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Our Economy & the World

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

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Key Global Developments

US Banks Increases their Holdings of Treasury Bonds to $2.4 trillion

Argaam

US banks increased their holdings of government Treasury bonds to $2.4 trillion, the highest level since the Central Bank started compiling data in 1973.

This comes at a time when banks reduced the size of lending to US companies in favor of investing in safe Treasury bonds, which is worrying observers who point out the risk embedded in the failure of lending levels to keep up with the growing level of deposits.

One of the reasons why banks tend to expand their holdings of government bonds, is that they are low risk, have high credit rating, and their value is considered significantly stable compared to other securities.

What contributed to this also is the calls from regulators on financial institutions in the wake of the Great Depression to keep sufficient liquid assets, to ensure overcoming any other financial crisis, which means strengthening their budgets through safe assets.

There are also the so-called stress tests, which are conducted on banks repeatedly by external auditors, attempting to predict what could happen in the worst case scenario. Having plenty of Treasury bonds in the financial statements helps banks pass these tests.

At the same time, banks tightened screening measures to determine who can get loans, leaving many high risk loan seekers unable to obtain credit unless at high interest rates.

According to Bloomberg, commercial loan growth rate at the Bank of America dropped, for example, more than 10 percent to less than 5 percent.
At the same time, consumer loans still suffer from the recession, shrinking to the 23rd quarter in a row.

Moody's Warns of UK Credit Rating Downgrade if it Fails to Retain Access to the Single Market

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Moody’s said in a statement that the UK’s credit rating could be downgraded again if the government fails to retain access to the single market.

Moody’s has given the UK an Aa1 rating, and said it could be downgraded again if the UK fails to retain access to the single market after Brexit, which would weaken growth in the medium term and adversely affect the fiscal policy of the country.

The ratings agency downgraded the outlook on the UK sovereign rating to negative from stable on 24 June, the day after the referendum. It stripped the country of its coveted triple A status in 2013, citing sluggish growth prospects and fiscal challenges

It added that one expected scenario is to reach several agreements to allow access to the single market for goods and services, especially financial services, but this outcome is still uncertain so far.

FGCCC calls on Gulf Government to Gradually apply the VAT

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The Federation of GCC Chamber (FGCCC) called for applying the value added tax (VAT) gradually. The Federation pinpointed that the private sector and citizens have to know the details and mechanism of the tax application and the sectors in which the tax will be applied as well as the extent of its impact.

The Federation stated that the VAT should not be imposed at the entry point of imported goods to the Gulf states, because it will be considered as additional customs duties, but it should be imposed on the actual sales.

It stressed that the trend for the application of the VAT in the GCC countries should consider not to reduce private sector investments at a time national economies need more spending and investment. It should also coincide with appropriate transparency-friendly legislations. A portion of tax revenues should also be redirected to non-oil sectors that need to be incentivized to increase their role in the diversification of income sources.

A portion of the collected funds from subsidy restructuring should be directed to industrial projects, especially SMEs.

The Federation believes that the imposition of the VAT will be borne by the final consumer and business owners in general, indicating that a clear and reasonable tax environment would be in everyone's interest.

The Federation called for the need to involve the Gulf private sector in developing the final arrangements before applying the value-added tax due to its possible adverse effects on the Gulf consumer and the business sector, unless the private sector opinion about the positive and negative effects that may result from applying the VAT is taken into consideration.

According to available data, the Gulf states intend to apply the VAT at the beginning of 2018.

Fitch" Expects a Gradual Rise in GCC Issuance of Corporate Bonds and Sukuks in 2017

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Corporate bond issuances may gradually take off in 2017 in the GCC region, according to global rating agency Fitch Rating.

The agency noted that the decline in liquidity at banks, which have caused creating a funding gap for companies due to their refraining from lending, pushing them to seek financing from the financial markets.

The Gulf companies will issue sukuks or a mix of sukuks and bonds rather than issuing bonds only in order to attract a wider group of investors.

The recent Saudi issuance of bonds, in addition to a similar issuance in Abu Dhabi and Qatar, will create a price reference that supports a wider growth of the capital markets in the Gulf region.

Fitch added that the new legislations aimed to facilitate regulatory procedures in the debt markets, adopted by several Gulf countries such as Saudi Arabia, Kuwait, Oman and the UAE, will help speed up the issuance of bonds and sukuks, and reduce their costs.

Oil's Heading to $40 If OPEC Agreement Fails, Says Goldman

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Goldman Sachs analysts warned oil prices might fall by more than 10 percent if "OPEC" failed to implement the production cut agreement at the end of this month to curb the global supply glut.

One analyst pointed out that doubts are growing about the coordination of efforts to curb oil production, which portends a decline in oil prices toward $40 a barrel if "OPEC" fails to implement the agreement.

Bank analysts did not specify whether they meant low "NYMEX" or "Brent" prices if the agreement reached in Algeria in September fails to set production between 32.5 million and 33 million barrels a day.

The Value of Acquisitions in the Middle East and Africa Jumps 400 percent

Al-Mal

The value of corporate acquisitions in the Middle East and Africa (MEA) jumped by about 400 percent during the third quarter this year, to exceed $30 billion, the highest quarterly increase in at least 12 years, compared with the same quarter last year.

