Issue : 14

Date : 29 May 2016

# Our Economy & the World

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

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# Key Global Developments

## Accelerated German Economic Growth, Supported by Increased Investment and Consumption

**Argaam**

The German economy grew at its fastest rate in two years during the first quarter of this year, with the rise in investments in the construction sector supported by moderate climate in the country.

According to the Federal Statistics Office in Germany, GDP rose by 0.7 percent during the first three months of this year, which is consistent with previous estimates published on May 13.

Data showed that construction activities in Germany grew by about 2.3 percent during the first quarter of 2016, with the rise of capital investment by about 1.8 percent, in addition to private consumption growth of 0.4 percent.

The German economy has benefited from rising consumer demand supported by low unemployment, in addition to corporate gains from the quantitative easing program, launched by the European Central Bank.

## Japan's Net External Assets Fall for First Time in Five Years, Still Top Creditor

**Reuters**

Japan’s net external assets fell for the first time in five years to 339.26 trillion yen ($3.10 trillion) at end-2015 as the rising yen bit into the value of overseas holdings, the finance ministry said.

The net value of assets held by the Japanese government, businesses and individuals fell short of 2014's record 366.86 trillion yen but Japan remained the biggest creditor nation for 25 years in a row.

Japan's net external assets were 1.7 times those held by Germany, which took over China as the world's number 2 creditor nation, the ministry said.

Japan's gross external assets rose just 0.7 percent to 948.73 trillion yen, slowing sharply from the 18.5 percent jump in 2014, as the yen's rise against the euro reduced the appraised value of external assets by 17.4 trillion yen, the ministry said.

External debt grew 5.3 percent to 609.47 trillion yen due to increased acquisitions of Japanese equities and other assets by foreign investors.

## Report: Exchange Rate Flexibility and Job Creation are Major Challenges Facing the Gulf

**Mubasher**

The Institute of Chartered Accountants said in a report that the Gulf States need to proceed with the adoption of a "basket of currencies" that includes the US dollar, euro, Japanese yen and Chinese renminbi. This will allow each country to have a more flexible exchange rate system.

In a statement, it added that the Gulf States need to change their economic policies with a larger participation from the private sector to maintain the growth prospects in the long term.

The institute noted that the main challenge for the Gulf States is to create some 130 million new jobs, and failure in that will exacerbate the risks associated with extremism and poverty.

It is essential for countries in the region to invest in infrastructure projects, as it would provide a large number of jobs, according to the statement.

## More than $90000 in Debt per US Household

**Argaam**

The average American family's share of debts amounted to more than $90,000, inclusive of families living without debts, while the average of families living with debts is more than $130,000.

These debts burden the family by more than $6,600 in interest per year, equal to about 09 percent of the average income.

The previous figures refer to entire families, not individuals, while the average student debt per household amounted to $48,172, and the average debt per individual is about $29,000, minding that a lot of households have two or more of debtor students.

## Eurozone, the IMF and Greece Reach a Debt Agreement

**Reuters**

The Eurozone gave Greece its firmest offer yet of debt relief in what finance ministers called a breakthrough deal that won a provisional commitment from the IMF to return to taking part in the bailout for Athens.

After talks, Euro group finance ministers gave a nod to releasing 10.3 billion euros ($11.5 billion) in new funds for Greece in recognition of painful fiscal reforms pushed through by Prime Minister Alexis Tsipras's leftist-led coalition, subject to some final technical tweaks.

But a bigger step forward was a deal under which the euro zone agreed to offer Athens debt relief in 2018 if that is necessary to meet agreed criteria on its payments burden. That was enough to win the IMF's approval to rejoin the Euro group in financing the Greek bailout.

## "OPEC" Next Meeting Will not Lead to a Decision

**«Bloomberg» (Al-Arabiya net)**

A Bloomberg poll showed that the vast majority of analysts rule out reaching an agreement to cut or freeze production in the OPEC meeting to be held on the second of June.

Analysts pointed out a lack of motivation among OPEC members to call for production cuts now, after «OPEC» strategy began to drive small producers out of competition, and also after prices rebounded by about 8 percent from the bottom reached in January.

Finally, both the International Energy Agency and Goldman Sachs said that the oil supply glut began to recede.

## Federal Reserve Member: Economic Data will Determine the Possibility of Increasing Interest Rate in June

**Argaam**

Patrick Harker, President of the Federal Reserve Bank of Philadelphia said the central bank should raise interest rates at its meeting in mid-June, unless the economic data showed a decline in the performance of the economy.

