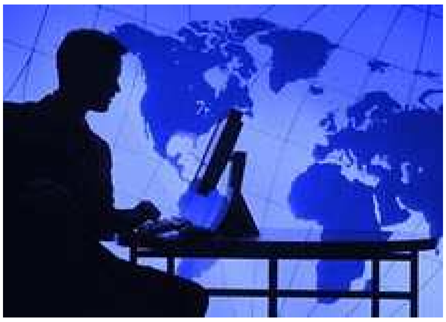
Professional approach to trading

WEEKLY REPORT
17 December 2012

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



This is the sixth 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

- US investors were concerned as stocks suffered their first weekly decline in a month, driven by growing uncertainty over ongoing budget talks. But there were reassuring signs, as both retail sales and industrial production recovered, jobless claims fell to a nine-week low, and industrial production increased by the largest margin in two years, reflecting a recovery of manufacturing, as well as an improvement in the housing market and auto sales. The Federal Reserve announced monthly bond purchases to bolster economic growth, and granted permanent normal trade relations to Russia and Moldova;

- The European Central Bank expressed concern over financial instability in the euro zone, although European stocks recovered. European leaders granted new powers to the Central Bank to supervise at least 150 of the largest European banks. Although problems in the euro zone remain, German business confidence improved for a second month, easing fears over a possible German recession, and European markets were calmed after the release of a long-awaited bailout fund for Greece;

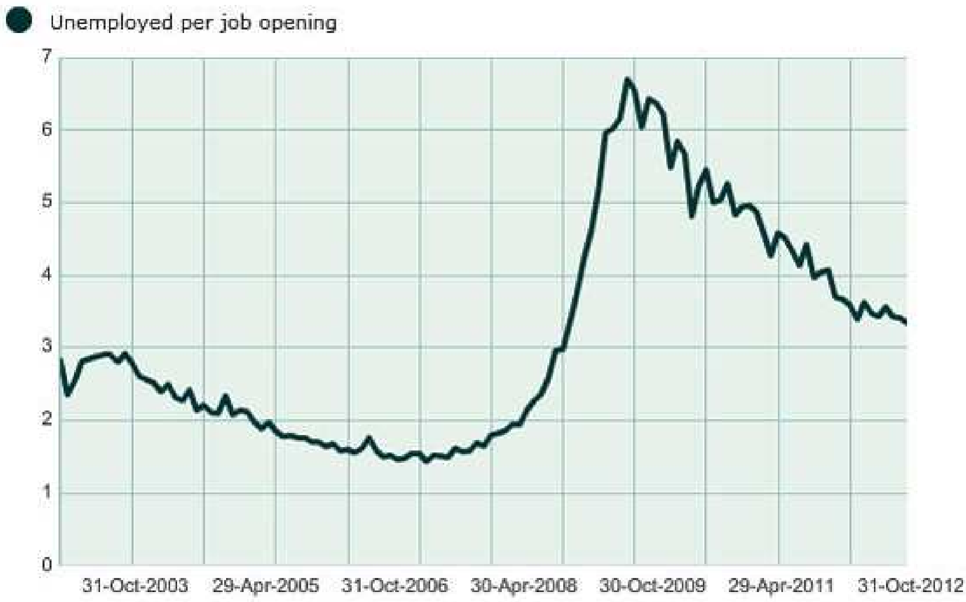
- Asian stocks rose for a fourth week, as Japanese exports expanded and Chinese manufacturing grew. China also opened capital markets by raising the investment limit for foreign investing in domestic stocks and bonds, in order to attract new investment;

- Armenia received $51 million in new IMF loans, despite warnings over poor tax collection. Customs data also raised concerns over possible price rises for imports of Russian gas, despite government arguments to the contrary.

US Markets Concerned over Approaching Fiscal Deadline

US investors were concerned as ***stocks suffered their first weekly decline in a month***, driven by growing uncertainty as the political conflict intensified over budget talks aimed at addressing the looming “fiscal cliff,” or the January 1st deadline when $600 billion in automatic spending cuts and tax increases will automatically take effect unless Congress takes action.

But there were ***reassuring signs***, as both ***retail sales and industrial production recovered*** in November, and jobless claims fell to a nine-week low. Industrial production increased in November by the largest margin in two years, reflecting a recovery of manufacturing, as well as an improvement in the housing market and auto sales. Most importantly, most manufacturers plan to invest more next year, and orders for capital equipment, excluding defense and aircraft, increased by 2.9 percent in October, the biggest increase since February. The US labor market also showed signs of improvement, as the competition for new jobs improved (see chart below).



