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Our Economy & the World

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Key Global Developments

US Consumer Spending Exits Second Quarter with Strong Momentum
Reuters

US consumer spending rose more than expected in June as households bought goods and services, suggesting strength that appeared to be sustained early in the third quarter.

Despite healthy consumer spending, report from the Commerce Department showed inflation still muted. Economists say this, together with weak business investment and the second quarter's anemic economic growth pace, could encourage a cautious Federal Reserve to keep interest rates at current low levels for a while.

Consumer spending, which accounts for more than two-thirds of US economic activity, increased 0.4 percent in June after a similar gain in May. Economists polled by Reuters had forecast consumer spending advancing 0.3 percent.

When adjusted for inflation, consumer spending rose 0.3 percent after climbing 0.2 percent in May.

The dollar reduced its losses against the euro and the yen after issuance of the data.

Consumer spending in June was lifted by a 0.7 percent rise in purchases of non-durable goods. Spending on services increased 0.5 percent, but outlays on long-lasting manufactured goods such as automobiles fell 0.3 percent.

Where Do Foreign Capitals Go?
AlArabia Net

The Heritage Foundation issued its annual Index of Economic Freedom, which measures the ease of doing business, and attraction of capitals and foreign direct investments around the world.

The index showed that China and Hong Kong alone have attracted over $231 billion in foreign direct investments (FDI) ($128.5 billion for China and $103.3 billion for Hong Kong), which is two and a half times what the US was able to pull from investments during the same period that was estimated at approximately $92.4 billion.

Britain came in the fourth place with over $72 billion in investments, followed by Singapore ($67.6 billion).

The five countries are considered the most FDI attractive in the world. However, that does not necessarily mean they are the most economically free. Economic freedom is not a synonym for investment opportunities, if so, China would have been in a lower positions. India is classified under the same category with China and almost have the same population but could only capture $34.4 billion in FDI in 2015.

Capitalists have the ability to adapt to difficult business conditions, if they can see an opportunity to achieve attractive returns on their investments in a given country.

However, there remains a link between how economically free a country is and its ability to attract FDI. That is what put Hong Kong in an advanced position in terms of having capital inflows. Despite Hong Kong's affiliation to China, a British agreement with Beijing in 1997, when Britain handed over Hong Kong to China, stipulates that the economic system of Hong Kong remains independent and unchanged, which is summed up in the famous phrase: "one country and two regimes."

As a result of this economic freedom, Hong Kong has been able to become next to China with over $100 billion in FDI last year.

In contrast, there are other countries topping the list of the Index of Economic Freedom, but were unable to attract the same amount of investments like Singapore, which ranks second to Hong Kong in the index, followed by New Zealand, Switzerland and Australia. Economic freedom is not the only factor in determining whether the country is able to attract FDI. Other factors include the country's market size and growth prospects, as well as its location and proximity to other markets.

The most restrictive of economic freedom of the five countries are Turkmenistan, Zimbabwe, Venezuela, Cuba and North Korea, all of which are outside the circle of attraction for capitalists.

"Obama" Considers TPP a Weapon against China

News Agencies

US President Barack Obama defended the Trans-Pacific Partnership (TPP), which is having fierce criticism from all parts in the US. He stressed that the TPP will cut China's economic influence in Asia.

At a press conference at the White House, Obama advocated the TPP saying that if we do not put solid rules and standards for trade and exchanges in the Asian Pacific region, China will.

The TPP, which was signed early February after five-year negotiations aims to establish the largest free trade zone in the world between 12 countries located on the Pacific coast, including Japan, the US, Peru and Australia.

The US Congress is to approve the deal, which raises concerns in the US civil society and was rejected by the two candidates for the presidential elections, Donald Trump and Hillary Clinton.

Obama told a White House news conference with Singapore Prime Minister Lee Hsien Loong during a state visit that the TPP provides rights that cannot be guaranteed by any trade agreement prepared by China in Asia.

He added that China has already begun to offer its own version of trade agreements to countries of the region, noting that these provisions do not include social or environmental rules or measures against human trafficking and corruption.

"If the US does not lay down good rules, Chinese rules will prevail in the region, which is witnessing the highest growth in the world. The 12 nations signatory to the TPP are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam.

The Obama administration advocates at the same time another free trade agreement with the EU that is facing considerable opposition and is raising fears from imbalanced trade rules.

