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Our Economy & the World

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

- **Key Global Developments Over the Past Week**
- **Special Analysis: Iran-Saudi Row Threatens any OPEC Deal, Puts Role in Question**
- **From the International Press: A Chronic Problem: Ideas for Reducing the Debt Burden**
- **An Analysis of Global Financial Market Performance and Changes in Prices of Goods and Raw Materials**

Key Global Developments

China's Unemployment Rate Stands at 4.05 Percent End of 2015

Argaam

China's urban registered unemployment rate stood at 4.05 percent at the end of 2015, the Ministry of Human Resources and Social Security said in an online statement.

While China's economy grew at its slowest rate in 25 years in 2015, official unemployment figures have remained low. Many analysts believe the figures, in particular registered unemployment, are unreliable indicators of nationwide employment conditions.

China's premier, Li Keqiang, has said the country will hold the urban registered unemployment rate below 4.5 percent in 2016.

EU's Juncker Pushes Leaders on US Trade Deal

Multiple news agencies

European Commission chief Jean-Claude Juncker will press EU leaders at a summit next month to back a historic free trade deal with the United States despite growing skepticism about the pact, a spokesperson said.

Washington and Brussels want the Transatlantic Trade and Investment Partnership (TTIP) completed this year before US President Barack Obama leaves office, but it has faced mounting opposition, especially in France and Germany.

Despite mounting opposition to the deal and the slow pace on the TTIP talks since they began in 2013, Juncker "reaffirmed his trust and confidence" in the EU's chief negotiator, EU trade commissioner Cecilia Malmstroem, the spokesperson said.

There is deep suspicion in Europe that the deal will erode ecological and health regulations to the advantage of big business.

A poll said that 66 percent of French people don't trust the government to defend the country's interests in the negotiations.

TTIP aims to topple regulatory and tariff barriers to trade and investment.

ECB to Keep Deploying Tools to Combat Low Inflation Risk: Visco
Arqaam

The European Central Bank will keep using all instruments at its disposal to counter the risk of low inflation in the euro region, Governing Council member Ignazio Visco said.

“For monetary policy, the main challenge remains the persistence of excessively low inflation,” Visco, who is also governor of the Bank of Italy, said in a speech delivered on Tuesday in Rome at the central bank’s annual meeting. “We will continue if necessary to deploy all the instruments made available to us in our mandate.”

In March, the ECB predicted the inflation rate in the euro area would average 0.1 percent this year, before accelerating to 1.3 percent in 2017 and 1.6 percent in 2018.

Global Glut to Temper Oil Price Gains This Year: Reuters poll
Reuters

Global oversupply in crude oil is likely to limit price gains this year despite a series of unplanned outages and shrinking U.S. shale production, a Reuters poll showed.

Wildfires in Canada, political unrest in Venezuela and supply disruptions in Nigeria and Libya have wiped out nearly 4 million barrels of daily production.

That has soothed some of the concern about oversupply and helped push oil prices close to $50 a barrel for the first time in seven months.

But some analysts surveyed do not expect the annual average oil price to exceed that level by much before next year.

In the latest monthly Reuters poll, the 33 analysts surveyed forecast a 2016 Brent crude LCOc1 average price of $43.60 per barrel, up $1.30 from a forecast of $42.30 a month earlier.

That marked a third consecutive monthly rise in forecasts for Brent prices, which have averaged about $39 so far this year.

But record-high global oil inventories were expected to curb any major gains for some time.

Brent futures were expected to average $56.40 per barrel in 2017 and rise to $64.30 in 2018, the poll showed.

However, some analysts expressed concern over the uncertainty surrounding Saudi Arabia's strategy as it battles Iran for market share and after the appointment of new energy minister Khalid Al Falih.

Analysts also expressed surprise at the pace at which Iran has increased production and forecast a return to its pre-sanctions level of output by the third quarter of this year at the latest.

With Iran likely to increase output by at least 500,000 to 1 million bpd in the near term, and despite the fall in U.S. shale production of 600,000-800,000 bpd, the overall market will continue to remain oversupplied as demand growth is expected to remain weak.

