the role of tourism, with OR105mn (\$272.7mn) to be allocated to the sector over the next five years. Tourism's contribution to the Omani economy is estimated to reach 3% of GDP by the end of this year. Under the government's economic initiative, it is set to further increase the rate of hotel room construction in Muscat by more than a fifth between 2011 and 2015, including a \$1bn convention centre development planned for the capital. Data from the Ministry of National Economy show Oman had more than 200 hotels by end-2009, providing over 10,000 hotel rooms for visitors.

Development of logistics and transport infrastructure is an essential component of plans to diversify the Omani economy. Nearly half the government budget, or approximately OR7bn (\$18bn), of the eighth five-year development plan for the period 2011-2015, is to be allocated to upgrading the road, port and airport network. Some \$2.5bn is to be spent on the development of six airports, while funds are also earmarked for the expansion of ports, construction of new logistics cities, industrial free-zones and Oman's first railway network, progress on which has already fallen behind schedule due to the current fragile political situation.

Effective execution of large-scale transport and infrastructure projects would make a significant contribution to confronting the problem of weak job creation, a key grievance of the protestors, with growing numbers of Omanis looking for employment elsewhere in the GCC region in recent times. Any delays to project implementation, therefore, could risk further inflaming tensions. Oman's economy grew by an estimated 4.7% last year, though GDP growth is set to slow to between 4% and 4.5% in 2011 and to about 4% in 2012. Similarly, inflation of 3.5% is expected this year, before falling to 3% next year, as growth slows, while public finances are expected to remain in good shape, with a government surplus of about 17% of GDP projected for 2011, buoyed by receipts from the country's oil production of about 860,000 barrels a day.

Other Middle East

Jordan: GCC Membership Would Provide Fillip, Aiding Regional Ties

In May, GCC leaders said they welcomed Jordan's application for membership, which would benefit the country via financial aid and cross-border trade and investment, as well as potentially favourable terms for oil imports for what is a resource-starved country. This would help the Hashemite kingdom reduce its fiscal deficit, which is expected to rise to 7% of GDP this year, from 5.4% in 2010, as the government was forced to raise wages to quell popular discontent earlier in the year and cover a fuel shortage resulting from the sabotage of a gas pipeline from Egypt. Another regional collaboration that would aid growth is the proposed rail link from the southern border of Saudi Arabia to the northern border with Syria, but, at present, commencement and completion dates are unclear. More immediate concerns, however, given that over 65% of the population is under 30, are addressing high levels of youth unemployment and rampant corruption among the wealthy and political elite.

Changes to the 1952 constitution, including the creation of a constitutional court and enhanced powers for parliament, have been proposed. King Abdullah II has signalled his readiness to rewrite the constitution. The proposals come in response to the widespread political unrest in the MENA region, with the Hashemite kingdom keen to avoid a repeat of the events of Black September in 1970, which led to a bloody, albeit short, civil war in Jordan. The importance of Jordan to regional stability is high, given its strong ties with the west, especially the US, and the GCC countries, particularly with Saudi Arabia, so the significance of the recent civil unrest should not be underestimated.

Latin America

Argentina: Cristina Fernández Well Placed for Re-Election to Second Term

Anecdotal evidence continues to point towards consumer-price inflation well above the 9.7% year-on-year rise in July, published by the government statistics agency, Instituto Nacional de Estadística y Censos (INDEC), with private-sector estimates suggesting inflation currently around 20% to 30%, in line with wage rises agreed following recent union negotiations. There are also expectations of high inflation, with a projection from a survey in July, conducted by La Universidad Torcuato Di Tella (UTDT), still elevated, at 25% over the next 12 months.

A lack of urgency in tackling inflation is undermining the Argentine peso. Banco Central de la República Argentina has been selling significant amounts of foreign currency to stabilise the peso, with net dollar sales of around \$700mn (ARS2.9bn) in

August, the most since June 2009. There is also evidence to suggest that large parts of the populous are averse to holding pesos, choosing instead to buy dollars, either on the black market or via trading dollar-denominated securities abroad and liquidating them. Capital outflows amounted to \$9.8bn (ARS41.1bn) in the first half of 2011 alone, compared to \$11.4bn (ARS47.8bn) for full-year 2010.

