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Our Economy & the World

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

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Key Global Developments

French, German employer groups press for more EU convergence post-Brexit

Reuters

French and German employers' groups called on the governments of the European Union's other two biggest economies to push on with the single market project now that Britain has voted to quit the bloc.

"The Franco-German motor, more indispensable than ever to this integration, needs to recover its strength," said a joint statement from France's MEDEF and the BDI and BDA of Germany.

"In all domains the union needs to speak with a single voice," it said, pressing for governments to "reinforce the European market on its two economic pillars, the single market (free movement of goods, services capital and labour), and the euro, and for this (euro) immediate, credible and visible measures to reinforce its governance to encourage convergence between member states."

The grouping also demanded that new ways be found to cooperate with Britain.

Brexit Aftermath: Goldman Sachs Predicts U.K. Will Enter a 'Mild Recession' Early 2017

Argaam

Goldman Sachs predicts the U.K. economy will dip into a mild recession early 2017, following Brexit.

Goldman Sachs said in a report that the U.K's GDP will increase by 1.5 percent this year, down by 0.5 percent from previous estimates. UK GDP will grow by 0.2 percent in 2017, compared with previous estimates of 1.8 percent. The American bank reduced its forecasts for global economic growth by 0.1 percent to 3.1 percent this year.

The report pointed out that the UK foreign trade will be adversely affected by Brexit, with the difficulty of exporting value-added services to the EU countries.

It added that uncertainty would affect companies' decision to postpone new investments in the short term.

"Goldman Sachs" predicts that the Bank of England will cut its base rate by 25 points to 0.25 percent, with the addition of new quantitative easing measures.

"Risky Trinity" Requires Urgent Global Policy Action, BIS says

Reuters

Global economic policy urgently needs rebalancing, the Bank for International Settlements (BIS) said, as the world faces a "risky trinity" of high debt, low productivity growth and dwindling firepower at the world's big central banks.

The BIS, an umbrella body for major central banks, said in its annual report that the global economy was highly exposed even before Thursday's vote by Britain to leave the European Union.

"There are worrying developments, a sort of "risky trinity", that bear watching," said the head of the BIS monetary and economic department, Claudio Borio.

"Productivity growth that is unusually low, casting a shadow over future improvements in living standards; global debt levels that are historically high, raising financial stability risks; and room for policy manoeuvre that is remarkably narrow."

He said the global economy cannot afford to rely any longer on the debt-fuelled growth model that has brought it to the current juncture.

Despite sub-zero interest rates and trillions of dollars of stimulus, Europe and Japan's central banks are struggling to lift inflation and growth. Markets have grown accustomed to that support, but they are growing concerned the firepower is mostly spent.

"Should this situation be stretched to the point of shaking public confidence in policymaking, the consequences for financial markets and the economy could be serious."

In an apparent nudge to the U.S. Federal Reserve, it said policymakers needed to put more focus on raising rates when they have the chance so that they have room to cut them again when the next downturn comes.

The BIS urged a global change in attitude in both fiscal and monetary policy. Fiscal policy should be designed to cope with financial boom and bust more systematically; monetary policy needed to monitor booms and busts from a systemic risk view, to keep the financial side of the economy on an even keel.

"There is an urgent need to rebalance policy in order to shift to a more robust, balanced and sustainable expansion."

"We need to abandon the debt-fuelled growth model that has brought us to this predicament. It is essential to relieve monetary policy, which has been overburdened for far too long."

Global Foreign Direct Investment Jumped 38 percent to $1.76 trillion in 2015

News agencies

In cooperation with the Arab Investment and Export Credit Guarantee Corporation, the United Nations Conference on Trade and Development (UNCTAD) launched the 2016 Global Investment report. The report revealed that foreign direct investment increased by $485 billion, 38 percent, in 2015, to $1.76 trillion, compared with $1.3 trillion in 2014. This is due to several reasons, including the surge in acquisitions and mergers across borders by $289 billion and by 67 percent to $721 billion during 2015.

However, in contrast, global foreign direct investment balances inflows declined slightly by $130 billion and 0.5 percent to less than $25 trillion by end of 2015, compared with $25.1 trillion in 2014.

The geographical distribution of inflows by region witnessed a radical change with the developed nations outperforming developing countries again, attracting $962 billion in investments in 2015, 72 percent of global total investments, compared with $765 billion for developing countries with a share of 26 percent only after they had more than half of global flows in 2014. Concerning multinational companies' activities and their role in investment, the report noted a slight increase in the assets of foreign company branches worldwide by $4,524 billion, 4.5 percent, to about $105.8 trillion end of 2015. Their exports also rose to $7.8 trillion while their level of employment increased to 79.5 million workers. Return on FDI inflows declined by $191 billion, 12 percent, to $1.4 trillion in 2015, while the rate of return on investment balances fell to 6 percent in the same year.

