Issue : 11

Date : 8 May 2016

ECES
The Egyptian Center for Economic Studies

Our Economy & the World

This week's issue of "Our Economy and the World" includes:

Key Global Developments

Sharp Slowdown in US Economy in Q1

Reuters:

The US economy slowed down sharply in the first quarter of the year, recording its lowest growth rate in two years with the decline of the rate of increase in consumer spending and rising dollar, affecting exports. However, activity is expected to accelerate in light of the strong labor market.

The US Labor Department said that the GDP increased at an annual rate of 0.5 percent, the weakest since the first quarter of 2014 with companies accelerating the disposal of unwanted goods accumulated in warehouses.

The economy has also been affected by declining oil prices, negatively impacting the profits of oil field services firms such as Schlumberger and Halliburton, causing the fastest contraction in corporate spending since the second quarter of 2009, when the recession was nearing its end.

Fitch: Emerging Markets' Debts Reach New Record Levels

El Borsa website:

The Financial Times said that the debt burden in the private sector in emerging markets reached new record levels in 2015, according to new data, which confirmed the worsening of problems facing corporations in developing countries.

According to a report issued by Fitch credit rating agency, total private debt in major emerging market countries rose to about 78 percent of GDP in 2015, up from 71 percent at end of 2014.

Ed Parker, author of the report, said that the rapid rise in private debt in emerging market countries, particularly those denominated in foreign currency, increased the downside risks to their economies and their financial systems as well as their sovereign credit worthiness at a time of rising global instability.

Emerging Markets Receive Capital Inflows of $25.5 Billion in April

Reuters:

Emerging markets have received $25.5 billion in portfolio investments this month, with bonds accounting for the lion's share of the money, although flows were below the 21-month high hit in March, said the Institute of International Finance (IIF) on Thursday.

The IIF, which tracks investment flows to and from emerging markets, said that the emerging bond markets received $20.5 billion in April, while equities took the rest.

Inflows were $37.1 billion in March, the first positive month after eight months of losses.

According to the IIF, Latin America attracted $11.2 billion, citing growing interest in Brazil where the possible impeachment of left-wing President Dilma Rousseff could make way for a new government.

Washington Watching the Currencies of Five Major Countries to ensure "Fair Competition"

Washington- Agence France Press:

The US Treasury Department confirmed in a report that the US would conduct economic monitoring of five countries, including Germany and China, to make sure that their trade or monetary policies are not granting them "unfair competitive advantages."

The semi-annual report on currency exchange said that the Treasury Department would closely monitor and assess the direction of these countries and their policies in the exchange markets, revealing the "watch list" developed under a law passed in 2015.

The Department identified the five countries, which also include Japan, Taiwan and South Korea, based on large trade surplus with the US, the surplus in the current account, or large and unilateral interventions in the exchange market.

The report pointed out that after long measures if none of these countries achieved these three criteria and did not change its policy, the US administration can impose sanctions ranging from a ban on participation in public US markets to exclusion from trade agreements with the US.

Poll Results: Analysts Raise their Expectations for Oil Prices in 2016

Reuters:

Oil analysts are increasingly confident that the oil prices decline wave of the past two years has ended, raising their average price forecasts for the second month in a row, and expecting market rebalance by 2017, backed by improved demand and low US shale oil production, a Reuters poll showed.

It is unlikely that the pace of supply and demand rebalance in the global market would slow down due to the failure of producers in and outside OPEC to agree on freezing oil production during a meeting held earlier this month.

The poll, which included 29 analysts, showed slightly more optimistic expectations, as analysts raised their projections for average prices of benchmark Brent crude futures in 2016 to $42.30 per barrel compared with $40.90 a barrel in the March poll.

The last month poll saw an upward revision in expectations for the Brent price in 2016 for the first time in ten months.

The average Brent price reached $40 a barrel since the beginning of the year.

IMF: An Obvious Decline in Japanese and Chinese Economies in 2016

Hong Kong – Agence France Press

The International Monetary Fund (IMF) announced that the Japanese and Chinese economies would witness an evident slowdown in the next two years, but growth in Asia would continue to be solid thanks to domestic consumption, which will offset weak global trade.

The Fund expected that government support measures, the decline in prices of raw materials and weak unemployment rates would contribute to regional growth, calling on the authorities to continue their reforms.

According to the Fund, however, the challenges from other regions would be present for growth prospects in the Asia-Pacific region, noting economic recession in developed countries, weak volume of world trade, and volatile capital markets.

The Fund predicted that Asia would grow at 5.3 percent in 2016 and 2017 compared to previous projections of 5.4 percent.

