Issue : 5

Date : 20 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 changes in the prices of goods and raw materials**
- **An overview of key world developments last week**
- **News from the international press warning against an economic bubble looming over Europe**
- **Special analysis about whether emerging market currencies are experiencing a recovery**

## Global Market Performance

Reuters - Argaam:

Japanese stocks fell for the fourth session in a row during Friday trading due to continued strengthening of the yen, and in spite of energy companies' stock gains supported by high oil prices. The Japanese "Nikki" index fell by 1.2 percent to 16724 points, down by about 1.3 percent this week. "TOPIX" also fell by about 1.02 percent to 1345 points and JPX Nikkei-400 declined by 1.1 percent to 12,144.78 points.

Chinese stocks recorded the biggest weekly gains since last November, supported by the rise of the yuan, and recovery of the real estate sector. The "Shanghai" Composite Index rose by 1.7 percent to 2955 points at closing, marking weekly gains of 5.2 percent.

US stocks also rose during Friday trading supported by the financial and health care sectors to continue their positive performance in the wake of the Fed's statement, recording gains for the fifth week in a row.

The "Dow Jones" Industrial Index jumped 120.8 points to 17,602.3 points, while the "NASDAQ" index rose by (20.6 + points) to 4795.6 points, and the "S&P 500" benchmark rose by (8.9 + points) to 2049.5 points.

At the weekly level, the "Dow Jones" industrial index made 2.26 percent in gains, the "NASDAQ" rose by 0.9 percent, while the broader "S&P 500" recorded weekly gains of 1.35 percent.

In Europe, "Stoxx Europe 600" benchmark rose by 0.3 percent, or by about one point to 341.7 points, but scored a weekly loss of 0.2 percent, after four weeks of gains.

The French "CAC" index also rose by (19.6 + points) to 4462.5 points, and the German "DAX" index rose by (58.6 + points) to 9950.8 points, while the British "FTSE 100" index declined (-11.4 points) to 6189.6 points.

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Also, gold futures for April delivery at settlement fell down by 0.9 percent, or by $10.70 to $1254.30 an ounce. The precious metal recorded a weekly loss of about 0.4 percent.

In the oil markets, the US "NYMEX" fell by 1.89 percent or by 76 cents to close at $39.44 a barrel and made about 6.9 percent in gains this week. Also, the "Brent" benchmark fell by 0.8 percent or by 34 cents to close at $41.20 a barrel and achieved weekly gains of 2.3 percent.

**Implications for Egypt:**

Global financial market performance is still affected by stimulus programs and movements in oil prices associated mainly with the attempt to restrain oil supply in the markets. Most of the global markets were affected by the improvement that began showing on US economic indicators, the decision to stabilize interest rates, China's announcement of its new economic plan along with the start of discussions of the British budget and mitigation of fears regarding its exit from the EU. This reflected on the Middle East and the Arab region with positive movements 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.

Estimates suggest shifts in the trading of institutions in the global markets with expansion of investment in risky assets at the expense of bonds and fixed-income assets, which could contribute to improving performance of the global financial markets at the present time.

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# Key Global Developments

**GCC Financing Needs Amount to $151 Billion in 2016**

**Kuwaiti newspaper Al-Qabas:**

Kuwait Financial Center (Markaz), in collaboration with the Kuwait Banking Association (KBA), delivered a presentation about the outlook for sovereign debts in GCC countries. The presenter was M.R. Raghu, Head of Research at Kuwait Financial Center (Markaz) and Managing Director of Marmore Mena Intelligence, an affiliate company owned by Markaz that provides services of research and financial analysis of economies and markets in the MENA region.

Raghu pointed out that overall financing needs of the GCC countries in 2016 are estimated at a total of $151.3 billion, including $78.1 billion expected to be drawn from reserves (52 percent), $57.7 billion to be obtained from local and global bond issuance (38 percent), while the remaining 10 percent to be obtained via loans. Overall, the cumulative total of combined GCC governments' debts over the period until 2020 is estimated at between $285 to $390 billion through local and international bond issuance.

