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WEEKLY REPORT

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

This is the first 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

- After US election, markets remain volatile as fiscal crisis threatens to push the economy back into recession; despite signs of improvement, as trade deficit decreased and exports rose, the European debt crisis and sluggish growth in emerging markets weakens US market;

- In Europe, the Euro posted moderate gains despite crisis over new 31.5 billion euros ($40.1 billion) bailout for Greece; European Central Bank noted worsening economic outlook and may activate bond-purchase program;

- For Asia, US-Chinese tension over US trade gap and US criticism over unfair trade practices and under-valued Chinese currency; China and Japan face export slowdown; Chinese GDP grew by lowest level since 2009, threatened by domestic over-investment, excess credit and weak exports;

- Global commodity markets sluggish due to world economic weakness, but steady increase in gold prices expected, as Iran purchases $2 billion worth of gold monthly;

- For Armenia, new opportunity after Iran bans imports of consumer goods; Italian airline enters civil aviation sector, but low profitability from Armenian airport's excessive prices for services limits options, and Armenian Armavia carrier closer to bankruptcy.

US Markets: Volatility & Fiscal Pressure

Although the US presidential election tended to calm the market, a degree of ***volatility remains***. Specifically, the election, which was capped by a victory for President Obama, resulted in a divided government, as the Republicans held control of the House and the Democrats maintained their majority in the Senate. For many investors, the election did not reassure the markets due to mounting concerns over the looming showdown over the US fiscal situation. This concern centers on the 1 January 2013 deadline that will necessitate the automatic introduction of $607 billion in tax increases and $1.5 trillion in reductions in federal spending.

On 8 November, the independent Congressional Budget Office (CBO) recently warned of a real danger that the ***US economy may "fall back into recession***," adding that the impact may trigger a decline in the US economy by 0.5 percent if Congress fails to act. But if Congress does avert the automatic $1.2 trillion spending cuts and extend the Bush tax cuts, annual deficits would average nearly 5 percent of GDP over the next decade and public debt would increase to 90 percent of GDP in 2022.

Yet at the same time, there were also hopeful ***signs of a strengthening US economy***, as the US trade deficit decreased to the lowest level in nearly two years as exports rose to a record high. According to figures released by the US Department of Commerce on 8 November, the deficit narrowed to $41.5 billion in September, and exports increased by 3.1 percent to an all-time high of $187 billion. The ***increase in exports*** ended two months of decline and was driven by ***stronger sales of commercial aircraft, heavy machinery and farm goods***. US imports rose 1.5 percent to $228.5 billion, mainly due to an ***increase in imports of consumer goods, including shipments of the new Apple iPhone 5***, and due to higher oil prices. There was also a temporary driver of US export growth: a 32 percent rise in soybean exports due to summer drought.

Overall, despite the jump in exports, it will not likely drive broader economic growth, as the ***European debt crisis and sluggish global growth in emerging markets continues to weaken demand*** for US products. US exports to the EU were unchanged for September-August 2012, exports to Latin America increased 4.2 percent, but exports to that region's largest economy, Brazil, declined. For 2012, the US deficit is at an annual rate of $554 billion, slightly less than the $559.9 billion 2011 level, and the US deficit with China increased to $29.1 billion in September, 6.8 percent higher than last year.

Developments in Europe

For this period, the ***Euro posted moderate gains*** despite an approaching critical vote on austerity measures in the Greek parliament, and overcame a three-week low in value to the Japanese yen and advanced after a two-month low against the US dollar.

The ***main concern in the European markets was the Greek parliament's vote for a new set of austerity measures***, required for fresh bailout funding. If the vote over the deeply unpopular austerity measures fails, it would trigger a deeper Greek recession, driving investors into safe-haven assets, thereby weakening the Euro. The euro-zone finance ministers will not decide to release funds for Greece until late November as they wait for a report on the country's compliance with the terms of its bailout. The release of a new bailout of 31.5 billion euros ($40.1 billion) of aid for Greece, which has been frozen since June, will be considered at a meeting in Brussels on 12 November.

In a broader European context, the European Central Bank (ECB) is concerned that the ***economic outlook is worsening***, and has moved to keep the main interest rate unchanged, now at a record low of 0.75 percent, with inflation in Europe projected to remain above 2 percent for 2012, before set to decline in 2013. The ECB is prepared to activate its bond-purchase program if European governments meet expectations. The International Monetary Fund (IMF) has also urged euro-zone members facing high borrowing rates to seek a bailout that will activate the ECB bond-purchase program, clearly pressuring Spain, which resists the move.

Focus on Asia

As usual, the main focus of developments in Asia centers on China. The ***widening US trade gap with China has sparked trade tension*** between the two countries, and the tension is likely to only continue in the second Obama Administration. The US charges that Chinese trade practices are unfair and that China keeps the yuan undervalued against the US dollar (a lower valued yuan makes Chinese goods cheaper for US consumers and American products more expensive in China). Although Obama administration will push China to move more quickly to allow the rise in value of the yuan, the US will not raise tension further by labeling China as a currency manipulator, which would require negotiations within the World Trade Organization (WTO).