Slow Corporate Growth in the Eurozone Beginning of Q2

Reuters:

Published survey results showed that corporate growth in the Eurozone slowed down slightly last month but remained intact, suggesting that the massive stimulus program adopted by the European Central Bank supports the activity, but did not enhance consumer prices so far.

The final reading of the Purchasing Managers' Index in the Eurozone - which is a good indicator of growth - reached 53.0 in April, in line with the preliminary reading and slightly below the level of March, which stood at 53.1.

The index remains above the fifty-level that separates growth from contraction since mid-2013.

The Eurozone economy grew at 0.6 percent on a quarterly basis in the period from January to March, according to preliminary data that exceeded expectations. However, the inflation rate came down again from zero in the last month.

European Commission: The End of Schengen Would Cost 5 to 18 Billion Euros

Kuwaiti Al- Qabas Newspaper:

Reintroducing permanent border controls within the European Union, abolishing its passport-free Schengen area, could cause economic damage of between 5 and 18 billion euros (5.75 to 20.7 billion dollars), the European Commission said Tuesday.

The estimate was included in the EU executive arm's latest growth forecast, which signaled that the bloc's economic outlook was darkening. A report of nearly 200 pages included a reference to the Schengen issue.

The cost of "a permanent and more systematic reintroduction of border checks would be significant for EU cross-border workers and travelers, road freight transport and public administration and would range from less than 5 to 18 billion euros per year," it said.

The EU Commission noted that extra border checks would result in delays in freight delivery times, longer journey times across the EU, and require public sector manpower to be enforced, and could also cause longer-term damage by discouraging trade and tourism.

According to some studies, the return of internal borders would have the same effect as raising import prices by 1 to 3 percent, which would cause economic losses of 20 to 55 billion euros, the commission said.

As Asia's Rice Crop Shrivels, Food Security Fears Resurface

Reuters:

Nearly a decade after a spike in global food prices sent shock waves around the world, Asia's top rice producers are suffering from a blistering drought that threatens to cut output and boost prices of a staple for half the world's population.

World rice production is expected to decline for the first time this year since 2010, as failing rains linked to an El Nino weather pattern cut crop yields in Asia's rice bowl.

A heat wave is sweeping top rice exporter India, while the No. 2 supplier Thailand is facing a second year of drought. Swathes of farmland in Vietnam, the third-biggest supplier, are also parched as irrigation fed by the Mekong River runs dry.

The three account for more than 60 percent of the global rice trade of about 43 million tons.

"As of now we haven't seen a large price reaction to hot and dry weather, because we have had such significant surplus stocks in India and Thailand. But that can't last forever," said James Fell, an economist at the International Grains Council (IGC).

Rice inventories in the three top exporters are set to fall by about a third at the end of 2016 to 19 million tons, the biggest year-on-year drop since 2003, according to Reuters calculations based on U.S. Department of Agriculture data.

Negative Data in Britain Because of Fears of Exit from the EU

Asharq al-Awsat:

The approach of the British referendum on potential exit from the EU adds more concerns on the ability of economic activity to overcome the repercussions of “isolation” from Europe. Expert forecasts continue to confirm the likelihood of a slowdown in the movement of basic industries, coupled with weak production, especially after growth in Britain in the first quarter of this year.

The British construction sector slowed to its lowest level, amid concerns about weak British recovery during the current and the next years. Contracted manufacturing activity also decreased in April for the first time in three years, adding more anticipation and uncertainty about the state of the British economy after the June 23rd referendum.

A survey by Markit showed that factory purchasing managers' index fell to 49.2 points in April from 50.7 points in March, below the main level of 50 points, which separates growth from contraction, contrary to previous expectations of an increase to 51.2 points.

The Markit report showed that the construction company purchasing managers' index fell to 52 points in April, from 54.2 points in March, which is the worst rate since June 2013.

The new downturn for British manufacturing and construction sectors adds burden to the service sector to revive the British economy, feeding pessimism over the coming period.

Implications for Egypt

Egypt must realize that the emergence of an economic war now is no surprise, but raises old economic fears that the use of monetary instruments will be an alternative to addressing the economic crises resulting from excessive consumption of natural resources, ongoing decades-old trade wars and the change in economic models. Such models now require a drastic review not only in the short term, but also through radical shifts in underlying fundamentals. Everybody needs to know now that changing monetary policy as a reliever may represent a catalyst for growth in the short term, but will not address countries' economic problems, especially that monetary policies alone have not succeeded in addressing economic problems.

