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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 second issue of the second volume in a 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

- The outlook for the US economy continued to improve, as unemployment remained steady and job creation continued to grow, with GDP expected to increase by 2.1 percent in 2013. But an unexpected widening of the trade deficit, as imports increased at a rate nearly four times more than exports, complicating talks over a limit on government borrowing, and a challenge for President Obama's new nominee for Treasury Secretary;

- Reflecting a deeper weakness in Europe, projections of a 0.3 contraction in GDP for 2013 only encouraged investor unease, compounded by a rise in the unemployment rate, although corporate and consumer confidence showed a slight, but sustained improvement in confidence. Also reassuring investors, Greece adopted new tax laws, fulfilling a key prerequisite for obtaining international financial aid, after receiving a new aid package;

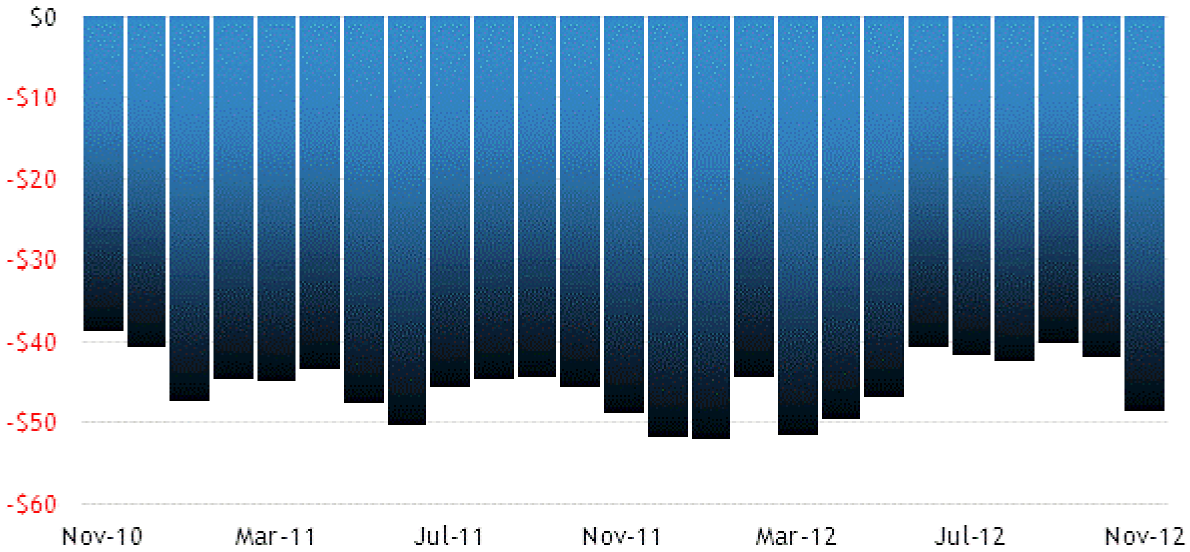
- In Asia, the outlook for the Chinese economy improved, and the new Japanese government announced a large stimulus package, aimed at sparking a recovery from recession and to curb deflation and bolster growth;

- Global oil prices were down, due to concern over decreasing Chinese demand, an increase in global supply and increasing US oil production.

US Investors More Hopeful

After a reassuring unemployment report released at the beginning of the month, the overall outlook for the US economy continued to improve, as state and local governments announced plans to invest in the construction of new facilities and to hire new employees after reducing their workforce by almost 500,000 jobs over the past five years. The new hiring and spending plans reflect a return to their most secure financial position since the start of the 18-month US recession. Most importantly, healthier state and local governments, which accounted for about 12 percent of GDP in 2011, will bolster a projected economic expansion, as GDP is set to increase by 2.1 percent in 2013, after posting growth or 2.3 percent in 2012.

