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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 third 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 markets posted impressive gains last week and overall, rising optimism and greater consumer confidence helped to bolster the outlook for a sustained economic recovery;

- Investor confidence in Europe was shaken by a breakdown of EU budget talks, although the euro gained, reflecting confidence over new aid to Greece. Yet investor concern over instability in the euro zone was driven by the downgrading of France's credit rating;

- Asian stocks posted the largest weekly gains since September, capped by gains in Australia, Singapore, South Korea and Taiwan, mainly due to improvements in the US economy and new data showing a recovery in Chinese manufacturing. But the Japanese market suffered another downturn last week, as exports fell and market volatility mounted in the face of a looming parliamentary election;

- In the global commodities market, gold futures rose to a five-week high and silver posted a six-week high, driven by greater investor demand for precious metals. Global oil prices stabilized, although oil prices are expected to decline as global demand is set to decline due to increased output and new US and Canadian production;

- The Armenian government amended the tax code to simplify reporting requirements for small business. Leading pharmaceutical firms also launched efforts to meet European standards and obtain new state production certificates to enter the European market.

US Markets: Stocks Rally & Holiday Shopping Sparks Consumer Spending

US markets posted impressive gains last week, as the US Standard & Poor's 500 Index of leading stocks posted its biggest weekly rise since June. The increase was triggered by both a surprising improvement in German business confidence and by last week's holiday shopping season. US technology stocks led the rally, with Hewlett-Packard, Dell and Advanced Micro Devices posting gains of over 4.1 percent, and more than 80 million Americans began their usual holiday gift spending.

In another ***sign of growing confidence*** in the US economy, the value of 10-year US Treasury bonds rose to their highest level in over a month. The increase was also driven by a planned sale of $99 billion in Treasury bonds next week by the US Federal Reserve Bank and by optimism over talks between Congress and the White House to take action to manage the "fiscal cliff" crisis involving a combination of $607 billion in automatic spending cuts and tax increases that takes effect in January unless an agreement on long-term deficit reduction is reached. According to the independent Congressional Budget Office (CBO), those measures would result in a 0.5 percent contraction of GDP, a serious development as US GDP is only projected to grow by about 2.2 percent in 2012, and only 2 percent in 2013.

Developments in Europe

Investor confidence in Europe was shaken by a breakdown of EU budget talks. The collapse of negotiations over the European Union's next seven-year budget was a result of a heated ***fight between member states strongly defending their own national economic interests***, as France fought for farm subsidies, Denmark, the Netherlands and the UK demanded a rebate and objected to a 50 billion-euro program for transport, energy and telecommunications, and EU states in Eastern and Southern Europe protested cuts in spending on infrastructure projects. The breakdown led German Chancellor Angela Merkel to rule out any agreement until early next year, when new talks will focus on the 1.09 trillion euro ($1.4 trillion) budget for 2014-2020, which contains spending of 973 billion euros. France successfully blocked attempts to reduce subsidies for agriculture, which accounts for over one-third of spending, reflecting the political power of French farmers, but also backed by Spain, Greece, Ireland, Italy and Poland.

Despite concern over the EU budget, ***the euro gained*** in market trading last week, and posted its biggest gain against the yen in nine months, reflecting confidence that Brussels will extend ***new financial support for Greece*** in talks set for next week. But Greece continued to be the centerpiece of the wider euro crisis as European officials failed to reach an agreement over the latest financial aid package to Greece last week. After nearly 12 hours of talks failed to finalize the details of the new loan, although Greece requires more than 30 billion euros in additional financial aid to stabilize the Greek economy until 2016. Earlier in June 2012, financial aid was suspended, mainly in response to the Greek government's failure to fulfill promises of imposing budget cuts and implementing specific economic reforms. But more recently, the Greek prime minister was able to secure parliamentary support for new spending cuts, tax increases and labor market reforms focused on cutting debt, which reached a massive 190 percent of GDP this year.

Yet ***investor concern remains over longer term structural stability*** in the euro zone. That concern was confirmed by recent investor surveys carried out by Fitch Ratings that found while as many as 86 percent of investors welcomed the decision by the European Central Bank to invest in state bonds issued by weaker euro zone members and nations, and supported EU plans to create a banking union as "major positive steps," some 81 percent of the investors surveyed stated that "significant economic, financial and political risks remain" in the euro zone.

Reflecting the vulnerability of the Cypriot banking sector after suffering heavy losses from their over-exposure to Greek state bonds, Cyprus is negotiating with the EU over the terms of a 17.5 billion euro ($23 billion) loans. Cypriot banks are burdened by some 152 billion euros in debt, or about eight times the overall size of the country's GDP, triggering a serious downgrading of its credit rating and forcing Cyprus to seek additional external loans from Russia and China. ***France also suffered from a downgrading of its credit rating***, from an AAA-rating to AA1, as French debt is viewed as over-valued and investors were concerned over a lack of competitiveness in the French economy. But last week, GDP posted an unexpected, but slight 0.2 percent gain for the third quarter, easing fear that France would enter into recession.