Argentina remains heavily reliant on domestic funding, with the government continuing to avoid international capital markets. Some \$20bn (ARS83.9bn) of debt-service payments fall due next year. Continuing to rely on domestic capital will therefore put added strain on the economy and crowd out private-sector investment, already woefully low at 19.4% of GDP, and thereby limit economic growth, expected to be 8% to 8.5% this year, after 9.2% in 2010.

Public expenditure rose 36% year on year in June and, despite the substantial rise in government revenues, up 27.1%, Argentina is forecast to run a budget deficit equal to 2% of GDP this year. The trade account also shows signs of deterioration, with the surplus in June falling 21.5% over a year ago to \$1bn (ARS4.2bn), even with the support of strong terms of trade, currently at an all-time high. The approval by Beijing, in July, of Argentine beef imports into China, and expectations of the commencement of corn exports to China next year, should provide a boost to exports.

In June, President Cristina Fernández de Kirchner announced she would run for a second term in presidential elections scheduled for October 23, 2011. Primary elections, in August, gave Fernández just over 50% of the vote, faring better than polls had suggested, with her closest rivals, Ricardo Alfonsín of the Radical Civic Union and former president Eduardo Duhalde, each receiving just 12.2% support. This suggests a continuation of the misguided economic policies seen under the Front for Victory (FPV) party over the past four years, including state interventionism. Without fundamental change, Argentina is likely to continue to struggle with runaway inflation, a widening government deficit, underinvestment and a worsening trade balance, despite benefiting from a global commodities boom.

Colombia: Upgrade to 'investment grade' Affirms Positive Outlook

Colombia's economy has continued its robust expansion this year, building on momentum from last year. This is illustrated by the acceleration in economic growth, with GDP expanding by 5.1% year on year in the first quarter, up from 4.8% in last year's fourth quarter, and 1.9% quarter on quarter. Growth was again driven by the mining sector, with Colombia benefiting from record-high terms of trade, while private consumption also provided a boost. As a result, inflationary pressures persist, with consumer prices up 3.4% year on year in July, from 3.2% in June, due primarily to a 4.8% rise in food prices.

While inflation remains within Banco de la República de Colombia's target range of 3% +/- 1%, the upward trend is a concern. Coupled with the supportive economic backdrop, this has led the central

bank to continue tightening monetary policy, with the key policy rate raised by 25 basis points, for the sixth consecutive time, to 4.5%, in July. Although the uncertain global backdrop persuaded the monetary authorities to keep the policy rate unchanged in August, the tightening cycle may not have ended yet as the central bank expects economic growth to accelerate in the second half and, in July, revised up its GDP growth forecast range for this year to 4.5% to 6.5%, from 3.9% to 5.5% previously.

Economic Indicators for Colombia, 2010–2012

	2010	2011F	2012F
Real GDP growth (% change over a year ago)	4.3	5.0	4.5
Consumption (% change over a year ago)	4.5	5.0	4.5
Gross Investment (% change over a year ago)	10.6	8.0	9.0
Consumer price inflation (% change over a year ago)	3.2	3.5	3.7
Budget balance (% of GDP)	-3.8	-3.4	-3.0
Current account (% of GDP)	-3.1	-3.0	-3.5
Key policy rate (%)	3.0	5.0	7.0
US dollar /Colombian peso exchange rate	1907.7	1760.0	1750.0

F is forecast.

Source: Nomura, August 2011

Legislation passed by Congress, in June, imposes fiscal restraint on the government. Colombia's fiscal sustainability law targets a central government budget deficit of no higher than 2.3% of GDP in 2014, compared to 4.1% last year. The constitutional amendment also includes a fiscal rule whereby a proportion of tax revenues from commodity production will be set aside to provide support in the event of a downturn. Foreign direct investment (FDI), largely flowing into the mining and energy sectors, is expected to mitigate the expected fiscal tightening, with the trade ministry expecting FDI inflows to rise substantially over the next few years.