Harker said to reporters that if the economic data in the next period came less optimistic than expectations, interest rates should not be risen next month.

The Federal Reserve member said that the economic data would determine whether to raise interest rates over the next month or not.

Harker explained that the economic data in question include employment and inflation reports, which are expected to be issued before the meeting scheduled on 14 and 15 June.

## Japan's Aso Says There's no Intention to Devalue Yen

**Reuters**

Japanese Finance Minister Taro Aso told parliament that the dollar/yen movement by 5 yens in two days is a move in one direction.

The Nikkei business reported that Aso told parliament that it would be good if dollar/yen settled around 109 yen.

## Britain will Lose Half a Million Jobs by Exiting Europe

**Asharq al-Awsat**

The British Treasury warned that a deflation could hit the UK if it exits the EU. It also warned of a potential loss of more than half a million jobs, in a new announcement that reinforces the position of Prime Minister David Cameron, and angers Brexit advocates.

After warning a month ago of a “violent economic shock” to be caused by Brexit in the long-term, the Treasury published worrying data on the impact of Brexit in the short term, a month ahead of the referendum on Britain's membership in the EU on 23 June.

The report revealed that “the British economy will shrink for a year,” noting that the UK will suddenly appear as “less open to trade and investment,” and will suffer the impact of uncertainty in corporate activity as well as strong fluctuations in the financial markets.

Ministry experts said that the GDP of the country will be in two years 3.6 percent less than its value if the vote is in favor of staying in the EU, and even six percent less in the most pessimistic scenario.

# Implications for Egypt:

In light of the new terms of the Greek loan agreement, and the US data-supported move towards raising the interest rates, it is necessary for Egypt to revisit its stance towards expansion of external borrowing. This should be done for investment projects that generate revenue capable of servicing debt to meet external loan payments and interest thereof. The country should not resort to external borrowing to finance the budget deficit except at a minimum.

The basic approach is to obtain funds for existing projects that need funding before borrowing to finance new projects. External borrowing should be coupled with technical and financial studies of the projects for which borrowing is contracted.

In case of external borrowing, due to its being relatively less costly than domestic borrowing and to diversify the sources of budget financing, it is important that borrowing be of a medium to long term nature, as is the case of the current external debt structure, whether from international institutions or the global financial markets. It should also be at rates that are close to current averages of Egypt’s external debt, while taking into account compatibility with Egypt’s economic reform plan.

# Special Analysis

## GCC Debt Issuance in 2016

**Kuwaiti Al-Qabs**

Middle Eastern governments have already set a record for debt sales, as the sustained fall in oil prices weakens public finances across the world's largest crude-exporting region.

Countries including Bahrain have borrowed $8.6bn on international capital markets so far this year, beating the previous high set in 2009, when the Gulf's construction projects and property boom came unstuck after Dubai shocked investors by asking for a debt standstill.

Debt markets in the region may receive a further lift in the next month as governments and state-backed companies attempt to wrap up sale plans before the holy Muslim month of Ramadan begins on June 7.

"The low oil prices have led to an acute fiscal crisis in the region, hence the sudden need for debt," said Philippe Dauba-Pantanacce, economist at Standard Chartered. "As these are small countries that want to maximize their borrowing opportunities they are looking at international markets to find the largest pool of potential lenders."

Gulf governments including Qatar, which last year raised a loan of more than $5bn, are already in talks with banks to tap international bond markets for the first time in years, emboldened by the success of Abu Dhabi's sale of debt in April, in which the emirate attracted $17bn of bids for a $5bn bond.

Bankers say Saudi Arabia is expected to issue its debut international bond after the summer, following the arrangement of a $10bn loan with a group of banks including HSBC, Bank of Tokyo-Mitsubishi and JPMorgan.

The issuance aims to ease pressure on local bank liquidity, which has tightened since the oil price slide, as well as providing a benchmark for the companies to tap markets.

Other possible future debt issuers include the UAE's federal government, which is looking into the possibility of raising its own debt in addition to bonds sold by individual emirates, and Iran, which is in talks with global credit rating agency Fitch.

"This is the year of debt," said one banker based in Dubai. "Amid the gloom, the DCM people are keeping busy."

The slide in oil prices has put government finances under intense pressure, forcing regional economies to reconsider borrowing needs as reduced oil export revenues widen budget deficits.