We have an opportunity now to attract investments that have flowed out of global and regional markets; especially that Egypt now avails real locomotives of growth and development, such as major national projects. However, this requires not only speeding up the amending of laws or introducing new regulations, but also putting an end to administrative and other regulatory problems afflicting the Egyptian economy and hindering investment.

Economic reform is the most important pillar for confidence building. It is the ideal route for achieving real stability and dissemination of its benefits. This is what we all aspire to as a nation. Reform, in its universal concept, is the optimal path to putting together as a roadmap with ambitious visions and goals in a way that ensures sustainable development.

Special Analysis

Depressed Oil Prices and Intensifying Conflicts Increase Middle East Economic Burdens

Middle East News Agency (MENA):

The International Monetary Fund (IMF) warned that continued depressed oil prices and intensifying conflicts in the Middle East and North Africa represent a burden on the region's economic activity.

The IMF projected in its Regional Economic Outlook Update report that growth rate in oil-exporting countries will rise from 2 percent in 2015 to 3 percent this year due to rising oil production in Iraq and the lifting of sanctions on Iran. However, it projected that the slowdown in economic activity in the Gulf Cooperation Council (GCC) will increase, while growth rate in oil-importing countries will remain at 3.75 percent in 2016-2017.

The IMF attributed the above to economic pressures resulting from hosting refugees and slow activity in the GCC countries in addition to continued security and social tensions. But the IMF pointed out that energy subsidy reforms helped to stabilize public debt and maintain macroeconomic stability. Improving targeted social safety nets also helped to protect low-income groups.

The IMF called for further progress in fiscal consolidation to stabilize public debt, which amounted in some countries in the region to between 90 percent and 150 percent of GDP, noting that the increase in exchange rate flexibility could reduce vulnerabilities and increase competitiveness.

The report stated that the conflict in Syria alone resulted in the killing of at least 250 thousand people and displacing millions, and that the huge costs of the conflicts in Iraq, Libya, Syria and Yemen are still rising.

The IMF pointed out that violence led to the scarcity of food and other necessities, the damaging of infrastructure and institutions, and high rates of inflation. It also led to weak levels of savings, and deterioration of public finances and external positions.

The report noted that the ongoing Syrian crisis has resulted in a GDP that is less than half what it was before the war, while it is estimated that per capita GDP in Yemen shrunk by more than 40 percent since 2010.

Conflicts have also weakened countries' economic prospects by reducing their resources and diverting them away from the necessary social and capital spending.

The report pointed out that hosting a large number of refugees added tremendous pressures on government budgets, infrastructure and public services. The deterioration of the security situation and lack of confidence led to a negative impact on trade, investment and tourism, weakening growth. Continued conflicts reduce the willingness of countries in the region to carry out the necessary economic reforms.

The IMF called in its report on the international community to expand and better coordinate subsidies with the escalation of the cost of conflicts in the Middle East, noting that development assistance should include long-term support to rebuild infrastructure in affected countries and promote resilience in the various economies in the region.

Implications for Egypt:

We expect the fragile recovery of the global economy and international trade in addition to conflicting oil price projections to reflect on Egypt's macroeconomic performance in 2016. It is also expected in the current year that the impact of fiscal adjustment policies will appear through spending cuts in a number of budget items to achieve some balance between economic growth and fiscal discipline. Internal developments in countries in the region will also affect growth opportunities in 2016. Therefore, proceeding with the implementation of economic reforms represents a basis for driving growth, especially with regards to reforms aimed at increasing production capacity and enhancing competitiveness.

We also expect continued high rates of inflation, attributed mainly to increased prices due to continued review and evaluation of government subsidy, as well as the increase in demand-pull inflation in 2016. In addition, the exchange rate continues to be under pressure due to lack of foreign currency despite increased exchange rate flexibility. This will help increase pass-through effects.

In light of the above, the Egyptian government has to focus on the implementation of large-scale packages of fiscal reform aimed at rationalizing public spending and boosting revenues. The aim is to consolidate the public budgets and ensure their sustainability, especially in light of the current challenges facing fiscal policy. Tax reforms should be a top priority for fiscal policymakers to boost tax revenues and ensure the equity and efficiency of the tax system through a review of the income and corporate profit tax systems as well as the adoption of value-added taxation. The tax system should also support small and medium enterprises and promising regions. Moreover, attention should be paid to controlling public spending items through rationalization of current expenditure such as limiting wage costs, moving forward in the reform of the commodity subsidy system, and raising the efficiency of investment spending. Attention should also be paid to enhancing the transparency and efficiency of public budget management and reducing deficits. These reforms should also be coupled with efforts to raise the efficiency of public debt management and increasing the average maturity of issues, and financing thereof from sources that ensure fiscal sustainability.

