Issue: 24

Date : 14 August 2016

Our Economy & the World

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

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Key Global Developments

U.S. EIA Lifts 2016 World Oil Demand Growth Forecast
Reuters

The U.S. Energy Information Administration raised its 2016 world oil demand growth forecast by 10,000 barrels per day to 1.45 million bpd.

In its monthly forecast, the agency cut its oil demand growth estimate for 2017 by 40,000 bpd to 1.45 million bpd.

The administration predicted a decrease of 700,000 barrels per day in US crude oil production this year compared to its previous forecasts for a reduction of 820 thousand barrels per day.

The EIA speculated that US oil production in 2017 will fall by 420,000 barrels per day, compared with a drop of 410,000 in its previous forecasts.

The administration left its forecast for oil demand growth in the US in 2016 unchanged at 160,000 barrels per day, while cut its forecast for demand growth in 2017 to 100,000 barrels per day from 120,000 barrels per day in the previous forecast.

Investors Look Forward to Investing in Africa's Renewable Energy Projects
News Agencies

According to a new survey conducted by “Havas Horizons,” international investors say Africa’s renewable energy industry will be the most attractive by 2020 and they are ready to invest therein.

Havas Horizon Service, which is dedicated to emerging countries and was launched in collaboration between French Havas and the Choiseul institute, said that investors believe in the ability of the African continent to become a global reference for renewable energy, an activity that has been accorded a distinguished position in their investments.

According to the study, which included 55 banking and financial institutions from January 14 to February 24, investment in energy projects, which has been for a long time considered risky represents now an opportunity to provide a significant return on investment.

It added that solar energy will be the most promising energy solution by 2020, and that Africa is now experiencing a general direction towards the development of renewable energy sources at the expense of fossil energy sources.

Despite the decline in the prices of raw materials, particularly oil, investors have expressed their confidence in the continent and stressed their desire not only to keep their investments in the continent but to boost them as well.

Investors said that there are five countries that offer significant investment opportunities, namely, Ethiopia, Nigeria, Morocco, Ghana, and Senegal. However, they saw that there are barriers to investment in the energy sector, especially legal and governance-related risks.

"Barclays": Central Banks and Governments Ran out of Options for Addressing the Economy

Argaam

The ability of policymakers to stimulate economic growth is dwindling rapidly, and both central banks and governments around the world are running out of options, according to new research from analysts at Barclays.

In Barclays' Global Economics Weekly note, the Bank said that the ability of central banks or governments to fix things through fiscal or monetary stimulus if the world faces an "adverse shock" to its economy is "increasingly exhausted."

Since the financial crisis, central banks around the world have embarked on unprecedented levels of loose monetary policy, cutting interest rates and launching huge packages of quantitative easing.

All of this policy action hasn't stimulated anywhere near as much activity as expected. Growth around the world remains subdued, with the Eurozone — where interest rates are below zero and bond-buying programs have been enormous—particularly weak.

UK Economy Started to Contract in July - NIESR

Reuters

Britain's economy started to shrink the month following the vote to leave the European Union, according to a forecast from the National Institute of Economic and Social Research.

Britain's economy contracted around 0.2 percent last month, NIESR estimated, pushing down quarterly growth in the three months to end of July to 0.3 percent from 0.6 percent in the three months to June.

NIESR research fellow James Warren said: "Our estimates suggest that there is around an even chance of a technical recession by the end of 2017," repeating NIESR's view in its economic outlook last week, when it chopped its forecasts for growth this year and next.

Business surveys suggest corporate activity has contracted sharply since the June 23 referendum.

U.S. Productivity Falls for Third Consecutive Quarter

Argaam

According to an official report, U.S. worker productivity fell for the third straight quarter this year, in a negative signal for the world's largest economy.

The Labor Department said that productivity dropped at a 0.5 percent annual rate in the April-June period, while analysts' forecasted a 0.3 percent rise.

In the second quarter, productivity decreased at a 0.4 percent rate compared to the same period last year, the fastest year-on-year pace of decline in three years.

Data showed a rise of 1.2 percent in goods and services production in the second quarter of 2016, while the number of working hours showed a 1.8 percent increase.

Productivity measures the amount of production per employee per one hour of work. High productivity is considered the basis of improving the standard of living in the countries over time and lead to higher wages and increased corporate profits.

US annual average productivity growth scored 1.3 percent during the period 2007 - 2015, compared to 2.2 percent per annum in the period 1947 - 2004.

