Issue: 20

Date : 17 July 2016

Our Economy & the World

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

- **Key Global Developments Over the Past Week**
- **From the International Press: World Food Prices Post Biggest Rise for Four Years in June: FAO**
- **Special Analysis: After Britain, Will Italy be the Next Threat to the European Union?**
- **An Analysis of Global Financial Market Performance and Changes in Prices of Goods and Raw Materials**

Key Global Developments

"Credit Suisse" Lowers Outlook for Oil Demand Growth due to Brexit Fears

Reuters

Credit Suisse said it cut its estimates for oil global demand growth, expecting Brexit to result in lower global economic growth and slower recovery of oil prices. Analysts said in a note that Britain’s vote in favor of Brexit is "the latest and perhaps the most powerful" catalyst for an imminent slowdown of global growth, which is likely to have a negative impact on oil demand in the second half of the year and in 2017.

The bank predicted a decline in oil demand in northwest Europe and the United States, and lower oil demand growth in emerging Asian markets as of the fourth quarter and next year.

However, analysts expected "strong" growth in US shale oil production of about 400 thousand barrels per day from the fourth quarter of 2016 to the corresponding quarter of 2017.

Credit Suisse downgraded its global oil demand growth forecasts in 2016 and 2017 by about 250,000 and 300,000 barrels per day, respectively.

However, the bank raised its forecast for the world Brent crude average price to $44.53 and $56.25 a barrel in 2016 and 2017, respectively, from US $37.77 and US $ 54.25 a barrel.

The bank also raised its forecast for the US West Texas Intermediate average price in 2016 and 2017 by $6.68 and $2.12 per barrel, respectively, to $43.59 and $55 a barrel.

It revised its forecast for natural gas price at the Henry Hub up by 19 cents to $2.43 per million British thermal units.

Germany Borrows for the First Time in 10 Years at Negative Rates

Argaam

Germany issued 10-year debt at negative rates, a first that signals investors’ rush towards safe assets.

The German Federal Bank said it sold more than 4 billion euros ($4.5 billion) in government bonds, together with a rate of -0.05 percent.

This is the first time that investors accept payment in exchange for lending government at 10-year maturity, with rising concerns about Brexit.

The German, Swiss and Japanese government bonds currently offer negative returns, with investors moving towards the acquisition of safe assets amid expectations for interest rates to remain at low levels for a long time.

EU-US Commercial Data Transfer Pact Enters into Force

Reuters

A new commercial data pact between the European Union and the United States entered into force on Tuesday, ending months of uncertainty over cross-border data flows, and companies such as Google, Facebook and Microsoft can sign up from Aug. 1.

The EU-U.S. Privacy Shield will give businesses moving personal data across the Atlantic - from human resources information to people's browsing histories to hotel bookings - an easy way to do so without falling foul of tough EU data transferal rules.

The previous such framework, Safe Harbour, was struck down by the EU's top court in October on the grounds that it allowed U.S. agents too much access to Europeans' data.

The Privacy Shield will underpin over $250 billion dollars of transatlantic trade in digital services annually.

Fitch: 2016 Will Strike a Record in Lower Credit Ratings for Countries and Companies

News Agencies

The global credit rating institution "Fitch" announced that 2016 would see a record in downgrading companies and countries.

Fitch warned investors that 2016 will see most downgrades, and will break the record reached 2011.

The agency noted that the decline in oil prices was one of the main pillars, which made 2016 see most downgrades, in addition to Brexit, which will make a decline in credit rating of the Eurozone countries inevitable.

"Fitch" called on countries and companies to re-adapt their economic conditions and cope with difficult economic conditions, pointing out that 22 countries are currently being assigned negative outlook ratings.

BARCLAYS: Britain is 'on the Cusp of Recession'

Argaam

Britain is battling against "spiraling uncertainty" and is now on track to slip into recession by the end of the year, according to the latest forecasts from bankers at Barclays.