***Alsaa News*: Global Economic Crisis is Back**

WAM

According to *Al-Saa News bulletin*, the global economy is expected to face many difficulties in the future. What appeared to be a recovery during the last period is merely a relative improvement from what the situation used to be at the beginning of the global financial crisis and is not a total or real exit from the crisis. There are many risks surrounding the world economy, which could drive it to a state of total collapse if governments fail to take the necessary actions.

The *bulletin* pointed out that challenges will increase if countries do not make real steps towards stimulating their national economies more effectively and sustainably. That also goes for major economies like the US, China, Japan and Germany.

**Britain Revises Downward its Outlook for Economic Growth due to Troubled Global Economy**

KUNA:

British finance minister George Osborne reduced on Wednesday the outlook for his country's economic growth this year and until 2020 due to "multiple risks" resulting from the troubled global economy.

Presenting the state budget before the House of Commons, Osborne said that the Office for Budget Responsibility at the ministry decided to reduce its outlook for economic growth this year from 2.4 percent to 2 percent.

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He added that the growth outlook for the next year was reduced from 2.5 to 2.2 percent and from 2.4 percent to 2.1 percent in 2018 and from 2.3 percent to 2.1 percent in 2019 and 2020.

**The Fed Keeps the Interest Rate Stable with Growth of the US Economy**
Reuters:

The Federal Reserve (the US central bank) kept interest rates stable on Wednesday, but hinted that average economic growth with "strong job increases" will allow it to resume tightening monetary policy this year.

But the Fed also noted that the US still faces problems as a result of uncertainty that mars the global economy even under new speculations by policymakers that predict increased interest rates twice by the end of this year, each by a quarter point.

In its policy statement in which the Fed kept the targeted corridor of overnight lending rate between 0.25 and 0.50 percent, the Fed stated that a number of recent indicators, including strong job increases, suggest further strengthening of the labor market. Inflation accelerated in recent months.

However, the Fed added, global economic and financial developments still posed a threat and would keep inflation low until the end of 2016.

**London Stock Exchange Announces Full Merger with Frankfurt Stock Exchange**
KUNA:

London Stock Exchange (LSE) announced on Wednesday it reached an agreement with its German counterpart (Deutsche Börse) to fully merge their financial activities, creating one of the largest capital market authorities in the world.

In a press release, LSE said that under the agreement its share will be 45.6 percent of the new company, while the German side's share will be 54.4 percent.

LSE said the merger of the two exchanges will enable them to save annual expenses of up to 450 million euros, representing 20 percent of the combined budget of the two exchanges, which last year amounted to 2.2 billion euros.

The statement stressed that the merger of the two exchanges, including the Milan Stock Exchange that is wholly owned by LSE, will allow the creation of a base for financing and encouraging economic growth for European companies as well as attracting more Asian and US investments to the European market.

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**Report: Emerging Market Debt Jumps to $1.6 trillion**
Reuters:

Institute of International Finance (IIF) said on Wednesday that total emerging market debt grew by $1.6 trillion in 2015 to more than $62 trillion, warning that the increase in debt raises the risk of default and threatens economic growth in the future.

The Washington-based institute, which is one of the most credible sources of data on investment flows to developing world, said that bonds worth $730 billion issued by governments and companies in emerging markets will mature in 2016. Other bonds worth $890 billion will fall due next year, a third of which is in US dollar.

Reuters said in an earlier report that the burden of debt service is a result of a borrowing spree following the global financial crisis in 2008.

The IIF said in a report that with countries' increasing use of the funds collected to pay off outstanding debts, it is likely that high levels of indebtedness - and hence the need to reduce leverage in the end - will restrict growth in emerging markets from now onwards.

The report noted that government bonds' issuance and borrowing since the beginning of the year was down by about 35 percent compared with the corresponding period last year.