US Trade Deficit ($billions)



Source: US Census Bureau

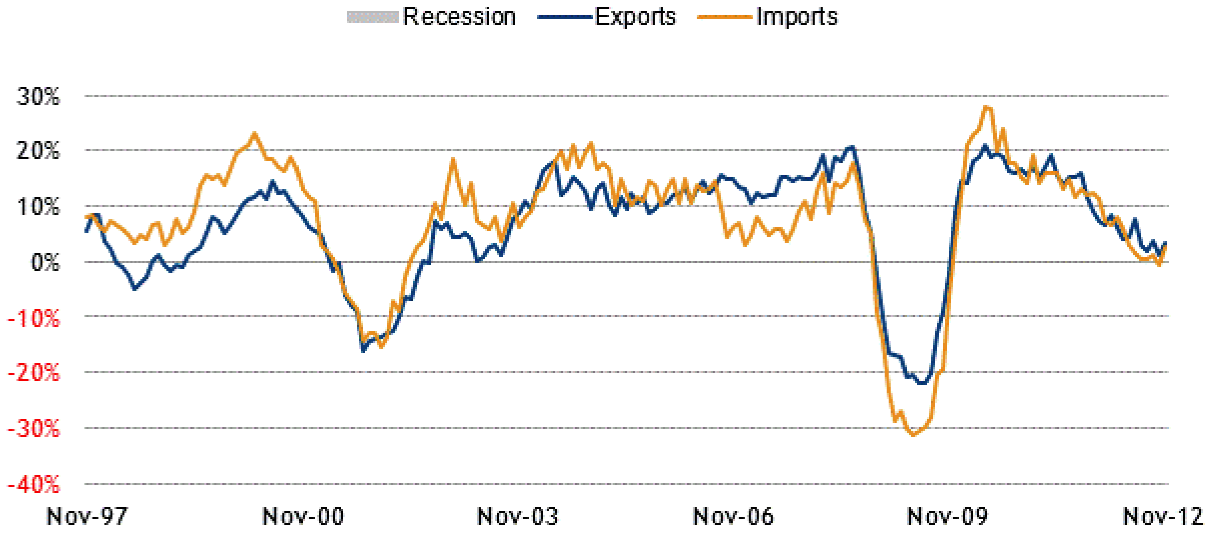
At the same time, a recent report by the US Commerce Department showed an unexpected widening of the trade deficit for November 2012 (see chart above), as imports increased at a rate nearly four times more than exports.

US Monthly Trade Balance ($billions)

Source: US Census Bureau

While the trend suggests the start of a global economic recovery, the 15.8 percent increase in the trade deficit, totaling $48.7 billion, represents the highest gain since April 2012. The 3.8 percent expansion in imports, to $231.3 billion (see chart above), was due to a near-record jump in demand for consumer goods, although US companies also benefited from greater sales worldwide, especially for automobiles and telecommunications products, contributing to a percent increase in exports, to $182.6 billion in November 2012.

US Exports and Imports (year-on-year percentage)



Source: US Census Bureau

In other news last week, President Obama nominated Jacob Lew, his White House chief of staff, as his choice for the new US Treasury Secretary. Lew has extensive budget experience, having previously served as the budget director for both Presidents Obama and Clinton. A speedy confirmation of his appointment by the US Senate is also important for the White House, as the Treasury Secretary will be a key participant in upcoming negotiations with Congress over the "debt ceiling," or the limit on the level of government borrowing. Those negotiations are essential, as US debt has already reached the $16.394 trillion limit on December 31, 2012.

Dimmer Outlook for Europe

In part reflecting the deeper weakness within the eurozone, the European Central Bank (ECB) lowered its projections for GDP growth, modifying its forecast downward to a 0.3 contraction in eurozone GDP for 2013. Eurozone economies decreased by 0.1 percent in the third quarter of 2012 after sustaining a 0.2 contraction in each of the three previous months, and as preliminary statistics revealed, GDP slumped by another 0.3 percent in the closing fourth quarter of 2012.

