Our Economy & the World

Global Market Performance:

(Reuters, Arqam, and news agencies)

Japanese stocks fell on Friday in thin trade as a stronger yen and retreating oil prices sapped investors' risk appetite. The Nikkei share average ended 1.4% lower at 15,967.17, but was still up 6.8% for the week after suffering a sizable 11.1% decline the previous week. The broader Topix declined 1.5% to 1,291.82, with only 2.29 billion shares changing hands, the lowest levelsince late January. With a stronger yen, investors fear a negative impact on the revenue of exporting companies along with declining competitiveness of Japanese products in external markets.

Chinese stocksfellat the end ofFriday'stradingsession, but postedweeklygains, which are the largest intwo months, with Beijing's efforts to increaselendingto supportthe slowing economy. TheChinese marketreceived supportfrom thesubstantial risein yuan-denominated loansin the past month, as well as the decisions ofthe CentralBank of China, whichwillcutrestrictions onrevenueof deposits andlending interest ratesin banks. The "Shanghai" composite indexdeclined by0.1% to2860pointsat closing, but posted a weeklygain of3.5%.

European stocksturnedlowerFriday affected by lower bank, oil and automobile stocks along with investors' profit-taking at the end ofa week that sawa strongperformance. TheEurofirst300indexoftop European shares ended the session lower by 0.7% to1285.07 points. Despite the decline in the index on Friday, it achieved its best weekly performance sinceOctober2015with a gain of 4.3%. The index gained supportthis weekfrom banksandenergy stocksafter a difficultstart of theyear, butthese sectorswitnessed sales forprofit-takingon Friday.

Oilprices fellduringFridaytradingwith the return offocusamong investorson theover-supplyin the global markets, especially after the Saudi foreign minister's remarks - but "NYMEX" posted a weekly gain. Price movementswere not affected bydata on crude oil rigs in the United States, which recordeda declinefor the ninthweekin a row.

At closing, "NYMEX" futures declined by3.7% or by $1.13, and the New York sessionclosed at $29.64a barrel. US crudehas posteda weeklygain of0.7%. Brentfutures(Aprildelivery) alsodeclined at settlement to 3.7%, or by $1.27andtheLondonsessionclosed at $33.01a barrel, but benchmarkcrude posteda weeklylossof 1.1%.

Gold prices also rose during Friday trading amid a broad decline in the dollar against most major currencies as well as falling stock markets, prompting investors to rush for the precious metal as a safe haven. Gold futures (April deliveryat settlement) rose by 0.4 or $4.50 to $1230.80 an ounce, but the yellow metal weekly posted weekly losses of 0.7%, which are the first in a month and the price of gold is still high by 16% since the beginning of the year. Among other precious metals, silver fell by 0.05% to $5.40 an ounce, and platinum 0.1% to $942.30 an ounce, while palladium lost 0.9% to $495.75 an ounce.

Meanwhile, thedollar index-which measuresperformanceagainst a basket ofmajor currencies-by 0.3% to 96.6 points, easing pressure on commodities, including gold.

Our Economy & the World

US stocks stabilized at the end ofFriday tradingamidmonitoring by investorsof the movements inoil pricesand their impacton the performance ofthe energy sector, but the major indexespostedthe biggestweekly gaininalmost threemonths. Dow Jones industrial average declined by21 pointsto16392points, while the NASDAQ index (+16 points) rose to4504points. The benchmark S&P 500 stabilized at1918points.At the weeklylevel, Dow Jones rose by2.6%, and the broader S&P 500roseby 2.8% bothposting theirbiggest weeklygain sinceNovember 20, while NASDAQ posted a weekly gain of3.9%, the largest since July 17,2015.

Key Global Developments

Saudi Arabia, Russia, Qatar and VenezuelaAgree toStabilize OilProductionatthe Level ofLast January

(CNN) -The Saudi Arabian Minister of Petroleum and Mineral Resources, Ali Al-Naimi, signed a tentative agreement between his country, Russia, Qatar and Venezuelato stabilizeoil productionat the level of last January 11, at the end of afour-way meetingofoil ministers, which was held in Dohaon Tuesday.

Globalmarketsare stillawash with oilpumped by OPEC and Russiaat a record rate, and at the same time, demand is falling due toweak globaleconomic growth.