Most analysts expect supply to match demand next year, but agreed that it could take much longer for the market's overhang of unused inventories to clear.

German Jobless Queue Shrinks to Post-Unification Low
Argaam

Unemployment in Germany fell to its lowest level end of May, with jobless claims falling more than expected, signaling the strength of the labor market in the country.

The unemployment rate fell to 6.1 percent, the lowest level recorded since 1992, the federal labour office said in a statement.

Jobless claims in Germany fell in May for the 8th month in a row, and declined by 11,000 claims, compared to April.

The number of unemployed persons reached 2.664 million end of May.

Although the labor market remains robust, experts warn that the flow of immigrants to Germany will increase unemployment this year.

ESCWA Estimates the Cost of War Damages in the Arab Countries at $600 bn
Asharq Al-Awsat

Abdallah Al Dardari, Deputy Executive Secretary for Program Affairs of the United Nations Economic and Social Commission for Western Asia (ESCWA) said that the ESCWA's initial estimates of the cost of war damages in the Arab countries so far amount to $600 billion, of which more than $200 billion in Syria (8 billion dollars for in city of Homs alone). He noted that countries of the region need to provide 100 million jobs until 2030.

In an interview with Asharq Al-Awsat reporter in Amman on the sidelines of the Arab Forum on Sustainable Development in 2016, Al Dardari said that that Arab countries need to establish an Arab bank for reconstruction and development similar to the European, Asian, African and American development banks. He added that we need a quantum leap in the funding method, especially that the capital available in the 11

Arab development funds is barely enough to rebuild a small part of the damage left behind by the war in one Arab country.

He also noted that the ESCWA has been proactive in monitoring what is happening in Syria, Yemen, Iraq, and Libya, stressing that the figures and analyses produced by the Commission since 2011 to date have become a reference for the international system and the region to know what is happening in these countries.

Executives Call for United Europe
Multiple news sources

Fifty-one chairmen and chief executives of Europe's leading multinational companies called at the European Roundtable of Industrialists for Europe to remain united, warning of the negative impact for Britain and the EU of Brexit.

In a letter to the media, they said, "we believe the case for Europe working and staying together has never been stronger."

Over the past 60 years, businesses have flourished and families have on average become more prosperous thanks to closer ties between people and institutions across Europe. The EU is now the world's largest economy and largest trading block. An unravelling of the single market and the rules governing 28 countries would reduce, not boost our prosperity.

The executives of multinational companies including *L'Oréal*, *Royal Dutch Shell*, *Siemens*, STMicroelectronics added: "While respecting the decision of the people in the United Kingdom, we believe that a Europe without the UK would be weaker, just as the UK itself would be weaker outside Europe."

OECD Blasts Governments for Slipping Into 'Low-Growth Trap'
Al-Borsa

The global economy is slipping into a self-fulfilling "low-growth trap" where ultra-loose monetary policy risks doing more harm than good, the Organization for Economic Cooperation and Development warned. In a highly critical editorial in the OECD's latest Economic Outlook, rich world governments bear the brunt of the blame for failing to revive demand and failing to overhaul their economies in the wake of the financial crisis in 2008.

According to the Paris-based group, which advises its 34 member countries, too much of the burden of lifting growth has been left to central banks. After pushing interest rates below zero and pumping money into their economies through asset purchases, they are starting to see diminishing returns and their actions could even generate financial-market volatility.

The remarks underline the lackluster growth as many emerging markets struggle with a slump in commodity prices and rich economies such as Europe and the US fail to return to the sort of performance they typically had before the global financial crisis in 2008.

While the OECD left its global growth forecast unchanged, it cut its 2016 projections for growth in the US and Japan, while raising its forecasts for the euro area.

U.S. gross domestic product is now expected to grow by 1.8 percent this year instead of the 2 percent predicted in February. Euro-area 2016 growth was revised up to 1.6 percent from 1.4 percent. The OECD kept its China forecasts at 6.5 percent this year.

Implications for Egypt:

In light of the global economic conditions, Egypt should develop plans and scenarios for dealing with the current situation and its possible developments. This should be coupled 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.

