Mood of austerity triggers frantic EU clean-up

AFP, *Brussels*

Brussels is attempting to switch into austerity mode in 2011, amid anger over EU funds that wind up in dog-fitness clubs and Elton John gigs.

However, efforts to slash costs are likely to hit a brick wall -- what one senior official describes as a "Rubik's Cube" of competing interests over the lion's share of European Union monies.

France defends farm funding, some 40 percent of all spending, tooth and nail; Poland likewise resists all moves on cohesion funding, or grants for poorer regions; while Britain jealously guards the hard-won rebate Margaret Thatcher secured in the 1980s.

If only small margins remain after the three great pillars of EU spending, cost-cutting is nevertheless the talk of the town in Brussels.

It was Britain's new Prime Minister David Cameron who blew a wind of austerity into the home of the European Union last year, when he launched a campaign to crimp the 2011 budget.

He initially wanted it frozen, but secured a 2.9 percent-increase ceiling instead of a planned six percent rise.

"The challenge for the European Union in the coming years will not be to spend more, but to spend better," Cameron said in a letter co-signed with France and Germany, and backed by Finland and the Netherlands.

Egypt economy faces rocky road after protests

REUTERS, *Dubai*

Egypt's military council faces a daunting challenge to stabilise the economy after 18 days of protests which may cut growth this year in half and have left regulators nervous about the reopening of its capital markets.

In the short-run, analysts hope that there will be an orderly transition to democracy and that may halt outflows of capital which have reached as much as $1 billion per day at the height of the revolt.

Many investors are also optimistic about the broader changes to business and policy that may follow under a freely-elected government but there is little prospect of a step change in the near term.

"In terms of the economy, Egypt has been run by the same technocrats for the last 30 years," said Tim Ash, head of emerging markets research at RBS. "I don't think you're going to see too much of a change."

"The establishment are still around. Their real agenda is no change until September," he said.

Egypt's economy was worth an estimated $217 billion last year, half of oil giant Saudi Arabia, and relies on foreign investments, tourism and fees from the Suez Canal

A month before the protests erupted on Jan. 25, analysts polled by Reuters had expected growth of 5.4 percent in the fiscal year ending in June, second in the Gulf Arab region only to Qatar. The government had forecast 6 percent expansion.

But while banks and some shops are reopening, tourists -- who account for between 5 and 11 percent of economic output -- are still shunning the popular holiday hub, making the growth predictions look optimistic.

Said Hirsch, Middle East economist at Capital Economics, said the main priority would be bringing society back to normal and get people working again.

"The military's role will be to stabilise the economic situation," he said.

Officials on Saturday pushed back the opening of the stock market for a second time, from Sunday to next Wednesday, and the Egyptian pound had to be propped up by intervention by the central bank last week.

At the peak of the unrest, some analysts speculated the bank would have to make an emergency rise in interest rates to aid the pound.

Optimism over Hosni Mubarek's departure -- which has helped emerging markets globally -- make that move less likely, but the currency's weakness also adds to the likelihood of higher inflation and an eventual rise in rates.

Ratings agencies also downgraded Egypt's sovereign ratings by one notch as protests intensified, citing possible damage to already weak state finances.

"We believe the central bank will hike rates by 100 basis points in an emergency meeting this month as inflation is likely to surge on the back of a weaker pound," said Dina Ahmad, CEEMEA strategist at BNP Paribas.

Lower private consumption, which accounts for around 70 percent of GDP, a drop in foreign investments and higher unemployment are also expected to hurt economic performance.

Although Mubarak's promise of a double-digit salary raise for public sector workers will now likely be scrapped, the transitional government is likely to keep up spending.

Lower taxes, higher subsidies and pressures to give more money to unemployed may also undermine the crude oil-importer's fiscal health, with the budget gap likely to balloon towards 10 percent of GDP this year, according to BNP Paribas.

"First we need to see a return to normality," said Lars Christensen, senior emerging markets analyst at Danske Bank. "Then I think the recovery could be relatively short."

Long-term, the outlook is cloudier.

If the economy worsens, any resulting social instability could become a graver geopolitical concern and to prevent that, Egypt may also be well-positions to receive a boost in foreign aid.

"I think it's the case that the United States and the Gulf (countries) could bring more aid to Egypt," said Hirsch. "A lot of money could come from the Gulf.

Gulf Arab rulers, as well as the United States, see Egypt as a key ally to counter Iran's growing influence in the region, and will want to keep the country economically healthy and stable.

Among Gulf countries, Yemen, Bahrain and Kuwait have already offered cash or concessions, eyeing similar young populations and simmering discontent.

Beyond that, the prospect of a freer and more transparent economy under new regime could draw substantial inflows of investment looking to grab market share in the country of 80 million.

"When you have less than, say, 10 percent of the population with checking accounts, there is potential for growth," said Karim Baghdady, managing director of Egyptian-based investment bank Beltone in New York.

"When you have a gray economy that is almost as large as the official GDP, if you are able to institutionalize that economy, then people will start securitizing their debts, able to borrow more, buy more. So there is a big domino effect."

AFP

A man folds his blanket in Tahrir Square yesterday as the soldiers continue to clean up the area and most protesters pack up and go home following the 18-day stand-off, which led to the resignation of President Hosni Mubarak following his 30-year rule.

Steel deal sets example for Japan Inc

AFP, *Tokyo*

The proposed merger of two Japanese steel giants is a sign of an industry looking to reassert itself and an example to Japan Inc. that restructuring is crucial to take on competition, say analysts.