China Pledges Economic Stability with the Approach of the G20 Meeting

(Reuters): Chinese policymakers returned from the Lunar New Year holidays with one collective message for worried investors at home and abroad that Beijing will put an end to the slowdown in the economy and will maintain the stability of its currency and jobs despite restructuring undertaken by troubled industries.

Chao Chin, spokesman of the National Development and Reform Commission, which is the highest authority concerned with economic planning in the country, told reporters in Beijing on Wednesday that the economic fundamentals in China have not changed and that the economy will continue to grow at a rate ranging between medium and high."

He added that the position of China as having the largest foreign reserves in the world has not changed, the large trade surplus has not changed, and the steady progress in internationalizing the yuan has not changed.

Christine Lagarde, Managing Director of the International Monetary Fund for a Second Term

(Reuters): The International Monetary Fund (IMF) said on Friday that its Board of Directors elected Christine Lagarde, Managing Director of the Fund, for a second five-year term effective on July 5. In its statement, the IMF said that Lagarde, who was the only candidate for the post, was elected unanimously.

"Standard & Poor's" Reduces Saudi Arabia’s Credit Rating with a Stable Outlook

(Arqam website): "Standard & Poor's" said it lowered the credit rating of Saudi Arabia’s sovereign debt from "A+" to "A-" with a "stable outlook." This decision reflects the repercussions of the decline in oil prices and the resulting expected rise in the budget deficit.

The agency said that the downgrade is based on its reduced outlook for oil prices to $20 a barrel, compared to previous outlooks. The current outlook is $40 a barrel in 2016, gradually rising to $50 in 2018 and beyond.

European Central Bank (ECB) Expects Increased Risks and Fears the Impact of Falling Oil Prices

(Reuters): The European Central Bank (ECB) said on Thursday that the modest economic recovery of the Euro Zone is moving forward, but risks are on the rise, and there are signs that the decline in energy prices can affect the prices of other goods and services.

According to minutesof the ECB Governors’ January meeting, new economic risks, especially from the emerging markets, continue to overshadow the outlook for the Euro Zone. The slowdown of wage growth suggests that a second wave of the repercussions of lower crude oil prices has already begun.

Although the bank kept the interest rates unchanged in January, it promised to revise and possibly modify its policies on March 10,a statement understood by the market thatan easing of monetary policy would be strongly likely.

Strong Data of the US Industrial Production in January

(Reuters): The US industrial production witness in January its largest increase in 14 months in light of increased manufacturing output and utilities. This is the latest indication that the economy has been recovering early in the year.

Other data issued on Wednesday showed a sudden decline in the number of US houses whose construction has started last month. It likely reason is bad weather, particularly in Northeast and Midwest regions. In light of the figures of building permits, which precede construction, it is likely that the building of houses will accelerate in the coming months.

China’s January Data Show Continued Deflationary Pressures

(Reuters): Consumer price inflation in China accelerated in Januarydue to theincrease infood prices. However, producer pricescontinued todeclinefor the 47th month in a rowwith a decline in primary goods pricesandweak demand, increasingdeflationary pressuresin thesecond largest economyin the world.

National StatisticsOfficeData showedon Thursday an increase of 1.8% in the consumer price index(year on year) last month,slightlysurpassing averagemarket expectations and following an increase of1.6% in December.

Investors Sell US Bonds at $48 Billion approximately in One Month

(Al-Wafd portal): Sales of US Treasury bills registered record levels in December, with exacerbating difficulties in the global economy, which made investors to lose confidence in the world's strongest economy.

This comes in light of economic difficulties faced by most countries, including low national currency exchange rates, slowing economic growth, and declining revenues. Additionally, investors react quickly to changes in US monetary policy and to the decline in US bond rates.

Egypt Buys First Consignment of US Spring Wheat since 2010

(Reuters): US Department of Agriculture data showed on Friday that Egypt bought 30 thousand tons of American hard red spring wheat this week. This is the first purchase of this kind since 2010. The deal comes at a time the wheat purchase program in Egypt, the world's largest wheat importer, troubles the futures markets. Chicago Board of Trade's futures are hovering around their lowest levels in five and a half years, reached last week in light of record global supplies.

Egypt's General Authority for Supply Commodities (GASC) has announced on Friday the purchase of 240,000 tons of French and Russian wheat.