Although Egypt is not a major oil producer but rather one of the major consumers of oil in the Middle East, the extent of being affected by oil developments is linked to its economic relations with the Gulf States. In spite of the relative improvement in oil prices over the last period against fragile hopes to reduce oil supply, oil prices are still low. Therefore, Egypt is still benefiting from the decrease in oil prices due to the reduced cost of imports of oil and derivatives, which are mainly used as production inputs. Thus, the government has an opportunity to reduce its budget deficit, and alleviate inflationary pressures. In addition, the recent drop in oil prices is in favor of the government in its pursuit to reduce the deficit in the public budget and the trade balance.

Coordinating economic policies is also essential to achieve economic stability that is manifested in continuing to achieve economic growth rates capable of facing the continuous increase in population; to create adequate jobs to absorb unemployment; and to stabilize the general level of prices.

Special Analysis

Iran-Saudi Row Threatens any OPEC Deal, Puts Role in Question

OPEC's thorniest dilemma of the past year - at least from a purely oil standpoint - is about to disappear.

Less than six months after the lifting of Western sanctions, Iran is close to regaining normal oil export volumes, adding extra barrels to the market in an unexpectedly smooth way and helped by supply disruptions from Canada to Nigeria.

But the development will do little to repair dialogue, let alone help clinch a production deal, when OPEC meets next week amid rising political tensions between arch-rivals Iran and oil superpower Saudi Arabia, OPEC sources and delegates say.

Earlier this year, Tehran refused to join an initiative to boost prices by freezing output but signaled it would be part of a future effort once its production had recovered sufficiently. OPEC has no supply limit, having at its last meeting in December scrapped its production target.

According to International Energy Agency (IEA) figures, Iran's output has reached levels seen before the imposition of sanctions over its nuclear program. Tehran says it is not yet there.

But while Iran may be more willing now to talk, an increase in oil prices has reduced the urgency of propping up the market, OPEC delegates say. Oil has risen toward a more producer-friendly $50 from a 12-year low near $27 in January.

"I don't think OPEC will decide anything," a delegate from a major Middle East producer said. "The market is recovering because of supply disruptions and demand recovery."

A senior OPEC delegate, asked whether the group would make any changes to output policy at its June 2 meeting, said: “Nothing. The freeze is finished.”

Within OPEC, Iran has long pushed for measures to support oil prices. That position puts it at odds with Saudi Arabia, the driving force behind OPEC's landmark November 2014 refusal to cut supply in order to boost the market.

Sources familiar with Iranian oil policy see no sign of any change of approach by Riyadh under new Saudi Energy Minister Khalid al-Falih - who is seen as a believer in reform and low oil prices.

"It really depends on those countries within OPEC with a high level of production," one such source said. "It does not seem that Saudi Arabia will be ready to cooperate with other members."

HIGHER EXPORTS

Iran has managed to increase oil exports significantly in 2016 after the lifting of sanctions in January.

It notched up output of 3.56 million barrels of oil per day in April, the IEA said, a level last reached in November 2011 before sanctions were tightened.

Saudi Arabia produced a near-record-high 10.26 million barrels per day in April and has kept output relatively steady over the past year, its submissions to OPEC show.

Iran, according to delegates from other OPEC members, is unlikely to restrain supplies, given that it believes Saudi Arabia should cut back itself to make room for Iranian oil.

"Iran won't support any freeze or cut," said a non-Iranian OPEC delegate. "But Iran may put pressure on Saudi Arabia that they hold the responsibility."

Saudi thinking, however, has moved on from the days when Riyadh cut or increased output unilaterally. Talks in Doha on the proposed output freeze by OPEC and non-OPEC producers fell through after Saudi insisted that Iran participate.

Indeed, differences between Saudi Arabia and Iran, which helped found the Organization of the Petroleum Exporting Countries 56 years ago, over OPEC policy have made cooperation harder - to say nothing of more fundamental disagreements.

For more than a decade after oil crashed to $10 in 1997, the two set aside rivalries to manage the market and support prices, although they fell into opposing OPEC camps with Iran wanting high prices and Saudi more moderate.