However, the premium demanded by investors to buy debt issued by Middle Eastern sovereigns instead of safer, US government debt has fallen since February as prices for Brent crude perk up from $32 per barrel to $43 and a weakening in the dollar eases pressure on currency pegs.

At the end of April, Abu Dhabi was able to borrow over 10 years at 3.12 per cent, around 125 basis points over US Treasuries. The same sale of debt in 2009 came with a 6.75 percent rate and a higher spread over the US benchmark.

But the increase in debt has also led to comparisons with the region's previous credit expansion and subsequent crunch.

HSBC's chief economist for the Middle East, Simon Williams, calculates that sovereign, financial and corporate borrowers in the six-nation Gulf Cooperation Council must repay or refinance $94bn in bonds in 2016 and 2017. This, he said, would be increasingly difficult amid slowing growth and rating downgrades.

So far this year, S&P and Fitch have both cut ratings on Saudi Arabia while Moody's has cut Oman's credit rating and lowered Bahrain's rating to junk, citing worries about the impact of low oil prices. Bankers are awaiting later this month Moody's ratings decision after placing Saudi Arabia on a review for possible downgrade.

Meanwhile, Qatar is looking to tap the market for dollars for the first time in five years, while the China Three Gorges Dam Corporation is set to return to the dollar bond market a year after its debut.

Qatar has mandated banks to arrange investor meetings, with a dollar bond likely to follow.

The Gulf state, whose finances have been squeezed by the collapse in oil prices, last issued in dollars in 2011. Its 2022 dollar bond currently yields 2.43 per cent, down from more than 3 per cent two years ago.

Qatar has been slashing expenditure of late as it adapts to what has turned out to be a prolonged period of low oil prices.

## Implications for Egypt:

Egypt should pay attention to the size of domestic debt and its servicing burden compared to external debt, which represents a small percentage of GDP relative to the regional average. The size of the debt cannot be contained without addressing the chronic budget deficit Egypt has been suffering from over the years, especially during the last four years in which revenues declined and expenses increased steadily. The burden of debt service can be reduced through the rational management of the portfolio of government debt.

There is currently a need to adopt “sukuks” as a financial instrument, which will attract Gulf Arab investments to the debt market, raising dollar receipts and reducing the burden on local banks. This will also widen the financing alternatives available. There is a need to take advantage of this instrument in the context of the country’s plan to develop and diversify financial instruments to increase the ability of companies and government and other legal entities in obtaining funding, with positive implications for the size of investments and employment at the national economy. This will enable these entities to diversify their funding sources, and to meet the needs of a large segment of public and private legal entities and companies willing to finance their activities and projects or expand them via sukuks.

The Ministry of Finance continues to increase medium-term bonds compared to Treasury bills with short-term maturities, and to build a yield curve for government issuances, through regular issuances of 1.5, 3, 5, 7, 10 year maturities and re-issuing them to create liquidity on the bond supply side. However, the secondary market for Treasury bonds is still weak, accounting for 1.1 percent of the total issuance, even in light of the growing supply of issuances in addition to more investor concentration in Treasury bonds. Therefore, there is a need to expedite the activation of the secondary bond market at the Egyptian Stock Exchange, as this market is still weak, non-deep, and dominated by banks in contrast to other markets globally, which are characterized by active secondary markets, allowing for medium and long-term financing for businesses.

# From the International Press

## Does Britain have the Luxury of Exiting the EU?

**Asharq al-Awsat**

Just days ahead the Brexit referendum, proponents and opponents continue their mutual accusations and political skirmishes in an attempt to reach out to voters who have not made up their mind yet. Projections for voting percentages are still close, according to recent polls. The question that presents itself strongly and paramount on everyone's mind without an explicit answer is that "Does Britain really have the economic luxury to exit the EU?"

Prime Minister David Cameron leads the camp opposing Brexit. His warnings of potential Brexit repercussions are escalating, while facing the arguments of his opponents, which describe his desire to stay in the EU as a sign of "weak patriotism".

George Osborne, the British Chancellor of the Exchequer, and Cameron's loyal ally warns in the same campaign of the likelihood of job losses in the financial services sector, saying that Britain may lose 285,000 jobs in the sector related to trade with Europe.

On the other hand, former London Mayor Boris Johnson and leader of pro-Brexit camp seeks to conduct a wide tour to gain more support for Brexit. Johnson scoffed at previous statements by Cameron that leaving the EU could "pose a threat to national security".