**Yelen: April Meeting May See a Hike in Interest Rate**
Argaam:

Head of the Federal Reserve, Janet Yellen, said in a press conference that the gradual rate hike will allow continuing to bring monetary policy back to normal, indicating that the labor market continues to improve.

According to Yellen, the outlook for inflation over the longer term is still valid, expressing optimism about its moving upward to the target level of 2 percent.

The Head of the Fed stressed that financial conditions had improved markedly in the US, but the Fed reduced its forecast for US economic growth this year due to slow global growth.

She explained that the US economy is resilient, hinting that the upcoming April meeting will probably witness a hike in interest rate.

Yellen was amazed by the lack of wage growth in the US, stressing the existence of both upside and downside risks.

## US Current Account Deficit Shrinks in Q4

Reuters:

The US current account deficit declined in the fourth quarter of last year, but it is unlikely this improvement will be sustained as a stronger dollar continues to affect negatively commodity exports.

The Department of Commerce said on Thursday that the deficit in the current account balance, which measures goods and services and investment inflows and outflows, fell by 3.6 percent to $125.3 billion. The deficit was revised upwards in Q3 to $129.9 billion from 124.1 billion.

## Public and Private Debts Threaten the Global Economy and Portends a Crisis Similar to 2008

Cairo - Al-Wafd Portal:

Economic researchers headed by Claudio Borio, head of the Monetary and Economic Department at the Bank for International Settlements, warned in the first quarterly report of increased debt in the five continents, threatening the world of a crisis similar to 2008, with a collapse in productivity growth and increasing debt.

The report noted that the decline that hit global stock markets at the beginning of this year and concern over slowing Chinese economy and developing countries, as well as markets threatened with the risk of collapse of oil prices, has become worrisome for private banks, esp. in Europe, noting that BIS should help financial institutions and secure financial stability. It attributed all this to public and private debts, which were also the reason behind the 2008 financial crisis that affected the entire world.

The report pointed out that public and private debt levels reached the same level as in 2007, exceeding 200 percent of national output. The private sector in major industrial countries has certainly begun to suffer from the debt incurred, especially in the US, while public debt has accumulated to reach today 104.5 percent of national output, according to the international Monetary Fund. In addition, dollar-denominated debts of companies in developing countries have recorded a significant rise.

## ECB Expects Interest Rates to Remain Low or Decline

Reuters:

Mario Draghi, President of the European Central Bank, said on Thursday that he expects interest rates to remain low or decline further for a long time.

Draghi spoke after briefing EU leaders on the economic outlook at the summit in Brussels.

He told reporters that the Board of Governors expects interest rates to remain at current levels or less ... for an extended period of time, and long after the end of the asset purchase program.

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**Implications for Egypt:**

Global economic news reflecting the adoption of the EU, Japan, the US and China of policies to stimulate economic expansion should stand as a lesson to Egyptian policymakers in conducting fiscal policy at this time, representing one of the economic stimulus models needed to overcome the current economic crisis.

The only way out of this crisis is that instead of denying current challenges, they must be placed in their proper place and dealt with accordingly. Addressing problems has become possible and the vision for the future has become more rooted. The will to reform is what can drive us out of this economic crisis. Hence, the end of the period of economic troubles, which everyone is anxious for, is mainly related to the country's ability to achieve growth capable of utilizing the youth, and hence achieve the optimal model of growth and social justice. It is also related to the political and economic potential of the government, and its ability to take the right decisions to overcome the crisis.

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# From the International Press

### Warnings of an Economic Bubble Hovering over Europe

Arabiya / El-Borsa Newspaper:

The European Central Bank (ECB) dealt a heavy blow to the markets, reducing three different interest rates. The ECB's decision was described as courageous, comprehensive and unexpected, aiming to revive the economy and eliminate the shadow of price deflation. The European measures included decisions to reduce the main interest rate from 0.05 percent to 0 percent, and lower the interest rate on deposits from -0.3 percent to -0.4 percent. Meanwhile, the value of the monthly quantitative easing program was increased from €60 billion to €80 billion. The ECB also expanded quantitative easing to include corporate bonds, and launched four long-term programs for bank lending.