Think Tank Sees British Economy Shrinking in Third Quarter
Reuters

Britain's economy will shrink this quarter and has a 50 percent chance of suffering a mild recession before the end of next year because of June's vote to leave the European Union, an economic think tank said on Wednesday.

A day before the Bank of England looks set to cut interest rates for the first time since 2009, the National Institute of Economic and Social Research (NIESR) said that the economic outlook had darkened and the BoE's ability to respond was limited.

NIESR expects the economy to shrink by 0.2 percent in the three months to September, and for growth in 2016 as a whole to slow to 1.7 percent, instead of the 2.0 percent forecast in May - the same as the International Monetary Fund forecast last month.

For 2017, NIESR sees growth of just 1 percent - the weakest since the 2009 recession and down from an earlier forecast of 2.7 percent. Inflation is likely to exceed 3 percent because of sterling's 10 percent plunge since the June 23 EU vote.

IIF: Financial Flows to Emerging Markets Jumped to More Than $28 Billion
Al-Mal News Website

The Institute of International Finance (IIF) announced that financial flows from investors around the world into emerging markets' portfolios jumped to more than $28 billion last month, compared with $13.3 billion in June, up more than 110 percent.
According to Reuters, Britain's exit from the European Union stimulated more investors to escape from developed countries where interest rates are close to Zero to emerging markets, which pay much higher interest rates.

The IIF also expected the financial flows to emerging markets, including Lebanon, Hungary, Venezuela, Ukraine and the Czech Republic, to rise by end of this year to about $550 billion, or more than 100 percent compared to last year.

According to the IIF, the government of India seeks to attract nearly a trillion dollars of foreign investments to implement infrastructure projects over the next few years. The Indian National Fund for Investment and Infrastructure recently signed memoranda of understanding with global sovereign wealth funds, including Russia's Rusnano, Abu Dhabi Investment Authority and the Qatar Investment Authority.

Federal Reserve Member Does Not Rule Out Interest Rate Hike at September Meeting
Argaam

Atlanta Fed President Dennis Lockhart said he does not rule out a rate hike in September, or later this year, he added that the Federal Reserve is closely watching for possible signs of asset bubbles.

"Lockhart" added that there are more economic indicators that will be released over the coming period, including two employment reports for July and August before the September 20-21 meeting.

Regarding support for the decision to raise interest rates in the next meeting, he said that he would like to see Americans determine for them what to do and whether to raise the interest rates or not.
He stressed the need to monitor relatively rising assets and make sure whether there are signs of bubbles.

China Says Willing to Explore Free Trade Deal with Britain
Reuters

China has an open attitude towards a free trade deal with Britain and is willing to study it, China's Commerce Ministry said.

June's vote to leave the European Union has forced Britain, which has negotiated its trade deals through the EU for decades, to rethink ties with the rest of the world, but striking new deals may prove hard while its EU relationship is in flux.

Chinese Commerce Ministry spokesman Shen Danyang, asked at a regular news briefing what China's position was on a free trade agreement with Britain, gave a positive signal.

"China is willing to proactively develop trade and business cooperation, has an open attitude toward discussing and signing a free trade agreement with Britain, and is willing to study this with Britain," Shen said, without elaborating.

The two countries like to talk about the "golden era" of relations, but ties have been tested by new Prime Minister Theresa May's decision last week to review a major nuclear power plant that China is supposed to partly invest in.

Implications for Egypt:

Recent global economic volatility points to escalating pressures on global economic growth opportunities. This requires Egypt to enhance measures taken to increase economic growth, particularly promoting SMEs output, in light of the expected recession in Britain and shifts in movement of global investment flows worldwide as well as the emergence of an escalating trade war between the US and China amid slow global economic growth. Against this backdrop, Egypt has to move more quickly to encourage domestic consumption while supporting its presence in the Arab and African regional markets in order to capture larger market shares in the medium term and to benefit from trade agreements with these countries.

From the International Press

Repercussions of the British Referendum .. IMF Lowers its Forecast for Global Economic Growth
Al Youm El Sabe'

The International Monetary Fund (IMF) cut its forecast for global economic growth for the current year and the next year, by 0.1 percent to 3.1 percent and 3.4 percent respectively, due to the uncertainty caused by the British's vote to exit the EU, amid an already fragile business environment and consumer confidence.

The Brexit vote implies a substantial increase in economic, political, and institutional uncertainty, which is projected to have negative macroeconomic consequences, especially in advanced European economies," according to the IMF's World Economic Outlook Update released today. And with the event still unfolding, the report says that it is still very difficult to quantify potential repercussions.

