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Our Economy

& the World

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

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- An Analysis of Global Financial Market Performance and Changes in Prices of Goods and Raw Materials

Key Global Developments

Concerns about Brexit causing UK labor shortage

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More than 25 percent of employers in the UK conveyed their concerns about possible labour shortage in the UK after Brexit, according to a survey conducted by the Chartered Institute of Personnel and Development (CIPD) along with HR firm Adecco.

"Almost three-in-ten employers say that non-U.K. nationals from the European Union considered leaving their organization," according to the survey, which quizzed 1,051 employers.

More than a quarter of businesses said they would "be willing to pay the difference" to secure EU workers if migration restrictions drove up costs.

Fed on course to raise interest rates at an upcoming meeting: Yellen

Reuters

The Federal Reserve will likely need to raise interest rates at an upcoming meeting, Fed Chair Janet Yellen said, although she flagged considerable uncertainty over economic policy under the Trump administration.

Yellen said delaying rate increases could leave the Fed's policymaking committee behind the curve and eventually lead it to hike rates quickly, which she said could cause a recession.

"Waiting too long to remove accommodation would be unwise," Yellen told the U.S. Senate Banking Committee, citing the central bank's expectations the job market will tighten further and that inflation would rise to 2 percent.

"At our upcoming meetings, the committee will evaluate whether employment and inflation are continuing to evolve in line with these expectations, in which case a further adjustment of the federal funds rate would likely be appropriate."

Yellen did not say if Fed policymakers expected the economy would warrant three interest rate increases this year, as they last signaled in December. Nor did she give indications whether the first rate hike of the year might come at its next meeting in March or at the June meeting, which is when most analysts expect a rate increase.

Yellen was appearing in Congress for the first time since Republicans took control of the White House and both houses of the legislature and she nodded to the uncertainties over the direction of U.S. economic policy.

"Changes in fiscal policy or other economic policies could potentially affect the economic outlook," she said. "It is too early to know what policy changes will be put in place or how their economic effects will unfold."

‘Frexit’ would cost France €30bn a year, warns central bank chief

Argaam

Marine Le Pen’s plans to take France out of the eurozone would raise the country’s debt costs by €30bn a year, the country’s central bank chief has said, in the latest major warning from France’s economic establishment over a prospective “Frexit”.

François Villeroy de Galhau, the governor of the Banque de France, placed a notional cost on the French treasury from a eurozone exit after Ms Le Pen’s far-right National Front party has fleshed out its plans to redenominate around €1.7tn of the country’s outstanding debt into a new currency within six months of coming into office

Last week, Benoît Cœuré, France’s most senior European Central Bank official, said a decision to exit the single currency would consign France to “impoverishment“, high unemployment and inflation.

Speaking to French radio on Monday, Mr Villeroy de Galhau said he did not want France to ditch the single currency and cautioned against Ms. Le Pen’s plans to embark on a major spending blitz where the central bank would finance government spending.

This form of debt was prohibited by every major economies in the world and threatens the independence of the central bank, said Mr Villeroy de Galhau.

EU expects euro zone economy to weaken this year

Reuters

Euro zone's economic growth is expected to lose some speed this year and to rebound in 2018 while the British economy will nearly halve its expansion by 2018, the European Commission said, warning of higher political risks.

The EU executive forecast that growth in the 19 countries sharing the euro would slow to 1.6 percent this year from 1.7 percent in 2016, but would gain speed in 2018 when the bloc's gross domestic product (GDP) is expected to increase by 1.8 percent.

Growth forecasts were slightly revised up for this year and 2018 from the Commission's previous estimates released in November when euro zone GDP was estimated to grow 1.5 percent this year and 1.7 percent in 2018.

Britain is expected to pay a higher cost for the political uncertainty surrounding its divorce talks from the EU. Its GDP growth is forecast to decline from 2.0 percent in 2016 to 1.5 percent this year, and to further slow down to 1.2 percent next year.

Consumer prices in the euro zone are forecast to markedly pick up this year, as inflation will surge by 1.7 percent from 0.2 percent last year. The 2017 estimate is higher than the 1.4 percent inflation growth predicted by the Commission in November.

But euro zone inflation is expected to slow again in 2018 to 1.4 percent and core inflation, which excludes more volatile prices, is set to rise only gradually.

