المركز المصري للدراسات الاقتصادية
The Egyptian Center for Economic Studies

Our Economy and The World

The Weekly Report

Issue: 75   Date: 22 October 2017

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

Key Global and Regional Developments over the Past Week

Reuters: Fed's Yellen says watching inflation closely but economy is strong

The U.S economy remains strong and the strength of the labor market calls for continued gradual increases in interest rates despite subdued inflation, Federal Reserve Chair Janet Yellen said on Sunday. "We will be paying close attention to the inflation data in the months ahead," Yellen said in prepared remarks at an international banking seminar in Washington. "My best guess is that these soft readings will not persist." Yellen also said she expected the U.S. economy to exceed its long-term trend during the second half of the year and repeated the impact of recent hurricanes on the economy should be temporary.

Read the full article

The National: 51 large Eurozone banks are exposed to changes in interest rates, ECB says

Fifty-one large euro zone banks are leaving themselves exposed to a sudden change in interest rates and may need to put aside more capital against that risk, the European Central Bank (ECB) said. The ECB is preparing to start dialing back its monetary stimulus after years of ultra-low interest rates and massive bond purchases, paving the ground for rate hikes further down the line. After simulating scenarios ranging from a sudden monetary tightening to the kind of lending freeze that followed Lehman Brothers' collapse, the ECB found that most of the 111 euro zone banks it tested are well prepared for interest rates shocks.

Read the full article

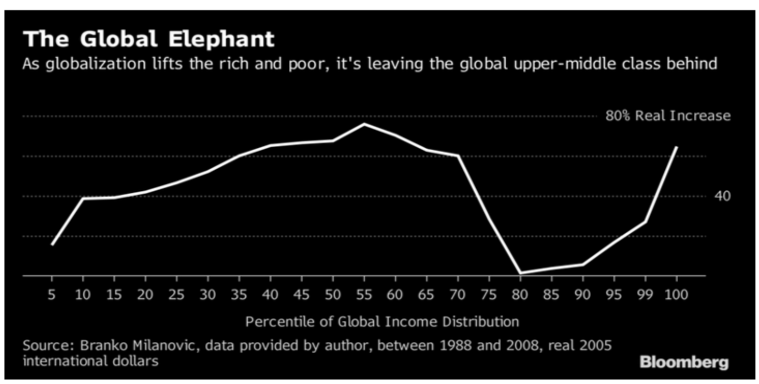
Reuters: Top international lawyers say Hong Kong rule of law under threat

The jailing of three Hong Kong democracy activists this year is a serious threat to the city's rule of law, a group of senior international lawyers said on Monday, adding the independence of the judiciary risks becoming a "charade". Joshua Wong, Alex Chow and Nathan Law were sentenced to community service last year for unlawful assembly but were dealt harsher punishments of jail in August after a government appeal. Hong Kong, a former British colony, returned to Chinese rule in 1997 under a "one country, two systems" formula that promises it a high degree of autonomy and freedoms not enjoyed on the mainland, including an independent judiciary.

Read the full article

[Bloomberg: What global finance chiefs are saying about the economy]

Don't celebrate too soon. That was the key message as policy makers and investors left Washington on Sunday after attending the annual meetings of the International Monetary Fund and World Bank. For once the mood was upbeat. The IMF bumped up its forecast for global economic growth this year and next. Stocks are surging, credit spreads are tight and market volatility is low.

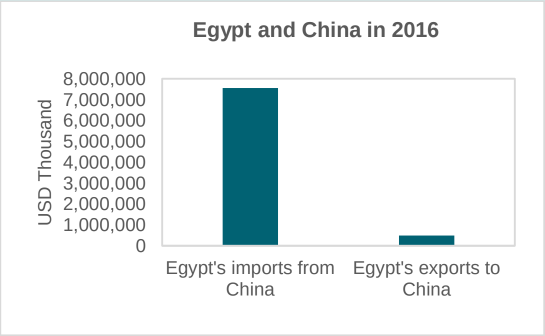


Read the full article

Reuters: China central bank chief surprises with gravity-defying 7 percent second-half growth forecast

China's central bank governor said the economy could grow 7 percent in the second half of this year, accelerating from the first six months and defying widespread expectations for a slowdown. The uncharacteristically explicit growth forecast by Zhou Xiaochuan came just days ahead of a twice-in-a-decade Communist Party Congress, where President Xi Jinping is expected to strengthen his grip in a leadership reshuffle. While China produced forecast-beating growth of 6.9 percent in the first half, many economists and investors had expected momentum would start to fade later in the year.