Between the two camps, a continuous poll by the British "Financial Times" shows in its latest results that the percentage of opponents to Brexit reached 46 percent, while that of those pro-Brexit reached 43 percent.

Away from the accusations and political punches exchanged by the two camps, numbers remain the most credible. Most numbers show that the British economy is now in its weakest position and cannot bear any major changes, whether due to internal factors or to poor global economic conditions.

Official data show a reduction in British factory production last March, which is the biggest fall in three years. The halt of some production in the steel sector due to excess production capacity worldwide led to a significant reduction in factory activities.

According to the National Bureau of Statistics the manufacturing activity fell by 1.9 percent in March, compared to its level a year ago, which is the biggest decline since May 2013, and is in line with the expectations of economists in a Reuters survey.

Manufacturing sector production increased slightly in March by 0.1 percent, slightly below expectations, after falling 0.9 percent last February.

However, according to the Bureau of Statistics, data do not indicate any changes in GDP estimates published last month, partly due to large upward adjustments of the broader measure of industrial production in February.

Overall industrial output rose by about 0.3 percent on a monthly basis in March, after falling 0.2 percent a year ago.

For the first quarter as a whole, data did not record significant change from those used in the first quarter of last April estimates, a quarterly decline of 0.4 percent.

The Bureau said that the manufacture of basic iron and steel sector dropped in March by 37.3 percent compared with a year ago, and contributed to the contraction of annual industrial production by 0.3 percent.

It is noteworthy that the industrial sector experienced the first recession after the global crisis in 2008. The second was in 2011 during the Lehman Brothers Bank bankruptcy incidence.

The British economy as a whole slowed in the first quarter, according to preliminary data, and the pace of growth fell to 0.4 percent, compared to 0.6 percent in the previous three months.

The National Institute of Economic and Social Research in the UK expected the economy to grow by about two percent only this year, and 1.9 percent next year, if the British voted for Brexit, compared to other expectations of an average growth of about 3.5 percent this year and the coming year if the vote was against Brexit.

The institute said in a report that the decision to leave the EU would be a big shock to the UK economy, noting that by 2030, the rising annual economic growth rate, over the next 15 years, will be between 1.5 percent this year up to 7.8 percent at the end of that period. Such rates are much less than the assumed UK growth rates in case of “staying with the EU” scenario.

According to Lloyd Bank’s purchasing managers’ index in the private sector, Britain recorded its lowest level in the index in more than three years in April by about 52.1 points, down from 53.7 points in March. The index at 50 points is the dividing line between growth and contract. London saw the largest commercial loss, reaching its lowest level in 38 months by about 51 points, while business activity in the north-eastern region fell for the second month in a row to the greatest extent in three years by about 49 points. Also, East Midlands registered about 55.7 and the East of England about 55 points, both recording faster growth and the best performance in England.

Pro-Brexit advocates say it is necessary, citing the danger of immigration to the British society. But Jonathan Portes, former chief economist at the Office of the Prime Minister, said that Britain receives about 323,000 immigrants from EU citizens and holders of nationalities of EU member States. Such immigration would be reduced by about 100,000 citizens only, and this decline would lead to an increase in the income tax by about two percent to maintain budget balance, noting that Britain’s loss of free movement in the EU, if it exits, means only a slight reduction in immigration.

British businessperson Aaron Panax went to the United States, speaking to the American people on the issue of Brexit at the Cato Institute, a Washington DC-based think tank dedicated to individual freedom, saying that the EU represents slow bureaucracy that undermines British sovereignty. He added that the flow of immigrants from other EU countries is depressing the wages of the British working class. The audience, comprising 12 political and economic experts, did not sympathize with a “Mr. Brexit” as some called Panax for being a co-founder of the Brexit campaign.

## Implications for Egypt:

In light of the global economic conditions that began to show coherence and a growing shift towards a change in economic balance away from blocs towards alliances, Egypt must realize that economic reform is the most important pillar of 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 at the national level, is the optimal path to putting together an action roadmap with ambitious visions and goals in a way that ensures sustainable development.

Therefore, Egypt should develop plans and scenarios for dealing with the current situation and its possible developments, along with a comprehensive assessment of the map of foreign transactions in light of the changes that occur, whether at the level of oil markets or the potential for structural changes in the EU in the coming period. This would allow greater flexibility in Egypt’s alternatives in dealing with any repercussions of those situations in the future.