In March, Standard & Poor's raised Colombia's long-term foreign-currency rating to 'investment grade', to BBB-, with a 'stable outlook', from BB+. Moody's followed suit in May and Fitch in June, upgrading the rating to Baa3 and BBB-, respectively. The rating agencies cited the government's ability to make progress with domestic problems, with a significant reduction in guerrilla activity and organised crime, resilience to external shocks, a history of timely debt payments and positive financial performance as factors contributing to sustainable debt dynamics.

With all three rating agencies having an 'investment grade' rating on Colombia, investment flows into fixed-income markets have continued to push down funding costs, with the yield on the 10-year government bond falling below 4% in August, from around 5% in February, prior to the upgrades. Inflows into local capital markets are expected to continue given the country's prudent fiscal and monetary policies, robust growth profile and stable political environment.

Eastern Europe and Former Soviet Union

Romania: Fitch Upgrade to 'investment grade' Reward for Progress

Romania's economy grew by 1.4% year on year in the second quarter, slowing from 1.7% in the first quarter, and by a seasonally-adjusted 0.2% quarter on quarter. Moderate GDP growth is projected to extend into the second half, with the IMF and EU both forecasting a 1.5% gain in output this year, compared to a 1.3% contraction last year. The risk to the outlook is that the expansion, predicated on strong export growth, decelerates due to a slowdown in the euro-zone economy. All of which suggests that the current loose monetary policy stance is likely to remain in place for now.

Inflation fell sharply in July as the impact of last year's rise in value-added tax (VAT) dissipated, with consumer prices up 4.9% over a year before, down from 7.9% in June. The National Bank of Romania (NBR), the central bank, expects inflation to fall this year as a result of base effects associated with food-price shocks and the 5% increase in VAT in 2010. Consequently, the bank's key interest rate was left unchanged at its August policy meeting, at 6.25%. The rate was last adjusted in May 2010.

In July, Fitch Ratings upgraded Romania's long-term foreign-currency rating to 'investment grade', to BBB-, with a 'stable outlook', from BB+. Several factors contributed to the upgrade, including the country's return to positive GDP growth, buoyant exports and narrowing current account and budget deficits. Crucially, the government has implemented economic austerity measures, with the general government deficit falling to 6.4% of GDP in 2010, down from 8.5% in 2009, and is expected to meet this year's target of 4.9%. Parliamentary elections, scheduled for next year, however, are a potential stumbling block to a further reduction in the budget deficit.

Greek lenders control approximately 17% of Romanian banking system assets, which led to sharp falls in the Bucharest equity market and Romanian leu, in July, as the euro-zone crisis intensified. While the NBR has said that funding lines to Greek banks amount to 3.5% of GDP, compared to the central bank's reserves of 30% of GDP, suggesting that exposure to Greece is manageable, the risk of contagion is clear. Rising bank non-performing loans, amounting to 13% of total loans outstanding at end-April, remain a concern, though the banking sector has a high capital adequacy ratio of 14.9% and an adequate level of provisioning against such loans.

Kazakhstan: Succession Concerns Simmer as Economy Booms

Kazakhstan's economy grew by 7.1% in the first half of 2011, compared to the same period a year earlier, with commodities, which make up more than 90% of exports, supporting the expansion,

while double-digit wage rises have kept domestic demand buoyant. Consumer-price inflation, on a year-on-year basis, has remained above 8% since January, accelerating to 8.8% in July, from 8.4% in June, underpinned by rising food prices. Demand for commodities from emerging-market economies, coupled with investment from China, to build oil and gas transportation infrastructure, and Russia, will support development of the country over the medium term. Increasingly, the country is being looked upon favourably as an investment location due to its political stability and regional cooperation, with border controls between Kazakhstan and Russia removed, in July. This has been reflected in the World Bank's Doing Business survey this year, in which the country was ranked in 59th place, up from 74th in 2010.

Economic Indicators for Kazakhstan, 2010–2012

	2010	2011F	2012F
Real GDP growth (% change over a year ago)	7.3	6.0	5.1
Consumer price inflation (% change over a year ago)	7.2	8.3	7.5
Government budget (% of GDP)	1.5	3.9	2.8
Current account (% of GDP)	3.2	5.5	4.2
Foreign exchange reserves (US\$bn)	28.2	40.5	47.1
US dollar/Kazakh tenge exchange rate	147.0	146.0	143.0

F is forecast.