Recent figures released by Eurostat showed a slight rise in the unemployment rate within the eurozone, increasing to 11.8 percent for November 2012, up 1.2 percent from the same period a year earlier or about 2 million more people without jobs. Most crucially, the weaker eurozone economies in Greece and Spain continued to struggle with excessively high unemployment rates of over 25 percent, with more than 60 percent of Greek and Spanish youth unemployed. But in better than expected results, a combined index of corporate and consumer confidence in the eurozone showed a slight, but sustained improvement in confidence.

Helping to reassure investors, the Greek parliament adopted new tax laws to increase state revenue by some 2.3 billion euros ($3.1 billion), fulfilling a key prerequisite for obtaining international financial aid in the near future. The move follows a decision by the 17 eurozone finance ministers approving a new 49.1 billion euro aid package for Greece, with 34.3 billion euros allocated to the Greek government immediately. The changes to the Greek tax laws were part of Greece's broader austerity policies, and introduced new measures to expand the tax base, impose a 20 percent capital gains tax and ease the corporate tax rate from 40 percent down to 32.8 percent. Greece still faces a serious challenge in improving the efficiency of its tax collection and has yet to tackle widespread tax evasion.

Focus on Asia

According to a new economic forecast released last week by Deutsche Bank, the Chinese economy is set to enjoy a stronger recovery in 2013, with new estimates predicting an 8 percent increase in GDP for the first half of the year, to be followed by a higher 8.5 percent rise in the second half, compared to only 7.6 percent growth for the second half of 2012. Much of the economic recovery is rooted in sizable improvements in the construction, healthcare and shipping sectors, and in energy. Weaker sectors of the Chinese economy identified in the report include the banking sector, which is expected to be damaged by a jump in defaulting and non-performing loans, and the steel and coal industries, which are suffering from increasing levels of surplus and excess capacity.

That positive outlook for the Chinese economy was also confirmed by recent data showing a 14.1 percent increase in Chinese exports in December 2012, compared to a year earlier and representing the highest increase in exports since May 2012. In addition, the Chinese economy was further bolstered by a 19-month high in manufacturing, fueling expectations for a recovery in the world's second-biggest economy following a seven-quarter slowdown. And as the level of China's overseas sales increased by 14.1 percent in December 2012, over a year earlier, far outpacing the expected 5 percent level that was forecast, inflation also increased higher than expected, to a seven-month high.

Also last week, the Chinese government announced new plans to allow individual Chinese investors to participate in overseas capital markets, a first-ever move viewed as part of a larger ambition to increase the role of the Chinese currency in global finance. The new trial program will be supervised by the People's Bank of China and will selectively serve a new group of pre-qualified individual domestic investors. The program is also seen as an attempt by the Chinese leadership to reduce its reliance on the US dollar after accumulating more than $3.31 trillion in foreign-exchange reserves, representing the world's single largest investment in dollars outside of the United States. The plan is to also gradually open more channels for capital outflows and to ease restrictions on Chinese residents' overseas investments, while also seeking to make the yuan a fully convertible currency. Although initially launched in 2006, this new announcement will permit individuals to buy securities in overseas markets through asset managers and funds.

Elsewhere in Asia, investors were encouraged by the new Japanese government's $116 billion (10.3 trillion yen) stimulus package, aimed at sparking a recovery from recession and to curb deflation and bolster growth. The stimulus package represents the first new policy initiative by the government of Prime Minister Abe, which was elected last month, and seeks to spur a 2 percent increase in GDP while creating some 600,000 new jobs. The new government also seeks to pressure the Bank of Japan to adopt "a bold monetary policy" focusing on expanding economic growth and boosting job creation. The new plan also seeks to address the appreciation in the value of the yen, which has weakened exports, and includes new measures to encourage and support overseas mergers and acquisitions by Japanese corporations.