Source : FactSet/Labor Department

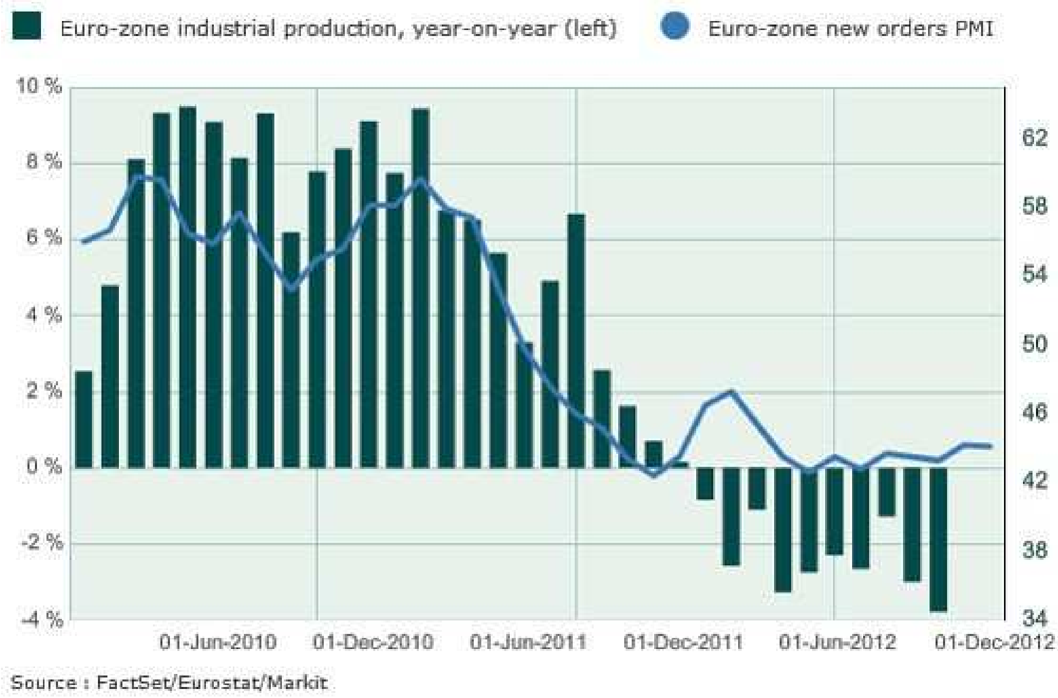
Adding ***more market optimism***, the US Federal Reserve Bank also announced a fourth round of ***bond purchases***, as it will buy $45 billion in Treasury securities every month beginning in January to bolster economic growth, an asset-buying move that comes in addition to a similar monthly purchase of $40 billion in mortgage-debt securities. The Federal Reserve also confirmed that interest rates will stay low “at least as long” as the unemployment rate remains above 6.5 percent and projected inflation does not exceed 2.5 percent. Yet the move also sparked a decrease in the value of Treasury bills for a second week, posting the first back-to-back loss in three months, as the bond-buying plan sparked speculation over increasing inflation. The decline was partially offset in late-week trading, however, as the yields on both the 30-year bond and the benchmark ten-year note increased, following a decline in the consumer price index (CPI), which fell 0.3 percent in the first decrease since May 2012.

In an important development last week, the ***US Federal Reserve imposed new stricter capital requirements*** for some two dozen foreign banks with at least $50 billion of global assets. In a move to reduce risk, the stricter rules will also require larger foreign banks to also pass “stress tests” designed to assess how the banks could face another serious economic crisis. Although most of the new requirements will not take effect until July 2015, the move reflects concern over the US Federal Reserve Bank's $538 billion in emergency loans to the US-based units of major European banks during the financial crisis, an amount nearly equal to the aid to domestic US banks. The new rules on capital will apply to bank with more than $50 billion of global assets and more than $10 billion in the US, and will required them to transfer their US businesses, including securities trading units, to regulated holding companies.

