Issue : 4

Date : 13 March 2016

ECES
The Egyptian Center for Economic Studies

Our Economy & the World

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

- An analysis of the performance of global financial markets and the changes in the prices of commodities and raw materials

- An review of key world developments over the past week

- Highlights of the international press regarding developments in shale oil

- A special analysis of the concerns raised by China in the global economy

Global Market Performance

Global stock and bond markets entered a state of confusion with a tendency to rise after the sudden decision of the European Central Bank to reduce interest rates and expand the quantitative easing program. The markets recorded a significant rise immediately after the decision was announced Thursday morning, before reversing direction due to a statement of the Bank's president, which was seen by many investors as negative and disappointing.

Japanese stocks rose at the close of Friday trading, with a decline in the yen, which boosted profit expectations for export companies. Investors' risk appetite improved thanks to the recovery in global oil prices. The Nikkei index rose by 0.5 percent, closing at 16938.87 points, but lost 0.4 percent over the week. The broader TOPIX index rose by 0.5 percent to 1359.32 points, while the JPX-Nikkei-400 index increased by 0.5 percent to end the day at 12296.16 points.

Chinese stocks rose at the end of Friday trading, but recorded weekly losses, due to failure of government funds' intervention to restore investors' confidence in the market. The "Shanghai" Composite Index rose by 0.2 percent to 2810 points at closing, reducing its weekly losses to 2.2 percent.

US stocks rose during Friday trading backed by the rise in the energy sector, the rise in oil prices and the dissipation of concerns about slow global economic growth. The major indices recorded gains for the fourth week in a row. The "Dow Jones' Industrial index rose by 1.2 percent or by 218.1 points to reach 17213.3 points. The "NASDAQ" index increased by 86.3 points to 4748.4 points, while the "S&P 500" benchmark index rose by 32.6 points to 2022.1 points.

European stocks also rose on Friday, with banks in the Eurozone receiving support from a new cheap financing plan by the European Central Bank, while the recovery of metal and oil prices enhanced the stocks of primary commodities companies. The FTSEurofirst 300 index of major European companies ended the trading session up by 2.7 percent to 1347.47 points after a loss of 1.8 percent in the previous session.

The bank stocks index headed gainers, jumping by 4.9 percent after volatile moves during the Thursday session, when the European Central Bank reduced interest rates and said it would start buying corporate bonds and possibly pay for banks that lend companies in an attempt to stimulate growth.

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Investors also turned to the purchase of stocks associated with primary goods following the increase in metal and oil prices. European oil and gas companies' stocks index increased by 2.6 percent with the rise in oil prices by more than 2 percent. The mining companies' stocks index rose by 2.7 percent after a sharp price rise in the main industrial metals.

In the major stock exchanges in Europe, the British Financial Times index closed higher by 1.71 percent after recording its lowest closing level in two weeks in the previous session. The German DAX and France's CAC increased by 3.51 percent and 3.27 percent, respectively. At closing, "Stoxx Europe 600 benchmark index jumped by 2.6 percent or by 8.7 points to 342.2 points, and recorded a weekly gain of 0.1%.

Oil prices rose during Friday trading supported by comments from the International Energy Agency, which showed that oil prices may have already passed through their lowest levels with the decline in supplies from outside OPEC, causing the erosion of the supply glut. They also received support from the decline in the number of drilling rigs in the US for the 12th week in a row.

At closing, "NYMEX" futures for April delivery rose by 1.7 percent, or by 66 cents. The New York session closed at $38.50 a barrel. The US crude oil achieved weekly gains of 7.18 percent. "Brent" Futures for May delivery also rose at settlement by 0.9 percent or by 34 cents. The London session closed at $40.39 a barrel. The benchmark crude oil recorded weekly gains of more than 4%.

Gold prices fell during Friday trading amid a broad rise in the dollar against most major currencies and the recovery of stock markets. The yellow metal also recorded weekly losses and gold futures for April delivery dropped at settlement by 1.1 percent or by $13.40 to $1259.40 an ounce, scoring weekly losses of about 0.9 percent.

