Issue: 21

Date : 24 July 2016

ECES
The Egyptian Center for Economic Studies

Our Economy & the World

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

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Key Global Developments

IMF Cuts Global Growth Forecast
Middle East News Agency

The International Monetary Fund (IMF) cut its global growth forecasts citing uncertainty over Britain's looming exit from the European Union.

The IMF cut its global growth forecast for 2016 and 2017 by 0.1 percentage point for each year from estimates issued in April.

It said that Britain is among the countries that will experience the largest reduction in growth in 2016 and 2017.

IMF chief economist Maury Obstfeld said in a statement that the IMF was preparing to upgrade its assessment for global growth before the Brexit referendum because of the growth that exceeded expectations in Japan and the euro zone as well as the recovery of commodity prices.

Opportunistic Foreign Investors May Swoop on UK Assets as Pound Slumps
Argaam

Commercial property buyers are lured by the combination of the cheap pound and declining value of London real estate.

Wells Fargo bought a new office building in London, despite previously planning to only lease the property. The US bank did not disclose the price, but CNN Money said it spent £300 million on the brand new building.

The pound has dropped 12 percent since the U.K. voted to leave the European Union almost a month ago, cutting real estate values in dollar terms.

Zhang Songqiao was another foreigner snapping a good deal. The Chinese property magnate bought a £42.3 million ($55.6 million) hotel in central London on Tuesday. In dollar terms, that's nearly $8 million cheaper than before the Brexit vote.

Brexit to Drag on Global Growth, IMF says
AFP

The International Monetary Fund cut its forecast for global growth because of uncertainty caused by the British decision to exit the European Union amid a troubled economic climate.

In its report about the new quarterly forecasts, the IMF said that the results of the vote in the UK have increased downside risks to the global economy.

The Fund predicted that global GDP would not exceed 3.1 percent in 2016 and 3.4 percent in 2017, down 0.1 points compared with April, and a disturbing a recession compared with 2015.

It wrote that the currently recorded decline is still small, but the situation may get worse if London and its European partners do not reach an agreement on the terms of the new economic relations, and no solution is reached regarding access to the European single market.

The report said that the long negotiations that would likely precede drawing up the new relationships may leave behind larger effects than expected on the global economy.

According to a catastrophic scenario the Fund considered less likely, the report predicted a decline in world economic growth to 2.8 percent as of 2016, and the euro zone would be exposed to generalized tensions in the banking sector.

But the impact of Brexit on Britain will be quick, as the Fund seemed much less optimistic for British growth this year, expecting it to be 1.7 percent, down by 0.2 points and would deteriorate further in 2017 to a 1.3 percent, down by 0.9 points.

In the worst case scenario, Britain would suffer from a "recession" because of the likely move of a large part of services from the center of business in London to other European cities, and recording a further decline than expected in consumption and investment in the rest of the country.

IMF chief economist Maurice Opstfeld said that the future effects of Brexit are exceptionally uncertain.

The Fund said that the general climate is not favorable and Brexit adds a large dose of uncertainty about making progress in an already weak global economy, after it was ready to increase global forecasts slightly before the shock of the British referendum.

Greece Beats Target with €2.5 billion Budget Surplus

Argaam

Greece showed a primary budget surplus of 2.5 billion euros ($2.8 billion) in the first half of the year, data from the finance ministry showed Tuesday, beating a target of a EUR1 billion deficit due to lower spending and higher revenues.

The state budget only takes into account central government operations and doesn't include general government accounts, which comprise local government, and a portion of military spending in addition to some social-welfare expenditure.

Total revenue for the period reached EUR23 billion, exceeding its target by EUR146 million, the ministry said.

Budget outlays for the same period reached EUR24 billion, lower than the target by EUR3.35 billion, it added.

The primary budget surplus figure also includes some EUR2 billion in revenues from the country's public investment program, that mostly includes European Union funds aimed at boosting Greece's infrastructure and the economy's competitiveness.

Current U.S. Economic Recovery May End up as Longest Ever

Argaam

The seven-year-old economic recovery in the U.S. is already the fourth longest since 1850, and the odds of the current expansion breaking the record is not so farfetched, according to Market Watch.

The long road back from the Great Recession began in mid-2009 and July marks the 84th month of recovery. By next February the expansion is likely to move into third place.

The expansion can break an all-time record of 120 months if the economy continues to chug along until June 2019 — three years from now.

Most modern recessions have been proceeded by a cycle of Fed Interest rate hikes that make loans more costly to obtain. During the current recovery the central bank has kept its benchmark short-term interest rate near zero almost the entire time.