Barclays expects that the UK will slip into recession by the end of 2016, with growth falling by 0.1 percent, thanks to the massive uncertainty surrounding Britain after the country voted to leave the European Union in late June.

The Brexit vote caused the pound to crash, and plunged Britain into an unprecedented situation where the country simply doesn't know what its political or economic future will look like. That uncertainty will bash confidence, stunt investment, and generally just weaken the economic picture.

As Barclays notes: "We expect that spiraling uncertainty will adversely affect firm and household confidence, forcing them to be more cautious and hold back on spending."

The bank continues: "We expect the aforementioned spiraling uncertainty to push the UK economy into recession from H2 16. We forecast headline GDP growth will average -0.1 percent due to a marked contraction in fixed investment."

Trade Ministers of the G20 Adopt a New Strategy for Global Trade Growth

WAM

G20 trade ministers have approved a broad trade growth strategy in their Shanghai meeting. The trade growth strategy adopted by the Group of 20 trade ministers spelled out broad principles for stimulating trade, including lowering costs, boosting trade finance and stimulating the service sector, as well as developing trade and improving the e-commerce index, which would contribute to global welfare and development.

The ministers expressed their commitment to the ratification of the "trade facilitation agreement" by the end of 2016 and providing the necessary resources to the mechanisms supporting "trade facilitation," specially designed to help developing and least developed countries to implement the agreement. They also agreed to work with other members of the WTO to convert the temporary RTA transparency mechanism into a permanent mechanism.

The ministers pledged to promptly implement the outcomes of the two ministerial conferences of the WTO held in Nairobi and Bali, and advance negotiations on the remaining issues of the "Doha Development Agenda," specially related to agriculture, access to non-agricultural markets, services, development and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The Ministers of Trade called on both the United Nations Conference on Trade and Development, the World Trade Organization, the Organization for Economic Cooperation and Development and the World Bank—in consultation with the International Monetary Fund (IMF)—to continue the search for further ways to promote coherence and integration between trade and investment regimes.

The G-20 trade ministers also pledged to strengthen capacity building to establish comprehensive and well-coordinated global value chains. They also pledged to develop and implement initiatives to support developing countries, and small and medium enterprises (SMEs) in key areas of the global value chains, including infrastructure, technology, and communications between supply chains, agriculture, development, e-commerce and skill development. They will also work to strengthen the capacity of developing countries and SMEs to comply with national and international standards as well as technical regulations; and to facilitate their access to information on trade and investment opportunities, welcoming all companies worldwide of all sizes, especially small and medium ones, to participate and capitalize on global value chains.

Implications for Egypt:

In light of financial and economic volatilities that the world is currently going through, and growing recession fears, Egypt has to take more robust actions to enhance growth, especially that downside risks are rising in the absence of decisive actions. Recovery from the global crisis is still very slow and fragile; while risks to ongoing recovery are increasing.

In spite of the increased pace of US economic growth, entities such as the IMF warned that growth in Europe and Japan was very disappointing. Slowing growth in China's oil sector harmed commodity exporters, including Brazil and Russia. Therefore, Egypt has to accelerate structural economic reforms, increase financial support, and to maintain its easy monetary policy. Also, there is a need for more fiscal consolidation in light of the current public domestic debt situation. These reforms should be associated with supply-side measures for fiscal stimulus to boost demand in the near term and absorb adverse shocks, especially that emerging markets, according to several international reports, will adapt better towards the recent wave of capital outflows thanks to increased reserves, lower foreign currency debts, and adopting more flexible interest rates.

An earlier IMF report said that more prudent fiscal policies, reduced public debt, stronger financial supervision, and flexible foreign exchange system would help avoid sudden currency shocks that characterized previous waves of capital outflows witnessed by emerging markets in the late 1980s and 1990s.

