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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 Expects a Decline in GCC Non-Oil Growth to 1.75 percent in 2016
Reuters

The IMF expected average non-oil growth in the economies of the Gulf Cooperation Council (GCC) to decline to 1.75 percent in 2016, with the tightening of fiscal policy and reduced liquidity in the financial sector, compared with growth of 3.75 percent last year.

The IMF said in a report on growth prospects in the Middle East and Central Asia region that non-oil growth in the GCC is expected to improve to three percent next year, with the decline in the pace of fiscal austerity.

GCC countries mainly rely on oil revenues to finance massive programs of government spending and to maintain a large number of government employees as well as to subsidize energy and water prices and other services for its citizens.

But the drop in oil prices since mid-2014 by almost half exercised pressure on the budgets of the GCC countries, forcing them to adopt unprecedented austerity measures, including the reduction of benefits and rewards for government employees, energy subsidies and the introduction of new taxes to cope with declining oil prices.

The Fund said in a report, which Reuters obtained a copy of, that in the medium term, declining tax burden and partial improvement in the price of oil would lead to higher non-oil growth in the GCC to 5.3 percent, which is much lower than the average for the period 2000 - 2014, which amounted to 7 percent.

GCC comprises Saudi Arabia, United Arab Emirates, Bahrain, Oman, Qatar and Kuwait. The Gulf States have been seeking for a long time to diversify their economies away from oil and gas revenues.

The Fund does not usually issue forecasts for individual countries of the GCC, but are classified within the oil-exporting countries in the Middle East and North Africa and Central Asia.

The Fund added that falling oil prices and ongoing conflicts pose a burden on the economic prospects in the Middle East and North Africa, Afghanistan and Pakistan, pointing out that the uncertainties arising from the conflicts in Iraq, Libya, Syria and Yemen are weakening confidence, while lower oil prices are affecting exports and economic activity in oil-exporting countries.

The Fund predicted the region would achieve modest overall growth of 3.5 percent in 2016 with a slight improvement

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expected in 2017. It said that these expectations are highly uncertain because of the volatility in oil prices and risk of regional conflicts.

The Organization of Petroleum Exporting Countries (OPEC) agreed to cut oil output at a meeting in Algeria last month, but observers are doubtful about the possibility of implementing the agreement because of expected differences between OPEC oil producers on the reduction of production quotas and the possibility of participation of independent producers such as Russia in the reduction.

Rich Nations Say on Track for Promised $100 billion Climate Finance
Reuters

Rich countries said they were on track to keep a promise to provide developing nations with $100 billion a year to tackle climate change by 2020, up from an estimated $62 billion in 2014.

The pledge of fast-rising funds, first made in 2009 to help the poor rein in greenhouse gas emissions and adapt to rising temperatures, was a key to ensuring all governments signed up for the 2015 Paris Agreement to combat global warming.

"We are confident we will meet the $100 billion goal from a variety of sources, and reaffirm our commitment to doing so," developed nations said in a report compiled by Australia and Britain.

The funds, from both the public and private sector, would be up from an estimated $62 billion in 2014 and $52 billion in 2013, it said.

The Paris Agreement will enter into force on Nov. 4 after winning backing from major emitters led by China and the United States.

At a 2009 summit in Copenhagen, governments promised to mobilize $100 billion a year by 2020 to help developed nations limit their emissions and adapt to heat waves, floods, more powerful storms and rising sea levels.

OPEC Requires $10 Trillion to Meet Oil Demand
Argaam

Secretary General of OPEC, Mohammed Barkindo, said the oil industry around the world needs to invest heavily over the next twenty years, or face the risks of not being able to meet future demand.

Barkindo added in the "Oil & Money" conference in the British capital London that the recent decline in oil prices had a negative impact on private investment, especially in exploration and production activities, and posed serious threats to both producers and consumers.

Barkindo added that this decline impacted everyone, and therefore, it is necessary to restore balance in the market as well as investments.

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The Secretary General of OPEC noted that investments in the global oil sector, which fell by 26 percent in 2015, are expected to decline this year by 22 percent, and will continue this slowdown in 2017.

Risks to China from 'Very Fast' Credit Growth Rising Rapidly – IMF
Reuters

China's credit growth has been "very fast" by global standards and without a comprehensive strategy to tackle the debt overhang, there's growing risk it will have a banking crisis or sharply slower growth or both, the International Monetary Fund said.

