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Our Economy and the World

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

- An analysis of global financial market performance and developments in commodity prices and raw materials
- An overview of key global developments over the past week
- News in the international press about the wheat price crisis and Egypt's role
- A special analysis of the repercussions of Britain's possible exit from the EU
- Weekly commentary about the implications of the global situation for Egypt: An analysis of the speech of Dr. Mohamed El-Erian, the internationally renowned economist, regarding the impact of global financial instability on Egypt

Global Market Performance

Reuters - Argaam - news agencies:

Chinese stocks rose at the end of Friday's trading session after sharp losses last Thursday due to statements by the Chinese central bank governor indicating the possibility of introducing more stimulus measures. The "Shanghai" Composite Index rose by 1 percent to 2767 points at closing, but recorded weekly losses of 3.3 percent.

The Japanese Nikkei index rose on Friday to its highest close in nearly three weeks, with the risk appetite recovered due to the steady decline of the yen and US stock gains overnight. It rose by 0.30 percent to 16,188.41 points, recording its highest close since February 8th. Also, the benchmark index rose by about 1.4 percent over the week. The broader Topix index rose by 0.3 percent to close at 1311.27 points, with the rise of all but ten of the 33 sectoral indexes. The index of the week's transactions closed at a rise of 1.5 percent. The JPX-Nikkei index 400 rose by 0.4 percent to 11,883.82 points.

US stocks fell on Friday, which is a weak ending of a week of gains. Stronger-than-expected data on the US GDP and consumer spending increased the possibility that the Federal Reserve would raise interest rates sooner than expected.

The Dow Jones Industrial Index closed the trading session at Wall Street down by 57.32 points (0.34 percent) to 16,639.97 points. The broader Standard & Poor's index 500 declined by 3.65 points (0.19 percent) closing at 1948.05 points. The NASDAQ composite index, which is mostly a technology shares index, closed higher by 8.27 points (0.18 percent) to 4590.47 points. The three indexes ended the week on gains with the rise of the Dow Jones by 1.5 percent, Standard and Poor's by 1.6 percent and NASDAQ by 1.9 percent.

European stock indexes rose during Friday trading for the second session in a row. The energy sector received support from the rise in oil prices. The benchmark index recorded weekly gains, and at the end of the session "Stoxx Europe 600" benchmark index jumped by 1.6 percent (5 points) to 332 points, recording a 1.6 percent increase in weekly gains. The "FTSE 100" British index increased by (+83 points) to 6096 points, and the German stock index "DAX" jumped by (+182 points) to 9513 points, while the French "CAC" index rose by (+67 points) to 4315 points.

Gold prices also fell on Friday, affected by the rise of the dollar and global stock markets, but fund purchases continued with investors' expectation that the G20 meeting will not result in any significant progress towards a coordinated stimulus program.

Gold prices fell in spot transactions by about 1 percent to $1223.60 an ounce at the end of trading in the US market after it had fallen by 1.9 percent earlier in the session. However, it recorded over 9 percent in gains throughout the month, which is the largest increase since January 2012, after safe investment purchases raised prices to the highest level in a year on February 11th.

Oil prices fell on Friday due to profit-taking sales after strong gains over the week that pushed US crude oil to record the biggest weekly increase in seven years. The world benchmark Brent blend contracts of the nearest maturity closed the trading session lower by 19 cents (or 0.54 percent) to record $35.10 a barrel at settlement after jumping earlier in the session to $37, which is the highest level since January 5th.

US crude oil contracts closed lower by 29 cents (or 0.9 percent) to $32.78 a barrel after they had jumped about $1.7 earlier on Friday. Brent ended the week with over 6 percent in gains, while US crude jumped by 11 percent over the week, which is the largest weekly increase in seven years.

Key Global Developments

IMF Warns: The Global Economy is More Vulnerable to Shocks

Argaam:

The International Monetary Fund (IMF) said that the global economy is weak, warning that it is more vulnerable to downside shocks. This comes after the IMF revised downward its outlook for the pace of global economic growth last month to 3.4 percent this year and 3.6 percent in 2017.

In a released report, the IMF noted that weakness comes with the increasing financial instability and falling asset prices.

It warned that the outlook for global economic growth could drift off course due to market turbulence and the collapse in oil prices as well as political conflicts, calling on the G20 to develop a plan for new mechanisms aimed at protecting the countries that are most vulnerable to shocks.