Since Mario Draghi assumed the position of President of the ECB in November 2011, the Bank has lowered the interest rate 10 times and introduced 6 long-term programs for bank lending. The bank also launched an asset purchase plan in March 2015, and extended it in December of the same year.

And despite all measures taken by Draghi, especially pumping more than €700 billion into the financial system through quantitative easing, the interest rate in the Eurozone is still negative. The industrial activity is the lowest in three years, and investor confidence remains weak.

Draghi stressed that inflation rates are likely to remain negative for a few months, but will recover slightly at end of the year. He also lowered his expectations for growth of the European economy to 1.4 percent this year. Draghi predicted interest rates would remain at current levels or lower for a long time, which may extend beyond the end of the quantitative easing program.

While some experts welcomed the new measures, others warned of the risk of bubbles in asset prices and of reducing focus on the structural reforms that are essential for a sustainable recovery in Europe.

During most of its short life, the European Central Bank deplored the fact that inflation is very high. However, it is now concerned about just the opposite, i.e., deflation. Fear of deflation explains the set of measures announced by Mario Draghi last Thursday. Three months ago, the President of the Central European Bank frustrated markets by revealing less stimulus measures than expected. This time, however, he did not announce half the measures.

The European Central Bank has three rates of interest, which were all reduced on Thursday. It also used to buy bonds for cash with a value of €60 billion a month, but increased the amount to €80 billion a month for at least a year, and purchases may continue for longer.

The ECB also launched a scheme of paying to commercial banks in exchange for borrowing funds, provided they recycle funds to the private sector in the form of loans to households and companies.

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However, that was not enough to satisfy the unquenchable thirst of financial markets for more and more stimuluses. The euro fell initially in foreign stock markets, then rose when Draghi said that the ECB saw no need to cut interest rates further.

Certainly, there is a need to support demand in the Eurozone. Since December, the ECB lowered its outlook for growth in the single currency bloc in 2016 from 1.7 percent to 1.4 percent. However, the real big change was in the ECB's outlook for inflation. Three months ago, the bank had expected a rise in the Eurozone's cost of living by 1 percent this year, but now it expects an increase thereof of 0.1 percent.

Draghi's plan is to make money available and cheap. However, the problem of the Eurozone is not the lack of credit availability, which reached the highest level in five years. The problem is the weak demand for loans even under historically low interest rates. There are limits to what central banks can do, and the ECB is rapidly approaching such limits.

Draghi knows that monetary policy—interest rates, quantitative easing and loan incentives—has limits to what it can do, and should preferably be accompanied by structural reforms and a more robust use of fiscal policy.

Catherine L. Mann, OECD Chief Economist and Head of the Economics Department, supports that point of view. She believes that the ECB carries a burden greater than necessary to stimulate the Eurozone economy. She is quite right about that.

Higher government spending will help boost growth, and will convince firms and households to take advantage of available low cost loans. Until the time comes when Europe has a more reasonable approach towards fiscal policy, the entire burden will remain on Draghi. The ECB cannot solve all the problems of the Eurozone, though. It can only buy time.

**Implications for Egypt:**

The European Union is one of Egypt's largest trading partners. It is also considered one of the largest suppliers of foreign investments and a major source of trade with Egypt. Thus, any potential negative impact faced by the EU will have an impact on economic life in Egypt and on the prospects of export growth.

Egypt has certainly been exposed to several economic shocks since 2009 to date, negatively affecting its economic performance. However, it is reassuring that what Egypt is currently suffering is not comparable to what some other countries in the region are going through. This is a good indicator of Egypt's ability to overcome the crisis, provided the right decisions are taken. We cannot isolate Egypt from the outside world. So, Egypt's crossing this economic turning point does not relate solely to the country's internal performance, but also to global performance.