The Fed did raise rates for the first time in nine years in December, but only by a quarter of a percentage point.

It's held off raising rates again so far this year because of fresh worries about the health of the labor market, the broader U.S. economy and unsettling developments overseas such as the U.K. vote to exit the European Union.

IMF Raises Mideast Growth Forecast for 2016

AFP

The International Monetary Fund raised its 2016 growth forecast for the Middle East and North Africa after a rebound in oil prices.

The region, along with Afghanistan and Pakistan, is set to see economic growth of 3.4 percent this year, better than a previous projection of 3.1 percent, the IMF said.

At the same time, it cut the growth forecast for 2017 to 3.3 percent, down from 3.5 percent in April, citing fallouts from "terrorism" and geopolitical tensions in its World Economic Outlook Update.

The region includes major oil exporters such as the Gulf Arab states, Iraq, Iran and Algeria, as well as oil importers such as Egypt, Morocco and others.

Following the lifting of international sanctions in January, Iran's oil exports have reached more than two million barrels per day, close to their pre-sanction levels.

Oil prices fell worldwide since mid-2014, reaching below $30 a barrel earlier this year. However, prices have seen some improvement in the past few weeks, and oil is currently traded at nearly $45 a barrel.

China Eases Investment Rules in Free Trade Zones

Kuwaiti Al-Qabs Newspaper

The Chinese government has decided to ease investment rules in four free trade zones (FTZs), temporarily allowing foreign investors to found wholly-owned enterprises in a number of fields, including iron and steel production and gas station operations.

Xinhua news agency, citing an official statement, said that the resolution on temporary adjustment of regulations for administrative approvals in the Shanghai, Guangdong, Tianjin and Fujian FTZs was passed by the National People's Congress Standing Committee.

The adjustment contains a total of 51 items, with more than 20 of them involving changes from administrative approval to managerial registration for foreign investment.

It also approved wholly foreign owned enterprises in dozens of areas outside of the negative list on foreign investment, covering sectors ranging from agriculture to transportation.

Meanwhile, non-financial outbound foreign direct investments made by Chinese companies jumped 58.7 percent in the first half from the same period last year to USD86.77 billion. China's outbound direct investment soared in June by 44.9 percent to $15.34 billion. Its investment abroad increased by 61.9 percent in the five months from January to end of May compared with the corresponding period last year to reach 479.26 billion yuan ($72.86 billion).

Kerry Says Informal U.S./UK Trade Talks Could Start before Brexit

Reuters

It is more important than ever for the European Union to strike a trade deal with the United States, Secretary of State John Kerry said, adding there was no way for Britain to strike a trade pact with Washington before leaving the bloc.

Britain voted in a referendum last month to leave the EU but Prime Minister Theresa May's new government has yet to decide on when to trigger formal exit talks.

Speaking in London, Kerry said it would be "physically impossible" to cut a trade deal with the United Kingdom before it leaves the EU although he said after talks with new Foreign Secretary Boris Johnson that informal talks could begin earlier.

Implication for Egypt:

Egypt must pay attention to the fact that global economic developments are witnessing new shifts in terms of effects. The US has begun to relatively emerge from recession and developing countries are seeking to enter into new partnerships in light of China's efforts to transform into a global economic powerhouse through the Asian Bank, while fears of looming recession in the EU are rising. This requires the Egyptian government to put together stimulus policies that rely mainly on the development and revitalization of domestic industries, import substitution, and export promotion to markets where Egypt enjoys a comparative advantage, especially Arab and African markets. Egypt must also develop medium-term policies for the development of small and medium enterprises to promote economic growth and development away from the effects of the global financial crisis, which is currently taking new turns.

Egypt should also take into account the importance of continued assessment of the expected impact of Brexit, as its repercussions are still emerging, and Egypt, unlike many countries around the world, has yet to take steps to conclude a trade agreement with Britain.

China's move to ease free zone procedures to attract more investments highlights shortcomings of the Egyptian Investment Law, issued in March 2015 with respect to this vital sector, which represents a major part of Egyptian exports and products. This requires taking quick steps to reorganize the private free zones sector in the Egyptian legislation.

From the International Press

How Strong is the Asian Infrastructure Investment Bank (AIIB) Led by China?

Argaam

China's influence around the world is growing in a way that irks many. In the meantime, the recent financial turmoil in the second largest economy in the world exposes investors to risk.This combination of power and risk has led some to be afraid of China, and others to be afraid for it.