Source: Nomura, August 2011.

In April's presidential election, President Nursultan Nazarbayev secured another five-year term, as widely expected, receiving 95.5% of the vote, up from 91% in the previous election in 2005, with a high official turnout of almost 90%. Despite this, questions over the president's health persist, most recently in July, when reports circulated that he had gone to Germany for an operation, bringing issues of a succession plan for Nazarbayev into focus. Although there are several potential candidates, until the succession issue is clarified, it will remain a source of concern for investors, especially given the various groups that need to be appeased by his successor, including industrial and ethnic groups, and the fact that Nazarbayev has been president for over 20 years, making the political transition all the more sensitive.

Asia

Pakistan: Structural Reforms Absent from Populist Budget

In May, US military forces tracked down and assassinated Osama Bin Laden in the northern city of Abbottabad. The fallout from the death of the Al-Qaeda leader has severely strained relations

with Washington, which carried out its own intelligence and did not first consult with the Pakistani authorities, thus bringing into question Pakistan's sovereignty. An unintended outcome of the incident could be a reduction in US financial aid to Pakistan, which has averaged around \$2bn annually over the past decade, but the episode raises serious questions about the role of Pakistani intelligence, the army and the government.

Subsequently, in June, the government announced the budget for fiscal year (FY) 2011/2012, ending June 30, 2012, targeting a budget deficit of 4% of GDP, down from 5.7% in FY2010/2011. Although the headline figures are encouraging, with the deficit reduction to be achieved via a projected 22% year-on-year rise in government revenues and a modest 4.6% increase in spending, including a 58% reduction in subsidies, long-overdue structural reforms were still lacking. Measures announced in the budget were largely populist, with civil servants' salaries to increase by 15% and pension payments to rise by 15% to 20%. Support for consumption is also expected from the increase in income tax exemption limits and a reduction in the general sales tax to 16%, from 17%. Nevertheless, with tax collection – only 1% of Pakistanis pay income tax – and bill payments remaining a serious problem, and the planned reduction in subsidies likely to only make the position worse, the government's revenue projections appear unrealistic.

In July, prior to its monetary policy committee meeting, State Bank of Pakistan (SBP) governor Shahid Kardar stepped down as central bank governor, citing differences with the government that were impeding the bank's independence. Later in the month, the SBP unexpectedly lowered its key policy rate by 50 basis points, to 13.5%, a move that was brought about, in part, by the central bank's constructive view on inflation, which it expects to fall within its target range of 11% to 12% in FY2011/2012, despite an acceleration in inflation in July, with consumer prices 13.8% higher from a year earlier, up from 13.1% in June, largely reflecting rapid food-price inflation.

Monetary easing could act as a counterbalance to proposed fiscal tightening, with the SBP stating that the decline in private-sector investment, which is being crowded out by government borrowing, and the deteriorating external environment, also influenced its decision to reduce interest rates. The current account swung into a deficit of \$75mn in July, compared to a \$0.4bn surplus in June, as the trade deficit widened due to weak export performance. Recent trade data illustrate the risks to Pakistan of an external-led slowdown, with the fall in the cotton price, a key export earner, of around 25% since the peak in April, reducing export income, though this could be mitigated by a reduced oil import bill.

Africa

Nigeria: Goodluck Jonathan Wins Comfortably, Significant Challenges Remain

Following a one-week delay, due to the late arrival of ballot papers, presidential elections took place in Nigeria on April 16. Goodluck Jonathan, the incumbent and leader of the People's Democratic Party, won comfortably, with over 58% of the votes cast. While this should help provide political continuity, the threat of continued unrest remains since many in the predominantly Muslim north of the country, feel that Jonathan, who took over last year following the death of northern president Umaru Yar'Adua, should not be head of state due to an unwritten agreement that the role will switch alternately between a northern candidate and a candidate from the Christian south, such as Jonathan. Riots in the north after the election led to the deaths of over 800 people, illustrating the deep divide in the country, which is set to remain given that the north has an income per capita around only half that of the south.

