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Our Economy & the World

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

Key Global Developments

IMF: "Negative" Interest Rates Good for the Global Economy
Frankfurt - Middle East News Agency

IMF Managing Director Christine Lagarde said that the negative interest rates endorsed by Europe and Japan is positive for the global economy. However, she warned at the same time against the side effects of the central banks' unconventional policies.

In a speech at the German University of Frankfurt, Lagarde praised the current policies of the European Central Bank (ECB) and the US Federal Reserve. She called on governments to assume their role by implementing reforms that contribute to economic growth.

She added that the IMF is attentive to the global economy outlook, noting that the slowdown in economic growth over the past six months is attributed to slowing growth in China, low prices of basic commodities and financial tightening by some countries.

Lagarde said the general economic mood became more positive affected by ECB's new stimulus policies and the Federal Reserve's clear shift towards a slower pace of raising interest rates.

Standard and Poor's: Emerging Market Ratings Sink to Lowest Level Since 2002
Reuters:

This year's wave of downgrades has pushed emerging market countries' credit ratings to their lowest level in over 14 years, while the number of countries facing further cuts increased to record levels as well.

Data from Standard and Poor's on Tuesday showed that lower ratings for commodity producers such as Poland in recent months had pushed the average rating of top emerging market debt instrument issuers to below BB+, its lowest since 2002.

Some countries face more cuts too. Nine of the top 20 emerging market economies have been given negative outlooks, effectively representing downgrade warnings, matching the record levels registered in 2014 and 2002.

Major British Company Investments Decline Over Concern about Possible Exit from the EU

Middle East News Agency:

Investments of major British companies declined significantly due to growing fears among businessmen about possible disruptions that could result from voting in favor of Britain's exit from the EU in the referendum scheduled in June, according to a study conducted by British consulting company, "Deloitte."

The study showed that Britain's possible exit from the EU is considered now the greatest risk to businessmen, raising concerns about various issues such as weak demand in the eurozone, slowing growth in the UK, and higher interest rates.

IMF: China-Induced Global Market Shocks Will Increase

Reuters:

Global market spillovers from China's economic shocks will only increase in coming years as the country's financial influence grows and the yuan's use as a funding currency broadens, the International Monetary Fund said on Monday.

In a portion of its latest Global Financial Stability Report, the IMF said that developments in emerging markets now account for one-third to 40 percent of the variation between stock market returns and exchange rate fluctuations worldwide.

The IMF said markets have become extremely sensitive to the economic signals coming from China and that policymakers there must not send mixed messages.

"As China's role in the global financial system grows, clear and timely communication of its policy decisions, transparency about its policy goals, and strategies consistent with achieving them will be increasingly important to avoid volatile market reactions with wider reverberations," the IMF said in parts of the report released on Monday.

Expectations of Higher Oil and Gas Production in the Middle East

UAE Al Bayan:

Business Monitor International magazine predicted that oil and gas production would increase in the Middle East over the next ten years, despite the decline in world oil prices. The magazine said that oil production would rise by 9.6 percent from now until 2025, despite the impact of lower world price.

It added that plans to increase production are still ongoing backed by declining production costs and declining cost ratio to production. The magazine expected oil refining capacity in the region to increase while regional countries move towards diversifying economy resources and raise domestic demand for crude.

The magazine noted that the UAE, which is one of the main oil producing countries in the region, aims to raise crude production to 3.5 million barrels a day by 2018. The magazine expected domestic consumption of oil refining products to increase from 7.8 million barrels per day in 2015 to 9.4 million barrels a day in 2025, i.e., 0.6 million barrels per day less than previously projected by the magazine. Consumption is also expected to rise by 20.7 percent in the next decade, which is higher than the magazine's expectations of oil production growth by 9.6 percent during the same period. Also, gas consumption is expected to increase in the region, as electrical power plants are speedily using gas to replace diesel. Demand for electricity is also expected to rise in the region in the coming period.

Poll: Risks Do not Prevent Japanese Companies from Expanding in the Middle East
Al Mal News:

The Japan External Trade Organization (JETRO) conducted its latest survey (between September and November 2015) about the operations of Japanese companies in the Middle East.

The survey covered areas such as the outlook for business, management issues and the advantages and disadvantages of the investment environment.