Obama Warns against "Hysteria" after Brexit vote

Reuters

U.S. President Barack Obama warned against financial and global hysteria after Britain's vote to leave the European Union, saying that while full European integration may be on pause, cataclysmic changes are unlikely, according to an interview that aired.

"There's been a little bit of hysteria post-Brexit vote, as if somehow NATO's gone, the trans-Atlantic alliance is dissolving, and every country is rushing off to its own corner. That's not what's happening," Obama told National Public Radio.

Fitch Cuts UK Credit Rating

Argaam

Fitch downgraded the United Kingdom's sovereign rating to "AA" from "AA+" and said the outlook was negative - meaning that it could further cut its judgment of the country's creditworthiness after Brexit vote. Fitch has thus become the second credit rating agency to downgrade Britain.

According to "Fitch", uncertainty after Britain's exit from the European Union will lead to a slowdown in GDP growth in the near term, and changes in regulatory rules for investment and business.

The agency also cut its forecast for British GDP to 1.6 percent in 2016 down from its previous 1.9 percent estimates for growth.

"Standard & Poor's" has stripped the United Kingdom from its premier "AAA" credit rating, lowering it to "AA" on Monday. "Moody's" is expected to similarly downgrade Britain after reducing its outlook for the British economy on Friday from "stable" to "negative".

Implications for Egypt:

The news above shows that Britain's exit from the EU places us before a set of challenges that must be considered and studied closely and quickly in order to take appropriate measures and alternatives to avoid the negative repercussions of Britain's exiting the Eurozone and on the EU in general. This is particularly so as trade relations will be affected on account of the declining euro and sterling, which will cause a similar decline in Egypt's export opportunities to those markets as a result of lower prices against the dollar, and by extension against the pound. This will clearly cause an increase in British and European imports to Egypt, which requires the development of an integrated manufacturing strategy in the framework of a conducive development and investment strategy.

After Britain's exit, a recession in world trade is expected, which means a decrease in revenues from trade, both exports or traffic. These changes and expectations must be studied closely to find alternatives. It is worth noting that Gulf investments are the largest source of investment in Egypt, with Britain coming second. Currently, it is noticed that Gulf investments are leaving Britain; Egypt therefore should have a plan to attract those investments—a fact that requires business environment incentives.

Current estimates indicate that the early effects of Brexit will be mainly in the capital markets and exchange rates as a result of global volatility. The repercussions on trade and investment are expected on medium and long runs.

In light of the above, the Egyptian government needs to quickly conclude bilateral trade agreements with Britain to attain the best possible terms, especially that there will be competition in the coming period to conclude trade and investment agreements between many countries and Britain over the coming period.

From the International Press

Is the World Turning its Back on Free Trade?

Argaam

The "fair trade" system favored by some politicians, led by Lord Randolph Churchill, the British politician, is about to return with a new look as an alternative for the "free trade" system.

According to the BBC, changes may indicate renewed rejection of one of the most prominent international conventions, i.e., "free trade," led by senior politicians, and disappointment of voters.

Increased Revolt against "Free Trade"

Protectionism is the opposite of free trade, making foreign goods more expensive by imposing taxes on imports in order to make domestic products cheaper by comparison.

While few embrace the word protectionism, growing numbers of politicians are openly embracing the principle behind it.

Donald Trump has said he would put a 45 percent tax on goods from China and 35 percent on many from Mexico. Many economists mock this as crazy stuff, but it is a sentiment that goes down well with many Americans.

Bernie Sanders has made it very clear he is opposed to NAFTA, the free trade bloc with Mexico and Canada, and the planned Asia Pacific agreement.

He has been saying it for a while. This is him in 2011: "Let's be clear: one of the major reasons that the middle class in America is disappearing, poverty is increasing and the gap between the rich and everyone else is growing wider and wider, is due to our disastrous unfettered free trade policy."

Increased US Doubts about Free Trade

The person still most likely to end up in the White House, Hillary Clinton, was once a fierce defender of the Asia deal, and called to take the trade deal in light of her information on world developments.

The deal was negotiated, but was rejected and did not meet expected standards. There were hopes that it would be the gold standard for other deals.

What the US does will set the tone for the rest of the world, and the enthusiasm for free trade is being increasingly questioned in the rest of the world.

The "Vote Leave" campaign here advocates free trade, and says it will continue if we vote to exit the European Union. But opponents point out that new tariffs would be imposed.
One passionate Brexit campaigner, the entrepreneur and inventor Sir James Dyson, faces that prospect with equanimity. He told the Telegraph: "If Europe imposed a tariff of 10 percent on British exports, Britain will do the same in return, as its buys more from Europe than they buy from it.