Attacks by Boko Haram, a radical Islamist group, have increased in frequency, giving rise to fears that terrorist groups such as Al-Qaeda in the Islamic Maghreb may step up their activity in Nigeria, raising the urgency for the government to confront the threat. A report by the State Security Service, Nigeria's internal intelligence agency, stated that members of Boko Haram received training from groups that are associated with Al-Qaeda, in Afghanistan and Algeria.

Economic mismanagement poses an equally serious threat to Nigeria's prospects, especially in light of the depletion of the country's foreign-exchange reserves and its excess crude oil account earlier in the year, exacerbated by rampant government corruption. Nigeria's economy remains precariously placed, heavily reliant on high oil prices to support government spending. Any fall in oil prices owing to global growth fears therefore leaves the country vulnerable, especially compared to 2008, when a sharp sell-off in the oil price was cushioned by the excess crude account.

Financial-sector reform is likely to yield medium-term benefits, with three Nigerian banks nationalised in August. Credit growth is expected to remain weak in the near-term, however, as lending remains subdued, while power shortages will continue to be a drag on GDP growth, which the Central Bank of Nigeria projects to be 7.4% this year, after 7.8% in 2010. Inflation has started to fall, with consumer prices in July 9.4% higher from a year earlier, down from 10.2% in June, reflecting a drop in food-price inflation, and the first time since May 2008 that inflation has been in single digits. ♦

Michael E. Russell & Lyndon Barreto, September 2011

KEY ECONOMIC AND FINANCIAL INDICATORS (All data shown are as at end-August 2011 unless otherwise stated)