Egypt should start undertaking reform measures that focus on consolidating government spending, rationalizing consumption, paying particular attention to specific economic production sectors. It should also revive certain marginalized economic sectors. All these measures will be capable of reducing the deficit and improving the economy**.**

From the International Press

World Food Prices Post Biggest Rise for Four Years in June: FAO

Reuters

World food prices posted their biggest monthly rise for four years in June, buoyed by a surge in sugar and increases for most other edible commodities, the United Nations food agency said.

Food prices have been gaining ground since hitting a near seven-year low in January after four straight annual declines, and the United Nations Food and Agriculture Agency (FAO) now expects them to be stable for the next decade.

The 4.2 percent gain from May was the fifth increase in a row for the index, which measures monthly changes for a basket of cereals, oilseeds, dairy products, meat and sugar.

Food prices on international markets are now just 1 percent below the same month last year, the FAO said.

The FAO's forecast for 10 years of stable prices reinforced the view that agricultural commodities are emerging from an era of intense volatility unleashed by price spikes and supply tensions in 2007-2008.

Sugar prices rose 14.8 percent in June as heavy rains hampered sugar harvesting and affected yields in the world's largest producer, Brazil, the FAO said.

Wet weather also reduced the amount of sugar that could be recovered from each ton of cane, prompting producers to divert more sugarcane to ethanol production, boosting prices further.

Vegetable oil prices defied the upward trend to slip 0.8 percent, led by palm oil, which saw subdued global import demand and a seasonal recovery in production in Indonesia and Malaysia.

The FAO raised its forecast for world cereal production in the 2016-17 season to 2.544 billion tons, 15.3 million tons higher than last year but still below 2014's record harvest.

The upgrade is mainly based on improved prospects for wheat production, now forecast to hit 732 million tons due to better weather in the European Union, Russia and the United States.

Wheat utilization is also set to rise, the FAO said, as demand grows for its use in animal feed in the EU, Indonesia and the United States, but also for food consumption and industrial usage.

This higher consumption means global stocks by the end of the season in 2017 will be 1.5 percent below the opening level.

Implications for Egypt:

Egypt should pay attention at the beginning of the agricultural season to the need for planning agricultural targets according to world developments. Concerning world cereal production forecasts, the high level of global production implies that growth that is lower than the overall trend will continue for the third consecutive season. This reflects the negative impact of abnormal climate conditions caused by "El Nino" in the southern hemisphere, where the season has advanced more. This requires taking serious steps to produce new types of rice and grains that are less water consuming and more productive, along with introducing tight controls on agriculture and the volume of grain crops grown, especially rice.

Planning should keep in mind that the situation in Asia may push food prices to rise globally in the new season. This will increase the burden on citizens and will require pre-emptive action to reduce the impact on prices and domestic inflation, particularly that global consumption of grains is expected to increase. These developments require the government to maintain strategic stocks of grains, especially rice, at the beginning of the season to ensure price elasticity. Also, the government should declare before the beginning of the year its export policy, allowable volume of exports and other controls. This will prevent problems that recur each season because of price fluctuations, which are expected to occur this year as well.

Special Analysis

After Britain, will Italy be the Next Threat to the European Union?

Asharq Al-Awsat

After Europe woke up on Friday June 24th to Britain's referendum results in favor of Brexit, which would cause many economic difficulties for both parties, it seems that banks' insolvency in Italy could be the next danger facing the EU.

The collision between Italy and the EU about a potential bailout of the troubled banking system in the country is approaching day by day, threatening to bring about further challenges for the European Banking Federation, and posing a potential greater threat to the stability of Europe after Brexit.

The banking system in Italy is in trouble. Non-performing loans reached $540 billion, amid a dire need for new capital. Italian Prime Minister, Matteo Renzi, wants to allocate the equivalent of about $60 billion of the country's public funding to attempt to stabilize the banking sector.