Now, the Sunni-Shia conflicts setting Saudi Arabia and Iran at each other's throats, particularly in Syria and Yemen, make the relationship between the two even more fraught.

The two disagree over OPEC's future direction. Earlier in May, OPEC failed to decide on a long-term strategy as Saudi Arabia objected to Iran's proposal that the exporter group aim for "effective production management".

With that backdrop, ministers may be advised to keep expectations low, an OPEC watcher said.

"The only aspiration OPEC should have for its 2 June meeting is simply not to repeat the chaos of the Doha process," said Paul Horsnell, analyst at Standard Chartered.

"A straightforward meeting with no binding commitments and, most importantly, no overt arguments would be the best outcome for ministers."

Implications for Egypt:

Although Egypt is not a major oil producer but rather one of the major consumers of oil in the Middle East, the extent of being affected by oil developments is linked to its economic relations with the Gulf States. In spite of the relative improvement in oil prices over the last period against fragile hopes to reduce oil supply, oil prices are still low. Therefore, Egypt is still benefiting from the decrease in oil prices due to the reduced cost of imports of oil and derivatives, which are mainly used as production inputs. Thus, the government has an opportunity to reduce its budget deficit, and alleviate inflationary pressures. In addition, the recent drop in oil prices is in favor of the government in its pursuit to reduce the deficit in the public budget and the trade balance.

Despite this benefit, there are other concerns, including pressure from foreign companies operating in Egypt in the energy sector, after the decline of their profits recently, which may drive them to exercise pressure on the Egyptian government, claiming their arrears. Add to this the position of foreign investment inflows from the Gulf countries, the status of Egyptian workers, and their transmittances.

The decline of oil prices over the past two years led to a decline of oil and gas revenues in total revenues of countries in the region, particularly in the Gulf, albeit oil continues to be the highest source of budget revenues. This also led to a reduction in government spending in the GCC and the emergence of a deficit after years of equilibrium or surplus. GCC countries that peg their currencies to the US dollar have to develop independent monetary policies that are at arms' length from the US monetary policy. They should not follow in the footsteps of the US monetary policy, as it does not favor economic diversification—a policy pursued vigorously by the Gulf States.

In a nutshell, oil markets are currently more concerned about the oil glut with expansion of production at deeper levels in the oceans, and the shale oil boom in the US, which makes it a future export competitor. Add to this increased production from countries such as Canada, Brazil, Iraq, Kenya, Uganda, and the decline of consumption by European countries due to improved vehicle fuel efficiency, especially the development of environmentally friendly technologies.

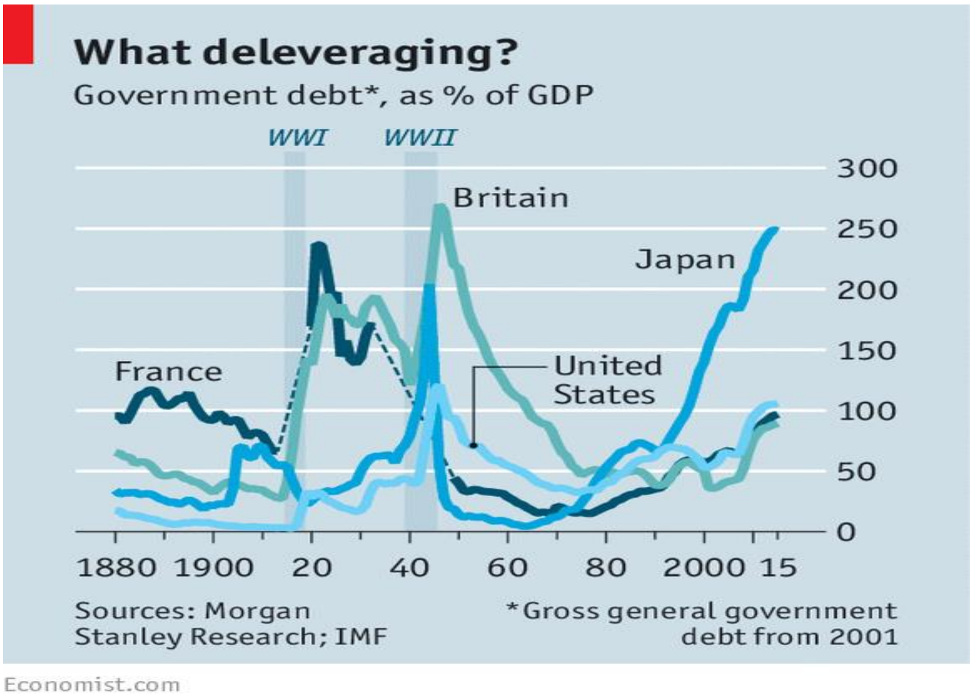
In light of these variables, the Egyptian government needs to reconsider the basis it used in setting the average price of oil at $40 per barrel in the new 2016/2017 budget, as this figure may be exceeded if an agreement is reached among oil producers.