However, this is not seen as sufficient to keep the ECB's stimulus plan to continue indefinitely. "

Oil discoveries drop to lowest level in 60 years

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Oil and gas discoveries are at their lowest level in 60 years, according to a new report by *IHS* Markit Research Firm. Only 174 new oil and gas fields were explored worldwide over the past year, compared with the annual average, which has been somewhere between 400 to 500 fields until 2013.

Given that the period between exploration and production usually take from five to seven years, it is likely that the current downturn would lead to a shortage of oil and gas supplies at the beginning of next decade.

Total oil and gas discoveries last year amounted to about 8.2 billion barrels.

At the same time, "Wood Makizi" data indicated a drop in the level of corporate spending on exploration activities to $40 billion in 2016, compared with $100 billion in 2014.

FAO: Agriculture is key to Solving poverty and climate problems

Al-Hayat

Failure to act now to make our food systems more resilient to climate change will "seriously compromise" food production in many regions and could doom to failure international efforts to end hunger and extreme poverty by 2030, FAO Director-General José Graziano da Silva warned.

"Agriculture holds the key to solving two of the greatest problems now facing humanity: eradicating poverty and hunger, and contributing to maintaining the stable climatic conditions in which civilization can thrive," he told participants at a roundtable on climate change during the World Government Summit in Dubai.

The FAO Director-General stressed in particular the need to support smallholder farmers in the developing world adapt to climate change.

The vast majority of the extremely poor and hungry depend on agriculture for their livelihoods, he said, adding: "They are the most vulnerable to the impacts of global warming and an unstable climate."

Innovative approaches exist that can help farmers improve yields and build their resilience, he said. He noted that farmers face major barriers, such as the lack of access to credit and markets, lack of knowledge and information, insecurity about land tenure, and high transaction costs of moving away from existing practices.

He pointed to the fact that 70 countries do not have established meteorological services as an example. FAO is working with the World Meteorological Organization to develop low-cost, farmer friendly services to address this need. "Adaptation to climate change makes economic sense: the benefits of adaptation are much bigger than the costs," he added.

One critical front for action is water management, according to Graziano da Silva. Millions of the world's small-scale farmers are already wrestling with water scarcity, which will likely intensify as a result of climate change, he said.

This is why at the last UN climate change conference FAO and partners launched a global framework on water scarcity in agriculture that aims to support developing countries in bringing stronger policies and programmes for the sustainable use of water in agriculture online.

The EU promises to retaliate against any US protectionism

AFP

In an interview published by the Financial Times, *European Commission Vice-President Jyrki Katainen* stressed that the European Union would retaliate if the US takes protectionist measures.

He said that should any party moves against our interests or violates international trade rules, we have our own mechanisms to retaliate. He added that the EU prefers to avoid a trade war with the US that may constitute a disaster for the global economy, but would retaliate if the Americans established protectionist barriers.

The newspaper pointed to the willingness of the European Commission lawyer and other trading partners to file a complaint to the "WTO" if the situation with the US escalated.

The US recorded its largest trade deficit since 2012 last year against the backdrop of continuing tension with China and Europe, boosting the efforts of US President Donald Trump to impose tariff barriers.

Washington conveyed its anger against Germany, which tipped the balance of trade between them in its favor, and accused it of using the depreciation of the euro against its trading partners, including the US to maximize the competitiveness of German exports.

Implications for Egypt:

Egypt must realize that the emergence of an economic war now is no surprise, but raises old economic fears that the use of monetary instruments will be an alternative to addressing the economic crises resulting from excessive consumption of natural resources, ongoing decades-old trade wars and the change in economic models. Such models now require a drastic review not only in the short term, but also through radical shifts in underlying fundamentals. Everybody needs to know now that changing monetary policy as a reliever may represent a catalyst for growth in the short term, but will not address countries' economic problems, especially that monetary policies alone have not succeeded in addressing economic problems.

We have an opportunity now to attract investments that have flowed out of global and regional markets; especially that Egypt now avails real locomotives of growth and development, such as major national projects. However, this requires not only speeding up the amending of laws or introducing new regulations, but also putting an end to administrative and other regulatory problems afflicting the Egyptian economy and hindering investment.