According to the JETRO website, most of the surveyed companies expect greater surpluses and to expand their business in the Middle East despite the security risks and falling oil prices.

More than half of the surveyed companies (56.2 percent) expected a surplus in operational profits during 2015. The UAE recorded the highest percentage (64.3 percent).

IMF: Capital Flows to Emerging Markets Remain Subdued
KUNA:

According to an IMF report, capital flows to emerging market economies remain subdued, due to the differential growth between emerging markets and advanced economies.

The report used data from the fourth quarter of 2015 in analyzing the slowdown of capital flows over the past five years.

The report said that slow capital flows are a policy concern because capital flows help support investment and growth. Long downswings, as in the past five years, are associated with "a high incidence of debt crises”.

"Countries that display greater exchange rate flexibility have insulated themselves better from the global capital flow cycle than in previous slowdowns," it added.

The slowdown of capital flows has affected all regions "regardless of their sizes" and was not confined to China, Russia, or other emerging economies such as Brazil, India and South Africa.

The report noted the importance of developing policies to lower public debt, stabilize shock absorbers and reduce risks of aversions.

"These measures can help mitigate the contraction and domestic spillovers of the global capital flow cycle in individual emerging market economies," it said.

IMF: Supply-Side Reforms Can Help Beat Sluggish Growth
Reuters:

The International Monetary Fund offered on Wednesday a solution to persistently sluggish economic growth that included proposals to deregulate product markets and adopt policies to boost labor market participation.

But the analysis in the IMF's annual World Economic Outlook acknowledged arguments from skeptics of such "supply side" reforms that deregulation can cause near-term falls in wages and price deflation and so need to be accompanied by fiscal stimulus.

The IMF said the new research shows that structural changes to labor markets and some more heavily regulated business sectors could help raise potential output over the medium term while also helping to strengthen consumer confidence in the near term.

It recommended deregulation of the railway and professional services sectors, and some network-based sectors such as air, rail and road transportation, electricity and gas distribution, telecoms and postal services, particularly in the euro zone and Japan.

Federal Reserve Meeting Minutes: The Majority of Members Opt for Cautiousness about Interest Rate Increase
Argaam:

The Federal Reserve meeting, which was held on March 15th and 16th, showed that central bank officials would prefer not to raise interest rate in the April meeting.

Many members favored adopting a cautious policy regarding raising interest rate, and conveyed their fears about a hasty decision, and that it would not be appropriate to make such a decision in this month’s meeting.

The Federal Reserve is expected to meet on April 26th and 27th amid expectations of keeping the interest rate unchanged at between 0.25 percent and 0.50 percent with speculations of increasing it only once this year.

Implications for Egypt

With the financial and economic volatility the world is currently going through along with growing fears of a recession, Egypt should take more robust measures to enhance private growth, especially that downside risks increase in the absence of decisive action. According to the International Monetary Fund, recovery from the global financial crisis between 2007 and 2009 is still “too weak and too fragile,” and risks to its durability are increasing. If policy-makers manage to meet challenges and work together, the positive spillovers on world confidence and the global economy will be significant.

Despite the increased pace of growth of the US economy and with a number of developing markets, such as Mexico, reporting good performance, the IMF warned that growth in Europe and Japan was disappointing. Slower growth in China negatively affected the oil sector and commodity exporters, including Brazil and Russia. Therefore, Egypt is now required to accelerate structural economic reforms, increase financial support, and continue its easy monetary policy stance as well as to pursue fiscal consolidation. It is also necessary to better train young labors and align labor market needs with generated skills with a view to reducing unemployment among the youth.

However, the IMF said in a recently published report that it is important that these global reforms be coupled with fiscal stimulus packages to boost demand in the near term and absorb negative shocks. It pointed out that emerging markets are coping better with the recent wave of capital outflows thanks to increased reserves, lower foreign currency debt and the adoption of more flexible interest rates.

The report said that these factors along with more prudent public finances, reduction of public debt, stronger financial supervision, and flexible foreign exchange policies prevent sudden currency shocks that characterized previous waves of capital flight in emerging markets in the late eighties and late nineties.