Britain's Exit from the EU will Cause the Sterling to Lose 20 percent of its Value

Reuters:

HSBC said on Wednesday that the sterling pound could lose up to 20 percent of its value and that economic growth in the UK could fall by up to 1.5 percentage points next year if the British voted for exiting the EU in the referendum scheduled for June 23rd.

The bank said in a memo that the vote on Britain's exit from the EU is likely to have huge consequences for all types of assets. After the vote, uncertainty would surround the British economy, causing a possible slowdown in growth and a collapse in the value of the sterling.

The bank expects that the sterling pound could fall by 15 – 20 percent against the dollar heading towards the lowest levels it recorded in the mid-eighties. This means that the British currency will move towards equalization with the single European currency. The Sterling was traded below $1.40 today for the first time in seven years, while the euro was traded just below 79 pence.

Fitch Reduces Outlook for Oil Prices due to High Production and Stock

Argaam:

Fitch reduced its estimates for average oil and natural gas prices this year due to increased OPEC production, and increasing crude stocks.

In its estimates, the credit rating agency reduced its outlook for average oil prices to $35 a barrel this year, compared to previous estimates of $45 a barrel.

Fitch also reduced its outlook for natural gas prices to $2.25 per thousand cubic feet compared to previous estimates of $2.50.

World Debt Exceeding $60 Trillion Since 2007

AL Mal newspaper website:

The Bank for International Settlements (BIS) announced this week that world debt ballooned by about $60 trillion dollars since mid-2007, when the mortgage crisis began in the US, causing the global financial crisis that spread to the rest of the world. As a result, these debts accumulated to exceed $200 trillion, or the equivalent of three times the size of the economies of all countries of the world.

Bloomberg reported that the largest increase in the debt came from China, which borrowed more than $31.7 trillion during the period from the second quarter of 2009 until the corresponding quarter of last year, especially from state-owned companies that received loans from banks dominated by the Beijing government, threatening a new financial crisis.

Analysts in the global financial markets harbor intense fears of the emergence of a new crisis in the next few years, similar to the sovereign debt crisis that swept emerging markets in the late 1990s, when the accumulation of debt in Indonesia, Thailand, South Korea and the inability of the Government of Russia to repay its debt lead to huge financing plans for bailout.

The Deficit in the US Balance of Trade at Highest Level in 7 Months

Argaam:

The deficit in the US commodity balance of trade widened during January to its highest level since last June, as company exports in the US were negatively affected by the strong dollar and weak global economic growth.

The commodity trade deficit increased from $61.5 billion to $62.2 billion in December, according to the US Department of Commerce data.

Iranian Oil Minister Zanganeh: The Production Freeze Plan is "Laughable"

Reuters:

The Iranian Students News Agency (ISNA) on Tuesday quoted Iranian Oil Minister Bijan Zanganeh as saying that a proposal from oil producers to coordinate a freeze in production is "laughable," because it does not allow Iran to regain market share lost during the period of sanctions.

Zanganeh said that some of Iran's neighbors have increased their production to 10 million barrels per day in the past few years and export this amount, and "now they have the audacity to say that all of us must freeze production together."

"They freeze their production at 10 million barrels while we have to freeze our production at one million barrels .. this proposal is laughable."

Fitch: Region's Projects Saw a Contraction in Liquidity Flows

The Kuwaiti newspaper Al-Qabas:

The credit rating agency Fitch said that low demand and falling oil prices will exercise pressure on producers of gas, oil and liquefied gas as well as pipeline and oil refining companies in 2016, noting that liquefied natural gas sector is facing an increase in production capacity as well. It reported that pricing pressures in Asia may worsen with the establishment of new trade centers and producers defending market share, noting that oil and gas projects in the Middle East are exposed to market risk and have experienced a contraction in liquidity flows, but they are still holding up thanks to the low price levels necessary to achieve profits.

Obama «Cautiously Optimistic» about the Congressional Approval of Trans-Pacific Partnership Agreement

Washington - AFP

US President Barack Obama expressed "cautious optimism" about the congressional endorsement of the Trans-Pacific Partnership Agreement, concluded between the US and 11 other countries in the Asia-Pacific region.

"I am cautiously optimistic that we can still get it done," he said. Once the trade deal is in place, "American companies and American workers will be better off than the existing trade regime that we have right now," Obama said.