Although the impact on the Egyptian economy of international developments has not fully materialized, it is necessary to point out that this situation could see a significant change in the light of reforms undertaken by Egypt and attempts to open up to the global economy.

From the International Press

Oil prices fluctuations raise the Russian public debt

Asharq Al-Awsat

Russian Finance Ministry expects the price of oil over the next two years to range between $40 and $60 a barrel, which would affect the main orientation of Russia's public debt policy for the period 2017-2019. This is because the dynamic nature of oil prices fluctuations remains a main source of risks faced by the Russian economy, according to a ministry statement on its official website. *Anton* Germanovich *Siluanov*, the Russian Finance Minister, had said earlier that the ministry proceeded in formulating a draft budget for the years 2017 - 2019 based on conservative estimates, setting the oil price at $40 a barrel.

The Ministry of Finance addressed in its report on the main orientation of the Russia's public debt policy for the period 2017 - 2019 the size of the public debt and its shifts. It said that the public debt could reach 14.7 percent of GDP by the end of 2017, expecting it to rise then to 15.7 percent of GDP. This means that the Russian public debt is increasing from one year to another, amounting to 11.1 trillion rubles in 2016, the equivalent of 13.2 percent of GDP, according to the ministry report.

The ministry pointed out that the share of federal spending on the public debt will increase from 4.5 percent of total spending in 2017 to 5.4 percent by the end of 2019. The average pace of public debt increase is higher than that of GDP growth. While the public debt amounted to about 7.5 trillion rubles on January 1, 2016, it rose to 11.1 trillion rubles by 31 December 2016. Nevertheless, the Russian Ministry of Finance believes that the debt burden at the beginning of 2017 is still within safe limits, i.e., less than 15 percent of GDP. Thus, the ministry considers that this indicator is moderate according to the international standards of the public debt.

The total size of the Russian public debt in 2016 amounted to about 606.6 billion rubles; 500 billion, including domestic debt, and 106.6 billion in foreign debt. According to the report, the size of domestic debts will rise to a record high in history in 2019 to about 1.1 percent of GDP. The foreign debt value will decline over the coming years, and compared to 2016 it will decline in 2017 by about 21.2 billion rubles, about 60.1 billion in 2018, and about 13.2 billion rubles in 2019. Contrarily, the report says that domestic borrowing will grow from 1.2 percent of GDP in 2016, to 1.7 percent in 2019. The domestic debt is expected to reach about 1.1 percent of GDP this year, while it did not exceed 0.6 percent in 2016.

With regard to external borrowing, or external public debt, the Russian Ministry of Finance warns in the negative scenario against what it calls accumulated risks related to the possibility of worsening terms of lending to Russia, and increased debt burden. It added that if the geopolitical tensions continued in 2017 - 2019 at the current level, Russian debts from international development banks would not exceed on average $215.4 million a year, equivalent to 14.8 billion rubles. The ministry stressed in its report that the growth of Russian external borrowing would be mainly at the expense of resources of the new Development Bank, which was established in the framework of the Brix Group.

Implications for Egypt:

The size of domestic debt and its servicing burden pose a significant challenge. 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, 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.

In recent years, domestic debt instruments have represented 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.

This calls for boosting the secondary market for Treasury bonds, which remains weak, and dominated by bank transactions contrary to other global markets that have active secondary markets that provide medium and long term finances to companies. This requires a taking a set of integrated measures to enhance the secondary market capability, including increasing the investors 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. The liquidity of the secondary market contributes to lowering the cost of these securities through reduction of issuance yield.

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Special Analysis

The real reason behind inflated US balance of trade deficit

Argaam

President Donald Trump promised to enhance the US economy, create more good paying jobs in the US by lowering the country's trade deficit. However, the problem, which exaggerated long time ago, is hard to solve soon. Trump's hopes are in conjunction with the trade balance gap widened to its highest level in four years to $502 billion, recording a deficit for the 41st time in a row. The US has not seen a trade surplus since 1975.

However, the problem seems simple to the White House, though some things have completely changed, such as the sharp decline in manufacturing as a percentage of the domestic economy, according to two reports of Market Watch and the Associated Press.