Read the full article



Source: Trademap, ITC

Special Analysis: IMF Global Financial Stability Report October 2017: Is Growth at Risk?

Near-Term Risks Are Lower

The global financial system continues to strengthen in response to extraordinary policy support, regulatory enhancements, and the cyclical upturn in growth. The health of banks in many advanced economies continues to improve, as progress has been made in resolving some weaker banks, while a majority of systemic institutions are adjusting business models and restoring profitability. The upswing in global economic activity, discussed in the October 2017 World Economic Outlook (WEO), has boosted market confidence while reducing near-term threats to financial stability. But beyond these recent improvements, the environment of continuing monetary accommodation—necessary to support activity and boost inflation—is also leading to rising asset valuations and higher leverage. Financial stability risks are shifting from the banking system toward nonbank and market sectors of the financial system. These developments and risks call for delicately balancing the eventual normalization of monetary policies, while avoiding a further buildup of financial risks outside the banking sector and addressing remaining legacy problems.

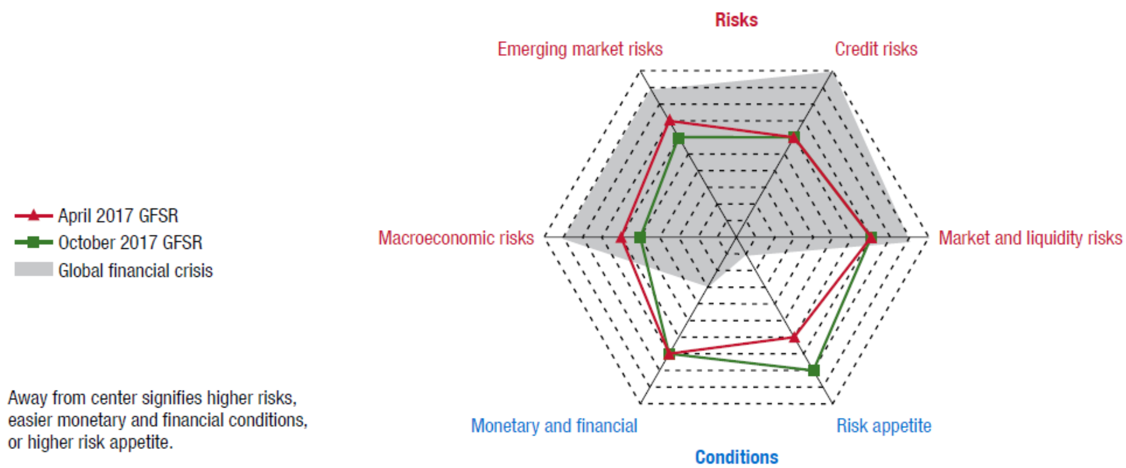
The Two Sides of Monetary Policy Normalization

The baseline path for the global economy, envisaged by central banks and financial markets, foresees continued support from accommodative monetary policies, as inflation rates are expected to recover only slowly. Thus, the gradual process of normalizing monetary policies is likely to take several years. Too fast a pace of normalization would remove needed support for sustained recovery and desired increases in core inflation across major economies. Unconventional monetary policies and quantitative easing have forced substantial portfolio adjustments in the private sector and across borders, making the adjustment of financial markets much less predictable than in previous cycles. Abrupt or ill-timed shifts could cause unwanted turbulence in financial markets and reverberate across borders and markets. Yet the prolonged monetary support envisaged for the major economies may lead to the buildup of further financial excesses. As the search for yield intensifies, vulnerabilities are shifting to the nonbank sector, and market risks are rising. There is too much money chasing too few yielding assets: less than 5 percent ($1.8 trillion) of the current stock of global investment-grade fixed-income assets yields over 4 percent, compared with 80 percent ($15.8 trillion) before the crisis. Asset valuations are becoming stretched in some markets as investors are pushed out of their natural risk habitats, and accept higher credit and liquidity risk to boost returns.