Implications for Egypt

The performance of global financial markets continues to be affected by stimulus programs and movements in oil prices related mainly to attempts to curb oil supply, which reflects positively on the Middle Eastern markets and the Arab region amid moderate liquidity. This suggests that Egypt, the region and the world are anticipating strong local or international developments that would be the main driver of change in financial market performance.

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Key Global Developments

IEA: Falling Oil prices May Have Reached Their Limit

Reuters:

The International Energy Agency (IEA) said on Friday that oil prices may have reached their lowest levels and will begin to recover with accelerated decline in production in the US and other non-OPEC producers and the growth of Iranian supply at a lower rate than expected.

The agency, which coordinates energy policy for industrialized countries, said it currently believes that non-OPEC oil production will fall by 750 thousand barrels per day in 2016 compared with 600 thousand barrels per day in previous estimates.

It added that US production alone would fall by 530 thousand barrels per day in 2016.

The IEA, which is based in Paris, said that there are clear signs that market forces are achieving positive results and that high-cost producers are reducing production.

The EU and the US are Planning to Conclude a Free Trade Agreement before the End of Obama's Administration

Argaam:

The EU Trade Commissioner said that the EU and the US are still able to reach a free trade agreement before President Barack Obama's term in office ends in January 2017.

In remarks to Bloomberg in Washington, Cecilia Malmstrom pledged the intensification of bilateral talks in the coming months. The European Trade Commissioner pointed out the fact that despite the importance of content over speed, the goal of the talks is to reach a final agreement between the two sides before the end of the Obama administration.

The EU and the US have been working for a year and a half to reach an agreement to end tariffs on goods, expand service markets, and strengthen bilateral cooperation. The US President and some European officials such as German Chancellor Angela Merkel consider a trade agreement between the US and the EU a policy priority.

Saudi Arabia Seeks to borrow $8 billion in 5 years

Al-Mal newspaper website

The government of Saudi Arabia is seeking a bank loan of between 6 and 8 billion dollars for the first time in more than ten years, in order to bridge the budget deficit, which jumped to about $100 billion last year. KSA suffers a deficit for the first time in its history because of the collapse in oil prices and the decline in export earnings. According to the Reuters news agency, Riyadh has asked the banks to make offers to grant it loans of this magnitude at a 5-year maturity with a possibility of extension. The agency was unable to

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contact the Ministry of Finance nor the Central Bank of Saudi Arabia to comment on the matter, as sources familiar with this loan has not announced their name because it had not been officially announced yet.

IMF: New Risks Threaten the Collapse of the Global Economy
AFP

The IMF stressed its call for joint action to prevent a global economic collapse, warning of the dangers of misguided policies.

Deputy IMF Managing Director David Lipton said there was a serious and growing opinion that policymakers around the world had exhausted options to support the economy or lost their will to do so.

To face up to this, he saw that leaders have to increase their efforts, including the provision of financial and monetary incentives, and to apply the necessary structural reforms to support growth.

Lipton said in a conference held by the National Association for Business Economics, Tuesday, that the fiscal policy - government spending and tax cuts - should occupy a more important place among policies, adding that the burden of increased growth rests on the advanced economies that have the financial room to maneuver.

He stressed that the risks are clearly more than before, and that taking a stronger joint action had become more of a necessity.

ECB Lowers Interest Rates and Expands Bond Purchases
Reuters:

The European Central Bank cut interest rates Thursday to strengthen the euro zone economy and to surprise financial markets by reducing the main refinancing rate to zero from 0.05 percent.

The Central Bank expanded the quantitative easing program by buying bonds of up to 80 billion euros a month compared to 60 billion euros, and reducing the deposit rate to -0.4 percent from -0.3 percent charging banks more for their deposits at the CB.

The step that pushed the euro down by 1 percent against the dollar sheds light on the difficulties faced by the European Central Bank given the decline in inflationary expectations and fears of extremely low price growth rates.