Oil Prices Drop 20 Percent in July
Kuwaiti Al-Watan website

The National Bank of Kuwait said concerns about abundant oil production in world markets still persist, as markets witnessed many developments after recovering from the negative effects of the British referendum to exit from the European Union.

The Bank added in its weekly report on global energy markets that world oil prices dropped by about 20 percent in July compared to the "high" levels recorded in June, amid expectations of a slowdown in global demand growth to 1.4 million barrels per day in 2016 and about 1.2 million barrels in 2017.

Analysts' attention turned to the US production of shale oil, which rose over the past four weeks, after a whole year of continuous decline. This rise coincided with the return of drilling rigs activity, which increased in number since last May.

The strength of the US dollar in turn caused the decline in oil prices since June; as the dollar index rose by 6 percent since May. The strength of the dollar also caused a cost increase for suppliers in currencies not pegged to the dollar.

The Bank noted that the level of global production and the level of global demand came close to equilibrium in the markets. The surplus in production fell against demand to 100,000 barrels per day in the second half of 2016. This represents a significant change from a surplus of 2.2 million barrels per day in the corresponding period last year.

According to the Bank, production from outside the Organization of Petroleum Exporting Countries (OPEC) contracted this year by about 0.9 million barrels per day to 56.5 million barrels, while the OPEC production increased by 476,000 barrels to 32.8 million barrels a day in June.

Nigeria's output rose by 97,000 barrels per day in June to reach 1.5 million barrels after doing some maintenance work, while oil production in Saudi Arabia rose by about 66,000 barrels per day coinciding with Summer.

Kuwait's production reached 2.8 million barrels per day in June, recording its highest level in two years with 40,000 additional barrels per day. Kuwait signed agreements with British Petroleum (BP) and Shell to improve technical services in order to continue increasing production activity in the oil fields.

Iran worked to increase its production by about 77,000 barrels per day, bringing total production to 3.6 million barrels as part of its efforts to produce four million barrels a day. Iran’s ambition is to attract at least $70 billion in investment to develop its oil sector.

China’s Central Bank Plans to Increase Yuan’s Global Usage
Argaam

China’s central bank said it plans to push the yuan’s global use by seeking more cooperation with other countries and improving the infrastructure needed to support wider use of the currency.

The comments were included in a three-paragraph statement, posted on the People’s Bank of China website, on its forthcoming 2016 annual report on yuan globalization.

The central bank also plans to increase the use of the yuan as a reserve currency with the increase in yuan funding channels. China’s central bank did not release any other details on the report results or the date of its publication in full.

The statement comes almost a year after China’s devaluation of its currency, which roiled global markets and sent stock and commodity markets tumbling.

Implications for Egypt:

In light of escalating global developments and growing recession fears in several regions worldwide, Egypt has to take more robust actions through economic reform packages that focus on reducing government expenditure and rationalizing consumption, encouraging certain productive sectors, and revitalizing marginalized investment economic sectors. These actions could help reduce the deficit and improve the economy.

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 denominated debts, and adopting more flexible interest rates.

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.

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ECES
The Egyptian Center for Economic Studies

From the International Press

Employment - North Africa Governments' Objective
Asharq Al-Awsat

Employment issues are prevailing in the plans of North Africa governments. The Egyptian government pays attention to national projects that employ thousands of workers to maintain unemployment at less than 13 percent. The Moroccan government succeeded in reducing the unemployment rate slightly, despite the drought, the shrinking agricultural sector and slowing overall growth, by providing a reasonable number of temporary jobs, in order to overcome the crisis. The Tunisian General Labor Union (UGTT) has become an engine of employment growth and a decision-maker in Tunisia.

Morocco's jobless rate fell to 8.6 percent in the second quarter this year from 8.7 percent in the same period last year, mostly on employment growth in the construction and services sectors, official figures showed.

Services, building activity and industry added 149,000 additional jobs to help offset 175,000 jobs lost in the agricultural sector due to severe drought, the High Planning Commission added. The government expects the 2016 cereal harvest to fall sharply after last year's record crop of 11 million tons due to bad weather and more farm job losses are expected in 2016.

The woes of the farm sector have put further pressure on the Moroccan government, which is already facing protests over austerity measures.

The industrial sector created 38,000 jobs, the data showed. Construction and services added 70,000 and 41,000 jobs respectively, more than in previous years, a sign that the Moroccan economy has started to recover from years of recession caused largely by the euro zone debt crisis. The euro zone is Morocco's main trade partner. However, jobs created by construction and services are mostly precarious, the commission warned.