We should also be aware that traditional exports will not grow continuously like in the early stages of development, because business opportunities will continuously be reduced and wages will rise, implying reduced competitiveness. Export growth depends on the introduction of new processes and discovering new markets, not just expansion of sales of existing products in the market. To achieve this, innovation and product differentiation to meet the needs of the market is a target in itself for middle-income countries.

# Global Financial Market Performance

**Reuters – Argaam**

Chinese stocks fell at the end of Friday trading session, marking the longest string of weekly losses since July 2012, due to fears of the effects of the economic slowdown in the country.

The main index of the Chinese market fell for the sixth consecutive week, with the decline in economic data compared with last month, and fears of capital outflows with the increase in US interest rate, in addition to high debt levels.

The "Shanghai" Composite Index fell marginally by 0.05 percent to 2,821 points at closing, due to losses in the industrial and pharmaceutical stocks.

Japanese stocks rose Friday following reports that Japanese Prime Minister Shinzo Abe has decided to postpone the increase in sales tax. The "Takata" share value declined by 8.1 percent - after rising more than 20 percent yesterday - after reports that the airbag maker is contacting "KKR & Co" about a possible acquisition.

The Japanese "Nikki" index closed higher by 0.4 percent at 16,834 points, and the "Topix" index also rose by 0.5 percent to 1,349.

The "Asahi" Newspaper said that Abe has decided to postpone the increase in the sales tax due to the slowdown in global growth and the impact of last month's earthquake.

On the other hand, US stocks rose during Friday trading and maintained their gains after statements of the chair of the Federal Reserve, Janet Yellen, about increasing the interest rate. Also, major indices made weekly gains, just before next Monday holiday.

The "Dow Jones" industrial index increased by 44.9 points to 17,873.2 points, the "Nasdaq" index by (+31.7 points) to 4933.5 points, while the broader "S&P 500" index rose by +8.9 points to 2,099.06 points.

On a weekly level, the "Dow Jones" recorded gains of 2.1 percent, considered the best since March 18, the "Nasdaq" made gains of 3.3 percent, which are the best since February 19th, while the "S & P" made weekly gains of 2.2 percent, which are the best since March 4th.

In Europe, "Stoxx Europe 600" rose by 0.2 percent or 0.7 points to 349.6 points, scoring weekly gains of 3.4 percent.

The British "FTSE 100" index rose by 5.1 points to 6,270.7 points, while the German "DAX" index increased by 13.6 points to 10,286.3 points, and the French "CAC" index rose by 2.1 points to 4514.7 points.

On the other hand, gold futures for June delivery settled down 0.5 percent, or by $6.60 to $1213.80 an ounce, the lowest close since Feb. 22, scoring a weekly loss of 3.1 percent.

In oil markets, the US "NYMEX" fell by 0.3 percent or by fifteen cents and closed at $49.33 a barrel, recording a weekly gain of 1.9 percent. The benchmark Brent fell by 0.5 percent or by 27 cents to close at $49.32 a barrel, and made weekly gains of about 1.2 percent.

With regard to economic data, US GDP grew by 0.8 percent during the three months ended in last March compared to the previous reading of 0.5 percent. The "Michigan/ Reuters' consumer confidence index dropped to 94.7 in May.

In her remarks, Federal Reserve Chair Janet Yellen said that an increase in the interest rate will be likely during the next two months if the economy continued to grow and the labor market continued its recovery, noting her expectations of the return of inflation to the targeted level in the next two years.

Next Monday, May 30, is a public holiday in the US, and the stock and bond markets will close to celebrate the "Memorial Day."

## Implications for Egypt:

Re-emergence of fears about Brexit and preliminary US signals to re-consider raising interest rates dominated the markets during last week's trading, in spite of the extraordinary activity that brought oil prices to the level of $50 a barrel. However, the Egyptian Stock Exchange did not benefit as much from the short-term foreign institutional investments that began to flow to many emerging market stock markets in the absence of internal incentives in the Egyptian Stock Exchange.

If the parallel foreign exchange market begins to shrink in Egypt, it could be a real incentive to attract investments that are looking for new opportunities. The repeated major issuances in the stock market will be an additional incentive to attract foreign investors again to the Egyptian market.

Estimates indicate that emerging markets, including Egypt, are in a better position in 2016 to restore part of their lost activity and investment liquidity. This requires the implementation of a development plan for the technological and legislative infrastructure and the introduction of new financial instruments to prepare the Egyptian stock exchange for more competition among the emerging markets, especially in light of the attention being paid by the government to the stock market as a primary financing platform in the coming period.