The ambitious Trans Pacific Partnership (TPP), reached in October and signed early February, aims to establish the largest free trade area in the world, including 12 countries representing 40 percent of the global economy.

To enter into force, it should be ratified by the 12 partner countries, but the US Congress is deeply divided about it. A number of Democrats oppose the deal.

Decline in Mergers and Acquisitions around the World by 23 percent since the Beginning of 2016

Argaam:

Merger and acquisition operations around the world fell sharply since the beginning of this year, while external demand to buy US companies hit a record high.

According to Reuters' news agency, mergers and acquisitions around the world have fallen by 23 percent to $336 billion since the beginning of this year compared to the same period of 2015.

Mergers and acquisitions around the world have registered a record increase last year, but are now facing a decline due to falling oil prices, and concerns about an economic slowdown in China.

China, Ireland, and Canada account for 88 percent of total foreign buyers of American companies since the beginning of this year.

Financial Markets Expect Further Reductions in the Rankings Oil States

Reuters

Financial markets are betting that the downgrading of Standard & Poor's of the credit rating of oil-producing countries on Wednesday will not be the last and that it may cut Saudi Arabia's rating to a level that is one notch higher than high risk rating after oil countries failed to agree on production cuts to strengthen prices.

Standard & Poor's downgraded Saudi Arabia by two notches and stripped the Kingdom of Bahrain of "investment grade" rating. It also downgraded the rating of Brazil, Kazakhstan and Oman, with the drop in oil prices, which drove it to undertake the second wave of large-scale ranking reduction during the year.

It is expected that other credit rating institutions, such as Moody's and Fitch, will follow in Standard & Poor's footsteps in the coming months. But levels of credit default swaps, used to insure debt or to hedge against problems thereof, expect more downgrading even by Standard & Poor's.

From the International Press

European Wheat Stocks Nearing Record Levels amid Slow Demand

Reuters:

Traders and analysts said that the debate on the terms of selling to Egypt and slow demand from Middle Eastern buyers affected by low oil prices have reduced hopes for the flow of EU wheat exports to reduce huge stocks.

Competition from Russia, Ukraine and Argentina—in a world enjoying record wheat supplies—limits prospects for accelerating EU exports after a slow start of the marketing season “July-June”.

EU exports have improved over the past two months. Benchmark prices were close to their lowest levels in five years, but export licenses of soft wheat show that exports in 2015-2016 are so far less by 15 percent compared to the previous season.

Following a record harvest of soft wheat in 2015, the EU is heading towards the largest wheat stocks at season-end due to slowing exports, while France is facing the largest stock in 17 years, according to official forecasts.

According to a trader in the export market, demand is now the driving factor after it was supply until recently. He added that the question now for the market is who would buy and at what price?

Weeks of tension between Egypt and its suppliers curbed the movement of trade. Egypt, the world’s largest wheat importer, has sent conflicting messages about whether it would accept any Ergot-contaminated wheat shipments.

The debate on Ergot contamination led to the stranding of a French wheat shipment, and the delay of Egyptian tenders. Payment delays have also made traders reluctant.
Despite the conclusion of contracts in the Friday tender, including a French wheat shipment, France’s sales this season do not exceed a quarter of the two million tons shipped to Egypt in the 2014-2015 season.

Further, France AgriMer last week revised downward its outlook for French wheat exports outside the EU by 300,000 tons to 11 million tons in light of the situation in Egypt, and despite strong sales to Morocco recently.

Agritel consultant, Sébastien Poncelet, said that exporting 11 million tons was still an acceptable level and means selling much larger quantities to Asia than what France had achieved so far. He added that the euro might extend a helping hand. If the euro falls to $1.08 “tomorrow,” we would have the cheapest wheat in the world.

However, the depreciation of the Ukrainian currency made its exports cheaper and reduced chances of selling French grains in Asia’s feed wheat markets.