Free Trade to End

The EU itself is, formally, a great supporter of free trade, while there is a suspicion that on the sly countries like France give advantage to their own industries, whenever they can get away with it.

Poland's deputy Prime Minister Mateusz Morawiecki declared the nation is too dependent on foreign money: "We want the invisible hand of the market supported by the visible hand of the state." The Hungarian Prime Minister has been following a similar path for some time.

This reaction, in the US and Europe, is part of the aftershock of the 2008 economic crisis and the sense of frustration and powerlessness felt by many voters.

But free trade is not just questioned in the West. China has recently imposed 46 percent tariffs on certain types of steel, and is heading to preventing free competition in the world.

Researchers believe free trade has been under attack for several years. According to a report, governments imposed 539 trade distortions in the first ten months of 2015.

Implications for Egypt:

These steps and new phenomena are affecting the prospects of increasing fair trade worldwide. This requires Egypt to pay attention to world developments and take the necessary actions. However, it must be taken into account that many procedures are still increasing the cost of Egypt's foreign trade transactions, especially with regards to exporting. Therefore, it is necessary to address such procedures to boost export growth, such as facilitating licensing, customs clearance procedures, and tax administration, in addition to reducing the cost of financing deals and the number of required procedures and approvals.

In light of recent measures taken by the government or the Central Bank of Egypt (CBE), it has become necessary to carry out a comprehensive sensitivity analysis of the effect of changes in the exchange rate on export indicators and the cost of imports, which did not appear fully so far. It is likely that recent exchange rate changes will improve Egypt's trade competitiveness. Also, a sensitivity analysis of the detailed impact of changes in the US dollar on exports and different sectoral imports should be conducted, which will facilitate formulating policies aimed at increasing exports and reducing imports.

It is also necessary to formulate an industrial development strategy and start implementation thereof. So far, the focus of the exports development strategy has been on market access procedures and providing export promotion incentives, whether through an export drawback scheme or changing the exchange rate without addressing the bigger challenge of production-related obstacles.

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Special Analysis

OPEC Strategy Records Lowest Revenue in a Decade

Al-Sharq Al-Awsat

The Organization of the Petroleum Exporting Countries (OPEC) revealed in its annual statistical report member countries registering in 2015 the lowest revenue rates since 2005. The report confirms figures previously circulated by the U.S. Energy Information Administration (EIA).

OPEC stated that crude oil revenue had a 46 percent drop in 2015 compared to 2014, collecting 518 billion dollars—the lowest in the past decade.

OPEC revenue plunged with the fall in oil prices. The drop came after OPEC’s de facto leader, Saudi Arabia, abandoned its role as swing producer in 2014, leading a transformation in agglomeration policies. Abstaining from traditional price bolstering methods through lowering production, Saudi Arabia allowed the market to self-recover.

OPEC added in its report that member countries’ budget deficit reached 99.6 billion dollars in 2015, compared with a 238 billion-dollar surplus. This is the first time that OPEC members register an account deficit since 1998.

Saudi Arabia has been greatly affected with Saudi export income recording 158 billion dollars in 2015, half of 2013’s revenue, according to OPEC figures. As for information circulated by the EIA, the Kingdom of Saudi Arabia recorded 130 billion dollar revenue in crude export, which is lower than 2005’s 140 billion dollars.

On the other hand, Iran disclosed a 27 billion dollar revenue, which is a quarter of what it had recorded in 2012, after the U.S. and the European Union started imposing sanctions because of the nuclear program. The ban was lifted beginning of this year. Libya was OPEC’s lowest income recipient in 2015 with less than five billion dollars.

Albeit oil price rates are expected to increase in 2017, OPEC’s income of 2016 and 2017 will not better the EIA’s predicted figures of 2005, keeping OPEC’s income at a low compared to its preceding four years. The EIA figures, however, are not adjusted for inflation.

OPEC's full-year 2016 oil export revenues will probably fall 15 percent, down for the third straight year and possibly the lowest in more than a decade before rising in 2017, the U.S. Energy Information Administration (EIA) said.

Members of Organization of the Petroleum Exporting Countries (OPEC), including Iran, will likely earn about $341 billion in 2016, about 15 percent below 2015 levels, based on projections of global oil prices and the group's production levels, the U.S. government's EIA said in a report.

The last time OPEC's export revenues fell for three years straight was 1983-86. At the projected level, OPEC's 2016 export earnings would be the lowest since 2004, when it earned about $295 billion.

Early in 2016, oil prices touched 12-year lows before staging a recovery to about $50 a barrel over the last two months. After a long run of oversupply, the oil market is expected to return to balance, driven by output declines, making the forecast for 2017 less bleak.

Supply outages across the world, including Canada and Nigeria, have accelerated crude's price rebound. For 2017, OPEC revenues are projected to be $427 billion, due to an expected increase in crude oil prices, higher OPEC production and stronger exports, EIA said.