And in a trade-related move, US President Obama signed new legislation into law ***granting permanent normal trade relations to Russia and Moldova***, but which also may trigger individual sanctions against Russian officials implicated in the death of lawyer Sergei Magnitsky and other human rights violations. The ***new law permanently exempts Russia from the Cold War-era trade barriers***, as the ***US seeks to expand trade and commerce with Russia***, especially since Moscow joined the World Trade Organization (WTO) last August.

Greater Confidence in Europe

According to the European Central Bank's (ECB) biannual Financial Stability Review, ***financial stability in the euro zone is still facing "stress and risk,"*** although tension has "lessened" over the past six months. The assessment was largely confirmed by an overall recovery of European stocks by some 20 percent since a low point in June, and as services and manufacturing output both contracted at a slower than expected pace in December. Confidence has also been bolstered by a decision by European leaders empowering the ECB to supervise the banking sector through a new Single Supervisory Mechanism (SSM), to take effect in March 2014. According to the terms of the new agreement, at least 150 of Europe's largest banks will be under the direct supervision of the ECB, which will assume greater power, including the capacity to grant banking licenses, investigate institutions, and impose fines on banks.



Although problems in the euro zone remain, the scale of the challenges appears to be lessening, as industrial output has been contracting less than expected, and with new orders beginning to stabilize (see chart above), and German business confidence improved for a second month, easing fears over a possible German recession.

European markets were also calmed after EU finance ministers approved the release of a long-awaited 49.1 billion euros ($64 billion) bailout fund for Greece. The first tranche of 34.3 billion euros was released, with the remainder to be dispersed by the first quarter of 2013, while the Greek government accepted creditor-demanded reforms and initiated a debt buyback of nearly 20 billion euros in bonds repurchased at a third of their face value from private holders.

Elsewhere, the British bank HSBC agreed to pay $1.9 billion to settle US money-laundering charges related to charges that the bank facilitated transfers of billions of dollars for Iran, despite international sanctions, and transferred money from Mexican drug cartels through the U.S. financial system to legitimize the funds. Under the terms of the settlement, HSBC agreed to forfeit more than $1.2 billion under a deferred arrangement and pay over $650 million in fines. The settlement follows a similar one by the British-based bank Standard Chartered, which will pay more than $300 million in fines for violating US sanctions against Iran.

Focus on Asia

Asian stocks rose for a fourth weekly gain, as Japanese exports expanded, aided by a weaker yen that fell to a nine-month low, largely due to an expected opposition victory in Japan's December 16 parliamentary elections, and as Chinese manufacturing grew, despite a broader slowdown in exports. ***China also moved to deepen capital markets*** as the Chinese state foreign-exchange regulator raised the investment limit for sovereign-wealth funds and central banks investing in domestic stocks and bonds, allowing foreign entities the option to invest over $1 billion in Chinese stocks and bonds. The change goes into effect immediately and seeks to attract new investment in local markets to bolster liquidity and raise investor confidence.

Commodities: Focus on Oil

The ***commodities market was dominated by a sustained rise in global oil prices***, in the fifth weekly gain since early November, driven by manufacturing expansion in the China and the US, the world's two largest oil consumers. The upward oil price rise was bolstered by growing Chinese consumption, now at 9.9 million barrels a day of oil, and representing some 115,000 more barrels a day than previously projected, for the final three months of this year, consuming 9.9 million barrels a day in the fourth quarter, according to the International Energy Agency (IEA). Chinese crude oil imports have risen to the highest level in six months and Chinese oil refineries processed more than 10 million barrels a day of oil for the first time. The latest trend has led many analysts to predict a continued rise in oil prices, projected to average $95 a barrel in 2013, up from the current level of just under $86 per barrel.

Although the IEA has raised its estimates for oil consumption for the fourth quarter of 2012 and into 2013, the Organization of Petroleum Exporting Countries (OPEC) has not decided to alter its production target as OPEC states generally see oil prices to be sufficiently high. The OPEC states produce some 40 percent of the world's oil and its official quota remains set at 30 million barrels a day, but which OPEC producers now exceed by about one million barrels a day. Overall, global oil consumption through the final quarter of 2012 is expected to average about 90.5 million barrels a day, or roughly 435,000 barrels more than previously assessed, with an added forecast for growing demand in 2013 by some 865,000 barrels a day, to roughly 90.5 million, an increase of some 110,000 barrels per day from previous forecasts.