Both sides have reasons to be afraid concerning the Asian Infrastructure Investment Bank (AIIB) led by China, which held its first annual meeting in Beijing and agreed projects worth $509 million. The Economist captures in a report the extent of this concern among investors.

Institutional Framework

- The AIIB reflects new willingness by China to put its external lending operations in an institutional framework, which observers described as generous and controversial at the same time.

- Another sign of the growing global influence of China lies in the revival of the transcontinental trade routes such as the "Silk Road" to revive trade between Beijing and many of the recipient countries.

- Analysts believe that the AIIB is the Chinese alternative to international financial institutions such as the "World Bank," led by the US, and the "Asian Development Bank," led by Japan.

- Critics argue that this Bank provides conclusive evidence on China’s intent to get around international financial institutions rather than cooperate with them. Some consider this as hostile.

- Markets looked at the AIIB in conjunction with China’s foreign exchange reserves reaching four trillion dollars. Since then, the yuan fell and foreign capital exited.

Unwarranted Fears

- Analysts believe that fears about China's influence in the new bank are exaggerated, because Beijing contributes less than 1 percent of its remaining reserves, while 70 percent of the Bank's capital, estimated at about $100 billion, is obtained from 56 other partner countries.

- The Bank also collects funds by issuing its own bonds. It also seems that matters are going according to a specific timeline, coinciding with the decline of capital in emerging markets and, therefore, highlights the role of the Bank in filling this gap.

- Unlike the World Bank, which many accuse of political bias, the AIIB will focus only on infrastructure, and there is no board of directors or permanent branch offices in borrowing countries, in addition to speedy project approval within six months.

- The Bank should not be evaluated or criticized in the absence of an alternative. Had it not been launched, China would be present alone as an international lender; but it sought to invite other countries to participate.

- Analysts stressed that if the China-led AIIB is given room, it would surpass other international financial institutions due to its ambitious plans, which include, for example, bringing electricity to 2.5 million rural houses in Bangladesh.

Implications for Egypt:

We believe that Egypt's participation in such regional development initiatives represents an important economic driver that must be maintained at this phase. The creation of this Bank gives an impetus to funding via multiple methods and channels to bridge a large gap in the provision of necessary funds for infrastructure and to advance sustainable economic development in participant countries. Contribution will also allow Egypt to take advantage of being a founding member of this investment entity.

This new entity represents a future power that is on par with international institutions like the World Bank. Egypt's participation as a founding member at this stage supports Egypt's potential request to host the AIIB headquarters in Africa. It also allows Egypt to have representatives in all the Bank's sectors during establishment, and creates an important opportunity for Egypt and Asia to invest and grow together.

Egypt's participation as a founder member will support its ability to access aid and soft loans to finance projects later on (we must take into account that founding members now include some economically troubled countries, which were keen to participate as founders). The fact that the AIIB's authorized capital will be provided by installments, and might increase with expansion in the future, makes participation less of a burden on Egypt's public finances.

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Special Analysis

Can We Ignore the Alarm Bells the Bond Market Is Ringing?

Al-Sharq Al-Awsat

The financial media tend to report breathlessly about what the stock market did yesterday. But savvy economic analysts have always known the bond market is the place to look for a real sense of where the economy is going, or at least where the smart money thinks it is going.

And right now, if the bond market is correctly predicting the economic path ahead, we should all be terrified.

But, please, read on before panicking. There's a lot more to the story.

The stock market can rise and fall for all sorts of reasons, and sometimes for no apparent reason at all. But the bond market, where trillions of dollars change hands and long-term interest rates are determined, is steadier (normally). Its prices are generally tied closely to the outlook for growth and inflation over the years ahead.

The long-term interest rates that currently prevail across all the major advanced economies are consistent with a disastrous economic future. Taken at face value, they imply that the smart money expects inflation will remain extraordinarily low for years to come, and that growth will stay so weak that central banks won't be able to raise rates for years. It is a shift that has accelerated since Britain's vote on June 23 to leave the European Union, but one that has been underway for years.

Look at the current shape of the American "yield curve," the chart of how rates compare for short, medium and long-term bonds. It implies a 60 percent chance of a recession in the next year based on historical patterns, according to Deutsche Bank analysts. Long-term interest rates hit record lows last week — which is to say the lowest in the 227-year history of rates in the United States.

Prices for inflation-protected bonds suggest that consumer prices will rise only about 1.4 percent a year through 2021 — and only 1.5 percent in the five years after that. They suggest that not only is the Federal Reserve unlikely to find conditions that warrant an interest rate increase in the remainder of 2016, but also that there is only about a 50 percent chance of a rate increase in 2017.