According to Crescent Petroleum’s weekly report, there are rapid changes currently being introduced to spending mechanisms, plans to raise the efficiency of government investments, and the move towards an optimal competitive environment to increase productivity of all sectors. It noted that despite losses in the region because of falling oil prices reaching $130 billion at the end of 2015, the reforms being undertaken are adequate. Such reforms, which focus on consolidating government spending, rationalizing consumption, focusing on specific productive sectors, and reviving some investment economic sectors, are all capable of reducing the size of deficits and improving the ability of economies of the region to pay their debts on a timely basis.

Special Analysis

Low-Skilled Labor Employment Model Reached Limit, no Longer Appropriate
WAM:

A study on the relationship between trade, competitiveness and knowledge prepared by the Dubai Economic Council revealed that with the structural changes in the global economy, the employment model of low-skilled labor has reached its maximum limit. This model will not be appropriate in the future, especially in the context of the state shifting to a knowledge-based economy that requires reliance on technology- and capital-intensive products, and hence a high degree of skills and production techniques so that they can access global markets.

The study stressed that sustainable economic growth is expected to be driven by the diversification of the productive base and the expansion of value-added activities to be achieved as the result of policies destined to further innovation and increase productivity. These policies are anticipated to enhance the local economy resilience and allow it to better absorb internal and external shocks.

It stated that there is consensus among economists that raising welfare depends to a great extent on the ability of businesses to make optimal use of available resources, stressing that sustainable productivity will permanently allow rising wages and the accumulation of physical and human capital as well as preserving the environment.

It made clear that international competitiveness is essential for economic success, and requires reaching efficient production levels and obtaining knowledge about new products, entering new markets as well as the development of new and more productive technologies, and availing incentives for entrepreneurs to invest with a view to achieving accumulation of physical and human capital.

Empirical evidence indicates that the first stage of economic development tends to be a smooth ride in most small open economies: as a result of the exploitation of their resource base and the progressive integration to the global economy, emerging economies are able to reap the benefits of catching up with more developed economies, especially in trade and capital markets. However, once countries reach the "middle-income status," achieving higher productivity levels becomes increasingly difficult. Few countries are able to keep the edge of their international competitiveness and continue to grow on a sustainable basis (e.g., Republic of Korea).

The study noted that countries might fall in the middle-income trap due to low-productivity growth. Countries caught in the trap become unable to compete with low-income, low-wage economies in manufactured exports and, at the same time, unable to compete with advanced economies in high-skill innovations.

It added that such countries cannot make a timely transition from resource-driven growth, with low-cost labor, to productivity-driven growth.

According to economic theory, traditional exports cannot be as easily expanded as in the initial stage of development because business opportunities are used up, wages are higher and cost competitiveness declines.
Therefore, the study sees that export growth depends on introducing new processes and finding new markets, not just on expanding sales of the same product to existing markets. To do this, innovation and product differentiation to meet the needs of the market become an important objective of middle-income countries.

To avoid becoming trapped without a viable high-growth strategy, the study sees that middle-income countries need to develop modern and more agile institutions for property rights, capital markets, successful venture capital, competition, and a critical mass of highly skilled people.

Evidence indicates that some East Asian countries, like South Korea, have successfully managed three critical transitions to avoid the middle-income countries' trap. These transitions are (i) from diversification to specialization in production; (ii) from physical accumulation of factors to productivity-led growth; and (iii) from centralized to decentralized economic management.

Implications for Egypt

In light of this change in economic models worldwide, it is necessary for Egypt to undertake a similar change in its economic plan in key areas such as community development, quality of life, urban planning and human capital, etc.

According to the study, there is a need to improve productivity in the economy as a whole, especially in terms of improving human capital accumulation. Egypt is moving vigorously in this direction and in determining the role of economic policy in this respect. There are two types of determinants: macroeconomic, most importantly the exchange rate, which would affect the competitiveness of the local economy, especially in terms of its impact on the profitability of export activities, as is the case when the real exchange rate changes, or its impact on the cost of domestic production; microeconomic determinants include the cost of capital.

At the microeconomic level, there are factors that determine productivity, most importantly the long-run strategy to keep energy costs below international levels. Another matter relates to easy access to low-skilled and low-cost labor that in turn contribute to low production cost and hence higher competitiveness at the global level.