Causes

- Americans buy huge quantities of cars, mobile phones, computers, TVs, toys and more clothing manufactured abroad than those manufactured in the US.
- The shift in manufactured production began in the late nineties and accelerated through a series of free trade agreements, and the integration of China into the global system, which contributed to the decline of industrial jobs in the US.
- Some 12.3 million workers are currently working in the US manufacturing sector compared with more than 17 million early this century.
- Trade is not the only or even the main reason for the decline in jobs in the manufacturing sector. Companies embraced new technologies, which reduced the number of workers they need.
- The White House is strongly pushing through a series of high-level meetings with major companies to create new job opportunities in the manufacturing sector, while "Trump" is relying on tax cuts and streamlining regulations to encourage corporate investment.

Queries and solutions

- "Trump" wondered more than once during his election campaign about why the world's largest economy is unable to achieve a trade surplus or at least record a lower deficit, and blamed trade agreements for that.
- Economists believe that the answer is not that simple. Trade deficit or trade surplus reflects various factors, including the strength of consumer spending at home and abroad and the strength of the dollar against other currencies, which are things that cannot be controlled easily.
- During the election campaign, "Trump" blamed other countries, especially China and accused them of deceiving the US and devaluing their currencies to have competitive advantages in exports.
- "Trump" proposed to impose punitive duties of up to 45 percent against countries such as China and Mexico, if what he called "unfair trade practices" did not stop, which he says caused the US to lose millions of jobs in the manufacturing sector.
- Many economists are worried about "Trump's" potential policies, arguing that he may fail to provide more favorable conditions for businesses and workers, and will ignite a trade war with other countries based on an "eye for an eye" approach.

Erosion of the industrial base

- Economist "Alan Tonelson" advocated trade policies that encourage manufacturing in the US policies long time ago. He was the first to talk about the importance of targeting a low trading deficit, saying that Washington ignored the crisis of eroded industrial base.
- "Tunlson" believes that political efforts to promote domestic manufacturing are manifested all over the world, and that senior executives understood this message. He also believes that some progress may be made fast but not as fast as "Trump" hopes.
- "Tonelson" says that automakers shifted their production processes to Mexico quickly after the "NAFTA" agreement signed in 1994.
- For her part, General Motors CEO Mary Barra said last month that large plants need a lot of money and it often takes several years to plan for them.
- In 2016, the US recorded $750 billion in commodity deficit. However, it made a large surplus in the services balance of $247.8 billion. This means that the US still has a chance in the services sector.

Implications for Egypt:

In light of the US experience, it is necessary that Egypt completes a strategy for industrial development, and starts its implementation. The focus of the exports development strategy has been so far on access to markets procedures, and granting incentives for exports development, either through the exports-refund program or changing the exchange rate without addressing the larger challenge of production obstacles for exports.

The devaluation of the Egyptian pound will not solely achieve the expected effect of increasing exports' competitiveness given the high imported components in the Egyptian products. Therefore, reducing the trade deficit requires expansion of the production base and working to raise the quality of Egyptian products, whether to cover the domestic needs of the market and face competition in local markets, or to increase the local component in the Egyptian exports and increase their competitiveness.

There are also many measures that still increase the cost of foreign trade transactions, especially in relation to exports. It is important to address these measures to stimulate export growth, such as facilitating licensing, customs clearance procedures and taxation, as well as reducing the cost of financing transactions and the number of required procedures and approvals.

In light of recent measures taken by the government or the Central Bank of Egypt (CBE), it has become necessary to carry out a comprehensive sensitivity analysis of the effect of changes in the exchange rate on export indicators and the cost of imports, which did not appear fully so far. It is likely that recent exchange rate changes will improve Egypt's trade competitiveness. Also, a sensitivity analysis of the detailed impact of changes in the US dollar on exports and different sectoral imports should be conducted, which will facilitate formulating policies aimed at increasing exports and reducing imports.

Global Financial Market Performance

Reuters/ Argaam

Chinese stock indexes fell at the close of trading, with the decline in Chinese companies' investment abroad, but managed to achieve weekly gains for the second time in a row.

At the end of the session, the "Shanghai" composite index fell by 0.85 percent to 3202 points, to achieve weekly gains below 0.2 percent.

Ministry of Commerce data showed a decline in Chinese corporate investment in foreign real estate by 84.3 percent in January compared to a year ago.