Across other major advanced economies, the signals sent by bond prices are even worse. Ten-year bonds are now offering negative interest rates in Germany, Japan, Switzerland, Denmark and, as of Friday's close, the Netherlands. That means buyers of these securities will get fewer euros, yen, Swiss francs or Danish kroner back than they invested, a development without precedent in hundreds of years of financial history.

But that phrase "taken at face value" is doing some heavy lifting here. There are reasons to think that current prices are reflecting idiosyncrasies in the supply and demand for safe assets, rather than a conviction among global investors that very bad times are ahead.

Many of the purchasers of government bonds do so not because they find the returns offered compelling but because they have to. Insurers face regulators who may require that they do so. Pension funds seek to offset long-term obligations with safe assets of similar duration. Banks buy bonds to comply with rules limiting how much risk they can take.

In the last few years, central banks have become the biggest buyers of bonds. The Federal Reserve's program of quantitative easing — buying bonds to try to stimulate the economy — ended in 2014, but the European Central Bank and the Bank of Japan are just getting going; the E.C.B. is buying 80 billion euros' worth of securities a month.

So you have a strong demand for bonds coming from institutions that are willing to buy at almost any cost — they are inelastic, in economic terms.

Then on the supply side, governments have not exactly been issuing vast supplies of new bonds, for reasons involving anti-deficit domestic politics. The value of outstanding German general government debt was $1.8 trillion at the end of 2015, for example, down from $2 trillion a year earlier.

Whatever you think of the wisdom of using government deficits to try to prop up a faltering economy, governments for the most part simply are not responding to very low interest rates and depressed economies by radically increasing deficit spending and thus increasing the supply of bonds.

So rising demand for bonds that is largely indifferent to price (even a willingness to buy the bonds at a certain loss) along with pretty much fixed supply combines to drive up prices, which in the bond market means driving down rates.

And even though the United States isn't the prime driver of this — the Fed has ended its Q.E. program, and American debt outstanding continues to rise — the bond market is sufficiently global that it's an important part of the story.

When German and Japanese bonds are offering negative returns, the 2 percent or so that United States Treasury bonds were offering earlier this year looked extremely attractive. Essentially the United States has imported this very low interest rate environment from overseas, even though the domestic economy is in pretty good shape and the Federal Reserve had been planning interest rate increases.

So even though in normal times bond prices give useful information about the likely path of inflation and growth, this might be an instance when those indicators are less useful.

Among the evidence that the recessionary signals out of the bond market are wrong? If bond prices are an unreliable yardstick, we can look to other markets that may be flawed, but are at least flawed in different ways.

And those other markets are not flashing recession warnings at all: The United States stock market closed on Monday at a record high; indexes of future stock market volatility are quite low; and oil prices, after a furious rally since the winter, have mostly held onto their gains.

So how much of the drop in interest rates can we really pin on these supply-and-demand factors in the market for bonds, as opposed to a genuine shift in investors' expectations about the future? Roberto Perli, an economist at Cornerstone Macro, has tried to disentangle the parts of the puzzle.

He estimates that about three-quarters of the drop in American Treasury yields since the start of the year is because of a decline in the "term premium," or the compensation investors demand for tying up their money over many years. This is largely attributable to those supply-and-demand factors. He attributes about one-eighth of the drop to investors' perception that the Fed will raise rates more slowly for any given economic circumstance than they had assumed at the start of the year.

He attributes only one-eighth of the drop to an actual belief among bond buyers that the economy will grow more slowly in the years ahead than they had thought at the start of 2016.

There is good news in that as well as bad. The good news is that most of the drop in long-term interest rates is being driven by things that have little to do with the underlying strength of economic growth. The bad news is that some portion of the drop really is being driven by more pessimistic economic views, at a time a great deal of pessimism is already baked in.

The bond market right now is like a speedometer that is mis-calibrated and therefore unreliable. It may be less useful than usual, and is not to be interpreted literally — but it’s still telling us something. And that something is that we should be worried about the possibility the world is in a nasty deflationary economic trap that won’t get better anytime soon.

Implications for Egypt:

Bond issuance now represents a part of the country’s fiscal policy and ways of bridging the widening financing gap. However, it is important that the resulting revenue is injected into investment and development projects that will generate stable cash flows in foreign currency to finance bond payments and interest due, so as not to represent a growing burden on the state budget if used to finance the budget deficit. Also, it is important to link the issuance to the way resources and revenues are used and to study marketing prospects in global markets before embarking on the issuance.