Elsewhere in Asia, both ***China and Japan continue to face a serious slowdown in export growth***. Japanese exports for September 2012 fell 10 percent, its steepest decline in several years, and for China, its third-quarter GDP posted growth of 7.4 percent, representing its lowest level in three years. China is threatened by domestic over-investment issues, excess credit and a weak export market, making its economic outlook worrisome. For Japan, there is also concern over the outlook as its economy restricted in the third quarter by the largest level since the 2011 earthquake, with Japanese GDP tightening to 3.4 percent, sparking ***investor caution***.

Commodities

In general, for this period, ***global commodity markets remain sluggish*** due to broader world economic weakness. As confirmed by the Reuters CRB commodity index, which tracks a basket of 19 commodities, overall commodity value is down over 8 percent on a year-on-year basis and declined over 4 percent on a month-on-month basis. ***Gold prices***, additionally, closed last week at a ***recent nine-week low***, as investors held off on opening bigger positions, although gold did post a gain of over $7 per ounce. That increase has continued, rooted in speculation following President Obama’s reelection. Investors also boosted assets in gold-backed exchange-traded products to an all-time high of 2,592 metric tons on 7 November, valued at $143.1 billion. ***And a further steady increase is expected*** as the US election suggests that US interest rates will continue to remain low, thereby boosting gold prices.

In addition, ***reports from sources in Iran*** on 9 November 2012 also suggest a ***new factor driving up gold prices,*** as ***Iran is reportedly stockpiling gold***, preventing exports and sales, and generally hoarding gold reserves in an attempt to stabilize its economy as the impact of Western sanctions expands and n the wake of a severe currency crisis (under US law, any sale of gold to Iran, whether by Turkey or any other country or citizen, is subject to sanctions). Turkish sources report that Iran has purchased roughly $2 billion worth of gold every month since July, driven by stricter US banking sanctions and the European boycott of oil. ***Iranian buyers are largely making these purchases in Turkish lira*** and the gold is generally purchases in the form of bullion, apparently being carried by hand in suitcases, by air to Dubai, and then by boat across the Persian Gulf to Iran. A ***second factor centers on plans by the Indian government***, which is the largest gold buyer in 2011, to increase gold purchases in this quarter.

Spotlight on Armenia

One of the ***more significant short-term developments in the Armenian market comes from Iran***. On 8 November, the Iranian government imposed ***new sweeping prohibitions on the import of more than 2,000 products considered "luxury goods***." Largely driven by a serious, sanctions-related shortage of foreign currency, the ***new ban covers a wide range of products***, including cars and motorcycles, and ***some 75 key consumer goods***, such as cosmetics, high-quality watches, home appliances, computers, and mobile phones, but also including high-end coffee and chocolate, and even toilet paper. For Iranian consumers, the ***Armenian market will offer an immediate and relatively easy alternative***, with even greater appeal for Iranian speculators and/or Armenian-Iranian middle men, to travel to Armenia and buy the consumer goods for illegal resale on the booming Iranian black market. The move follows the introduction of a ***similar ban last month***, although that time ***prohibited the export of some 50 items, including aluminum, sugar and wheat***.

Another recent ***development with an important longer term impact on the Armenian economy*** was the announcement last week that the ***Italian flagship airline, Alitalia, will begin a new series of regular direct flights*** to Armenia, on a Rome-Yerevan route, twice a week starting from 11 December. The new route, part of a broader market modification plan by the recently privatized Italian carrier, is to offer new "competitive prices" to attract travelers for the first three months. That unprecedented promotional campaign will offer an attractive pricing structure with Yerevan-Rome tickets to start from 299 euros ($380).

This ***development is significant, especially as the limited Armenian civil aviation sector has been weakened*** by the pullout last month of Britain's BMI airline, a subsidiary of British Airways, which closed its decade-long London-Yerevan route. That decision was based on low profitability due to the Armenian airport's excessive prices for ground services, gate fees and a virtual monopoly for aviation fuel in Yerevan. Given that reality, the Polish carrier LOT has already decided to terminate its Warsaw-Yerevan route in the coming weeks and Czech Airlines is also now seriously considering a decision to end Prague-Yerevan flights, leaving only Austrian Airlines, Air France and Aeroflot and the major carriers flying to Yerevan.

Beyond those problems over the management of Armenia's Zvartnots airport, which is operated by an Argentine company, the approaching ***likelihood of bankruptcy for Armenia's Armavia national carrier*** poses another challenge to the country's economy, with direct implications for the travel and tourism services sector. The latest problem for Armavia came last week, when the state-owned Armenian company providing meteorological services to airlines threatened to sue Armavia over some 142 million drams ($350,000) in outstanding debt. Armavia is also battling Zvartnots airport management over ***Armavia's debt of over $3 million*** as of last month.