The Finance Ministry has forecast the economy will grow this year by less than 2 percent, slowing from 4.4 percent in 2015. However, the planning commission said the drought would drag growth down to 1.3 percent in 2016. Informal labor abounds in Morocco, making it hard to produce reliable employment figures.

In Tunisia, where unemployment has settled above 15 percent, winner of Nobel Peace Prize and Secretary General of the Tunisian Union of General Labour (UGTT) said that he would not give the new government a blank check, and that he would monitor how committed it is to the agreed upon labor priorities.

The Secretary General, Hussain Abbasi, said that the UGTT will be interested only in how committed Prime Minister Youssef al-Shahed is to the Carthage document. He added that the government work should not exceed the document on which the dialogue in Carthage Palace was built.

Tunisian parties and national organizations signed the Carthage document a few weeks ago during the national dialogue held at the presidential palace. The document covers work priorities in the program of the national unity government, which President Beji Caid Essebsi called for, and is currently under consultation regarding its composition.

President Essebsi officially tasked Yousef al-Shahed, leader of the Tunis Appeal Movement Party, which leads the coalition government, to form a national unity government that will be entrusted with the task of reviving the economy and making wide reforms.

The politically and socially powerful UGTT did not comment on the choice of al-Shahed, but it stressed the importance of applying what was stated in the Carthage document.

Abbasi said in his statement that the document is clear and includes every security, economic and social aspect, as well as all that would take the country out of its crisis. He added that this should be followed by the next prime minister, and that he would not give a blank check to anyone whatsoever.

The designated prime minister, Youssef al-Shahed, said immediately after his designation that the new government will work according to the document, with a focus on five priorities, namely, win the fight against terrorism, war on corruption, boost growth, maintain financial balances, and address the hygiene and environment file.

Al-Shahed began consultations with political parties and organizations to select ministers and his government is expected to be submitted to the parliament for voting within weeks.

Implications for Egypt:

Though unemployment slightly declined recently in Egypt, its real rate is not truly reflected due to lack of clear data about the informal sector. According to previous statistics, the agriculture sector is leading activities, a matter that signals the need to increase jobs in the manufacturing sector in order to reduce poverty and unemployment. High unemployment among the educated indicates that radical changes in education and educational outcomes should be made, considering the persistent problem of structural unemployment resulting from supply and demand distortions in the Egyptian labor market, as in the labor market mismatch.

Therefore, the state strategy should focus more on the geographic distribution of developmental projects, in light of unemployment levels in rural areas, especially among females. Rising unemployment among women means that their economic abilities are not utilized. Projects like your-job-near-your-home will thus help reduce unemployment and raise female employment rates in particular.

Small and medium enterprises (SMEs), which are an essential tool to address unemployment, need radical action to ensure increasing investments in this sector and improving its effectiveness by creating an integrated institutional entity based on the best international practices, thus becoming a model in the Middle East for adopting entrepreneurship and developing SMEs. Doing that will maximize SMEs role in economic development, create jobs and increase exports. The government announced its intent to include these steps in a law regulating SMEs that is under discussion now as part of an amendment package that includes: licensing, land allocation, and SMEs incentives in addition to the establishment of an integrated IT infrastructure system for founding and managing SMEs as per the Presidential initiative to provide about LE 200 billion in funding for this sector over four years.

It is worth mentioning that the central bank's current strategy to boost growth through a low-interest rate funding strategy and to expand the financiers' base will lead to concrete actions to reduce unemployment in Egypt, provided that this strategy is associated with structural changes in the legislations regulating SMEs, licensing, investment, land allocation, and taxation especially for SMEs and the informal sector.

Special Analysis

Why Is the Stock Market So High? Ask the Bond Market
Al-Sharq Al-Awsat

The American stock market has reached new highs this summer for some unsettling reasons.

Since the sharp decline set off in late June by the British vote to leave the European Union, stocks have recovered smartly, reverting to an upward trend that has prevailed since 2009. That wasn't unexpected: Relief rallies often have occurred after market shocks.

This time, though, many of the factors that typically propel a rising market are absent: Corporate earnings aren't strong, the economy isn't booming, and stock prices aren't cheap.

None of those fundamental indicators have been auspicious, but it hasn't mattered because the fuel that is making the stock market soar seems to be coming from outside the stock market entirely.