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"Nasdaq" Intends to Buy US Stock Options Company from the German Stock Exchange
Reuters

Nasdaq said it was buying a US company, specialized in managing options contracts, for $1.1 million from the German Stock Exchange, the latest deal from a series of merger talks.

International Securities Exchange runs three electronic exchanges for options contracts collectively representing more than 15 percent of US trading, while Nasdaq manages three other exchanges. With the merger, Nasdaq will own more than 40 percent of the market, expanding its leadership as the largest US operator of options exchanges.

US Budget Registers Deficit in February
Argaam:

The US Federal Government registered a budget deficit of $193 billion during February, slightly higher than the deficit recorded in the corresponding month in 2015 at $192 billion.

Total spending rose last month by 9 percent to $362 billion compared to the corresponding month in 2015, while total revenue rose by 21 percent to $169 billion.

In terms of total budget deficit since the beginning of the current fiscal year to date, the US government budget deficit fell by 9 percent.

Iran Says it Will not Freeze Oil Production Unless after it Regains Market Share
Reuters:

Director of the Office of Iranian President Hassan Rouhani said that Iran must regain its share of the global oil market before participating in any agreement between the producing countries to restrict supplies.

Speaking at the Royal United Services Institute in London, Mohammad Nahavandian said that the oil market should be managed more wisely.

He added that for Iran to participate in supply reduction, the basic requirement is to regain the market share it had, and from that point to help in reducing supply.

Implications for Egypt

Global economic news reflect the beginning of stability in global oil markets thanks to efforts to curtail oil supply and surplus. However, this is faced with the problem of the extent of Iran's compliance with this reduction. Indicators suggest the possibility of Iran increasing oil supply in the market, which would bring back another round of instability in prices of oil products. As a result, Egypt's budget will be affected as a result of declining oil subsidies and possible effects related to the size of targeted Gulf investments and worker remittances.

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The news also reflect a strong possibility of forming new trade unions between Europe and the US, which could lead to revitalization of world trade and boosting demand for raw materials and petroleum products, which would increase traffic through the Suez Canal. It may also support the transfer of some industries from European markets to the southern Mediterranean markets and Eastern Europe. However, there is a need for the Egyptian government to thoroughly revise its export items to European markets and to assess possibility of their replacement with cheaper US imports due to lower tariffs following the agreement.

In addition, the adoption of the EU, and previously Japan, of policies to stimulate economic expansion should stand as a lesson to the Egyptian administration in conducting fiscal policy as one of the economic stimulus models needed to overcome the current economic crisis.

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From the International Press

U.S Shale's Message for OPEC: Above $40, We Are Coming Back

New York, Reuters:

For U.S. shale oil producers, $40 is the new $70.

Less than a year ago major shale firms were saying they needed oil above $60 a barrel to produce more; now some say they will settle for far less in deciding whether to crank up output after the worst oil price crash in a generation.

Their latest comments highlight the industry's remarkable resilience, but also serve as a warning to rivals and traders: a retreat in U.S. oil production that would help ease global oversupply and let prices recover may prove shorter than some may have expected.

Continental Resources Inc., led by billionaire wildcatter Harold Hamm, is prepared to increase capital spending if U.S. crude oil reaches the low- to mid-$40s range, allowing it to boost 2017 production by more than 10 percent, chief financial official John Hart said last week.

Rival Whiting Petroleum Corp., the biggest producer in North Dakota's Bakken formation, will stop fracking new wells by the end of March, but would "consider completing some of these wells" if oil reached $40 to $45 a barrel, Chairman and CEO Jim Volker told analysts. Less than a year ago, when the company was still in spending mode, Volker said it might deploy more rigs if U.S. crude hit $70.

While the comments were couched with caution, they serve as a reminder of how a dramatic decline in costs and rapid efficiency gains have turned U.S. shale, initially seen by rivals as a marginal, high cost sector, into a major player - and a thorn in the side of big OPEC producers.

