ARAB BANK

AB WEEKLY ECONOMIC MONITOR

Volume 1, Issue 14, 22 June 2008

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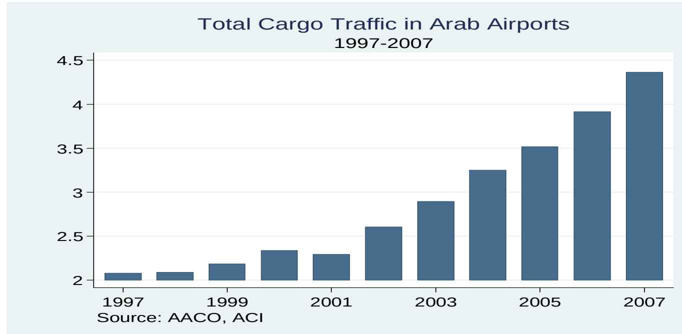
Transportation Cost and Trade

For the most part of the past century, oil prices have been relatively low and declining in real terms. Declining shipping costs due to reduced fuel cost is probably the single most-important factor that has affected global trade. In addition however, improved technology has reduced the weights of many items that are transported over long-halls. As well, countries of the world have sought to reduce international tariff and non-tariff barriers which also induced trade growth. These three factors largely explain the fabulous growth in global trade and in globalization that the world has been experiencing. In terms of figures, global trade has been growing at nearly 6% per annum for the past six decades. Ocean has the largest share of bulky manufactured products that are haled over long distance. According to IIATA, 36% of world trade by value is transported as cargo, $3.25Tr; however this only represents 5 % of world trade by volume[1]. In the US, air shipment while representing a fraction of total trade, has been growing rapidly. For instance, in the past 40 years, air shipments have grown to represent some 33% of U.S. imports and exports with countries outside North America[2].

Yet the recent sustained and fiery increase in oil prices is threatening to decelerate trade growth or even reverse some of the long-term globalization trends. For example, while China has an obvious advantage in terms of production costs relative to the US, the rising fuel costs have markedly increased the shipping and delivery costs of Chinese products, particularly bulky and capital-intensive ones such as steel. Specifically, at today's oil prices, rising transportation costs have already more than offset China's cost advantage, giving US steel a competitive advantage in its own market for the first time in over a decade[3].

In our region, trade represents about 4.5% of the world total. However, trade is expected to grow quite remarkably[4]. Over the period 2000-2007, the growth of cargo has proceeded at more than 85% as shown in Figure 1 below.

Figure 1

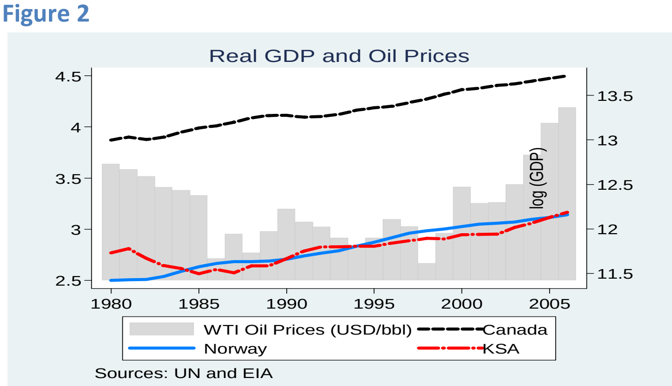


This notwithstanding however, estimates have it that Arab countries have been facing rising operating expenses as a result of soaring costs linked to an increase worldwide fuel prices by 42%. This increase pushed the price of jet fuel to $1.65/gallon, which raised the fuel cost of Arab airlines by 66.5% to reach some $3bn.

The Cost of Diversity

Arab oil producing countries, particularly members of the GCC, have long sought to diversify their economy. What is the value of diversity? Well, let's select three countries from three continents that are oil producers, KSA, Norway and Canada. KSA has nearly 21% of the world reserves and produces 13% of the world output. Norway has less than 1 percent of world's oil reserves and produces 3% of output while Canada has 2.2 % of world's conventional oil and produces 4.1% of the world's conventional output. Obviously, however, KSA is least diversified and more dependent on oil as a source of income than the other two countries. Accordingly it is much more susceptible to the vagaries of international oil markets and particularly to oil price changes. Clearly, KSA GDP marked in red below has oscillated much more markedly than the other two countries.

Figure 2



The figure illustrates that dependence on oil begets much more volatility. Why is diversity important in economics? Economic diversity reduces fiscal revenue, income and employment volatility. But what does volatility do? Well let's think about it this way: many farmers in Arab countries have left their villages

[1] http://www.iata.org

[2] Hummels D. (2007): "Transportation costs and international trade over time" Purdue University, West Lafayette, Indiana.