According to the report, the basic forecasts for global economic growth in 2016 and 2017 were contingent on the "benign" assumptions that uncertainty following the U.K. referendum would gradually wane over the coming period.

In this scenario, the arrangements between the EU and the UK settle to avoid a significant increase in economic barriers (as described in the "limited scenario" of the IMF experts report on the United Kingdom in 2016), the financial markets will not see major turbulences; and the political implications will be limited to a few repercussions.

But these moderate assumptions may not be realized. The most negative results are still a possibility. With economic activity exceeding so far the expected level in 2016, and due to the impact of Brexit in light of the above assumptions, forecasts for global growth were reduced.

Forecasts for the advanced economies declined by 0.1 percentage points in 2016 and 0.2 percentage points for 2017, while remained unchanged in emerging markets and developing economies.

In advanced economies, the greatest reduction in growth forecasts were for the UK. The IMF cut growth outlook by about 0.2 percent in 2016 and approximately 1 percent in 2017, attributing it to the possibility that increased uncertainty after the referendum could lead to a significant decline in domestic demand compared to previous forecasts, although growth in the first part of 2016 was slightly stronger than the expected level in April.

In the US, growth was weaker than expected in the first quarter of the year. This caused growth forecasts for 2016 to drop by about 0.2 percent. There are frequent signs of a recovery in the second quarter and the remainder of the year, which is consistent with the decline in adverse waves arising from the strength of the US dollar and low investment in the energy sector.

Forecasts indicate that Brexit impact on the US will be minimal. Low long-term interest rates and the gradual return to normal monetary policy will counterbalance the widened differences between the rates of returns on corporate bonds, dollar appreciation and some decline in the level of confidence.

In the Eurozone, growth was 2.2 percent, which is higher than the expected rate for the first quarter of the year, due to strong domestic demand, including some recovery in investments. While highly frequent indicators signal lower growth in the coming period, growth prospects could have been altered slightly higher than the forecast issued in April for 2016 and 2017 if it were not for the referendum repercussions for the UK.

In light of the possible impact on consumer and business confidence and the potential pressures on banks due to increased uncertainty, growth forecast for 2017 was cut by 0.2 percent compared to April outlook. However, projected growth for 2016 is still slightly higher because of the results of the first half of the year. The delay in dealing with the legacy of the existing problems in the banking sector is still one of the risks to these forecasts.

Japan’s economic activity is slightly better than expected in the first quarter of the year, though domestic demand is still weak, while inflation declined. The announced delay of hiking the consumption tax from April 2017 to October 2019, could have raised growth forecast for 2017 by 0.4 percent next year. However, the yen appreciation in recent months affected growth in 2016 and 2017. As a result, growth forecasts for Japan in 2016 were cut by about 0.2 percent and growth forecasts for 2017 are not expected to increase by more than 0.2 percent.

In China, short-term prospects have improved thanks to recent policy support. Standard lending rates were reduced five times in 2015. The fiscal policy shifted to an expansionary stance in the second half of the year. Spending on infrastructure increased and credit growth accelerated.

The direct impact of Brexit on China is expected to be limited, due to limited exposure of China to commercial and financial transactions with the UK, as well as the willingness of the authorities to act to achieve the target growth range.

Hence, the growth prospects for China remain unchanged from April with a slight upward revision for 2016. However, the negative impact on China could be significant if growth in the EU was significantly affected.

In the Middle East, oil-exporting countries benefited from the limited recovery in oil prices recently, while fiscal consolidation to address the structural decline in oil revenues continued. However, many countries in the region are still trapped by unrest and conflicts.

There are several economies whose prospects are also affected significantly by geopolitical tensions, domestic armed conflicts and terrorism, especially in the Middle East, with increasing consequences across the borders.

Implications for Egypt:

Egypt should pay attention to the impact of slowing global growth and its effects on the region. The declining growth in the GCC will lead to a slowdown in aid flows o Egypt, and to a possible drop in investments and in the number of Egyptians working there, and hence incoming remittances.

The legislative system related to the investment climate in Egypt needs a comprehensive review. It is important to establish a system of electronic establishment of firms and lower the establishment time spent and its procedures. Legislations should also be amended concerning company establishment and its procedures, governance, contracting, land allocation mechanism, utility connections, the tax system, the market exit system, and bankruptcy. In addition, an effective mechanism for settling investment disputes should be put in place. The current investment law needs a review to reflect the country's vision for investment and avoid the flaws that appeared in implementation following the amendments in March 2015, which did not produce the expected effects so far, especially in the absence of a clear investment map.