Japan's biggest steelmaker Nippon Steel and third-ranked rival Sumitomo Metal Industries are working towards a merger that would create the world's second-largest steel firm by 2012, behind Luxembourg-based ArcelorMittal.

The agreement is the first steel industry merger in a decade in the country, and analysts say the move sets an example to the rest of Japan Inc. as it grapples with a weak home economy, a strong yen and rising overseas rivals.

"There is a desperate need for mergers and acquisitions to stitch together Japan's diffuse corporate base," said Nicholas Smith, director of equity research with MF Global in Tokyo.

The Nippon Steel-Sumitomo Metal move is seen as indicative of the growing need for steelmakers to gain leverage as prices for coal, iron ore and other raw materials of steel touch record levels.

"Increased scale will make them stronger in negotiating with raw material suppliers -- the rapid run-up in material prices had really hammered profitability," said Smith.

"The merger will give Nippon Steel the scale to consider acquisitions of raw material suppliers, like the Chinese steelmakers have done," he said, noting Chinese crude steel production has more than quadrupled in the last 10 years.

The deal also serves as an example to the rest of corporate Japan.

Many see consolidation in Japan's corporate space as essential to taking on overseas competition, with too many companies making the same products compared with the likes of South Korea and industrial champions such as Samsung.

"Often in comparison with South Korea, Japan is said to have too many players in such markets as autos and electrical machinery," added Hideyuki Araki, economist at Resona Research Institute.

"They vie for the same pie and can be worn out in domestic competition. There is no doubt that a single company that has a strong grip on the industry can better compete in international markets," he said.

Rate rises and graft scandals threaten India growth

AFP, *New Delhi*

India is set for scorching growth this year but concern is mounting about its longer-term outlook, with the central bank seen hiking interest rates further and corruption scandals worrying investors.

The stock market has already dropped some 17 percent this year, hit by fears that economic growth will cool due to higher interest rates and souring foreign investor sentiment amid a spate of high-profile corruption scandals.

In January, foreign institutional investors turned net sellers for the first time in eight months, dumping some $1.4 billion in Indian stocks, according to industry data.

"Corruption and ensuing political risk has without question become a major concern" with foreign investors, Mumbai brokerage Espirito Santo Securities said in a commentary.

The government says it is confident India's economy will expand by 8.6 percent in the fiscal year ending in March, eclipsing the previous year's 8.0 percent growth.

But growth may slacken to 7.7 percent next year as resurgent oil prices and further rate rises to tame inflation "take their toll", Credit Suisse economist Robert Prior-Wandesforde cautioned.

Goldman Sachs economist Tushar Poddar said he was holding to his growth projection of 8.7 percent for next year but added risks to the forecast were "firmly to the downside".

Such growth would delight Western nations where expansion is anaemic, but India is striving to lift its expansion to double digits -- levels it says are needed to raise living standards of its impoverished millions.

Signs of an economic slowdown were highlighted in data late last week, which showed that industrial output growth in December slackened to 1.6 percent from 19 percent the same month a year earlier -- its weakest pace in 20 months.

"There is the worry that the (monetary) policy tightening will inflict serious damage on growth," said Kevin Grice of Capital Economics.

But despite appeals from business, which fears the economy is losing traction, the poor numbers are not expected to deter the central bank from tightening monetary policy in March for an eighth time in just over a year as it seeks to lower inflation running at over 8.4 percent.

"We must understand ultimately if inflation is not controlled, you cannot sustain a high growth rate," central bank deputy governor K.C. Chakrabarty said last week.

Rising prices have also emerged as a dominant concern of the Congress government, whose core supporters -- the poor -- have been worst hit by galloping prices, especially of food.

On top of the economic worries, a slew of scandals have broken out, including the arrest of a former telecoms minister on suspicion of selling mobile licences at cut-rate prices, costing the treasury up to $40 billion.

REUTERS

A policeman stands guard next to the entrance of India's central bank, the Reserve Bank of India, headquarters in Mumbai.

AFP

US President Barack Obama arrives to speak to the press at the White House in Washington on February 11.

Obama struggles to balance budget cuts, investment

AFP, *Washington*

US President Barack Obama unveils his fiscal 2012 budget Monday, an election year plan forged from conflicting needs to cut spending and stoke the economic recovery.

With vast crisis payments and sharply lower tax revenues making it difficult for the government to balance its books, Obama will set out an austerity plan that will help set the tone for next year's presidential race.

It is expected to address widespread public anger that the government is living beyond its means, detailing tens if not hundreds of billions of dollars of spending cuts, while making investments that will help "win the future."

To square the circle, Obama has already said the budget will set in motion cuts to non-essential programs worth $400 billion over five years.

It is also expected to cut $78 billion from the defense budget over five years, slash energy subsidies for the poor and freeze public workers' pay.

But faced with high unemployment and an economic recovery that is still struggling to escape the orbit of the 2008 economic crisis, Obama will also give states more flexibility to pay for unemployment benefits.

He will also argue for an $18 billion plan to improve high speed Internet access, and $8 billion for high-speed railways in the fiscal year starting October 1.

At 2,448 pages and a weight of 10 pounds (4.5 kilograms) the budget will contain something for most members of Congress, but plenty more that will be loathed.

Ahead of the budget's publication, Republicans have been outdoing themselves in the promotion of ever-deeper spending cuts and criticizing Obama for not doing enough.

Republicans argue spending cuts will help boost growth, while the Obama administration argues cuts are needed, but should be carefully measured for fear of derailing the recovery.

Bringing the two sides together is likely to be a long process that takes up most of the year. Congress has yet to approve the fiscal 2011 budget.