From the International Press

Announcement of New European Anti-Tax Evasion Measures

Asharq Al-Awsat:

The EU's 28 finance ministers meeting in Amsterdam announced their determination to intensify the fight against tax evasion in response to the scandal of "Panama Papers." The ministers expressed their unanimous support for the recent European initiatives, including the creation of a common blacklist of tax havens.

After this global scandal, which has been unfolding for three weeks, the Dutch Minister of Finance, Jeroen Dijsselbloem, whose country holds the rotating EU Presidency, said that the sense of emergency was clearly growing, and that everyone was very busy filling the gaps.

"We have been very busy fighting each other on our tax systems so that our countries are as attractive as possible for investors. Now we got to the point that large companies tend not to pay taxes," he added.

During the open meeting in Amsterdam, all ministers endorsed the initiative launched ten days ago by five European countries (Germany, Spain, France, Italy and Great Britain) regarding the automatic exchange of information, within the EU, in order to identify beneficiary shell companies.

The French Minister of Finance, Michel Sapin, said that there is a common and declared will to fight unknown mechanisms, which do not allow knowing who is behind these companies. At present, there are financial arrangements that allow the establishment of legal structures (limited liability sole proprietorships or corporations), hiding the identity of the real beneficiary, confusing data, and complicating to a large extent the task of tax authorities. The 28 finance ministers also agreed to create a black list of tax havens that is common to all EU countries, at the request of the European Commissioner for Economic Affairs, Pierre Moscovici, who wants to achieve this goal by the end of the summer.

The negotiations will be difficult, since many member countries have different policies regarding tax havens. Initially, the issue is to develop a standard method for detection of the havens that should be on the list. Relevant proposals will be presented to the 28 ministers at the next meeting in May.

As for the call on multinational companies to show greater transparency, the EU's Dutch presidency stressed that starting next week talks between member states would begin regarding Brussels' proposal of availing basic information, both financial and tax-related, about large companies to the public.

In Strasbourg, the European Commission launched middle of this month new measures to combat the multinational companies' lack of tax transparency, amid the "Panama papers" storm, which intensified pressure on all major countries to combat tax evasion. The plan developed by Pierre Moscovici, European Commissioner for Economic and Financial Affairs, Taxation and Customs; and Jonathan Hill, the British commissioner in charge of financial stability, will be presented to the European Parliament after public consultation and evaualtion. The plan was anticipated for a long time, and comes in the wake of the shock that hit the entire world after the International Consortium of Investigative Journalists revealed a large-scale tax evasion system.

According to the Commission's new memorandum, individual EU countries should disclose accounting and taxation data of multinational companies, including the size of their revenues and profits, as well as the tax base and value of paid taxes in various member states.

Once a company has a branch in the EU and revenues of no less than €750 million, it would be required to publish these items regardless of its nationality, European or otherwise.

As for companies that do not have branches in the EU, the Commission will require the same information, though regarding their overall activities worldwide, along with requesting more details about their activities in the countries listed as tax havens.

So far, major companies, whose total revenues exceed €750 million, are solely required to disclose basic data, thus opening a loophole for tax evasion. Another loophole that keeps company activities outside the EU secret is confining the requirement for countries to disclose data to the EU bloc.

According to One, a European NGO, without this information, it would be impossible to know more about the activities of multinational companies in a large number of tax havens or reveal indicators of possible forms of tax evasion.

The British Ministry of Finance said that several other countries joined a program launched by major European countries to stop tax evasion and corruption. Some 19 additional authorities agreed to exchange information automatically regarding who the real owners of companies are, after Britain, Germany, France, Italy and Spain announced the plan last week. Among the new countries that signed the program are the Netherlands, Sweden and Belgium.

The Panama leaks earlier this month, from a Panamanian law firm, regarding foreign tax arrangements increased pressure on countries to improve taxation transparency. The leaks had repercussions in many countries, including Britain, where the financial affairs of Prime Minister David Cameron's family underwent auditing.

British Finance Minister, George Osborne, said in a statement that it must be clear to all countries and tax authorities that the world was moving decisively in the direction of increasing taxation transparency. The UK will continue to pursue the creation of an internationally agreed-upon list of those who refuse to do the right thing, he added.

Transparency International said that this announcement proves that countries realized the importance of exchanging information regarding company owners, but there is a need to do more.

Implications for Egypt:

The issue of international tax evasion is one of the issues that Egypt needs to pay attention to urgently in light of its escalation at the international level. Tracking such companies at the international level is very difficult, and requires lawyers with broad experience. Sometimes, a series of companies are affiliated. To prove corruption requires strenuous efforts, and a political will that some countries may lack.