The country' strategy should include further geographic distribution of developmental projects based on the unemployment levels in the rural areas, especially among females. Rising unemployment rates among females indicate that their economic potentials are not properly utilized. Projects like "your job near your home" will achieve the goal of reducing unemployment and raise employment rates among females in particular.

It is worth noting that low foreign direct investment in Egypt is not attributed to geopolitical factors in the region or to the global financial crisis looming on the horizon alone. They can be explained also by internal factors related to managing the investment climate, addressing its obstacles and eliminating administrative overlaps as well as the length of licensing procedures and approvals regardless of all the reform efforts undertaken in this respect.

Special Analysis

Mergers and Acquisitions in the Middle East Grow Steadily in Q2
Asharq Al-Awsat

Global cross-border mergers and acquisitions (M&A) volume and values were subdued in Q2 2016, as investors held their breath, but the Middle East region saw an increase in both inbound and outbound cross-regional activity in the first half of 2016.

Hesitancy persisted as global markets remained volatile, and consequently, the Index, which tracks quarterly deal activity using a baseline score of 100, dropped to 176, down 33 percent from Q2 2015, the lowest Index result since Q3 2013, according to global law firm Baker & McKenzie’s quarterly Cross-Border M&A Index.

Buyers announced 1,320 cross-border deals worth US$214 billion, a 4 percent drop in volume and a 45 percent drop in value compared to Q2 2015. Although North America was the largest cross-regional outbound market by volume, the EU (particularly the UK) and North America experienced the largest reductions in deal values.

According to the Baker & McKenzie report, the drop can be attributed, at least in part, to fewer megadeals – those above US$5 billion in value – in the first half of the year. While there were 21 megadeals struck in the first half of 2015 with a total value of US$296 billion, the 18 thus far in 2016 are worth 23 percent less at US$228 billion. Only three of those occurred in Q2 2016 (worth US$29 billion).

On the sector side, Industrials topped the volume charts with 199 deals, while the Pharmaceuticals sector produced the highest-value Q2 deal: Boehringer Ingelheim's US$12.56 billion acquisition of Merial.

The Middle East Index dramatically increased from its Q1 2016 position of 141 to 437 in the second quarter of the year, signifying the strength of cross-border M&A activity in the region, with the UAE standing out as the most active country in the region in respect of both inbound and outbound investment.

Will Seivewright, Corporate/M&A Partner at Baker & McKenzie Habib Al Mulla based in the UAE said that the underlying economic fundamentals, such as anticipated GDP growth in the UAE and Saudi Arabia, continue to draw investors to the region, and we expect cross-border deal activity to remain steady as organizations begin to strategically prepare for each country’s long-term development plans leading up to 2020 and beyond.”

"Risk factors continue to influence investment decisions, but we are already seeing more strategic and focused outbound investment from the Middle East,” added Zahi Younes, Corporate & Securities partner at Baker & McKenzie's associated firm in Riyadh. “GCC countries' increasing efforts to diversify their investment portfolios will change the M&A landscape, allowing them to become key strategic investors around the world and enabling international investors to capitalize on opportunities.”

The UAE attracted the most interest from international investors in H1 2016 and was the target country of 11 of the 16 deals into the Middle East. The US remained the top bidder country for the first half of the year, with five deals valued at US$60 million, while China led by value with three deals valued at US$1.37 billion.

The Energy & Utilities sector was the busiest in Q2 2016 by both deal volume and value, with three deals valued at US$1.37 billion, the top two driven by China.

Implications for Egypt:

The world has recently seen significant acquisition activity in light of troubled assets of a number of large companies following the global economic crisis. The decline of the Egyptian Stock Exchange during the past two years revealed opportunities to acquire a number of important and strategic companies at cheap prices due to the political and security situation. Despite strict controls in the relevant law in these cases, these operations are usually carried out in a legal framework that allows their implementation, especially in light of the fragmented ownership structure of many companies and individual investors' concern about how long investors will retain these investments in light of instability.

Many indicators confirm that the recent period has seen investor sentiment being inclined towards seizing opportunities and cheap deals. In light of the rule that says if there is a limited number of investors in the market, and numerous assets for sale, investors conclude the cheapest, yet strongest, investment deals. Here we have to stress that acquisitions over the past years led to a large inflow of liquidity due to these companies' restructuring of those acquired companies and the development of their production lines, which led to increased production capacity and rising demand for labor.