In a working paper, the IMF said Beijing should act quickly before the problem becomes systemic, and that the problems of both creditors and debtors needed to be addressed simultaneously.

The paper is one of multiple warnings the IMF has made about the Chinese economy this year.

The Fund has projected the world's second-largest economy would grow 6.6 percent in 2016, but said expansion would gradually slow to around 5.8 percent in 2021.

Corporate China is sitting on $18 trillion in debt, equivalent to about 169 percent of the country's gross domestic product.

Rating agency S&P Global has estimated China's banks will need as much as $1.7 trillion in capital to cover a likely surge in bad loans.

In its paper dated Oct 14, the IMF said "Just cleaning up the banks by moving bad loans off bank balance sheet and recapitalizing the banks, or allowing companies to go bankrupt without recapitalizing banks would not revitalise economic activity."

It said that so far, authorities had failed to implement a full-fledged strategy as China's approach involved mainly handling the "overcapacity problem, with less discussion of financial implications".

On Tuesday, China's central bank said Chinese banks extended 1.22 trillion yuan ($181.3 billion) in new loans in September, a three-month high and well above expectations, while money supply growth edged up.

British Parliament will Likely Ratify the Brexit Deal
Argaam and news agencies

The British government lawyer before the London High Court said that the parliament will likely ratify the deal to be reached with Brussels at the conclusion of negotiations on Brexit.

Lawyer James Eadie said the current position of the government is that the agreement would be referred to Parliament for ratification.

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Lawyer James Eadie made the comments while defending the Government in the case currently being heard in the Royal Courts of Justice, which contends Theresa May cannot trigger Article 50 without the approval of MPs in parliament.

The London Court completed studying the complaints filed by British citizens demanding to refer the matter to Parliament before and not after the deal was reached.

Judges said they would announce their decision soon.

The complainants consider the June 23 referendum consultative and must be approved by the parliament, while the government sees it has the powers to start the exit process.

BRICS Development Bank to Lend $2.5 billion Next Year
Reuters

The development bank set up by the BRICS group of emerging economies will ramp up lending to $2.5 billion next year after making its first loans to back green projects, its president KV Kamath told Reuters.

The BRICS - Brazil, Russia, India, China and South Africa - agreed to create the New Development Bank (NDB) in July 2014 with initial authorized capital of $100 billion. The lender was officially launched a year later.

"The second year is scaling up, concentrating on people, getting all the skillsets in," said Kamath, a veteran Indian banker appointed as the first head of the Shanghai-based NDB.

With Russia, Brazil and South Africa on the economic skids and China slowing, the initial euphoria has faded, yet Kamath said the BRICS had much to gain by deepening their cooperation.

"The fact is that these countries, collectively, have for the last few years contributed to more than 50 percent of incremental economic wealth that has been generated globally," said Kamath. "I don't see that changing."

The Bank has already approved loans totaling $900 million to green projects in each member state.

Kamath, 68, said there was plenty of room for new lenders like the NDB and the Chinese-led Asian Infrastructure Investment Bank (AIIB), in addition to established institutions like the World Bank.

"Infrastructure alone has needs globally of $1-1.5 trillion a year – all the multilateral banks put together can do maybe 15 percent of this," said Kamath, who ran India's ICICI Bank Ltd (ICBK.NS) from 1996 until 2009.

"The phrase I would like to use is cooperate and work together, rather than compete. I don't see competition as a key challenge in this context."

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Implications for Egypt:

International institutions still point out continued pressure on the economies of the Gulf region and China in light of slowing global economic climate and the emergence of developments that may lead to the escalation of risk to a number of economies, especially China. Excessive lending by China has increased risks to the Chinese economy, which is one of Egypt's main economic partners at present.

Egypt should focus in the coming period on improving its internal economic infrastructure and rely strongly on developing its industrial bases, and encouraging feeding industries through promoting small and medium enterprises. In light of continued volatility at the international level, the likelihood of a recession and a slowdown in global growth rates is high, which requires Egypt to stimulate sustainable growth drivers that are less affected by global developments, which would support local economic growth.

It is also important to note that the situation in the Gulf region may affect the demand on Egyptian workers. This requires proceeding with the economic reform programs at faster rates to promote job creation and absorb the expected slowdown in Egyptian remittances. However, the authorities should be cautious about growth of public debt, especially that the aggravation of the sovereign debt crisis worldwide coupled with shortage of sources of funding would represent a growing risk to the global economy.