At the same time, indebtedness among the major global economies is increasing. Leverage in the nonfinancial sector is now higher than before the global financial crisis in the Group of Twenty economies as a whole. While this has helped facilitate the economic recovery, it has left the nonfinancial sector more vulnerable to changes in interest rates. The rise in leverage has led to a rise in private sector debt service ratios in several of the major economies, despite the low level of interest rates. This is stretching the debt servicing capacity of weaker borrowers in some countries and sectors. Debt servicing pressures and debt levels in the private nonfinancial sector are already high in several major economies (Australia, Canada, China, Korea), increasing their sensitivity to tighter financial conditions and weaker economic activity. The key challenge confronting policymakers is to ensure that the buildup of financial vulnerabilities is contained while monetary policy remains supportive of the global recovery. Otherwise, rising debt loads and overstretched asset valuations could undermine market confidence in the future, with repercussions that could put global growth at risk. This report examines such a downside scenario, in which a re-pricing of risks leads to sharp increases in credit costs, falling asset prices, and a pullback from emerging markets. The economic impact of this tightening of global financial conditions would be significant (about one third as severe as the global financial crisis) and more broad-based (global output would fall 1.7 percent relative to the WEO baseline with varying cross-country effects). Monetary normalization would go into reverse in the United States and would stall elsewhere. Emerging market economies would be disproportionately affected, resulting in an estimated $100 billion reduction in portfolio flows over four quarters. Bank capital would take the biggest hit where leverage is highest and where banks are most exposed to the housing and corporate sectors.

Figure 1.1. Global Financial Stability Map: Risks and Conditions

Risk appetite has grown markedly as near-term stability risks have declined.



Source: IMF staff estimates.
Note: The shaded region shows the global financial crisis as reflected in the stability map of the April 2009 *Global Financial Stability Report* (GFSR).

Read the full report

> **“The global financial crisis showed policymakers that financial conditions offer valuable information about risks to future growth and provide a basis for targeted preemptive action. Changes in financial conditions shift the whole distribution of future GDP growth. Wider risk spreads, rising asset price volatility, and waning global risk appetite are significant predictors of increased downside risks to growth in the near term, and higher leverage and credit growth provide relevant signals of such risks in the medium term.”**

Recent Developments in Financial and Commodity Markets

Reuters: Oil jumps on fears of new Iran sanctions, Iraq conflict

Oil markets jumped on Monday on concerns over potential renewed U.S. sanctions against Iran as well as conflict in Iraq, while an explosion at a U.S. oil rig and reduced exploration activity supported prices there. International Brent crude futures LCOc1 were at $57.82 at 0645 GMT, up 65 cents, or 1.1 percent, from the previous close. Prices were being pushed up by worries over renewed U.S. sanctions against Iran. U.S. President Donald Trump last Friday refused to certify that Tehran is complying with the accord even though international inspectors say it is. Under U.S. law, the president must certify every 90 days that Iran is complying with the deal. Congress will now have 60 days to decide whether to re-impose economic sanctions on Tehran.

Read the full article

Bloomberg: Even bulls are getting left in the dusty by the S&P 500 rally

Equity strategists, a group not exactly known for their skepticism, are seeing their best guesses left for dead as the S&P 500 Index piles on gain after gain, including five straight weekly rallies. At 2,553, the benchmark gauge now sits 53 points above the most optimistic of the 18 predictions that Bloomberg compiled at the start of 2017.

Read the full article