But ***OPEC is coming under pressure to lower oil exports*** to maintain price stability, as Iraq has recently posted its largest increase in oil production since 1998, becoming the second-biggest oil supplier within the OPEC cartel. Iraqi oil production expanded by 650,000 barrels a day this year to 3.35 million, in part based on technical assistance from foreign oil companies who profit margin is limited by agreements with the Iraqi government that set a fixed amount of return per barrel produced, regardless of international price levels. Iraqi production is set to further increase, and may reach an average of 3.7 million barrels a day.

Although Saudi Arabia restricted crude oil production in November to a 13-month low, greater oil supplies in Libya and Nigeria, as well as Iraq may force OPEC to cut back oil production in order to sustain prices at desired levels. Saudi Arabia is especially vulnerable to any downward trend in oil prices, as it has based its state budget on a level of $95 a barrel, more than $10 below current price levels. Meanwhile, the impact of international sanctions against Iran, formerly the second-largest oil producer within OPEC, has led to a 50 percent fall in oil exports from Iran, with oil production falling to 2.65 million barrels a day in October, representing the lowest level since February 1990. Elsewhere, Libya is actively rebuilding its oil industry and is set to increase oil output to some 1.7 million barrels a day in 2013, up from about 1.5 million a day in December, and Nigeria, Africa’s largest oil producer, also expects output to reach normal levels in the first quarter in 2013, after a downturn over the last few months caused by floods, theft and pipeline leaks that forced several oil producers to suspend pumping, cutting national production by as much as 500,000 barrels a day.

Telecommunications

Despite opposition from the US, UK and several other countries, a ***new agreement updating international telecommunications rules*** (ITR) was adopted last week during a meeting of the International Telecommunication Union (ITU), a unit of the United Nations in Dubai. Opponents to the changes to the existing 1998 telecommunications rules were concerned over the possible impact on Internet regulation, privacy and state censorship. Some private firms were also opposed to the new agreement, with Google Inc. expressing concern that the move would only help the “many governments” seeking to “increase regulation and censorship of the Internet,” adding that Google supports a “free and open web.” Overall, the new ITR agreement broadened the scope of international regulation of telecommunications by including the Internet, and adopted measures granting countries the right to access international telecommunications networks and services and the capacity to block spam, as well as changes to the system of taxation of telecommunications companies.

Spotlight on Armenia

The International Monetary Fund released more than $51 million in new loans for Armenia last week, but warned of the need for a “radical improvement” in tax collection and the business environment. The IMF noted that doing business in Armenia continues to be “difficult,” due to the country’s geopolitical isolation and closed borders, governmental corruption and an overall absence of “clear and predictable” government regulations. Although the loans represent the latest installments of a larger three-year $409 million aid package that was first approved in June 2010 to facilitate the country’s economic recovery, the IMF remains concerned over the government’s failure to “boost tax revenue” and “strengthen the legal framework, improve governance, and enhance competitiveness.” With this latest loan, Armenia has received roughly $325 million from the IMF to date.

IMF Deputy Managing Director Nemat Shafik explained that the latest loan was to bolster growth, noting that the Armenian economy has "continued to recover from the deep recession experienced in 2008-09 in the context of the global financial crisis," with growth accelerating in 2012. For his part, however, Guillermo Tolosa, the IMF's resident representative in Yerevan, warned that "Armenia remains well below all its comparators regarding its tax revenue-to-GDP" ratio, but praised the government for granting more power to the State Commission for the Protection of Economic Competition (SCPEC), although the state has yet to effectively reform the customs service, the source of "some practices that could lead to unfair advantages for some players in the market."

Meanwhile, Armenian Energy and Natural Resources Minister Armen Movsisian announced last week that the Armenian government still hopes to successfully conclude negotiations with Russia to prevent an increase in the price of Russian natural gas imports. Movsisian explained that the talks over a new gas price with Gazprom are expected to reach a new agreement by the end of the year. According to customs data, Armenia imported some 304.6 million cubic meters of Russian gas officially valued at some $74.4 million for the third quarter of 2012, indicating a price rise of roughly $244 per thousand cubic meters, up from the rate of $180 per thousand cubic meters declared by the government.

Further suggesting that the price has already increased, customs data for the first half of 2012 have also demonstrated that Armenia paid Gazprom $220 million per thousand cubic meters of gas. The discrepancy has led some analysts to speculate that the government has secretly sold its 20 percent share in ARG national gas distribution company to Gazprom in order to subsidize the retail price until after the February 2013 presidential election.