From the International Press

Recycling … How did the West Turn its Waste Into an Industry?
Argaam:

Waste disposal went through several stages in the Western hemisphere before it turned into an industry, benefiting the countries that paid attention to its importance and other countries following in their steps. "The Atlantic" magazine has recently published a detailed report on development phases of waste processing in the West. According to the report, people’s handling of waste is not a tradition but rather a habit that could be changed.

Rich Countries and their Waste

- A new impressive tradition spread in the West, where citizens do the sorting that waste collectors used to do in the past. The rich and the poor alike started separating old bottles from paper and food waste.

- Recycling reversed the old hierarchical system, which was based on social differences, and has become an indicator of environmental awareness. Recycling is no longer an old tradition or a sign of poverty.

- Wastes differ with cultures. The Germans and the Swiss are known for rational spending, but at the same time they throw more waste than the Americans who rely heavily on credit cards.

- Wealth contributed to the increase of waste in European societies due to increased purchases of canned food, which accounts for 87 percent of packaged goods.

Processing of Waste Could be Changed

- The speed by which communities started implementing recycling after they were known for increased waste means that the method of handling waste should not be seen as a deeply rooted tradition in society.

- The Germans, who are now world champions in recycling, were known for throwing away many plastic bottles and packaged goods in the 1960s and 1970s. The government and the popular Green Movement changed this through laws, taxes and raising awareness.

- By the year 2010, Germany, Austria and Belgium were recycling more than 60 percent of their waste, compared to 20 percent in Portugal and Greece. Waste processing in Turkey remained almost at zero, though. In Japan, intensive recycling processes are in place in parallel with the burning of waste.

Cultural Differences

- Ways of handling waste in Europe can be classified geographically into three regions: in the first, Northern Europe, which stretches from Belgium and Germany to the Nordic region, there is less landfill dumping and more recycling. In the second, the Mediterranean, landfills are still more than recycling. In the third, Eastern Europe, there are no recycling operations and waste end up in landfills.

- The contents of garbage bins differ from one country to another. In Sweden, for instance, 68 percent of waste is paper, while paper in French and Spanish waste is less than 20 percent, and textiles dominate the Swiss and Danish waste.

- With the beginning of the twenty first century, rich countries began to generate more waste and implement more recycling operations. The duties and taxes levied on dumping wastes in landfills in northern Europe have become three or four times higher than in Eastern Europe.

- The Germans consume a lot of plastic (5.5 million tons per year), but recycle 42 percent thereof. In the Netherlands, the shift towards burning waste in the 1980s fell short of encouraging people to reduce their waste.

The Communist Bloc

- The shortage of raw materials made recycling of daily interest for the Eastern Bloc during the Cold War. At that time, anything from scrap metal to door knobs became a matter of life or death for the metal industries. In 1955, up to 2000 tons of scrap metal were collected weekly.

- The communist parties in the Eastern bloc imposed disciplinary measures against those who waste raw materials. At the same time, they introduced incentives, including the granting of cloth pieces in return for worn out shoes and the granting of rice in exchange for leather. In the early 1950s, half a kilo of used paper in East Germany was equivalent to a roll of wallpaper, while a kilo of bones was equivalent to a bar of soap.

- East Germans recycled 40 percent of their waste, a level that the British were unable to reach until 2010, while the Spanish and the Italians have not reached it yet. However, the collapse of communism significantly delayed recycling. Two years after the collapse of the Berlin Wall only one hundred collection points remained in Germany.

- Waste collection was linked to industrial needs rather than to protecting the environment. East Germany used to get 10 percent of its raw materials from recycling.

Developing Countries

- Developing countries do not necessarily have to apply the same recycling methods used in European and US cities. In Colombia and Brazil, the authorities have acknowledged since the 1980s the importance of garbage collectors as important partners in waste management.

- In India, some 3 million garbage collectors recycle about seven million tons of waste per year, saving municipal councils millions.