The fact that helped attract Western companies to the Egyptian market through acquisitions is availability of investment opportunities, whether in the industrial, agricultural, or tourist sectors. Therefore, and despite the political instability, evidence confirms international interest in investing in Egypt, especially if the country takes more serious steps to resolve economic disputes.

That is why sectors such as food, agriculture, medicine and basic resources in Egypt may be a target for acquisition in the coming period, which calls for the need to tighten control over the transactions and the development of a new legal mechanism for the exit of major shareholders.

Global Financial Market Performance

Reuters/ Argaam

Chinese stocks fell at the end of Friday's trading session, despite continued gains of the real estate sector, with concern over the weak performance of the second largest economy in the world.

Investors awaited announcement of the Chinese authorities of the export and import data and inflation rate, amid expectations of the central bank adding new stimulus measures in an effort to boost growth.

Investors in the Chinese stock market suffered last week from growing concerns about the performance of the economy amid a worrying rise in debt levels, and lack of clarity regarding the stimulus measures the authorities could pump to stimulate the economy.

The "Shanghai" Composite Index fell 0.2 percent to 2,976 points at closing, but was relatively stable this week.

Japanese stock indices also stabilized at the close of Friday trading, with a rising value of the yen against the dollar. This comes following the announcement of the Bank of England of a number of stimulus measures on top of which lowering the interest rate to 0.25 percent from 0.50 percent and expansion of the asset purchase program.

At the end of trading, the Japanese "Nikki" index stabilized at 16,254 points, while the "TOPIX" index dropped 0.24 percent to 1,280 points.

US stocks rose during Friday trading and boosted gains supported by the monthly employment report, which showed strong data that exceeded July expectations. The "NASDAQ" and "S&P" scored a new record closing, and posted weekly gains

The "Dow Jones" industrial index increased by more than 1 percent or by 191.5 points to 18,543.5 points. The "Nasdaq" index increased by 54.8 points to 5,221 points, while "S&P 500" index rose by 18.6 points to 2,182.8 points.

On a weekly level, the "Dow Jones" recorded gains of 0.6 percent. The "Nasdaq" rose by 1.1 percent, while the broader "S & P 500" posted weekly gains of 0.4 percent.

In Europe, "Stoxx Europe 600" rose by 1 percent or 3.5 points to 341.3 points, achieving weekly gains of 0.2 percent.

The British "FTSE 100" index rose by 535.3 points to 6,793.4 points, while the German "DAX" index rose by 139.3 points to 10,367.2 points, and the French "CAC" index rose by 65 points to 4,410.5 points.

On the other hand, gold futures for December delivery settled lower by 1.7 percent or by $23 to $1,344.40 an ounce, the largest losses since May 24, scoring a weekly loss of about 1 percent.

In the oil markets, the US "NYMEX" fell by 0.3 percent or by 13 cents and closed at $41.80 a barrel, but recorded a weekly gain of 0.5 percent. The "Brent" index fell by 2 cents to close at $44.27 a barrel, and made weekly gains of about 1.7 percent.

Regarding economic data, the monthly employment situation report showed the addition of 255,000 jobs in the US in July, while expectations indicated addition of 185,000 jobs. The unemployment rate settled at 4.9 percent.

Implications for Egypt:

The Egyptian Stock Exchange (EGX) continued its upward trend last week, recording one of its biggest increases since the beginning of the year. This is a result of internal factors related mainly to the exchange rate and the beginning of discussions on obtaining the IMF loan as part of a $21 billion financial package. The impact of global markets on the EGX has been limited thanks to relative stability in those markets in the absence of fundamental changes. In other words, EGX has continued to react more to its internal conditions in light of the strength of internal variables, along with the emergence of positive developments in global markets that led to price cohesion and offsetting previous losses. This presents a positive opportunity for the introduction of new instruments or developing new trading systems in the Egyptian stock market, especially that external variables are now exercising less pressure on the performance of the local market. This will contribute to increasing the prospects of attracting foreign investments in the stock market over the coming period if conditions continue as they are.

We reaffirm that the country's current approach in considering the sale of company quotas in the Egyptian stock exchange or global markets requires deliberate study of its timing and pricing mechanisms. Its chances of success should also be studied in the light of the current situation in most global markets, to ensure the success of these planned placements as part of the financial package announced by the government last week.