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From the International Press

International Bonds: An Opportunity to Drive Growth and Diversify Funding Sources around the World

Al-Sharq Al-Awsat

Saudi Arabia is catching up with Qatar and Argentina in the race for reviving global bond markets this year, after emerging market governments collected about $100 billion from the sale of foreign currency bonds over the first nine months of 2016, nearly double the levels recorded a year ago.

It is expected that the Saudi government will put up bonds ranging from $10 to $15 billion in the last quarter of the year, but will not be the biggest this year. Argentina's return to the world markets by a huge bond issuance worth $16.5 billion boosted sovereign bond issuances in the first nine months of the year. This is the first issuance by Argentina since its debt default in 2002. Argentina returned to markets again recently and held meetings to sell bonds in euros. Also, the size of issuances rose due to the sale of Qatari bonds worth nine billion dollars in May. The Omani government raised $2.5 billion last month through a bond issuance that is the first in nearly 20 years, under a plan to borrow up to ten billion dollars from abroad.

JP Morgan expects sovereign bond issuances to amount to $121 billion this year.

International bonds are an option among many options for the kingdom to overcome the crisis of lower oil prices, and the high cost of maintaining political and security stability in the region. The kingdom took many steps since last year, starting from using monetary reserves and investment funds to its plan to rationalize domestic expenses, and borrow domestically and internationally not only to overcome the crisis, but also to drive growth.

International bonds are not only linked to emerging economies, but are also an essential part of funding and recovery plans in major economies. Japan is increasingly buying bonds, with its economy facing external shocks. The European Central Bank relies on the purchase of 80 billion euros in bonds monthly from member states in order to drive growth.

Reviewing data on world debts, we find that there is no link between economic underdevelopment and indebtedness. The most indebted countries in the world are those with the largest economies. Global growth leaders such as the BRICs depended in a large part of its growth on foreign loans, similar to other economically strong countries, such as Turkey. So, the important thing is to pay attention to the conditions of bond issuance and how to benefit from them.

Bond conditions vary in terms of yield, maturity, and beneficiary. Omar El-Shenety, CEO of Multiples Group, believes that the Kingdom will use its good position when offering bonds. He told Al-Sharq Al-Awsat that Saudi bonds are good and will attract demand. The Kingdom's foreign debt is limited, has adequate monetary reserves, and with very minor risk of default, especially in light of the steps taken to rationalize spending, implement vision 2030, in addition to the recent rise of oil prices above $50. He pointed out that the Kingdom should pay offer long- and medium- term bonds rather than short-term bonds, which is what the Kingdom is already doing according to available data.

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Italy announced last week that it would sell 50-year maturity bonds, its first ever.

"Fitch" credit rating assigned AA- to the Saudi bonds due to be issued, while the rating of the Italian economy is «+BBB», which is lower than Saudi Arabia, which means better opportunities in terms of interest and duration for the Saudi economy.

El-Shenety asserted that the bond offering is in line with the Kingdom's 2030 development plan, which aims to diversify sources of funding. He explained that the Kingdom issued local bonds to finance the deficit, and is now taking a big step towards opening up to international markets. He expected the Saudi stock exchange to benefit from this step.

The Saudi government's direct debt amounted to about 273.8 billion riyals ($73 billion) on 31 August 2016, of which 236.3 billion riyals ($63 billion) representing domestic debt and 37.5 billion riyals ($10 billion) foreign debt, according to data from the official reports of the Saudi Arabian Monetary Agency. This compares to a public debt of 135.5 billion riyals ($36.1 billion) in 2011, 83.8 billion riyals ($22.1 billion) in 2012, and 60.1 billion riyals ($16 billion) in 2013, reaching its lowest level in 2014 of 44.3 billion riyals ($11.8 billion).

With oil prices declining sharply, public government debt rose in Saudi Arabia to 142.2 billion riyals ($37.9 billion) in 2015, and hence the volume of public debt rose to 273.8 billion riyals ($73 billion) by the end of last August.

Standard & Poor's asserted in its recent rating of Saudi Arabia that it expected the Kingdom to finance the deficit over the next three years through drawing down financial assets and issuance of debt instruments. It noted that the stable outlook is due to expectations that Saudi Arabia would take new steps to prevent any deterioration in the country's financial position.