Implications for Egypt:

In light of international experience, it is better that garbage-recycling facilities are established in the collection areas (governorate landfills) to ensure availability and minimize cost. This will encourage waste scavengers by allowing them to scavenge garbage and extract what they want at the dumping place rather than in the streets as they currently do. Encouraging this system requires a number of important steps that should be enshrined in an integrated legal framework that encourages the manufacture of equipment that are related to garbage collection and recycling in Egypt. Such equipment should not be given customs incentives with the exception of those that are not manufactured in Egypt. A tax incentive should be provided for equipment manufactured locally or equipment with a local content exceeding 50 percent. The law should include a mandate for governors in contracting to provide for flexibility in the overall system of "collecting and recycling wastes" in Egypt, without breaching the model contract that will be drafted.

There is also a need to develop a comprehensive strategic plan for managing the various solid wastes in Egypt in a way that achieves economic returns and creates jobs to the youth by establishing recycling facilities to re-inject waste in the market as raw materials that will reduce the manufacturing cost.

Global Financial Market Performance

Reuters - Argaam:

Chinese stocks fell for the third session in a row at the end of Friday trading, due to global market losses, and anticipation of Chinese economic data. The Chinese market's main index recorded a weekly loss of 0.8 percent, after achieving the largest monthly gains in almost a year in March. The "Shanghai" Composite Index fell by 0.8 percent to 2984 points at closing, down from the level of 3,000 points for the first time since March 29th.

The Japanese stocks rose at the end of Friday trading session, but recorded weekly losses, with a decline in the yen and rise in the stocks of export companies. The Japanese "Nikki" index increased by 0.5 percent to 15,821 points, down by 2.1 percent this week. Also, the "TOPIX" index rose by about 1.2 percent to 1287 points.

The European stock indices also rose during Friday trading supported by the rise in oil prices, which positively affected the stocks of energy companies. However, they also recorded a loss for the fourth consecutive week. At the end of trading, the "Stoxx Europe 600" benchmark jumped 1.1 percent, or by 3.7 points, to 331.8 points, but recorded a weekly loss of 0.4 percent. Also, the British "FTSE 100" index rose (+67.5 points) to 6204.4 points. The German "DAX" index rose (+91.6 points) to 9622.2 points, while the French "CAC" index rose (+57.2 points) to 4303.1 points.

Meanwhile, the US stocks stabilized just before the end of Friday trading and gave up the majority of the gains made earlier in the session backed by the rebound in oil prices, which led to the rise of the energy sector. Major indices achieved weekly losses. The "Dow Jones' industrial average rose by 35 points to 17576.9 points after its gains exceeded 150 points. The "NASDAQ" index rose (+2.3 points) to 4850.6 points, while the "S&P 500" benchmark index increased by (+5.6 points) to 2047.6 points.

Also, gold futures for June delivery jumped at settlement by 0.5 percent, or by $6.30 to $1243.80 an ounce. The yellow metal has achieved a weekly gain of 1.7 percent, which is the highest since March 17th.

In the oil markets, the US "NYMEX" rose by 6.6 percent, or by $2.46 and closed at $39.72 a barrel, achieving a weekly gain of 8 percent, which is the largest since February. Also, the "Brent" benchmark rose by 6.4 percent, or by $2.51, and closed at $41.94 a barrel, achieving a weekly gain of 8.5 percent.

Implications for Egypt:

A financial report published by Al-Arabiya website revealed that Arab and Gulf stock markets focused during last week's trading on the leading stocks, as well as on speculative transactions and profit reaping. Volatility and decline dominated traded liquidity between one market and the other and between one session and the other, which led stock markets to lose many investment opportunities and much of their strength and attractiveness.

A report by Sahara Group for Financial Services said that technical indices are still ranging between negative and neutral without registering breakthroughs toward stability and positive interaction with the local developments in each market, and positive response towards the financial and economic developments in the region.

The report pointed out that with trading focused on leading stocks, it was clear that speculation aimed to increase the pace of trading and its prices, and hence profit-taking, taking into account that the current period is witnessing an increase in the pace of trading of leading stocks, which will be susceptible to volatility.

In other words, the leading stocks during the announcement of results and the preceding expectations constitute the main pillar that controls the performance of stock markets, with no guarantees that the performance results would be positive for all stocks. Many medium and small stocks have positive and operating results that can be classified as good investment opportunities. But the strength of the leading stocks and increase in its dominance of trading, its values and their impact on the general index weaken other stocks' ability to influence and acquire more of the traded liquidity.