There is a consensus that Egypt has not yet reached economic recession. Despite going through adverse economic circumstances, Egypt achieved growth for the second year in a row, and possesses several advantages that enable it to overcome the crisis. Such advantages include a sizable market, a young labor force, and a unique geographical location. Also, the country is witnessing remarkable economic mobility, albeit reforms must happen faster.

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# Special Analysis

**Are Emerging Market Currencies Showing Signs of Life?**
Argaam:

Currency markets in emerging economies have been stumbling for the last few months. Foreign exchange investors may have found a flicker of light to follow in the emerging economies. However, this light has become barely discernible last year due to China’s slowdown, the dollar’s hefty appreciation, and the oil price debacle.

However, a report published by the "Financial Times" believes that emerging markets’ currencies are showing signs of recovery. The "Morgan Stanley" index, which tracks the performance of emerging markets’ currencies, recorded on Friday, March 4, its highest level since December despite their falling values by a fifth in 2015.

**Did a Strong Rise Begin?**

According to Paul McNamara, EM investment director at GAM, the poor performance of the major currencies in emerging markets is coming to an end, but this does not mean that a strong rise has begun.

This comes despite the stability of oil prices and the dollar with no possibility of the Federal Reserve resorting to take more steps to raise interest rates in the near term.

Investors believe that emerging markets’ currencies need stable oil prices and not raising interest rates by the Federal Reserve, as well as improved economic data in these countries.

The problem is that the slowdown in some major emerging economies affects smaller counterparts as is the case in Brazil, Nigeria and South Africa.

**Smaller Emerging Economies**

Regarding smaller emerging economies, though economic data is improving in countries such as Argentina, Peru and Colombia, they are negatively affected by the performance of Brazil in Latin America.

Political risks overshadow the economic performance. The corruption scandal is still reflecting on the economy in Brazil, and the political tensions in Russia and Turkey are causing volatilities in their markets.

In China, the largest emerging market and second largest economy in the world, there are wide concerns among investors about slowing growth that were raised by the central bank's decision to devalue the yuan.

Currency market analysts believe that China's central bank is drawing on its reserves to halt the depreciation of the yuan, but will depend later on real market forces, while others argue that the bank allows such depreciation.

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## Combined Factors

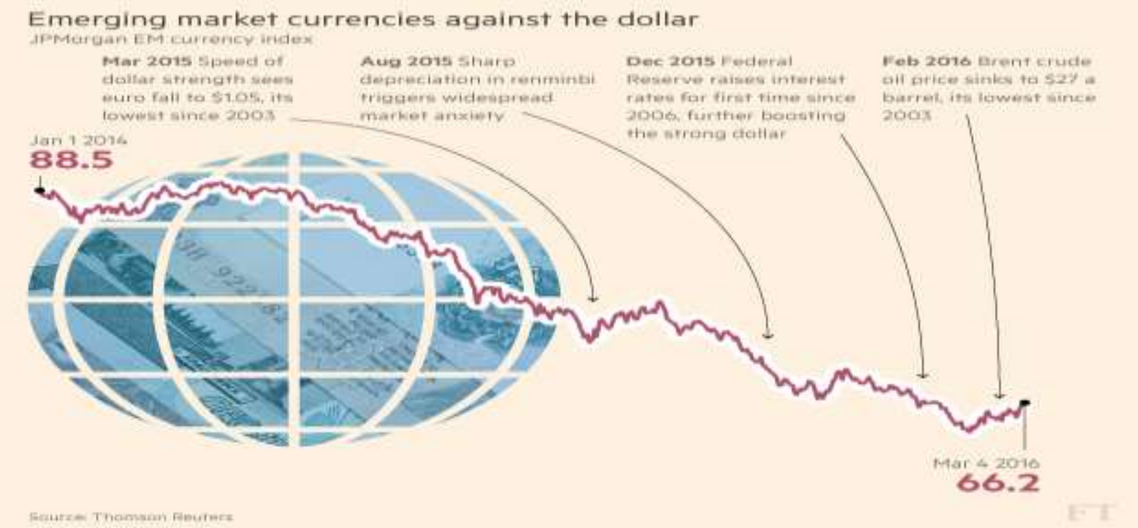
According to "Bank of America" experts, the recovery of emerging markets' currencies will be due to technical factors rather than economic data.