Merrill Lynch: Global Markets Entering a Deflationary period is Unlikely

(Mubasher): The Bank of America Merrill Lynch's Research Unit said on Thursday that the global economy entering a deflationary period is unlikely at present despite the decline in global commodity prices.

It added in a research memo that despite the collapse of global commodity prices and shrinking producer price index in China, global core inflation remains stable. It went on to say that the risks involved in the global economy entering a deflationary period makes that seem unlikely, with steps taken by central banks to increase inflation rates using monetary tools at their disposal.

US Core Inflation Records in January its Highest Level in 4.5 Years

(Reuters): Basic consumer prices in the USincreased in January at the highest pace in nearly 4.5 years, with the increase in rentals and cost of medical care in a sign of growing inflationary pressures that may pave the way for the Federal Reserve Board to raise interest rates gradually this year.

The US Department of Labor said on Friday that its consumer prices index, which excludes food and energy, rose by 0.3% last month. This is the highest increase since August 2011 and followed a rise of 0.2% in December.

The Federal Reserve Board targets a 2%inflation rate.

From the World Press

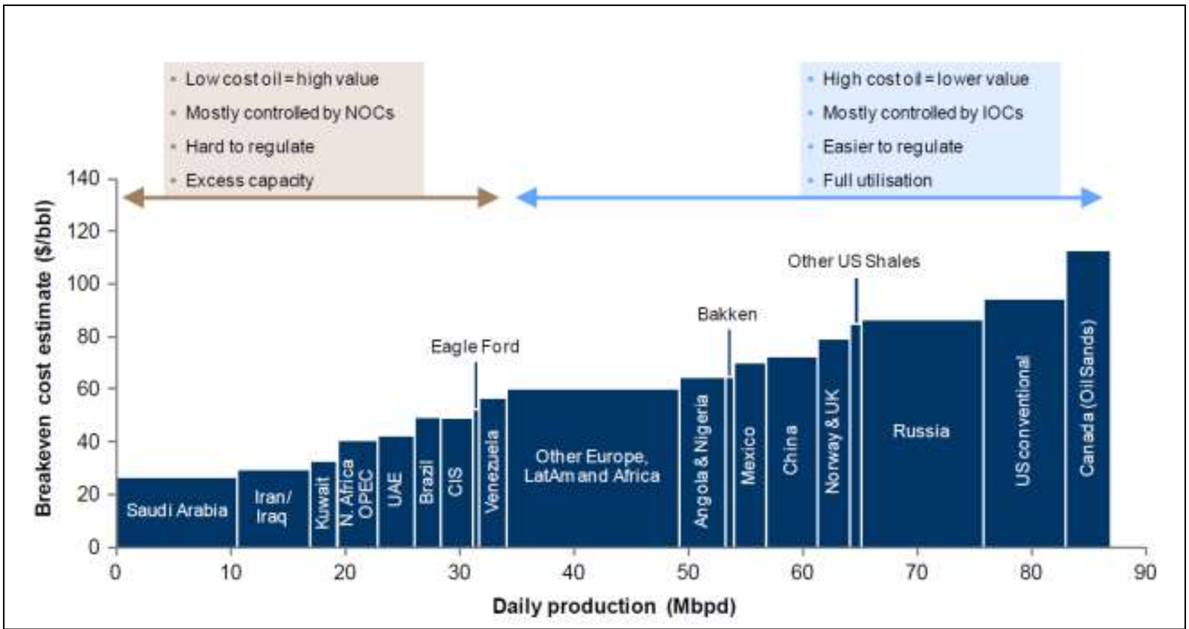
What happens if oil prices drop below $30 a barrel?

http://www.argaam.com/ar/article/articledetail/id/408667

Many believe that low oil prices help boost economic growth, but "Our Finite World" believes that the drop in oil prices below $30 will have several economic repercussions.

Costs:

Most countries cannot afford the costs of oil extraction at $30 a barrel. Only a few countries are capable of that, including Saudi Arabia, Iran and Iraq. Of course, these countries alone cannot supply all the oil needs of the world. The following figure shows oil extraction costs for the largest producers in October 2014.



Costs are not limited to the extraction stage only. There are other obligations such as taxes, which increased the production costs to more than $100 a barrel in some "OPEC" countries. Independent companies have additional burdens such as stock yields and loan interest payments. They need higher crude prices to be able to meet such obligations.