Indeed, Italy is facing a problem of non-performing loans that forced the government to create a 5-bilion-euro fund to help fragile banks. The volume of such loans with Italy's oldest bank, Monte Paschi, amounts to 47 billion euros. The European Central Bank (ECB) calls for cutting that amount by 8 billion euros by the end of 2017. In general, total outstanding loans in Italy amounts to 360 billion euros ($399 billion), while its debts amount to 140 percent of GDP.

The problem for Renzi, Italy and the EU as a whole, is that the European Banking Federation's rules prohibit taxpayer bailouts as a first resort for insolvent banks. The rules, developed years ago, insist that shareholders and creditors should be bailed out before taxpayers.

Bankruptcy laws are another problem that will face Italy. Procedures usually take eight years in court compared to the European average of three years, making it difficult for banks to sell non-performing loans at decent prices.

Renzi tried to capitalize on the instability created by Brexit in Europe to persuade EU authorities to suspend the ban on government aid to the Italian banks. During the last week of June, there were negotiations between the Italians and the European Union on this issue. The German Chancellor, Angela Merkel, and ECB officials in Germany refused to even think of exempting Italy from the rules.

The constitutional referendum to be held in Italy this year is not less dangerous than that held in Britain. Economic Indicators, banking problems and the constitutional referendum indicate that Italy is in a severe crisis, the consequences of which may extend to all Europe.

The Italian Treasury said that the government's budget deficit in the first six months of 2016 amounted to 27.7 billion euros, an increase of about 5.8 billion euros from the deficit recorded in the corresponding period last year. The ministry pointed out that despite the rise in the deficit in the first six months of 2016, public finances are still moving towards meeting the objectives of the government for the full year.

The public sector budget recorded a surplus of approximately 8.6 billion euros in June, down from a surplus of 12.1 billion euros in the same month last year. June usually posts a budget surplus due to the expiration of tax returns' deadline in mid-year. Italy aims to reduce the public deficit in the government's budget this year to 2.3 percent of GDP or less than the EU's 3 percent ceiling, and slightly less than the 2.6 percent deficit posted last year.

Italians will vote during the referendum on reforms to its Senate, the upper house of parliament, to concentrate power in the lower house of parliament.

If the Italians agree on the proposed constitutional reform, Prime Minister Matteo Renzi will be able to pass laws that can improve the country's economic competitiveness. If the reform is denied, the current government could fall and a political crisis could break out. According to estimates by the General Confederation of Italian Industry, the country will see a recession, capital outflows and accumulation of new debts, if the reform is denied.

ECB governors conveyed their concern about the situation of banks in the Eurozone and the repercussions of Brexit, according to their last meeting minutes revealed last Thursday. Meeting minutes are published after the lapse of four weeks of their occurrence.

The meeting was held in Vienna on June 2nd, three weeks prior to the Brexit vote that was held on June 23.

Other things that worry ECB governors include efforts of banks in the Eurozone to correct their finances, which is a demanding job, according to the bank, but will contribute significantly to boosting economic recovery in the Eurozone.

In particular, governors stressed the need to address the issue of bad debts that have become more urgent in recent weeks after Italy sought to obtain permission from the European authorities to provide financial assistance and guarantees for its banks, already burdened with bad debts worth 360 billion euros ($399 billion).

Implications for Egypt:

Considering the current concerns about the Italian economy, Egypt has become more vulnerable to Brexit repercussions. According to “Al-Saa News,” Brexit is a strong shock not just to the British economy or the European economy, but also to the global economy as a whole. Growth opportunities that are now available to the global economy are, without doubt, less than they were before Brexit, which increases the originally heavy pressures on the global economy.

The decision of British voters to exit the European Union, according to the recent referendum results, is a turning point in global developments that puts an end to the dream of European unity and the EU model. The European economy in general is expected to remain in uncertainty for quite some time in the future, posing a threat to global economic stability.

The situation now requires Egypt to develop many detailed scenarios for the repercussions of the situation in the EU in light of potential future exits by other countries with which Egypt maintains close economic and commercial ties. This could result in increasing Egypt’s exposure to these crises in light of its growing economic relations with Italy in particular and with the European Union in general.