Focus on Asia

Overall, ***Asian stocks increased*** last week, in the largest weekly gains since September, capped by gains in Australia, Singapore, South Korea and Taiwan, mainly due to improvements in the US economy and new data showing a recovery in Chinese manufacturing. But the ***Japanese market suffered another downturn*** last week, as the yen fell by 3.8 percent in the past month and market volatility mounted in the face of the country's December 16 parliamentary election. Japanese exports also continued their decrease for a fifth straight month, falling 6.5 percent in October from a year earlier, resulting in a trade deficit of 549 billion yen ($6.7 billion).

Following a decision by the European Union to back off from a conflict with China over airliners' emissions, ***China Eastern Airlines concluded a contract with Airbus*** for the purchase of sixty A320 aircraft. Although the total price for the deal was not released, Airbus offered China Eastern Airlines a "substantive" discount to the official price of $5.4 billion for the planes, and also accepted 18 regional jets from the Chinese carrier in return. The Chinese order for the A320s, which are set to be delivered from 2014 to 2017, are for domestic flights, reflecting a downturn in Chinese demand for longer-haul international routes.

Commodities

Oil prices stabilized last week to a level of about $87.50 per barrel after a new ceasefire between Israel and Hamas helped to ease investor concern over tension in the Middle East. But over the longer term, according to new analysis released by the International Energy Agency (IEA), the ***global demand for oil is expected to decline*** through the remainder of the year. The decline in oil demand is tied to continued economic weakness and sluggish growth in Europe and due to the temporary implications from Hurricane Sandy in North America. The projected level of global demand for the fourth-quarter of 2012 now stands at an estimated 90.1 million barrels of crude oil per day. The slowdown in global demand is matched by an increase in global output, indicating that a ***downward trend in oil prices is expected***, especially as supply disruptions have eased and new US light oil and Canadian oil sands production have each increased. Other developments included a 1.3 percent ***rise in gold futures*** to a five-week high at $1,750 per ounce, and a 2.3 percent ***increase in silver prices***, to a six-week high of $34.206 an ounce, as the weakening dollar contributed to ***greater investor demand for precious metals*** as an alternative.

The Middle East

The International Monetary Fund (IMF) concluded a ***new $4.8 billion loan agreement with Egypt*** last week after concluding negotiations with the government. The fresh loan covers support for a number of sectors of the economy, but comes after promised cuts in energy subsidies and spending cuts. Egypt also expects a much larger package of ***$14.5 billion in financing*** from other Western donors and multilateral institutions over the coming months.

Spotlight on Armenia

In addition to the broader negotiations with the European Union over a Deep and Comprehensive Free Trade Agreement (DCFTA), the Armenia government is also ***actively promoting bilateral commercial and investment ties*** with several European countries. On November 20, in the latest of these bilateral efforts, an ***Armenian-Czech business forum*** was held in Yerevan. Organized by the Armenian Development Agency (ADA), a dozen Czech companies participated, including banking, insurance, real estate and financial services firms, food producers and innovative firms specializing in medical technology. The forum seeks to expand bilateral trade and specifically attract Czech investment, as well as launch new efforts targeting industry and tourism as priority areas. ***Bilateral Armenian-Czech trade*** reached $26 million last year, a 32 percent increase from the 2010 level of $19.7 million.

The Armenian government approved a set of ***amendments to the tax code*** last week that will significantly ***simplify tax reporting requirements for small business***. The changes, if adopted by the parliament, will offer important incentives for smaller firms with annual turnovers of less than 58.3 million drams ($144,000), including a reduction in the number of financial reports that they are required to file with the State Revenue Committee. Under the new proposed law, those smaller businesses will have to file only 4 financial reports, rather than the current 16, thereby, cutting administrative expenses and overhead for the firms. The smaller firms will also be offered a new option to have their profit tax calculated on the basis of turnover rather than earnings. The new tax amendments follow an earlier round of simplifying modifications, including a 50 percent reduction in the number of annual payments for corporate income, property, and land taxes, as well as for pension contributions.

Leading ***Armenian companies in the pharmaceutical sector*** launched intensive efforts last week to meet ***European Union standards*** and obtain production certificates from a newly established Armenian state agency. in order to companies have one month to get prepared for checking and get certificates for exporting their medicine to the European market. According to Samvel Zakaryan, the chairman of the Medicine Producing and Importing Union, explained that pharmaceutical companies must meet a recently adopted set of requirements that were imposed after a scandal in the county’s health sector that involved corrupt procurement practices, and both the sale of expired and unsafe medicine and the manufacture and distribution of inferior products in violation of safety and health regulations. But the changes within the pharmaceutical sector are also part of a broader campaign to meet higher standards governing exports to the European Union (EU). Three market leaders, Arpimed, Liquor and Pharmatech, have emerged as the companies closest to meeting the new requirements and are expected to obtain the new state certificates within one month, and will be well positioned to garner EU market entry.