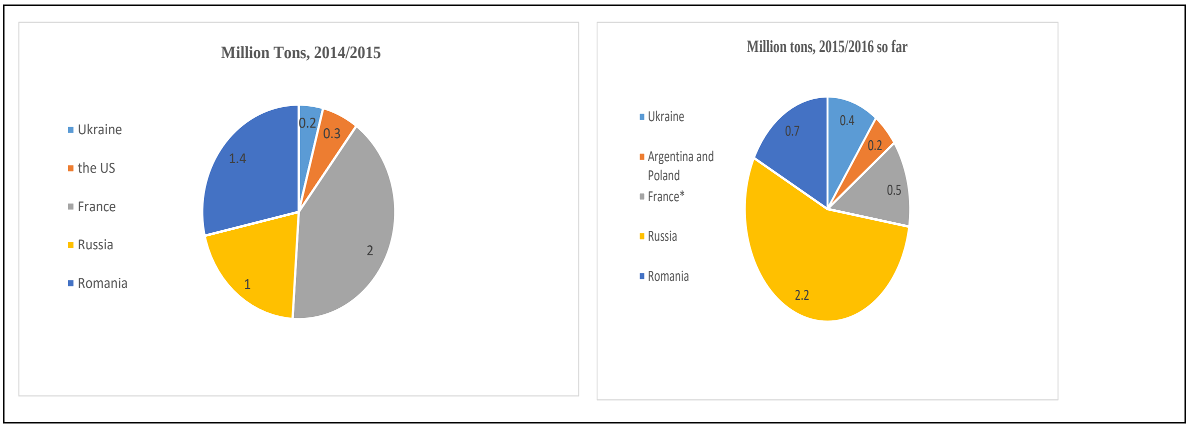
EU countries such as Germany, Poland and the Baltic states, which supply high-quality wheat to the Middle East markets, have gloomy outlooks due to signs of slowing purchases from oil-dependent countries.

EU exports were negatively affected by the tensions related to the terms of the Jordanian tenders.

Traders are waiting for the return of Saudi Arabia to the market after a slowdown in its usual tender cycle.

A German trader said that due to falling crude oil prices, governments do not have the liquidity they expected only a few months ago, adding that the decline in wheat prices since November encouraged the delay of purchases, but importers cannot postpone their purchases indefinitely.

Wheat Imports of the Egyptian Government by Origin (Fiscal Year Starts June 1st)



Source: The General Authority for Supply Commodities (GASC).

* Including a shipment of 60,000 tons rejected by Egypt.

Special Analysis

The Consequences of Britain's Possible Exit from the EU

(CNN) - British Prime Minister David Cameron announced that he would hold a referendum on Britain's membership in the EU on 23 June, adding that he would support Britain's staying in the EU after reaching an agreement with EU leaders in Brussels.

Cameron said: "Let me be clear, leaving Europe would compromise our economic and national security. … It is a leap into the dark." He added, "those *who want to leave Europe cannot tell you if British businesses would be able to access Europe's free trade single market or if working people's jobs are safe or how much prices would rise."*

"Our plan for Europe gives us the best of both worlds. It underlines our special status. But our special status also means we are out of those parts of Europe that do not work for us. So we will never join the Euro, we will never be part of Eurozone bailouts, never be part of the passport-free no borders area, or a European Army or a EU super-state."

He also warned of global threats from Russia and ISIS, saying that the challenges facing the West today pose a real threat, saying, "this is no time to divide the West."

The European Council President Donald Tusk announced reaching a deal, in Brussels, on the reforms requested by Britain for staying in the EU, pointing out that all the members of the EU supported the agreement for Britain's stay in the Union.

On its part, Moody's credit rating agency warned that Britain's possible exit would have significant negative repercussions on its economy. The agency said in a report that Britain's loss of its membership in the EU would affect its global credit rating and would raise the cost of government borrowing, which would negatively affect budget deficit and public debt reduction plans.

It explained that Britain's giving up of its membership in the EU would negatively affect the flow of foreign investments to Britain because of worsening uncertainty among investors, stressing that it would be forced to give a negative outlook to the British economy. Moody's said that accelerating the choice of when to hold a referendum was a positive step that would prevent the British economy from entering into a long period of uncertainty affecting prospects for economic growth and direct investment.

A study by “Open Europe” said that Britain’s exit from the EU would lead to a decline in gross domestic product by about one percentage point in 2030. It said that exiting the single market and the customs union would not be offset by any new trade agreement to be concluded with the EU.

The study pointed out that Britain would not thrive outside the EU unless it was prepared to use its restored freedom to take active measures for trade liberalization and deregulation.

However, opening the country's borders to compete with countries characterized by low cost of labor is contrary to the declared desire to stem immigration, which is an essential point in justifying its exit from the EU.