In addition, the Japanese government also plans to use the country's foreign exchange reserves to finance sizable investments in European bonds. Much f the new sate spending will be directed to programs to rebuild the Tohoku region, which was devastated by the March 2011 earthquake and tsunami, and to strengthen disaster prevention. The second largest area for state spending is for targeted "wealth creation," through measures aimed at strengthening the competitiveness of Japanese industry and to stimulate innovation. Further spending will focus on social security, healthcare, education and regional development.

Global Commodities & Currencies

Global oil prices dropped last week, closing to $93 per barrel, as the higher than expected rate of Chinese inflation renewed investor concern over Chinese demand. Higher concern over any decrease in Chinese energy demand reveals the fact that China, as the largest oil-consuming country after the US, accounted for 11 percent of global demand in 2011, thereby directly impacting global oil prices, and leading analysts to predict a further drop in oil prices, to as much as a drop of $10 or more over the coming few months. Another factor driving oil prices down is an increase in both supply and US production, as the level of US crude oil output climbed 0.2 percent to 7 million barrels a day last week, reaching its highest level since 1993, and reflecting a longer term trend of US production increases over the last 17 of 18 weeks.

In the global currency market, the yen fell by 1.2 percent versus the dollar in its weakest level since June 2012. The yen also sustained its longest weekly losing streak in almost a quarter-century after the Japanese government confirmed its plans to devalue the currency. The value of the euro rose in value against all of the 16 most-traded currencies, with a 2.1 percent rise against the dollar, mainly reflecting renewed optimism that Europe is gradually recovering from its economic downturn and debt crisis. The Australian and New Zealand dollars also rose for a second week, bolstered by a 6 percent increase in China's imports for December, representing the sharpest gain in six months, reflecting the emergence of China as Australia's biggest trade partner and New Zealand's second-largest export market.

Spotlight on Armenia

In a newly released annual survey by "The Wall Street Journal" and the Heritage Foundation think-tank, Armenia was rated as "one of the most free and open" economies among former Soviet states. The 2013 Index of Economic Freedom survey rates some 177 countries and territories across four specific areas: economic freedom, the rule of law, the size of government and market openness. The Armenian economy was ranked 38th with positive marks for its "relatively efficient" regulatory framework and "better management of public spending," or 17th among the survey's 43 countries in Europe and in a group of economies defined as "moderately free," but also including France, Spain and Turkey. The generally positive ranking for the Armenian economy was also due to the survey's recognition of the "improvement" in the country's overall performance, a simplification of business procedures, a relatively light tax burden and a "moderate" non-salary cost of labor.

The survey expressed concern over the state of the rule of law, however, stating that "although Armenia performs relatively well in many categories of economic freedom, stronger foundations are needed in areas like judicial independence and government transparency." The survey went on to add that "despite progress in tackling corruption, particularly within the tax and customs administrations, the close relationships within political and business circles raise concerns about cronyism and undue influence by vested interests."

Armenian officials recently reported a significant improvement in the performance of the country's long-troubled and inefficient tax revenue collection system. Citing statistics from the State Revenue Committee (SRC), tax collection rose to 792.2 billion drams (around $2 billion) for January-November 2012, representing nearly a 12 percent increase over the same period last year. Based on the new data, the Armenian government now seems set to meet the target for tax collection set for the end of 2012. That target of 874.4 billion drams in tax collection is some 13 percent higher than the goal for 2011, but must be met in order to justify and facilitate the government's determination to lower its budget deficit to around 3 percent of GDP while simultaneously increasing state spending by 4 percent in 2012.

The improved tax collection figures showed a broader improvement in the collection of many different taxes, but the single most important increase was in the collection of the value-added tax (VAT), which represents the largest source of state budgetary revenue. According to the data, VAT collection increased by 12.6 percent, reaching almost 337 billion drams for January-November 2012, the amount collected in corporate profit taxes increased by 16.3 percent from 2011-2012, and excise taxes on tobacco and alcohol, import duties and mining royalties were all improved from the prior year.

-Richard Giragosian