The group earned about $404 billion in net oil export revenues for 2015, down 46 percent, the biggest drop since EIA began tracking the data in 1975. In 2015, Brent crude LCOc1 prices plummeted about 35 percent, or $20 a barrel, as major producers grappled with one of the worst gluts in history.

Attempts at a deal between OPEC and non-OPEC producers to shore up crude prices by freezing output fell apart this year when Saudi Arabia demanded that Iran, its main rival for influence in the region, join in.

Iran has explicitly said it had no plans to freeze the level of its oil production and exports, as the country tries to raise its crude exports to pre-sanctions levels.

Implication 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.

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Global Financial Market Performance

Reuters/ Argaam

Chinese stocks rose at the end of Friday's trading session, posting their biggest weekly gains in a month following positive economic data.

Chinese data showed that manufacturing PMI has reached 50 points in June, signaling a return of positive performance of the industrial sector in the world's second largest economy.

China's stock market benefited from growing investor speculations about injecting more stimulus measures, especially with concerns about the vote in favor of Brexit.

The "Shanghai" Composite Index rose 0.1 percent to 2,932 points at closing, marking weekly gains of 2.7 percent, after having achieved a monthly rise of about 0.5 percent in June, the first monthly rise since March.

The Japanese stocks also rose at the end of Friday's trading session, to record a rise for the fifth day in a row, supported by recovery of global markets.

The Japanese stock market recorded sharp losses in the wake of the British vote in favor of Brexit, but it was able to offset about half of its losses with the recovery of global markets supported by speculations about central banks' injecting more stimulus measures.

The Japanese Stock Exchange's main index, "Nikki", recorded gains of 4.9 percent this week, its biggest weekly rise since mid-April. It rose 0.7 percent to 15,682 points. The "TOPIX" index also increased by about 0.7 percent to 1254 points.

US stocks rose slightly during Friday trading supported by the manufacturing and energy sectors in conjunction with the rise in oil prices, after dissipation of markets' fears following results of the Brexit referendum. Major indices posted weekly gains**.**

The "Dow Jones" industrial index increased by 19.3 points to 17,949.3 points. The "Nasdaq" index rose by 19.8 points to 4862.5 points, while the broader "S&P 500" index rose by 4.1 points to 2102.9 points.

On a weekly level, the "Dow Jones" achieved gains of 3.1 percent, the "S & P 500" index made 3.2 percent in gains, the biggest weekly gains for the two indices this year, while the "Nasdaq" posted a gain of 3.3 percent.

In Europe, "Stoxx Europe 600" benchmark rose by 0.72 percent or by 2.36 points to 332.2 points, the highest close since June 23. It posted weekly gains of 3.2 percent, the largest since May 27. The British "FTSE" index rose by 73.5 points to 6,577.8 points**.**

The French "CAC" index rose by 36.5 points to reach 4,273.9 points. The German "DAX" index rose by +96 points to 9,776.1 points.

On the other hand, gold futures for August delivery settled higher at 1.4 percent, or about $18.40 to $,339 an ounce. The precious metal posted weekly gains of 1.3 percent, while silver prices jumped by 5.2 percent or by 96.5 cents and closed at $19.588 an ounce, achieving 10.1 percent in gains this week, the largest since August 2013**.**

In the oil markets, the US "NYMEX" rose by 1.4 percent, or by 66 cents to close at $48.99 a barrel, recording a weekly gain of 2.8 percent, while the "Brent" index rose 1.3 percent, or by 64 cents and closed at $50.35 a barrel, and achieved weekly gains of about 4 percent.

With respect to economic data, the "ISM" index of manufacturing purchasing managers rose to 53.2 in June from 51.3 in May, the largest monthly rise in fifteen months**.**

The Fourth of July is a holiday in the United States, the stock exchange will be closed to celebrate Independence Day and will resume work the next day**.**

Implication for Egypt:

The Egyptian Stock Exchange was clearly affected throughout the trading week by the decline in global financial markets and the fluctuations experienced as a normal reaction to the results of the Brexit referendum. This happened amid investors tending to acquire safe assets, billions of dollars moving out of global stock markets as well as in the absence of internal incentives or institutional support for investments in the Egyptian stock exchange.

We therefore repeat that there is a need to closely monitor the Egyptian Stock Exchange’s performance and its transactions at present, especially that there are Egyptian shares listed on the London Stock Exchange. It is also necessary to develop quick substitutes in order to deal with any possible trouble that may occur. The aim is to minimize its effects on the Egyptian Stock Exchange. This may include activation of some short-term precautionary measures, increasing disclosures of companies listed in the Egyptian Stock Exchange or even stimulating medium-term domestic institutional investment to ensure capital market stability amid this global financial chaos**.**