The Kingdom will rely on the newly established Public Debt Management Office, and the global and local investment banks it assigned, to coordinate a series of meetings with debt instrument investors.

Many countries around the world are shifting to external borrowing to get lower interest rates, and this is happening in most emerging countries. Argentina offered $4.5 billion in bonds with five-year maturity at an interest rate of 6.875 percent this year. The Latin state is known for high inflation, and its data cannot in any way be compared with those of Saudi Arabia.

Implications for Egypt:

The issuance of dollar-denominated bonds currently represents part of Egypt's fiscal policy and mechanisms to bridge the widening financing gap. However, the resources resulting from the issuance should be directed to investments and development projects that are able to generate stable cash flows in foreign currency to finance bond payments of principal and interest in a way that does not represent an escalating burden on the state budget. In fact, issuances should always be linked to the way their resources and revenue are used. Therefore, before embarking on the issuance, its marketing prospects should be studied closely.

The importance of the issuance at this time lies in Egypt's return to international funding markets in light of the national economy's need to finance the funding gap, through borrowing or dollar-denominated bonds or other methods. However, the results of the issuance promotion process should be taken into account in light of the situation in global markets, Egypt's international credit rating and revenue levels on issuances by developing countries in global markets.

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However, Egypt is expected to face challenges in the coming issuance of international bonds, because of the likelihood of higher interest on the US dollar, unrest in emerging markets, and the shock caused by Britain's exit from the EU. However, the difficulty is reduced by virtue of the economic reforms to be applied and changes in monetary policy and hence similar improvement in financial policies and their economic impact.

In addition, we see a need to adopt “sukuks” as a financial instrument at the government level, 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.

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Special Analysis

European Concern over the Current Situation in Portugal
Al-Hayat

Swiss experts have expressed concern about the current situation in Portugal. After Britain's exit from the EU, criticisms and discussions have reemerged about Portugal being the weak link of the Eurozone. The British government pumped annually billions of dollars into the coffers of Brussels in the form of aid and contributions in order to intervene in the interest of any troubled European government, when needed.

The question is: will Portugal be expelled from the EU, or is there a tendency in Brussels to bail them out again? Lisbon's budget has reached zero level, and Portugal is expected to move away from its austerity plans due to internal political reasons.

At present, Portugal is trying to blow up previous economic reforms to replace them with laws that favor workers, especially that the unemployed currently receive negligible financial and social assistance.

It is true that the Portuguese fiscal deficit remains under control. Anchored at 2.5 percent of GNP, it is still below 2.8 percent according to Brussels experts. But the problem lies in fact in Portugal's debt, which represents 132 percent of GNP.

It is worth noting that Portugal is a risky place to invest for the Swiss, except for some recreational tourism opportunities, such as the purchase of luxury hotels or resorts that attract tourists.

Researchers at the University of Lugano note that Portugal's anemic economic growth, the collapse of investment, the low level of international competitiveness, and inability of local banks to secure the necessary capital to operate internationally terrify everyone. If we look at the banking sector, we find that the presence of the Swiss has long been absent. To date, there is no serious motivation from Brussels to intervene to bail Lisbon out, as financial liquidity in the latter is acceptable until the end of the year.

Apart from grades of credit rating agencies such as «S & P» about Portugal, everyone, including Swiss bankers, are awaiting the rating of the Canadian DBRS credit rating agency, which is the only major credit rating agency that has yet to give a "junk" rating or "non-investment grade" to Portuguese Treasury bills.

In the event of a negative Canadian rating, Portugal will be vulnerable to serious risks that will prevent its access to international financial markets. Thus, Portuguese youth of working age might find themselves faced with the necessity to migrate to secure a living. Hence the Swiss concern about the influx of thousands of Portuguese youth in search of a job in the Swiss cities that has suffered for many years from lack of job opportunities as a result of foreign workers, including the Germans, the French, and the Italians. This will weigh financially on the government of Berne, which offers financial assistance for up to one year to every foreign worker that loses his job.

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Implications for Egypt:

Egypt has become more vulnerable to developments in the EU, considering current concerns about the Portuguese economy, and previously about the Greek and Italian economies. Global growth opportunities are now decreasing in light of prevalent financial tensions across many countries, problems with sovereign debt, lack of growth, and the reduction in exports and foreign direct investment. This increases the heavy pressure on the global economy. The European economy is also expected to remain in uncertainty for quite some time in the future, representing 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.