Commitments:

Implementing prospecting projects takes years and companies cannot stop the project just because prices happen to be declining during its implementation. These companies have to meet their debt burden obligations, whether the project is completed or not. Also, costs following the first phase of drilling are relatively low, while the new well provides supply and revenue for several years.

Large exporters will not stop drilling new wells because of their governments' need for oil taxes to fund their programs. They have the advantage of low production costs, and therefore increased production provides them with good proceeds despite of low crude oil prices.

In most cases, oil companies buy "derivative contracts" (financial instruments related to other assets, such as oil, that grant parties thereof the right to these assets at a certain date. They depend on the contract price at the date of contract inception). Thus, companies protect themselves against falling prices, and hence are not worried during the contract period.

Employees are the most important asset of any company, and if the company loses its employees,

replacing them won't be easy. Therefore, oil companies try hard to keep their employees, and need revenue to fund salaries.

Most oil exporters have sovereign wealth funds they can use for spending on government services for several years without citizens sensing a problem even with the sharp decline in crude oil prices.

TheDebt Bubble:

There is growing concern that oil companies are unable to pay their debts, creating a serious debt bubble. During the Great Depression in the US, legislators allowed the extension of commercial real estate debt maturity despite the sharp decline in the value of real estate. This helped mask the problem for some time until it exacerbated to an extent it was no longer possible to hide. Currently, legislators tend to follow the same policy with oil companies.

Temporary Benefit:

Falling oil prices have positive effects in the short term, as they promote industrial activity, creating new jobs. However, a protracted decline in oil prices weakens production in the long run, and hence prices must increase to reflect the actual cost of production.

Raw materials, including crude oil, are highly volatile as a result of being intensively used and being non-renewable. Therefore, stakeholders must maintain a constant balance between supply and demand. Such balance is lost today due to the supply glut.

Oil prices recorded a significant decline in 2008, but resumed their upward trend supported by stimulus measures such as lower interest rates in the US and significantly increased loans in

China, which boosted demand on houses, cars and starting new projects, reflecting positively on the prices of raw materials.

The cease of the quantitative easing program in the US and increasing loan restrictions in China contributed to the decline of oil prices. However, it is difficult to adopt similar measures in the current crisis. The US interest rates are still very low, and governments are already burdened with significant debts that are about to exceed safe limits.

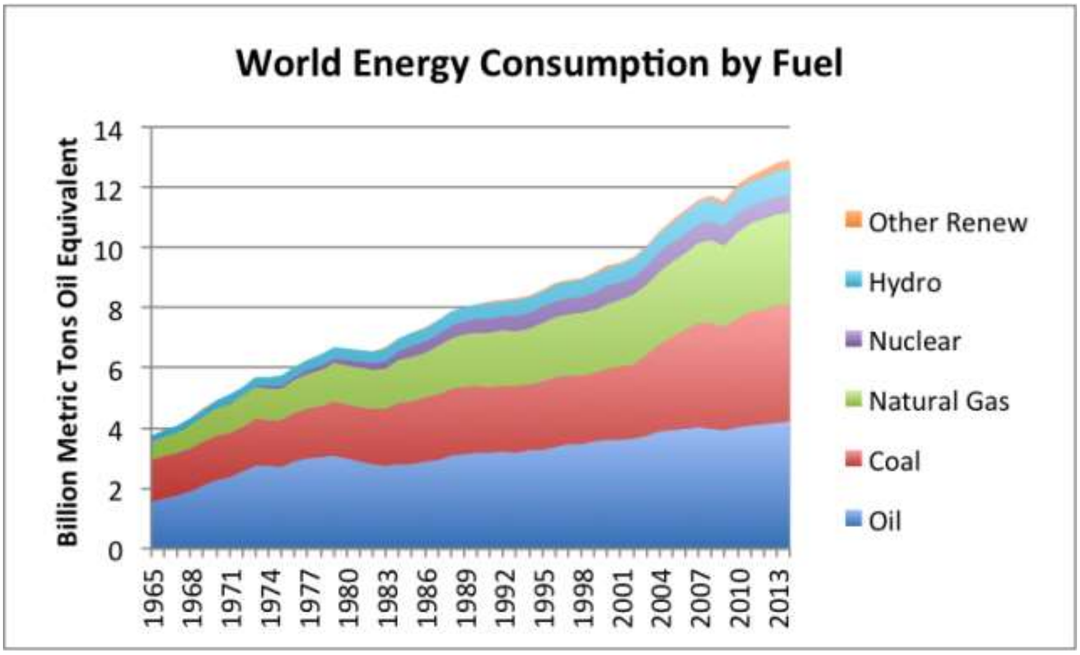
Risks of Falling Prices:

Prolonged price deflation threatens to decrease oil supply and hence failure to meet the world's energy needs. Banks will be averse to lend oil companies in most countries, which will lead to the bankruptcy of some companies and halting production. Even the non-distressed companies

will suffer due to problems faced in securing the needed funding to cover key items such as wages and costs of international shipping.

This problem is not confined to oil. The prices of coal and natural gas are also declining, which threatens to decrease their production. Further, reduced fossil fuel supplies could result in serious economic consequences.

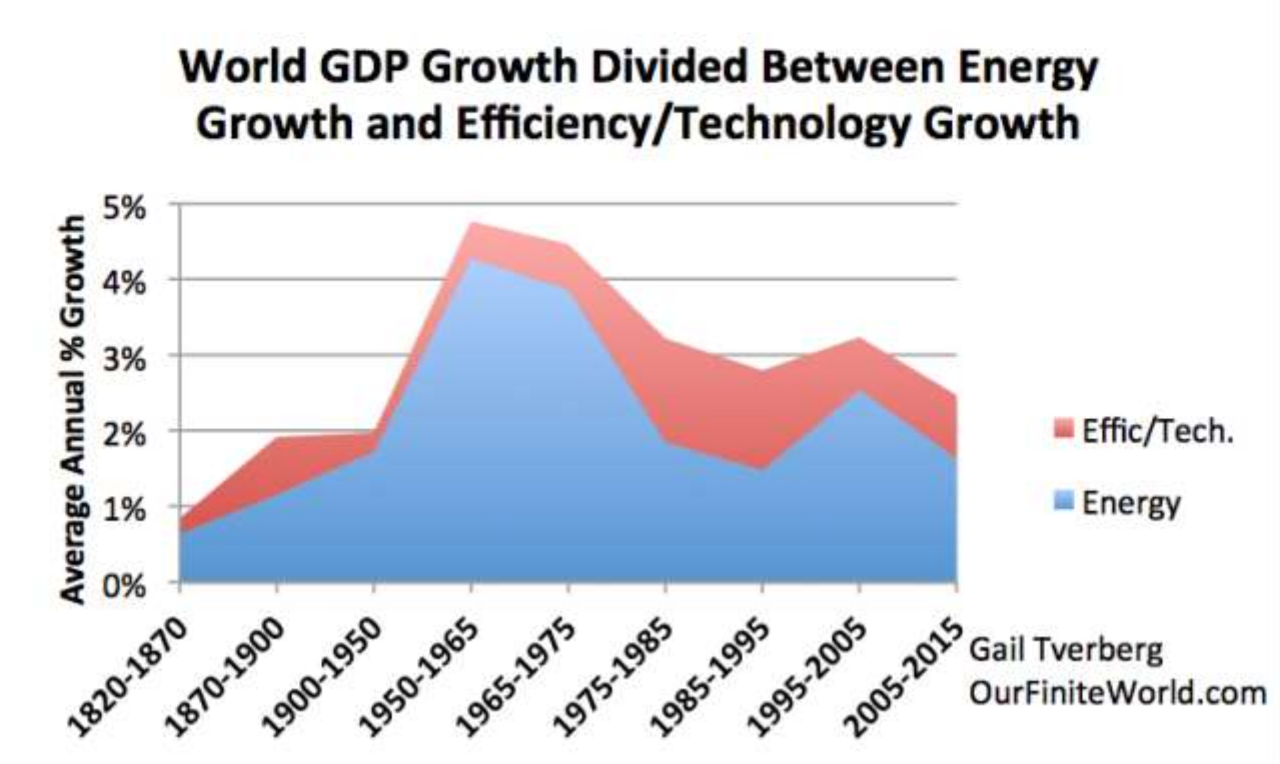
The current media propaganda that economies can achieve progress without traditional energy sources is not valid, as it gives the impression that renewable energy sources are ready and available to meet global demand. At this stage, fossil fuels are indispensable. The following figure shows shares of different energy sources in world energy consumption.