In fact, it appears that we need to thank the bond and foreign exchange markets for providing the underpinnings for the stock rally.

Bonds have risen sharply in value, and their yields, which move in the opposite direction, have plummeted. That has made stock prices look cheap and dividends generous. The average dividend for the Standard & Poor's 500-stock index is about 2.1 percent — much higher than the yield on a 10-year Treasury note. Many investors have moved to stocks in search of a better deal.

That has helped make stocks rise, even though stock valuations aren't particularly appealing after seven years of price increases.

"On a historical basis, the overall stock market has become expensive, but not relative to bonds," said David A. Rosenberg, chief economist and strategist at Gluskin-Sheff in Toronto. "People have been looking in the stock market for yield, in the form of dividends, because the bond market has become so expensive and bond yields have gotten so low."

That's part of the story. But there's more. Not all parts of the stock market are being affected in the same way. Another factor, the strong dollar, has made stock sectors that are fairly impervious to exchange-rate shifts especially attractive. When foreign earnings in, say, euros or pounds translate into fewer dollars, American stocks with predominantly domestic revenue streams usually benefit.

That’s why many American utility and phone company stocks — which both pay high dividends — have been soaring.

“These stocks have hit a sweet spot,” said Craig Moffett, a senior analyst at MoffettNathanson, who focuses on telecom companies, including Verizon, AT&T, T-Mobile and Sprint. As a group, telecom companies have far outpaced the market as a whole, even though Mr. Moffett is skeptical about the prospects for the sector’s stocks. Many of them are overvalued, he says.

“As an analyst, it’s frustrating,” he said. “It doesn’t seem to matter what the specific issues are for these companies as businesses. Their stocks at the moment are trading for other reasons: interest rates and the dollar.” He has found a strong correlation between these factors and telecom stocks.

“At the moment,” he said, “interest rates and exchange rates outweigh the stock fundamentals.”

Stock investors, therefore, may want to seek guidance from these markets, especially the bond market, which has moved into historically unusual territory.

The 10-year Treasury note, for example, has had an average yield of more than 6 percent since 1965 but has fallen to less than 1.5 percent today, and that counts as a solid yield in the current global market. More than $13 trillion in government bonds around the world carry negative yields, a concept that is difficult to grasp. Buy a bond and you will lose money — unless yields drop even further into the negative zone, driving up bond prices.

Negative yields attest to severe global economic weakness. Central banks have held interest rates low to try to stimulate the economy, and with inflation at very low levels, bond investors have accepted minuscule or negative yields. Still, among the world’s major economies, the United States is perhaps the strongest now, and the Federal Reserve signaled on Wednesday that it remained open to a rate increase this year.

Market prices suggest that a rate increase won’t occur before December, especially with a presidential election looming in November. But other central banks have been moving toward even more expansive monetary policies, adding luster to the dollar and hurting returns of American companies with major overseas revenue streams.

Given those realities, investors hungry for better returns and higher yields have been flocking to the American stock market, especially to high-dividend-paying, low-foreign-revenue utility and telecom stocks. Both sectors have risen more than 20 percent this year.

The current interest rate and exchange rate alignment may well persist for a good while, but there are no guarantees. A recession, a surge in inflation, an unexpected rise in interest rates or a major political shock or natural disaster could wreak immediate damage. And interest rates and inflation have rarely remained at today's low levels for very long.

Mr. Rosenberg therefore suggests that investors begin to hedge against these risks by diversifying with inflation-indexed bonds, gold and some reasonably priced stocks in sectors like railroads, automobiles, banking and construction.

Mr. Moffett is certain that at some point, the usefulness of his kind of detailed stock analysis will be restored.

"Many of the valuations in the market don't make sense right now in isolation," he said. "The risk for investors is that if interest rates start to rise, stock prices could start to shift almost overnight. That may not happen soon, but eventually it will happen. And for a lot of people, that won't be a very pleasant moment."

Implications for Egypt:

Egypt should pay attention to the size of domestic debt and its servicing burden compared to external debt, which represents a smaller percentage of GDP relative to the regional average. The size of the debt cannot be controlled without addressing the chronic budget deficit Egypt has been suffering from over the years, especially during the last four years in which revenues declined and expenses increased steadily. The burden of debt service can be reduced through the prudent management of the portfolio of government debt.

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.