The surprise in the leaks is not the nature, size or quality of shareholders only, particularly that some of the involved names disclose their shares in these companies in their tax reports or financial disclosures, and thus they are not violating the international law. However, the situation turned to hiding information for manipulation or tax evasion purposes, which is the real violation that actually requires tracking and studying, and needs international cooperation to face up to such practices, being harmful to the economy.

The Ministry of Finance has previously issued a statement making it clear that Egypt has tax legislations that allow tracking international tax evasions and tax avoidances. Also, Egypt has entered into several agreements to avoid double taxation that allow exchange of information with various countries to combat tax avoidance and evasion. Egypt is also a signatory to multilateral agreements to achieve this goal. All these mechanisms will enable the tax administration in Egypt to obtain information related to international tax evasions and face up to such operations.

The Income Tax Law No. 91/2005 addresses these situations by activating the neutral price principle, which governs transactions between related parties in a way that ensures that the real price is set to prevent tax fraud. There are also articles related to rules of combating tax avoidance, whether public or private.

Global Financial Market Performance

Reuters & Argaam:

Chinese stocks fell significantly by the end of Friday trading session due to falling prices of basic commodities and negative signals about the country's economy.

Investors in the Chinese stock market tended to record a strong sell-off due to losses in the commodity markets during the past sessions amid fears that more companies are moving towards selling their shares to obtain sufficient funds to pay their debts**.**

Several Chinese companies, especially in the mining sector, are in default, raising concerns about a possible credit crisis in the country.

The "Shanghai" composite index fell 2.8 percent to 2913 points at closing, falling by about 0.9 percent during last week.

The Japanese stocks also fell by the end of Friday session, registering weekly losses; due to the rise of the yen, amid anticipation of the US jobs data.

The Japanese "Nikki" index fell by 0.2 percent to 16,106 points, falling by about 3.3 percent during the current week's trading, while the "TOPIX" index fell by 0.1 percent to 1298 points.

Meanwhile, the US stocks rose during Friday trading in conjunction with the rise in oil prices after absorbing the negative effects of the Employment Situation Summary, which showed disappointing data. Major indices recorded losses for the second week in a row.

The Dow Jones' industrial average increased by 80 points to 17740.6 points, and the "NASDAQ" index rose (+19 points) to 4736.1 points. Also, the S&P 500 benchmark index increased by (+6.5 points) to 2057.1 points.

In the European markets, the "Stoxx Europe 600" index fell by 0.3 percent or by 1.1 points to 331.6 points, scoring 2.9 percent in weekly losses—the largest since February 12**.**

The "FTSE 100" British index rose (+8.4 points) to 6125.7 points, and the German "DAX" index rose (+18 points) to 9869.9 points, while the French "CAC" index dropped (-18.2 points) to 4301.2 points.

On the other hand, gold futures for June delivery rose at settlement by 1.7 percent or by $21.70 to $1294 an ounce. The precious metal achieved a weekly gain of 0.3 percent.

In the oil markets, the US "NYMEX" rose by 0.8 percent, or by 34 cents to close at $44.66 a barrel, and recorded a weekly loss of 2.7 percent. The "Brent" benchmark rose by 0.8 percent or by 36 cents to close at $45.37 a barrel, and recorded 2.7 percent in losses this week.

The US Department of Labor announced that the world's largest economy added 160 thousand jobs in April, the lowest in seven months, compared to expectations of adding 208 thousand jobs. The unemployment rate settled unchanged at 5 percent compared to expectations of falling to 4.9 percent.

Implications for Egypt:

The performance of global financial markets continues to be affected by stimulus programs and movements in oil prices related mainly to attempts to curb oil supply, which reflects on the Middle Eastern markets and the Arab region, including Egypt, amid moderate liquidity. This suggests that Egypt, the region and the world are anticipating strong local or international developments that would be the main driver of change in financial market performance.

Estimates suggest shifts in the trading of institutions in the global markets with expansion of investment in risky assets at the expense of bonds and fixed-income assets, which could contribute to improving performance of the global financial markets at the present time. Also, global capital markets have been monitoring recent developments in the US economy, which maintains an upward pace and is perhaps one of the few economies in the world about which the IMF’s revised figures were relatively optimistic.

We believe that the Egyptian market is also witnessing a state of cautious anticipation in transactions, which has reflected on the values and volumes of trading during the past period, and returned transactions to their selective levels that were dominant during the second half of 2015. However, performance will likely witness increased activity in the medium and long runs in light of transformations highlighted by recent global and domestic indicators.