The importance of the issuance at this time lies in Egypt’s return to the international financial markets in light of the national economy’s need to bridge the financing gap, by borrowing or via dollar-denominated bonds or other. But we must consider the results of the promotion process for the issuance in light of the situation in global markets on the one hand, and Egypt's credit rating by international institutions, on the other, in addition to revenue levels on developing country issuances in global markets.

We expect Egypt to have difficulty in the next bond issuance, because of the possibility of increased interest on the US dollar as well as unrest in emerging markets. Add to this the violent shock of Britain's exit from the European Union. However, this difficulty is alleviated by virtue of the economic reforms to be applied and changes that are taking place in monetary policy, with positive implications for fiscal policy and the economy as a whole.

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

Global Financial Market Performance

Reuters/ Argaam

Chinese stocks fell at the end of Friday trading session, marking the first weekly decline in a month, with the decline in speculations of injecting new stimulus measures.

Shares of consumer product companies and energy companies declined, with falling oil prices, and speculations of declining demand on other energy sources such as coal.

China's stock market has suffered from the tendency of some investors to collect profits after the strong gains registered in the previous period, as well as expectations that the central bank would not inject new measures to stimulate the economy**.**

The "Shanghai" Composite Index fell 0.9 percent to 3012 points at closing, registering a weekly loss of about 1.4 percent.

Japanese stocks fell and the end of Friday session, with profit-taking, and the rise of the yen with the decline in the prospects for pumping strong stimulus measures by the central bank.

The Japanese stock market has been adversely affected by the rising value of the yen, after the Bank of Japan governor denied yesterday reports that predict the bank would inject stimulus measures that may include "helicopter money."

Investors still expect the Government of Japan to pump fiscal stimulus measures that may reach 10 trillion yen, in an effort to support growth and inflation.

The Japanese "Nikki" index fell by 1.09 percent to 16,627 points, but rose by 0.8 percent in a week. The "TOPIX" index fell by 0.9 percent to 1,327 points.

US stocks rose at the close of Friday trading after a weak opening as it received support from the telecom sector stocks, which reached equilibrium amid a declining industrial sector. Major indexes posted gains for the fourth consecutive week, and the "S & P" index hit a new record**.**

The Dow Jones' Industrial Average index increased by 53.6 points to 18,570.8 points. The "Nasdaq" index rose by 26.2 points to 5100.1 points, its highest close this year, while the "S & P 500" benchmark rose 9.8 points to 2175.03 points, a new record close.

On a weekly level, the "Dow Jones" index recorded 0.3 percent in gains, while the "Nasdaq" index posted gains of 1.4 percent, and the "S & P" rose by 0.6 percent this week**.**

In the European markets, the "Stoxx Europe 600" dropped 0.07 percent, or 0.2 points, to 340.33 points, and achieved a weekly gain of 0.7 percent, which is the second in a row.

The German DAX index dropped - 8.75 points to 10,147.46 points, while the "FTSE" British index rose 30.59 points to 6730.48, and the French "CAC" rose 4.85 points to 4381.1 points.

On the other hand, gold futures prices for August delivery dropped 0.6 percent, or by $7.60 to $1323.40 an ounce. The precious metal fell by 2.3 percent over the past week after it achieved profits during the last six weeks**.**

In the oil market, the US "NYMEX" fell by 1.3 percent or by 56 cents to close at $44.19 a barrel, recording a weekly loss of 3.8 percent, while the benchmark "Brent" index fell by 1.1 percent or by 51 cents to close at $45.69 a barrel, recording a weekly loss of about 4 percent**.**

Implications for Egypt:

The downward trend of the Egyptian Stock Exchange (EGX) over the past week relates to internal factors related mainly to the exchange rate and the beginning of discussions on implementing the value added tax. Rather than responding to the global markets, the Egyptian Stock Exchange has continued to exhibit relative stability. In other words, EGX continued to react more to its internal conditions over the past week in light of the strength of internal variables, along with the emergence of positive developments in global markets that led to cohesion and offsetting previous losses. This presents a favorable 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 provided that these conditions continue.

We emphasize that the country’s current approach to consider offering quotas of companies in the Egyptian stock exchange or global markets requires careful study of the timing as well as pricing mechanisms. The chances of its success should also be studied in the light of current developments in most global markets, which have been experiencing declining liquidity in favor of other investment safe havens such as gold and real estate. The purpose is to ensure the offering is a success and achieves its objective.