Growing rates of local development in Egypt along with the increasing geographical distribution of economic expansions and investments at the governorate level may represent a key factor in increasing Egypt's economic resilience in the face of such problems. Moreover, the coming period, which will witness the adjustment of the Egyptian financial model in the context of the economic reform program, may contribute to the improvement of financial efficiency in the medium and long runs. This merits attention and deserves to be one of the goals of fiscal policy to counter volatility of the global economy over the coming period.

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Global Financial Market Performance

Reuters/ Argaam

Chinese stock indices ended Friday's trading higher, posting gains for the second week in a row, with signs of economic stability overcoming fears of weak local currency.

Companies operating in the infrastructure sector led the gains of Chinese shares amid speculations of increased government spending on building bridges and railway lines.

Positive data this week showed stable Chinese economic growth at 6.7 percent during the third quarter, which reduced concern over the currency and accelerating credit growth.

At the end of trading, the "Shanghai" composite index rose by 0.2 percent to 3,090 points, the highest level in six weeks, and its weekly gains reached 0.9 percent.

The Japanese stock indices fell at the close of Friday trading, following an earthquake west of the country on Friday morning, just before the start of the season of announcing corporate results, which kicks off this week.

On the other hand, more than 350 Japanese companies will announce the results of their operations starting this week, with investors focusing on a number of companies to see if they were able to overcome the obstacles encountered, most notably the local currency's strength.

At the end of trading, the Japanese "Nikki" index fell by 0.3 percent to 17,184 points, while the "TOPIX" index fell by 0.4 percent to 1,365 points.

The Mitsubishi Motors' share rose by 5.2 percent to 564 yen after the announcement that Nissan Motor completed acquisition of 34 percent of the company.

US stocks got rid of the losses recorded at the beginning of Friday trading, affected by the dollar rise against most major currencies, and received support from the positive business results announced by "Microsoft." The energy sector also recovered with the rise of oil prices, and major indices posted weekly gains.

The "Dow Jones' industrial average fell by about 16.6 points to 18,145.7 points after losses by more than 100 points in early trading. The S&P 500 benchmark index declined by 0.2 points to 2,141 points, while the Nasdaq index rose by 15.5 points to 5,257 points.

In the European markets, "Stoxx Europe 600" stood at 344.3 points, the same level at the closure of the previous session. However, the index made a weekly gain of 1.3 percent.

The British "FTSE 100" index fell by 6 points to 7,020 points. The French "CAC" declined by 4 points to 4,536 points, while the German "DAX" index rose by 9 points to 10,710 points.

On the other hand, gold futures for December delivery rose at settlement by 20 cents to $1,267.70 an ounce. The precious metal achieved a weekly gain of 1 percent.

In the oil markets, the US "NYMEX" rose by 0.1 percent, or 22 cents, to close at $50.85 a barrel, posting a weekly gain of about 1 percent. The "Brent" index rose by 0.8 percent or 40 cents to close at $51.78 a barrel, but recorded losses by about 0.3 percent this week.

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Implications for Egypt:

Egyptian stock indices declined during the last trading week. Market capitalization of listed stocks lost about EGP 11.9 billion under pressure from foreigners' sales. EGX 30 declined by 2.68 percent (the highest weekly decline since last July), equivalent to 227.91 points, to 8,277.21 points amid pressure from the decline of leading stocks, which witnessed the largest weekly decline in four months. Meanwhile, the Egyptian stock exchange continued to perform consistently with the internal conditions of the Egyptian economy, especially in light of speculation about the exchange rate over the coming period as part of Egypt's economic reform program and the positive impact of the Saudi deposit on the Egyptian economy.

Estimates indicate the Egyptian Stock Exchange continues to interact positively with positive reform developments in the Egyptian economic structure, especially that the volume of trading still indicates the presence of idle liquidity that is willing to invest in the stock market if conditions improve over the coming period. Moreover, global capital markets are still experiencing sharp fluctuations, resulting mainly from continued pressure on economic indicators and the escalation of the debt crisis in most countries, especially sovereign debt, notable decline in liquidity, and a rising tendency recently to invest in safe assets compared with rates of investment in the stock markets.

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