From the International Press

A Chronic Problem: Ideas for Reducing the Debt Burden
Economist - Argaam

Debt levels grew spectacularly in the rich world from 1982 to 2007, when the financial crisis broke, and worries about the ability of borrowers to repay or refinance that debt caused the biggest economic downturn since the 1930s.

It could have been worse. The danger was that, as private-sector borrowers scrambled to reduce their debts, the resulting contraction in credit would drive the world into depression. Fortunately, this outcome was averted. But the Economist noted in a report that it may be too late to address rising debt levels.



Proposed Ideas

- The governments of rich countries allowed their debts to rise, offsetting the reduction in private debt. In addition, emerging markets (notably China) continued to borrow.

- Central banks also helped, slashing interest rates to zero and below. Although lower policy rates have not always resulted in cheaper borrowing costs (in Greece, for example), debt-servicing costs have fallen in most developed countries.

- Although this approach has staved off disaster, it has not got rid of the problem, as high debt forces interest rates to stay low, which encourages yet more debt.

- Central banks dare not push interest rates up too quickly for fear of causing another crisis. The developed world seems stuck with sluggish growth and low rates.

What If Another Financial Crisis Occurs?

- Another global financial crisis would require three ingredients. First, the assets financed by the debt build-up would need to fall sharply in price or prove uneconomic. Second, the debtors would have to be concentrated in big, globalized economies.

- Lastly, global investors would have to be heavily exposed to the debt in question. All this was the case in 2007-08, as debt secured by American housing turned bad, raising doubts about the health of the Western banking system.

- This time round the debtors are in different places. Some of them are emerging-market governments and commodity producers. But, except for China, none of these is crucial to the world economy.

- China's debts are mainly in domestic hands, rather than widely dispersed in the portfolios of international banks, pension funds and insurance companies. Rich countries' government debts are mostly in their institutional portfolios.

Debts and Inflation

- Getting rid of the debt will not be easy. Debt has been inflated away in the past, but central banks are still struggling to meet their current inflation targets. It is not clear that governments would be willing to put up with the high rates of inflation with debts increasing.

- Debt forgiveness sounds good in theory. But writing off either private-sector or government debt could cripple the financial sector, creating the very crisis the measure was designed to avoid.

- Morgan Stanley has some alternative suggestions. One would be to replace debt with equity-like capital. In the public sector, governments could issue GDP-linked bonds, for example.

- If a bond's repayment value is linked to real GDP, then governments would be spared the crippling surge in debt-to-GDP ratios that occurs during recessions. Governments could also issue irredeemable debt, which eliminate the risk of a refinancing crisis.

- All these ideas seem sensible, but they can be applied only to newly issued debt, not to the mass of obligations that has already been accrued. So, they will help only over the long term.

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 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.

Domestic debt instruments represent a rising share of bank deposits, at a time loan-to-deposit ratios are declining at the sector's level. The main role of banks as a financial intermediary is to employ deposits in projects that generate value-added to the economy. Therefore, a maximum cap should be placed on domestic borrowing and the size of securities issuances from total bank deposits. Also, Egypt should have an index linking bank investment portfolio in debt instruments to total available deposits with banks, if it truly wants to revive markets and fight economic recession. Therefore, the Ministry of Finance will have to reduce the size of issuances for a while, until the index is back to safe limits that allow the government to resume borrowing. This will push banks to exert more efforts in looking for alternative channels to employ their liquidity and direct it to the right channels by pumping it in the loans market and granting credit facilities to companies and entrepreneurs.