Global Financial Market Performance

Reuters/ Argaam

China's stock performance has stabilized at the end of Friday trading, following the announcement of better economic data from analysts, reducing the likelihood of pumping new stimulus measures.

The Chinese government announced that the country's GDP grew by 6.7 percent in the second quarter of this year, while it was estimated to grow by about 6.6 percent.

With better growth of the Chinese economy than analysts' expectations, investors reduced their expectations about the intention of the Chinese authorities to inject new stimulus measures.

The "Shanghai" composite index stabilized at the level of 3054 points at closing, posting a gain of 2.2 percent during the week.

Japanese stocks rose for the fifth session in a row at the end of the Friday trading session, supported by falling value of the yen with speculations of economic stimulus.

Japanese stocks posted strong weekly gains with Prime Minister, "Shinzo Abe," pledging to inject new stimulus measures to support economic growth in the country.

The Japanese market benefited from the Chinese government's announcement that it recorded an economic growth rate higher than analysts' expectations in the second quarter of this year, a good indication of the performance of the second largest economy in the world.

The Japanese "Nikki" index climbed 0.7 percent to 16,497 points, posting weekly gains that exceeded 9 percent, while the Topix index rose by about 0.4 percent to 1,317 points.

US stocks stabilized at the close of Friday trading, despite the release of economic data, while announcement of company results continues, with "Citigroup" profit falling by 14 percent in the second quarter.

With the stability of indices, the US stocks maintained their gains for the third consecutive week. The "Dow Jones" index closed at a new record high.

The "Dow Jones" Industrial Average settled at 18,516 points, recording 2 percent in weekly gains.

The "Nasdaq" index settled at 5030 points, recording 1.5 percent in weekly gains, while the "S & P 500" benchmark settled at 2,161 points, up by 1.5 percent over five sessions.

In the European markets, "Stoxx Europe 600" benchmark index fell by 0.2 percent or by -0.5 points to 338 points, while the "FTSE" British index rose by +15 points to 6,669 points.

The French "CAC" index fell by -13 points to 4,372 points, and the German "DAX" index settled at 10,067 points.

With respect to metals, gold futures fell by 0.4 percent, or by $4.8, to close at $1,327.4 per ounce, to post a weekly decline of 2.3 percent.

Silver fell by 0.8 percent or by 15.7 cents to $20.16 an ounce, but has gained ground over the last five sessions by 0.3 percent to continue to rise for the seventh week.

In the crude oil market, the US "NYMEX" rose by 0.6 percent, or by 27 cents, ending the New York session at $45.95 a barrel, recording a weekly gain of 1.2 percent.

The "Brent" crude rose by 0.5 percent (24 cents) to end the London session at $47.61 a barrel, achieving a 1.8 percent in weekly gains.

Regarding economic data, the US government announced a rise in retail sales last month of 0.6 percent versus 0.2 percent in the previous month. Industrial production also rose by 0.6 percent.

In China, the world's second largest economy grew by 6.7 percent during the second quarter, a rate that exceeded analysts' expectations.

Implications for Egypt:

Over the past week, the Egyptian Stock Exchange has continued to react more to its internal conditions, in light of the strength of internal variables, along with the emergence of positive developments in global markets that led to cohesion and the offsetting of previous losses. This presents a positive opportunity for the introduction of new instruments or developing new trading systems in the Egyptian stock market, especially that external variables are now exercising less pressure on the performance of the local market. This will contribute to increasing the chances of attracting foreign investments in the stock market over the coming period if conditions continue as such.

In reference to the New York Times' recent statement that the bond market right now is like a speedometer that is mis-calibrated and therefore unreliable, we believe that this statement, although less useful, cannot be interpreted literally. However, it still tells us that we should be concerned about the possibility of the world falling into a deflationary economic trap, which requires deliberation and preparation of deeper studies before introducing new dollar-denominated bonds in international markets.