[3] Rubin J. and Tal B. (2008):"Will soaring transport costs reverse globalization?" *CIBC World Markets* May 27.

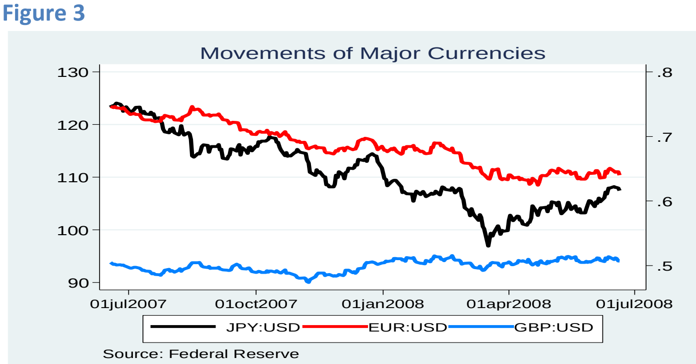
[4] ESCWA (2007): "ESCWA study on air transport in the Arab World" UN-ESCWA Beirut, Lebanon.

and migrated to urban areas largely because of the volatility of their incomes: when rain is plentiful, the season is good and their incomes are high. In bad seasons, they lose their crop and cannot afford to pay their cost. Now when farmers migrate to urban areas, it is far from certain that they will find employment. In essence they are taking a chance that the initial spell of unemployment will be compensated for by income levels that are steady when they finally land a job in public or semi public agencies. So volatility has caused migration, leaving one's land, demographic change, higher urbanization, reduced contribution of farming to employment (and possibly output). Mind you, these are merely the initial or direct effects. Indirect effects include the second stage migration when some of the villagers who migrated to urban areas, Cairo for example, decide to apply their decision internationally, i.e., leave the whole country.

Global Developments[5]

After last week's appreciation, the dollar slumped against the euro amidst speculation that the fed rate increase will be postponed to prevent further credit market losses. Meanwhile, the British pound had a volatile week as investors were conflicted on the path of UK interest rates.[6]

Figure 3



Oil prices remained above $130/bbl this week despite the unexpected 17% increase in fuel costs by China. In the gold market, a wave of selling resulted as the precious metal rose above $900/oz.

Table 1 Selected Commodities

	Week ending 6/15/2008	Week ending 6/22/2008	Change
Oil WTI ($/bbl)	134.87	**134.63**	(0.18%)
Gold ($/oz)	866	**907.50**	4.79%
Natural Gas	12.500	**12.805**	2.44%

Source: WSJ

Markets in the US and Europe ended the week at their lowest levels since March as investors continue to lose faith in the economy. In our region, industrial shares continue to boost ASE. As well, the Saudi recorded gains despite shrinkage in market liquidity. In other news, MSCI Barra announced it was downgrading Jordan from an emerging market to a frontiers equity market as "most constituents of the MSCI Jordan Index did not meet the minimum size and liquidity requirements for emerging markets"[7].

Table 2 Selected Market Indices,

Index	Week ending 6/15/2008	Week ending 6/22/2008	Change
Jordan	4819.9	**5044**	4.65%
KSA	9,688.45	**9,778.48**	0.93%
Morocco	14,399.63	**14,208.61**	(1.33%)
S&P500	1,360.03	**1,317.93**	(3.10%)
NIKKEI	13,973.73	**13,942.08**	(0.23%)
FTSE100	5,802.80	**5,620.80**	(3.14%)

Sources: Bloomberg and Official Markets

DID YOU KNOW?

- After the oil price increase of 1973/74, the US department of energy divided the US federation into five administrative areas, called petroleum administration for defense districts (PADD). The idea was to monitor production, consumption, storage and imports in each and every district and to help provide supplies in case of emergencies. Over time however, many of the 50 states went their own route and enacted legislations regarding clean air and gasoline additives in refineries and storage stations, etc. These state differences made it very difficult to supply gasoline from a (PADD) that has it to a PADD that is running short because state rules rendered gasoline fairly heterogeneous.

- Domestic savings in China hovers around positive 40% of GDP. In Jordan it has been negative, -7.3% in 2005 (CBJ, May 2008). These differences spill over into differences in trade surplus (China) or deficit (Jordan). Economists consider 'savings" as sacrifices of consumption today in order to achieve higher growth and higher consumption in the future.

- The government of Kuwait is tinkering with the prospects of another pay increase to citizens and residents. Problem is such a move might create a wage-price spiral effect and promote built-in inflationary expectations.{OBG, May 20, 2008)

INFORMATION

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[5] Reuters and Bloomberg
[6] FT and Bloomberg
[7] Al Rai, AlRiyadh and FT