Nimble shale drillers are now helping mitigate the nearly 70 percent slide crude price rout by cutting back output, but may also limit any rally by quickly turning up the spigots once prices start recovering from current levels just above $30.

The threat of a shale rebound is "putting a cap on oil prices," said John Kilduff, partner at Again Capital LLC. "If there's some bullish outlook for demand or the economy, they will try to get ahead of the curve and increase production even sooner."

Some producers have already began hedging future production, with prices for 2017 oil trading at near $45 a barrel, which could put a floor under any future production cuts.

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GLOBAL AMBITIONS

While the worst oil downturn since the 1980s sounds the death knell for scores of debt-laden shale producers, it has also hastened the decline in costs of hydraulic fracturing and improvements of the still-developing technology.

For example, Hess Corp., which pumps one of every 15 barrels of North Dakota crude, cut the cost of a new Bakken oil well by 28 percent last year.

What once helped fatten margins is now key to survival in what Saudi Oil Minister Ali al-Naimi described last week as the "harsh" reality of a global market in which the Organization of the Petroleum Exporting Countries is no longer willing to curb its supplies to bolster prices.

While Deloitte auditing and consulting warns that a third of U.S. oil producers may face bankruptcy, leading shale producers say their ambitions go beyond just outrunning domestic rivals.

“It's no longer enough to be the lowest cost producer in U.S. horizontal shale," said Bill Thomas, chairman of EOG Resources Inc. "EOG's goal is to be more competitive, lower-cost oil producer in the global market."

Thomas did not say what price would spur EOG to boost output this year, but said it had a "premium inventory" of 3,200 well locations that can yield returns of 30 percent or more with oil at $40.

Apache Corp. forecasts its output will drop by as much as 11 percent this year, but said it would probably manage to match 2015 North American production if oil averaged $45 this year.

One-reason shale producers can be so fleet-footed is the record backlog of wells that have already been drilled but wait to get fractured to keep oil trapped in shale rocks flowing.

There were 945 such wells in North Dakota, birthplace of the U.S. shale boom in December, compared to 585 in mid-2014, when prices peaked, according to the latest available data from the Department of Mineral Resources. Their numbers are growing as firms like Whiting keep drilling, but hold off with fracking.

Some warn that fracking the uncompleted wells can offer only a short-term supply boost and a sustained increase would require costly drilling of new wells and therefore higher prices.

"It's going to take a move up to $55 before we see anyone plan new production," says Carl Larry, director of business development for oil and gas at Frost & Sullivan.

To be sure, it is far from certain whether oil prices will even reach $40 any time soon. Morgan Stanley and ANZ expect average prices in the low $30s for the full year.

Some analysts also warn resuming drilling quickly may prove hard after firms laid off thousands of workers and idled more than three-quarters of their rigs since late 2014.

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In fact, John Hess, chief executive of Hess Corp told Reuters in an interview last week that U.S. shale firms should be rather considered as "short-cycle" producers, which might need up to a year to stop or restart production.

And even scarred veterans of past boom-bust oil cycles are not sure what will happen once prices start to recover - during the last big upswing a decade ago, shale oil did not even exist.

“We are a little concerned that this time there is one dynamic we've never had previously," said Darrell Hollek, vice president of U.S. onshore at Anadarko Petroleum Corp.

Implications for Egypt

Despite the fact that Egypt is not one of the top producers or exporters of oil shale, the extent of being affected by developments therein relates to economic relations with the Gulf States—the main competitor of shale oil producers. Despite relative improvement in oil prices over the past week at the backdrop of fragile hopes of a reduction in oil supply, prices are still low. Therefore, Egypt is still benefiting from the decline in oil prices through reduced cost of imports from oil and its derivatives, which are mainly used as production inputs. Therefore, the government has an opportunity to reduce its budget deficit and hence ease inflationary pressures. The recent drop in oil prices comes in favor of the government in its pursuit to reduce the deficit in the budget and trade balance.