Food is grown and transported using petroleum products. Roads are created and maintained using oil and other energy sources, and most of the advanced technologies are manufactured using petroleum products. Moreover, the share of renewable energy in global economic activity is still minimal.

Oil is still considered the largest and most important source of energy for the global economy,

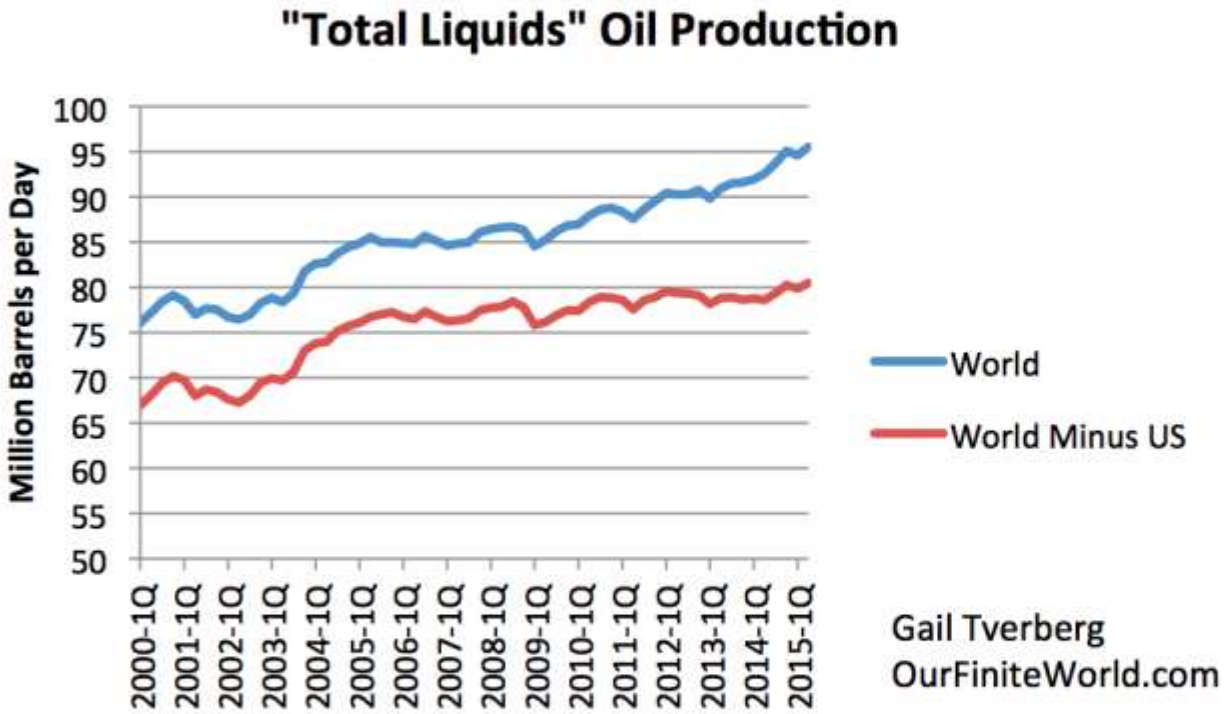
and there has been direct proportionality between the rates of energy consumption and the volume of world GDP since the 19th century to date. The following figure shows the relationship between world GDP growth on one hand and energy and technology growth on the other during the period 1820-2015.



Achieving the Difficult Equation:

Demand for raw materials can be stimulated through several measures, including increasing the wages of unskilled workers, engaging as many people as possible in the labor market and increased lending. But none of these measures moves at the required pace, not to mention the slowdown in China's economic growth and the return of Iranian production, which complicates the situation.

The rapid increase in US oil production since 2008 has contributed mainly to an imbalance between supply and demand. This production jumped by about 6 million barrels a day during 2008-2015. The following figure provides a comparison of world production with and without US production.



In 2014,the USincreased its oil production by double therate ofgrowth in demand, which led to acollapse in prices. Experts estimate the increase in USproduction in2015at 700,000barrels per day,exceeding theincrease inSaudiorIraqi production.

The UnitedStatesplayed amajor role incausing the supply and demand imbalance,so Saudi Arabia cannot be blamed alone for not respondingto those calling for lowering production.