According to the study, what is certain and common in various scenarios is Britain’s restoration of its control on its borders and reducing immigration from all countries, including Eastern Europe, thus depriving nationals of these countries of social assistance.

In the event of exiting the EU, the British parliament would be able to repeal European laws included in the British law. The possibility of Britain’s exit also raises questions about other topics such as the consequences on the everyday life of EU citizens residing in Britain, who would be treated like other foreigners. In other words, they would need residence and work permits. The EU would reciprocate by applying the same rules to British citizens.

Among other expected consequences is Scotland holding a new referendum for independence from Britain, refusing to be forcibly separated from the EU. Unlike the first referendum, the Scots may choose secession this time.

Weekly Commentary

Egypt and the Global Crisis ... Escaping Towards Growth

Mohamed El-Erian, the internationally renowned economist and chief economic advisor at Allianz and member of the Central Bank of Egypt (CBE) Coordinating Council, spelled his vision of the implications of global economic conditions for Egypt during a seminar at the American Chamber of Commerce last week. He pointed out that Egypt had experienced several economic shocks that negatively affected its economic performance. However, he said that it is reassuring that what Egypt is currently facing is not comparable to what other countries in the region are experiencing, noting that this is a good indicator of Egypt's ability to overcome the crisis, provided sound decisions are taken.

He said that the global economy is going through an important turning point as major countries have begun recently to take unplanned decisions that are detrimental to the global economy, including China whose economic performance and decisions have long been sound and capable of achieving growth. He added that Egypt could not be isolated from the outside world; therefore, Egypt's turning this economic curve is not conditional only on internal performance but external as well.

El-Erian expected economic instability to end soon, saying that countries' success in overcoming the crisis is dependent on decisions taken by each country in the coming period. In his opinion, there are two scenarios. In the first scenario, the country would overcome the crisis, and achieve growth capable of utilizing the youth, thus realizing the optimal growth model and social justice. In the second scenario, economic instability and rising unemployment will continue. Both scenarios depend on the government's political and economic ability to take the right decision.

He pointed out that Egypt is not in recession yet. In spite of its economic troubles, Egypt achieved growth for the second year in a row. It enjoys several advantages that enable it to overcome the crisis, such as a sizeable market, young labor force, and a favorable geographical location. He noted that Egypt is witnessing remarkable mobility, but things must happen faster.

El-Erian pointed out that, like the rest of the world, the Central Bank of Egypt (CBE) is currently the only player in Egypt. But, unfortunately, it does not possess the necessary instruments to achieve economic growth and overcome the crisis. He added that central banks, being independent economic entities, are the only entities that recently took decisions to contain the economic crisis worldwide, but they are not solely responsible for solving it.

El-Erian said that the official decision to float or not to float the pound must be taken as part of a comprehensive economic vision. He added that a holistic view of the challenges is important and that quick fixes are not enough, pointing out that we have to bear in mind that the final objective of any decision is to achieve development, and adapt to any solution that achieves it. He said that Egypt could not shape its exchange rate policy away from other essential requirements, because that leads to the wrong way. He stressed that no country sets its exchange rate policy in isolation from other requirements, such as fiscal policies.

He noted that the global economy over the past 7 years has been facing big and difficult challenges that burdened central banks in many countries of the world, especially the US, Europe, and China. He went on to say that, central banks have been doing a lot for a long time by virtue of their responsibility for the financial position, which became truly unstable.

He pointed out that China is trying to overcome the crisis by injecting huge investments in infrastructure outside its territory, while US companies are incurring losses due to the unstable financial situation, which has been reflected on employment. El-Erian suggested that the world needs time to recover from the current crisis, adding that the global financial system has become unstable. He went on to say that current challenges must be placed in their proper place and dealt with accordingly, saying that the 2009 crisis imparted a new concept to crises experienced by the world.

The global economy, he said, is going through an important turning point, and major countries began recently to take unplanned decisions that are detrimental to the global economy, even China, he said, whose economic performance and decisions have long been sound and capable of achieving growth.

El-Erian said that, according to recent data, the Federal Reserve is not confident in the recovery of its economy. Politicians in the Congress, he added, cannot take the hard decision, because indicators suggest things will not return to what they were, because debt levels are high and many politicians are taking a long time to understand what is happening.