However, other concerns include pressure by foreign companies operating in Egypt in the energy sector whose profits declined recently, which could push them to pressure the Egyptian government, demanding their arrears. Add to this the position of foreign investment flows from the Gulf States, Egyptian workers abroad and their remittances.

The important question now is how OPEC would respond, as countries producing oil have not reduced their exports yet. There is an oil supply glut in international markets, and with all the political changes in the region, it may seem that the time is not suitable for investing in oil, especially after the stocks of gas and oil companies inflated due to the drop in prices. But as most investors know, the moment when others flee may be an optimal opportunity for a profitable deal.

What worries oil markets most now is oversupply with production expanding at deeper levels in oceans, and the boom in shale oil in the US, making it a potential export competitor in the future. Add to this the increasing rate of production by countries such as Canada, Brazil, Iraq, Kenya, and Uganda. Also, consumption of the European countries has declined due to improving vehicle fuel efficiency, particularly the upgrade of eco-friendly car technologies.

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Special Analysis

China Raises Global Economic Fears Anew

(News Agencies - Asharq al-Awsat)

The Chinese government has identified the most important priorities in the draft five-year plan between 2016 to 2020, which was submitted to the 12th National People's Congress for consideration at the fourth annual session.

China's new plan aims to maintain a high to moderate pace of growth to double GDP and increase per capita income by the year 2020 compared with the 2010 level. It also aims to promote the five new development concepts, namely: innovation, coordination, green development, openness, and participation), and to develop core technologies, including information technology, new energy, aviation, biomedicine and smart manufacturing.

According to a report distributed by the Chinese Embassy in Cairo, the plan seeks to actively launch major international scientific projects, improve the quality and efficiency of supply, and stimulate real demand in order to promote the new growth momentum. It also aims to create new competitive advantages in foreign trade by exporting more high-quality products, as well as to continue implementation of the “Made in China 2025” plan, and focus on manufacturing innovation, and integration of information technology and industries.

The report said that the Chinese government attaches importance to accelerating the building of a new generation of information infrastructure and upgrading 5G communications technology to IP-6, implementing Internet Plus, and promoting internet technologies to revolutionize production and organizational techniques.

It stressed that the new five-year plan aims to increase the share of trade in services in total foreign trade to 16 percent, alleviate restrictions on foreign capital in the service sector, expand access to markets in the area of banking and securities, and encourage foreign investment in advanced manufacturing sectors, high-tech industries, and energy conservation.

The report pointed out the importance of speeding up implementation of the initiative “Building the Economic Belt of the Silk Road,” and expanding profitable cooperation to shape a new landscape of openness, stressing the importance of strengthening cooperation with international financial institutions, promoting the Asian Infrastructure Investment Bank and the new Development Bank (NDB BRICS), managing the Silk Road Fund properly, as well as establishing free trade zones with the countries along the belt and the road.

The report added that China will work on promoting talks with the Regional Comprehensive Economic Partnership, the GCC, and the free trade zone between China, Japan and South Korea. It will also make

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progress towards the conclusion of free trade agreements with Israel, Canada and the Eurasian Economic Community, as well as the EU and the Free Trade Area of the Asia-Pacific.

The report also noted that China has increased GDP by 6.5 to 7 percent, and maintained CPI growth at around 3 percent. However, the deficit this year is expected to reach 2.18 trillion yuan ($38.335 billion), an increase of 560 million yuan over last year, representing 3 percent of GDP.

The new Chinese strategy, which bears the name «Supply-Side Structural Reforms», pushes for a package of economic remedies that bear more of the hallmarks of the school of Ronald Reagan and Margaret Thatcher than the teachings of Marx and Mao's socialism. It embodies attempts to rework China's troubled plans to reform the deteriorating Chinese economy. But the new plan still faces increasing doubts about commitment to overall economic restructuring, which requires curtailing the powers of bloated state institutions, along with millions of local jobs.