Special Analysis

Global Monetary Policy: Japan Turns to Negative Interest

A report of the National Bank of Kuwait "NBK" research center said that the Bank of Japan adopted a negative interest-rate strategy in the face of a weakening economy and a global slowdown. The move to penalize banks' reserves will be added to the BOJ's asset-purchase program already in place. BOJ Governor Haruhiko Kuroda introduced a negative rate of 0.1% on certain excess holdings of cash.

The Bank of Japan has adopted the same strategy as the ECB in an attempt to tackle inflation and the yen reacted instantaneously tumbling after the announcement. The negative interest rate policy takes effect on February 16 and will operate similar to programs in Europe.

According to the New York Times, the bank's decision aimed to overcome stagnant prices in the country due to falling energy costs, and the weak global economy due to slow growth in China, and falling international trade.

A negative interest rate means the central bank charges commercial banks interest on deposits with the CB, or commercial banks charging depositors interest on their deposits with the bank as opposed to positive interest (in normal times), which the bank pays on deposits in its vaults.
Mohamed El-Erian, chief economic adviser to Allianz Group, said the move by the Bank of Japan was shocking, and highlights the country aspirations to weaken the yen to raise the rate of inflation, noting that “countries seek to achieve internal objectives regardless of international repercussions.”

"You see this most clearly on the currency front, where with the exception of the United States, the vast majority of countries hopes to weaken their currencies. I would put the Bank of Japan action in that category." El-Erian said "countries are fighting for a small amount of global growth as opposed to pursuing policies that create the incremental growth that the system is capable of. That’s the big tragedy – the system is capable of growing much faster but it’s being held back."
Negative interest is used to encourage banks to lend, inject more liquidity in new projects and increase investment and stimulate the economy and fight deflation, which drives consumers and companies to postpone their purchases and investments pending the possibility of lower prices in the future. This results in negative spiral of slowdown in economic activity, declining wages and a new price decline, which negatively impacts the economy as a whole.

Also, it is usually resorted to in cases of a weak economy or a decline in economic growth rates in the major economies, the decline in new investments, and availability of large untapped liquidity. On the other hand, this policy increases the proportion of high-risk investments.

Commentary

The world is experiencing inconsistent global monetary policy, as a shift in capital and investment flows has taken place and the USmanaged to grab a significant share of capital. However, it is not too late to overcome signs of meltdown. Oil-producing countries have manyeffective qualitative and quantitative instruments in the global oil markets. These instruments can be used to save money and investment markets, without negatively affecting consumption economies or targeted global economic growth. Global economic growth rates will be feasible at fair oil prices that exceed the production cost and minimum budget pricing.This means that the decision to stop global economic collapse and losses resides with oil-producing countries, which have to reconsider current production levels and their feasibility.

Coordinating economic policies is also essential to achieve economic stability that is manifested in continuing to achieve economicgrowth rates capable of facing the continuous increase in

Population ;to create adequate jobs to absorb unemployment, which threatens social peace and economic security;and to stabilize the general level of prices.

But reality is different. The Arab region has many promising growth opportunities. Thinking there is a lack of investment resources is nothing but a common mistake. What we actually lack is a daring spirit, risk-taking and the ability to utilize the tools and expertise used by the private sector in implementation of new projects that meet the actual needs of the region. Governmentsalone are no longer able to provide economic growth requirements or meet their financial needs. Persistence of the current situation signals a credit crisis, hence the need for developing financial products and comprehensivelyupgradingthe financial market system. Also, there is a need to study and assess investment scene developments along with allowing for large infrastructure investments and smaller investment projects.

The recent crisis in metal and oil markets raises concern about expected investment flows from oil states to Egypt, especially that the current situation portendshigherbudget deficitfor the Gulf statesand pressesin the direction ofthose countriestakingdeflationaryandprotectionistmeasuresthat may affect thevolume ofremittances fromEgyptian workers,in addition to increasingpressureson revenue growth prospects of the SuezCanal as a result ofslow world trade.

We believe that the decisions regarding changingexchange ratepoliciesgloballyandthe notableshifts inmonetary policiesrepresentfurther pressureon currencyprices inemerging markets, which requires enhancing the flexibility of Egyptian monetary policies along with setting an inflation target as a key factor in a shift in monetary policy.