Direct investment inflows to China also declined by 35.7 percent to 53.27 billion yuan (7.77 billion dollars), the weakest level in 16 months**.**

The decline in foreign investment comes in light of a package of measures recently taken by the Chinese authorities to curb capital outflows.

Japanese stock indices fell at the close of trading, with losses for energy, real estate development companies and automakers, despite the relative stability of the yen against the dollar.

At the end of the session, the Japanese "Nikki" index fell by 0.60 percent to 19,234 points, its lowest level in six days to broaden weekly losses to 0.70 percent. The "TOPIX" index fell by 0.40 percent to 1544 points.

The "Toshiba" share extended its series of losses for the fourth session on the back drop of the company postponing announcement of its quarterly results, and the rise in the value of assets to be written off. It fell at the end of trading by 9.25 percent to 184 yen.

On the other hand, the share of "Sharp" Electronics rose 2.80 percent to 331 yen after the company revised its forecast for operating profit in the current fiscal year, which ends March 31, up to 47.4 billion yen from 37.3 billion yen.

US stocks got rid of their losses during Friday trading and ended flat with the attention of investors drawn to the political developments in Europe and the holiday next Monday in the United States. Major indexes achieved weekly gains, as the "Dow Jones" posted seventh record close in a row.

The Dow Jones' industrial average rose 4 points to 20,624 points, the broader S & P 500 index rose (+4 points) to 2351 points, while the Nasdaq index rose (23.7 points) to 5838.5 points**.**

On the weekly level, the "Dow Jones" industrial posted gains of 1.8 percent, the "Nasdaq" index gained 1.8 percent, while S & P 500 index made a weekly gain of 1.5 percent.

In the European markets, "Stoxx Europe 600" rose less than 0.1 percent, or 0.1 points, to 370.2 points, and achieved a weekly gain of 0.8 percent.

The German "DAX" index settled at 11,757 points, while the French "CAC" index declined (- 32 points) to 4867 points. The British "FTSE 100" index rose (+ 22 points) to 7300 points.

On the other hand, Gold futures for April delivery settled down 0.2 percent or $2.50 to $1239.10 an ounce. The precious metal made gains of about 0.3 percent this week**.**

In the oil markets, the US "NYMEX" rose 0.1 percent or 4 cents to close at $53.40 a barrel, but made a weekly loss of 0.9 percent. The "Brent" index rose 0.3 percent or 16 cents to close at $55.81 a barrel, but recorded weekly losses of 1.6 percent.

The US will observe Monday the twentieth of February as official holiday. Stock and bond exchange will close to celebrate Presidents Day, and will resume work the following day.

Implications for Egypt:

Global financial markets have seen a slight tendency to rise with the continuation of the state of global uncertainty in light of Trump assuming the presidency of the United States and fears of changes in US economic and monetary policy.

Global markets closely monitor policy developments and decisions expected from the administration of US President "Donald Trump" after the official inauguration, the Brexit developments, and fears of a potential currency war or a new trade war at the level of major global markets.

According to the weekly report of the Egyptian Stock Exchange, main market performance indicators collectively fell. The main index of the Egyptian Stock Exchange, "EGX 30" dropped by 3.53 percent to 12,652 points. The secondary market indicators also tended to drop, " EGX 70" index for small and medium stocks fell around 2.26 percent to close at 512 points, while the broader "EGX 100" index dropped by 3.08 percent to reach the level of 1220 points and "EGX 20" fell about 3.02 percent to close at 11637 points**.**

The report pointed to a decline in the total trading value during the week to LE 17.3 billion, while total trading volume reached 1.098 billion securities executed on 150 thousand transactions compared to a total trading value of LE 7 billion pounds and traded volume of 1.338 billion securities executed over 171 thousand transactions during the previous week.

This decline in the Egyptian Stock Exchange is due to corrective factors following the strong gains it saw after floatation of the Egyptian pound. The catalyst for this decline was basically linked to the IMF's announcement of its recommendation to impose a tax on the stock market's capital gains. Despite denials from the Ministry of Finance, investors' fears pushed the stock market into a strong corrective wave at the end of the week trading.

Effects of the global economic situation on the Egyptian Stock Exchange trading are limited in light of the latter's strong link to the domestic economic variables on top of which changes in exchange rates and developments of the economic reform program.