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

The Ministry of Finance continues to increase medium-term bonds compared to Treasury bills with short-term maturities, and to build a yield curve for government issuances, through regular issuances of 1.5, 3, 5, 7, 10 year maturities and re-issuing them to create liquidity on the bond supply side. However, the secondary market for Treasury bonds is still weak, accounting for 1.1 percent of the total issuance, even in light of the growing supply of issuances in addition to more investor concentration in Treasury bonds. Therefore, there is a need to expedite the activation of the secondary bond market at the Egyptian Stock Exchange, as this market is still weak, non-deep, and dominated by banks in contrast to other markets globally, which are characterized by active secondary markets, allowing for medium and long-term financing for businesses.

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

Global Financial Market Performance

Reuters/ Argaam

Chinese stocks rose at the highest pace in a month by the end of Friday’s trading session, supported by speculations of accelerated mergers in the real estate sector.

Real estate stocks led the Chinese market gains, after the announcement by "Langfang" that "Evergrande" group is planning to increase its stake in the company, while not ruling out obtaining a controlling stake.

Investors' speculations on the possibility of further mergers in the real estate sector over the coming period increased, raising investors' optimism about the market and the performance of the sector.

The rise came despite official data showing slowdown in industrial production, retail sales and investment in China over the last month, signaling persistent difficulties that face the world's second largest economy.

The "Shanghai" Composite Index rose 1.6 percent to 3,050 points at closing, up by about 2.5 percent in the week.

Japanese stock indexes closed Friday's session at a higher level, supported by gains in the US market, which reached record levels in conjunction with the decline in the yen value against the dollar.

At the end of trading, the Japanese "Nikki" index rose by 1.1 percent to 169,120 points, while the "TOPIX" Index rose by 0.64 percent to 1,323 points.

"Sharp" shares also rose by about 19 percent after Taiwanese "Foxconn" said that Chinese anti-trust bodies have approved its acquisition of the Japanese electronics manufacturer.

The performance of US indexes during Friday trading varied, following release of weak economic data in conjunction with the rise in the shares of energy companies and the rise in oil prices. The "Dow Jones" and "S & P" achieved gains for the second week in a row. The "Nasdaq" index made a record closing for the second session in a row, and achieved weekly gains that are the seventh in a row and the longest series of gains since March 30, 2012.

The "Dow Jones' industrial average fell by 37 points to 18,576.5 points, "S & P 500" declined by 1.7 points to 2,184 points, while the Nasdaq index rose by 4.5 points to 5,233 points.

On a weekly level, the "Dow Jones" industrial achieved gains of 0.2 percent, "Nasdaq" rose by 2.3 percent, while the broader "S & P" settled near last Friday’s closing.

In the European markets, "Stoxx Europe 600" fell by 0.2 percent or by 0.5 points to 346 points, and achieved a weekly gain of 1.4 percent.

The British "FTSE 100" index declined by -1.3 points to 6,916 points, the French "CAC" index fell by -3.7 points to 4500 points, while the German "DAX" index fell by -29 points to 10,713 points.

Meanwhile, gold futures for December delivery settled lower by 0.5 percent or by $6.80 to $1,343.20 an ounce. The precious metal posted losses of about 0.1 percent.

In the oil markets, the US "NYMEX" rose by 2.3 percent or a dollar, closed at $44.49 a barrel and achieved 6.4 percent in weekly gains, the largest since the week ending on April 8. "Brent" index rose by 2 percent or by 93 cents and closed at $46.97 a barrel, the highest close since July 20. It has achieved a weekly gain of 6.1 percent, the largest since April 29**.**

Concerning economic data, the producer price index in the US fell by 0.4 percent in July, posting its sharpest monthly drop since September 2015. The retail sales have stabilized last month.

Implications for Egypt:

The Egyptian Stock Exchange (EGX) continued its upward trend last week, recording one of its biggest increases since the beginning of the year. This is a result of internal factors related mainly to the exchange rate and the beginning of discussions on obtaining the IMF loan as part of a $21 billion financial package. The impact of global markets on the EGX has been limited thanks to relative stability in those markets in the absence of fundamental changes. In other words, EGX 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 price cohesion and offsetting 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 prospects of attracting foreign investments in the stock market over the coming period if conditions continue as they are.

We reaffirm that the country's current approach in considering the sale of company quotas in the Egyptian stock exchange or global markets requires deliberate study of its timing and pricing mechanisms. Its chances of success should also be studied in the light of the current situation in most global markets, to ensure the success of these planned placements as part of the financial package announced by the government last week.