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 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.

This requires taking a set of integrated measures to boost the secondary market for Treasury bonds. This includes: increasing the investor base; introducing mechanisms such as bond sale and repurchase arrangements; consolidating the clearing of bills & bonds with a view to activating lending mechanisms of government securities; maintaining regular issuances; creating reference points in both the issuance and trading markets; and finally consolidating the government securities clearing system to boost bond liquidity. The liquidity of the secondary market contributes to lowering the cost of these securities through reduction of issuance yield. Also, the tendering (Uniform vs. Competitive auctions) and secondary market trading systems should be revisited.

Global Financial Market Performance

Reuters - Argaam

Chinese shares recorded their first weekly gain in almost two months with speculations about the market joining the "MSCI" World index, despite fears of a slowing economy.

China's stock market received support during the week from growing expectations of adding shares in Chinese currency to the "MSCI" World Index, which means more cash flows to the market**.**

Investors are still worried about slowing Chinese economic growth, especially after data showed continued contraction of the manufacturing sector for the fifth month in a row, in addition to a decline in the value of the yuan.

The "Shanghai" composite index rose 0.5 percent to 2,938 points at closing, recording weekly gains of 4.2 percent.

The Japanese stock market declined during the week, with fluctuations of the yen and commodity prices, and the debate over the postponement of the sales tax increase.

The Japanese "Nikki" index rose 0.5 percent on Friday to 16,642 points, but scored a weekly loss of 1.1 percent, while the "TOPIX" index rose by about 0.4 percent to 1,337 points.

The US stocks fell during Friday trading after the employment situation report in conjunction with the decline in oil prices, but cut their losses after absorbing the disappointing data, and the varied weekly performance of key indices**.**

The "Dow Jones" industrial index fell by 31.5 points to 17,807.1 points after losses of about 95 points after the data release. The "Nasdaq" index also fell (- 28.8 points) to 4942.5 points, while the benchmark "S&P 500" declined (- 6.1 points) to 2099.1 points.

At the weekly level, the "Dow Jones" recorded 0.4 percent in losses, while the "Nasdaq" recorded gains of 0.2 percent, and the broader "S&P" stood at near last week's close.

In Europe, the "Stoxx Europe 600" fell by 0.8 percent or by three points to 341.2 points, posting 2.4 percent in weekly losses after three weeks of gains.

The French "CAC" index dropped (- 44.2 points) to 4421.7 points, the German "DAX" index declined by (- 104.7 points) to 10,103.2 points, while the British "FTSE 100" index rose (+ 24 points) to 6209.6 points.

On the other hand, gold futures for August delivery jumped at settlement by 2.5 percent or by $30.30 to $1242.90 an ounce. The precious metal recorded the biggest daily rise since March 17, and achieved a weekly gain of about 2.2 percent.

In the oil markets, the US "NYMEX" dropped by 1.1 percent or by 55 cents to close at $48.62 a barrel and recorded a weekly loss of 1.4 percent. The "Brent" index fell by 0.8 percent or by 40 cents to close at $49.64 a barrel, posting losses of about 0.6 percent this week.

With respect to economic data, the US Department of Labor's employment situation report showed that the economy added 38,000 jobs in May, its lowest monthly pace since September 2010, while the unemployment rate fell to 4.7 percent, the lowest level since November 2007.

According to analysts, these disappointing data indicate slowing labor market and uncertainty about the US economy, reducing chances for the Federal Reserve's decision to raise the interest rate at the June meeting. Federal Reserve official Lael Brainard called on the Federal Reserve to wait on this decision**.**

Implications for Egypt:

The performance of global financial markets during the week continues to be affected by stimulus programs and movements in oil prices related mainly to attempts to curb oil supply, which reflects on the Arab markets, including Egypt's, 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.

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 indicators.

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.