Caution must be observed regarding the recessionary conditions prevailing in world economies and their implications for emerging markets, which will show on the performance of stock and currency markets.

The lack of liquidity of emerging market assets worries many investors because of the US's attracting of liquidity. The more currency pairs move together in the market, the greater the need to monitor the movement in trade and global markets.

The performance of the US dollar should not be overlooked and there is optimism about it. Also,   emerging markets are attracting investors even more.

The most important question for investors now is the extent of support by a set of factors for emerging markets' currencies such as weakened dollar, calmed fears about China, stable oil prices and improved economic conditions.



## Implications for Egypt:

By the time the Central Bank of Egypt (CBE) decided to devalue the pound significantly after months of ignoring this demand, the level of reserves had dropped to barely cover three months of imports, which is not enough to defend the pound again in case the dollar resumed climbing to new heights.

However, this bold step means that the CBE has what to bet on to improve the position of its foreign reserves and provide the dollar liquidity needed for the economy, which was heavily affected by the lack of foreign currency in recent months.

**Bringing Foreign Investors back to the Government Debt Market**

One of the most important goals sought by the CBE is to bring foreign investors back to the government debt market after leaving in 2011. Their exit at that time caused the collapse of international reserves after fleeing with the $11 billion they were investing in the local debt market to benefit from the large differences in interest rates between the Egyptian pound and the US dollar.

The exit of these funds contributed to the decline in foreign reserves from the highest value reached ($36.5 billion) to about half this value within one year only. Previous attempts to bring these investors back were not successful.

The CBE’s plan to attract foreign investors to government debt instruments depends on a number of aspects. Most importantly, reducing the overvalued pound, ensuring repatriation of investors’ money if they wish to exit the market, and raising domestic interest rates to attractive levels.

Devaluation of the pound by 14.5 percent almost achieved the first goal. The National Bank of Egypt and Banque Misr revealed the offering of options to insure foreign investments in the debt market, and to provide foreign investors with the necessary liquidity for exiting when they desire to do so.

**Attracting the Dollar from the Informal Market to the Formal Market**

The CBE announced that it would adopt a more flexible approach in the foreign exchange market to address FX distortions, indicating the possibility of partially leaving the pound to supply and demand forces, which will strip the informal market of any advantage.

Devaluation of the pound led to the disappearance of differences between the two markets. Such a step could convince companies with US dollar revenues and exporters to sell their dollar earnings in the official market rather than the informal market, hence augmenting the banking system’s dollar resources needed to meet the demand on US currency by traders and investors.

The CBE has taken other steps in coordination with state-owned banks to convince US dollar holders to keep their dollars in the banking system. These banks increased the interest rate on the US dollar to high levels to achieve this objective.

**Attracting Foreign Companies that are Hesitant to Enter the Market**

One of the biggest problems faced by companies in the past was the shortage of the US dollar needed to

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finance production inputs or for profit repatriation. This made a large number of foreign companies reluctant to bring investments to Egypt before the currency crisis is resolved.

Devaluation of the pound, unification of the exchange rate and lifting restrictions on dollar-denominated deposits will attract companies again to the domestic market, as they will be able to provide the necessary liquidity to pay supplier dues and repatriate their profit.

Those factors, which the CBE bets on, will supposedly increase dollar proceeds for the country in general, and resolve the bottlenecks faced by companies in most sectors of the economy. This will eventually bring in more dollar resources that will enable the CBE to build monetary reserves and extinguish the fires spread throughout the economy, in a repeat of 2003 events, when the CBE abandoned the fixed exchange rate and opted to provide dollar liquidity. (Al Borsa newspaper site)

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