Frontier Market	Macroeconomic Data												Market Performance				Forecast						
	% change on year ago				Latest 12 months				Currency vs \$				Sovereign Rating		Budget Balance		3-Month Interest Rates		Current PER	Stock Market Index (FCG Frontier 150 Index) US\$	Change since 12/31/10 Local	Change since 12/31/10 US\$	6 month Currency vs \$ +/-
	Annual GDP Growth YoY	Quarterly GDP Growth QoQ*	Industrial Production Growth YoY	Inflation CPI YoY	Trade Balance \$ Bns	Current Account \$ Bns	Foreign Reserves Latest \$ Bns	Foreign Reserves August 2010 \$ Bns	2011 Latest	2010 Year ago	S&P	2011**	% of GDP	%	%	Aug. 31, 2011	Aug. 31, 2011	%					
MAURITIUS	3.8	-6.8****	4.6	5.5	-2.4	-0.8	2.9	2.3	27.89	30.85	n.a.	n.a.	4.47	9.3	1.39	2014.10	10.38	2.15	+				
CROATIA	0.8	n.a.	1.8	1.9	-8.4	n.a.	16.4	15.2	5.19	5.73	BBB-	n.a.	0.25	10.5	1.24	1221.38	1.61	-4.33	-				
QATAR	16.0	n.a.	40.0	1.9	51.1	21.0	18.3	23.8	3.64	3.64	AA	11.7	1.80	12.6	15.00	1680.10	2.24	2.25	uc				
COLOMBIA	5.1	7.7	2.2	3.4	-1.0	-9.7	31.8	26.9	1792.00	1823.00	BBB-	-3.5	4.51	16.9	16.05	4332.34	-1.51	-8.33	+				
SRI LANKA	7.9	n.a.	9.3	7.0	-5.2	-1.4	7.5	5.4	109.94	112.66	B+	n.a.	8.21	16.5	0.79	3867.63	-3.85	-4.76	-				
ROMANIA	1.4	0.8****	3.2	4.9	-13.3	-5.7	54.7	48.8	2.92	3.36	BB+	n.a.	2.25	9.0	1.34	766.69	9.43	1.57	-				
PANAMA	7.5	n.a.	n.a.	4.9	-2.0	0.0	30.0***	2.4^	1.00	1.00	BBB-	0.4A	3.50	n.a.	1.38	3164.73	20.59	20.59	uc				
UAE	2.4^^	n.a.	n.a.	1.3	63.5	23.3	20.0****	12.5***	3.67	3.67	AA	11.5	1.00	8.6	7.94	694.47	-5.04	-5.05	uc				
KUWAIT	3.3	n.a.	n.a.	4.0	48.9	37.6	17.7***	16.7^	0.27	0.29	AA	28.4	1.00	11.3	15.44	1599.57	-15.65	-18.35	-				
NIGERIA	7.4	n.a.	7.3	9.4	24.1	7.8	32.9	36.8	151.90	148.79	B+	n.a.	5.21	10.1	8.48	1131.65	-19.90	-18.43	-				
VIETNAM	5.7	n.a.	9.6	23.0	-10.7	-3.9	12.2	14.1	20832.00	19485.00	BB-	-4.7	13.31	11.0	1.40	326.12	-14.67	-8.83	-				
OMAN	4.2	n.a.	n.a.	4.4	16.8	3.7	12.3	13.0	0.39	0.38	A	13.7	1.45	9.0	2.15	1994.74	-14.84	-14.84	uc				
LEBANON	7.5	n.a.	n.a.	5.8	-14.5	n.a.	28.4****	25.3***	1504.00	1507.50	B	-9.2	3.85	7.9	3.17	2402.50	-14.35	-14.18	-				
PAKISTAN	2.4	n.a.	-3.0	13.8	-15.3	0.6	16.3	14.3	86.80	85.60	B-	-5.7	13.04	6.9	3.33	1813.20	-11.36	-9.71	-				
KAZAKHSTAN	7.1	n.a.	-0.8	9.0	32.2	5.9	34.6	27.8	146.56	147.35	BBB	n.a.	3.00	4.8	8.25	244.58	-25.40	-25.74	-				
CYPRUS	1.5	1.6****	-3.6	2.9	-7.5	-1.8	1.2	1.1	0.69	0.79	BBB+	n.a.	1.54	4.4	1.14	116.82	-56.20	-59.19	-				
SLOVENIA	2.0	n.a.	4.4	0.9	-2.2	-0.1	1.1	1.1	0.69	0.79	AA	-5.1	1.54	12.5	1.38	1328.39	-2.67	-9.31	-				
JORDAN	2.5	n.a.	-1.5	5.4	-9.5	-1.6	12.5	12.5	0.71	0.71	BB	-5.6	3.24	18.9	2.89	792.50	-13.92	-13.80	uc				
ARGENTINA	9.9	11.8	2.3	9.7	9.9	3.2	51.7	51.1	4.19	3.95	B	-2.0	12.63	9.0	3.61	1379.93	-19.54	-14.95	-				
UKRAINE	3.8	n.a.	8.9	10.6	-10.5	-4.2	37.6	34.7	8.00	7.89	B+	-4.2	8.72	11.2	0.78	914.90	-8.51*****	-9.03*****	-				
GEORGIA	5.8	n.a.	n.a.	8.5	-3.5	n.a.	2.8	2.1	1.66	1.83	B+	n.a.	11.70	n.a.	0.29	536.67	-25.61	-30.87	-				
KENYA	4.9	n.a.	n.a.	16.7	-7.4	n.a.	4.2	4.0	93.60	81.03	B+	n.a.	3.85	7.6	0.76	1244.96	-30.66	-19.58	-				
COTE D'IVOIRE	2.4	n.a.	n.a.	5.1	4.1	1.7	3.3***	2.3^	456.02	516.26	n.a.	0.9A	n.a.	n.a.	0.54	2112.59	-2.47	-9.13	-				
BANGLADESH	6.7	n.a.	27.7	10.2	-7.4	3.7	11.0	11.0	73.85	69.43	BB-	n.a.	n.a.	10.8	1.28	1682.95	-22.35	-18.64	-				

Note: S&P credit rating shown is long-term foreign currency rating. UAE rating shown is for Abu Dhabi. * % change in GDP on previous quarter, annual rate. ** Economist Intelligence Unit or EFG Hermes forecast. A is actual, latest available figure. ***IFCG Extended Frontier 150 Total Return Index. ****Seasonally-adjusted figure. *****Change since 31 January 2011. ^As at 31 December 2008. ^^Estimated 2010 GDP growth. ^^As at 31 December 2009. ^^As at 31 December 2010. This is Stage Two of City of London's three-stage asset allocation process.

Source: City of London Investment Management, Bank for International Settlements, central banks, national statistics offices, International Monetary Fund, Standard & Poor's, The Economist, UBS, EFG Hermes, Inter-American Development Bank, World Bank.



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