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In the Headlines

FIGURE OF THE WEEK: +7.4%>YR/YR GROWTH IN CHINA'S Q3 GDP

Eurozone: Latest indicators and debt crisis update

Markit PMI data continue to point to a contraction in activity (<50) in October. The composite output index is now 45.8 (down from 46.1 in September) with the services component 46.2 and manufacturing 46.1. Regional components, particularly those for the two core countries also point to contraction, with the German composite output index 48.1 and the French down to 44.8. In addition, the surveys reveal weaker prospects in the ST, with new orders falling for the fifteenth consecutive month and jobs decreasing for the tenth month. Meanwhile, at the latest EU summit, leaders agreed to move forward on plans for the EZ single banking supervisory mechanism (SSM), although only the legislative framework will be ready by 1 January 2013. It is expected to become operational during 2013. The SSM is important, not just as a step towards banking union, but also because it is a condition for the ESM (bail-out fund) to directly re-capitalise banks that such a mechanism should be in place.

China: Q3 GDP

Growth of GDP slowed to +7.4% yr/yr in Q3 (+7.6% in Q2 and +8.1% in Q1), which was broadly in line with expectations. The data also showed that qtr/qtr growth strengthened in Q3, to +2.2% (from +2.0% in Q2 and +1.5% in Q1). In monthly data for September released last week, growth of industrial production was up +9.2% yr/yr (+8.9% in August), retail sales were up +14.2% yr/yr (+13.2% in August) and investment in fixed assets in Jan-Sept was up +20.5% yr/yr (+20.2% Jan-Aug). Overall, recent data point towards output at least stabilising and shifting towards a modest pick-up. However, the recovery still looks likely to be moderate by previous standards. One impact of China's dispute with Japan emerged, as the latter's exports to China fell by -14.1% yr/yr in September, although Japan's imports from China increased (+3.8%).

Germany: Mixed indicators

Recent indicators continue to provide a mixed overall economic picture. On the positive side, the Consumer Climate Index remained stable in September, still driven by relative optimism over the economy and the labour market, partly reflecting the decline in the rate of unemployment from 6.8% in August to 6.5% in September. In addition, exports of goods increased by +2.4% mo/mo in August, after +0.4% in July. In contrast, the Ifo Business Climate Index continued to fall—for the fifth consecutive month—at -0.9% mo/mo in September. Similarly, overall output decreased by -0.5% in August, following an increase of +1.2% in July, including printing (-2.3%), computers and electronics (-6.2%), machinery and equipment (-2.8%) and construction (-2.8%). New orders received by industry were also disappointing at -1.3% mo/mo in August, with domestic demand particularly weak (-3.0%) while foreign demand remained flat.

Lebanon: Heightened risk of conflict

On 19 October, a car bomb explosion in Beirut killed several people, including the head of the intelligence branch of the Internal Security Forces, Wissam al-Hassan, who was probably the target. The event is widely interpreted as linked to the civil war in neighbouring Syria and represents intensification of clashes between pro-and anti-Assad forces within the country. In turn, these reflect domestic sectarian tensions. The bomb blast may be a deliberate attempt to destabilise Lebanon, perhaps with the objective of returning the country to civil war. The government and its security forces will be seriously challenged in maintaining law and order and much depends on the reaction of pro-Syrian Hezbollah. Expect heightened tensions and further armed clashes but there is a marked resilience to adversity and significant hostility-associated trade disruptions may yet be limited.

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Countries in Focus

Mediterranean, Africa & Middle East – *Turkey: Policy*

Last week, the central bank lowered the overnight lending rate by 50bps to 9.5%—following a 150bps cut in September—while the overnight borrowing rate and the one-week repo rate (the policy rate) were again kept at 5% and 5.75%, respectively. In practice, lowering of the interest rate corridor's ceiling will have little impact as market interbank rates have already fallen to the bottom end. Expect the central bank to be cautious with regard to more effective monetary easing as its unorthodox tightening of policy over the last two years now appears to be successful in facilitating a soft landing of the economy (after overheating) through curtailing domestic demand and gradually reducing the current account deficit. The latter fell 33% yr/yr in January-August, but was still large, at USD36bn.

Americas – *Chile: Interest rates and update*

At last week's central bank monetary policy committee meeting the key interest rate was left unchanged at 5% for the ninth consecutive month. Headline and core inflation are below 3% and consensus expectations are that headline inflation will remain around 3% over the next 12 months. Domestic demand is moving in a positive direction and exports are improving, although with an uncertain outlook, given global demand. The monthly economic activity indicator (IMAMEC) in August was up +6.2% yr/yr and GDP growth in 2012 is still likely to be 4.5-5%. Against this backdrop, the decision on monetary policy was unsurprising and rates could remain at this level for some time. The overall policy framework is generally sound and the external balance does not pose undue strains at this point.

Asia-Pacific – *India: FDI and reforms*

FDI inflows in January-July—at USD13.4bn—were 38% below the corresponding period in 2011. However, in July, they registered USD2.3bn, which was up 30% on the year. Moreover, since then, the government launched a raft of economic reforms, which were met positively by international agencies (IMF, World Bank, ADB and OECD), governments (including the US) and by domestic corporates, as well as currency and equity markets. The government needs to ensure that the reform momentum is not lost and that it is broadened to address structural bottlenecks in infrastructure, power, labour markets and land policies. Expect FDI inflows to improve further but only if politics remains supportive, including legislative approval of existing (and any future) reform bills.

Europe – *Slovakia: Highest growth in EZ*

Revised estimates by the Statistical Office confirm that Q2 real GDP growth remained stable at +0.7% qtr/qtr sa and +2.8% yr/yr (+3% in Q1). Net exports were the sole growth driver in H1 as exports increased by +7.5% yr/yr—in part boosted by the launch of new capacity in the automotive sector—while imports grew by just +2.7%. Private consumption contracted by -0.2% yr/yr in H1, government consumption by -0.9% and fixed investment by -2.5%. Early indicators suggest that this growth pattern broadly continued into Q3. Overall growth should ease gradually, so expect around +2.5% in full-year 2012 and also in 2013. The current account recorded a surplus of 2.5% of GDP in H1. However, the fiscal deficit came in at 6.8% of GDP in H1, a cause of some concern, although expect that ratio to improve in H2.

Worth knowing

Uganda

GDP growth was +0.9% yr/yr in Q2 after +3.8% in Q1 (which was revised down from an initial estimate of +4.3%).

Cyprus

Last week, S&P lowered its LT sovereign rating by three notches to B from BB, and retained a negative outlook, citing ongoing delays in reaching agreement with the IMF and the EU on conditions for a bailout package, applied for in June.

Angola

A Sovereign Wealth Fund, Fundo Soberano de Angola, was launched last week with a start-up capital of USD5bn, making it the second largest in Sub-Saharan Africa after Botswana. This initial amount will be augmented through the revenues generated by oil sales of 100,000 bpd (from the country's total output of around 1.8 mbpd). An active investment strategy will be adopted.

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