The «supply-side» referred to in the initiative includes tax cuts and reduction of government burden on investors. But the main objective of the initiative remains to close or reduce the size of the mines and operational factories, which produce coal, steel, cement, and other industrial products, in excess of market demand, in addition to curbing credit and other subsidies that feed into current excessive production.

Some economists point out that the slogan «supply-side», at a minimum, is a step in the direction of painful measures that could result in the recovery of more healthy growth, noting it is a new and important initiative aiming to reactivate the reform process, especially that steps taken by Chinese policymakers have fallen through again and again and achievements in market-oriented reforms were meager and inadequate. Therefore, economic policymakers had to come up with new approaches to rescue the situation.

Many liberal economists are still not fully convinced that without the initiative the Chinese government will reduce its powers voluntarily, and receive serious setbacks due to laying off workers. Aligning state subsidized industries with real market levels would mean reducing millions of existing jobs.

A recent study concluded that more than 3 million workers in the steel industry, coal, and other similar industries are at a risk of losing their jobs over the next two years if the government implemented the downsizing decisions.

During the first wave of closure of state-owned factories, which began in 1997, nearly 30 million jobs were eliminated in less than ten years. But the Chinese economy has seen a big boom, especially after China's accession to the World Trade Organization in 2001, which led to the creation of jobs, absorbing more surplus labor.

Job losses are looming today in the Chinese horizon, and while it is slightly smaller than before, it may provoke further controversy, especially with the slowing economy. This threatens to erode the state's internal stability that Mr. Xi prizes.

Apart from correcting such economic distortions, discussions are still ongoing on the specific policies that fall under the slogan «the supply-side initiative». Officials and economists have called to reduce taxes on

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private companies and to grant private investors more shares in state-owned enterprises, ruling out the idea of full privatization. But this concept is vague enough to the point of using it to promote a larger government role in encouraging exports and strengthening troubled state-owned companies.

Reduction of inefficient industries supported by the state, nevertheless, enjoys universal support among various economists and policy makers. Further delays in the implementation of this reduction would undermine economic growth and harm workers, as mentioned by the executive director of the Unirule Institute of Economics in Beijing, which advocates economic liberalization.

Implications for Egypt

The global economy is going through an important turning point; all major countries in the world have recently taken unplanned economic decisions that harm the global economy, including China, which has long been known for its good economic performance and decisions. We cannot isolate Egypt from the outside world. Therefore, Egypt's turning this economic curve does not relate only to the internal functioning of the state but also to global performance.

Through its economic program, China provides again a global economic lesson that is rooted in the foundations of economic reform, through a real government program focused on innovation and managing the supply-side. The Egyptian government should draw on this in the formulation of its program, which is scheduled to be announced later this month, by supporting real structural and institutional reforms at the economic, financial, and administrative levels, as a central pillar to return to compete with major economies such as China.

Interestingly, the strategies that countries have started using to address economic crises away from the movements of cash liquidity and exchange rates that always raise concerns about changing inflation levels, which could lead to negative far-reaching impacts if the monetary policy is not managed wisely, are so much similar in light of limited alternatives. Russia, for instance, which was affected significantly by European sanctions and the sharp drop in oil prices, relied mainly on several strategies. Most importantly, reducing spending, availing cheap bank financing for the development of small and medium industries, reducing state ownership in some investments, and embarking on broad partnerships with a number of trade and economic powers. Add to this the attempt to strengthen local liquidity in the banking sector, reduce foreign imports, promote domestic consumption, reduce external borrowing as much as possible and raise domestic interest rates to support the currency, or assess a strategy to defend the currency in light of internal and external developments, along with setting policies to target inflation and curb it.

Certainly, the Russian model is very much similar to the strategies used by Egypt to face the same crisis. However, Egypt added to those policies working to attract foreign direct investments (FDI) in light of the fact that FDI is governed by determinants that make Egypt attractive in light of its resources and geographic and strategic location, qualifying it for further investments in the coming period.

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