According to Bloomberg, corporate acquisitions in the Middle East and Africa rebounded during the last quarter, with countries and companies tending to diversify their investments away from the oil industry, after oil prices declined by more than 60 percent since nearly 27 months to date.

The Swiss UBS Group managed to rank first place so far this year in terms of the acquisitions it supervised in the Middle East to witness the best year in nearly a decade, although it was not among the top five banks since 2009, and was outside the rankings of the best banks for these transactions last year.

ECB should Tail Off Bond Purchases: German Experts

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German experts urged the European Central Bank (ECB) to reduce its bond purchases, as they believe that several governments in the Eurozone will postpone major economic reforms.

The German council of economic experts pointed out that the quantitative easing policy in the euro zone is no longer appropriate, taking into account economic recovery in the unified bloc.

The council called on ECB President Mario Draghi to slow bond purchases launched by the bank to stimulate the financial system and revive growth in the euro zone.

President of the German Council of Economic Experts Christoph M. Schmidt told Agence France Press that the quantitative easing program launched by the central bank caused the Eurozone governments to slow down the implementation of necessary reforms.

The German experts predicted economic growth in the euro area will post 1.6 percent in 2016 and 1.4 percent in 2017.

Implications for Egypt:

International institutions still point out continued pressure on the economies of the Gulf region and China in light of slowing global economic climate and the emergence of developments that may lead to the escalation of risk to a number of economies, especially China. Excessive lending by China has increased risks to the Chinese economy, which is one of Egypt's main economic partners at present.

Egypt should focus in the coming period on improving its internal economic infrastructure and rely strongly on developing its industrial bases, and encouraging feeding industries through promoting small and medium enterprises. In light of continued volatility at the international level, the likelihood of a recession and a slowdown in global growth rates is high, which requires Egypt to stimulate sustainable growth drivers that are less affected by global developments, which would support local economic growth.

It is also important to note that the situation in the Gulf region may affect the demand on Egyptian workers. This requires proceeding with the economic reform programs at faster rates to promote job creation and absorb the expected slowdown in Egyptian remittances. However, the authorities should be cautious about growth of public debt, especially that the aggravation of the sovereign debt crisis worldwide coupled with shortage of sources of funding would represent a growing risk to the global economy.

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From the International Press

IMF Urges African Countries to Cut Subsidies, Boost Taxes

Asharq Al-Awsat

African exporters of oil and commodities should remove subsidies and boost taxes to weather their slowest growth in more than two decades, the International Monetary Fund said.

The Washington-based Fund cut its 2016 growth forecast for Sub-Saharan Africa to 1.4 percent, from 3 percent in May, as economies from Nigeria to Zambia reel from the drop in commodity prices.

Abebe Selassie, the director of IMF's African Department, said growth could start to recover next year to 3 percent, but only if the battered economies carry out fiscal reforms.

"Should they fail to do that, vulnerabilities will heighten and the crisis of the weak economic performance we have seen so far will get even more difficult," he told Reuters.

African economic growth was more than 5 percent in the decade leading up to the commodity price drop, but it is now being dragged lower by 23 resource-dependent nations like Nigeria, South Africa and Angola.

While average growth was 3 percent last year, countries that are more diversified like Rwanda and Senegal will continue to grow at more than 5 percent.

Nigeria, which is in its first recession for more than 20 years, has been seeking to widen its tax base, to offset lower revenues caused by the slump in oil prices.

Selassie said Nigeria's low debt was a source of strength, adding officials needed to offer more certainty through a "coherent and consistent policy package". He added that Zambia, which has been hit by lower prices of copper, could save some money by eliminating fuel subsidies, he said.

The East African nation plans to partly plug a gaping budget deficit this fiscal year from international capital markets.

Selassie said African nations needed to balance commercial debt, like Eurobonds, with other cheaper forms of financing from development institutions. Several nations have made debut Eurobond issues in recent years but the pace has slackened off.

Eurobonds "cannot be the main source of financing for countries. It can complement other forms of financing and importantly, you want to minimize the deficit financing."

Africa is suffering from the decline in oil prices and the crisis in the face of random immigration, as well as armed unrest, which affected Africa's largest oil producers – Nigeria

The EU Foreign Policy Chief Federica Mogherini said last week that European efforts to address immigration in coordination with the African countries of origin and transit began to bear fruit, four months after the EU’s adoption of the controversial carrot-and-stick approach.

The EU is combatting migration flows after more than a million people arrived to the continent last year. Many migrants escaped from war and violence in the Middle East, while others escaped from poverty in search of a better life.

In June, the European Commission proposed concluding agreements with partner countries to combat smuggling networks and to improve economic conditions to reduce the factors that cause people to escape. It also linked development policies with cooperation in the field of immigration.

The Commission said that work has begun with five priority countries, namely, Niger, Nigeria, Senegal, Mali and Ethiopia.

German Chancellor Angela Merkel had concluded a week she dedicated to Africa on October 14, hoping to reduce the flow of migrants and asylum seekers to Europe to escape a continent suffering from conflict and poverty.

Merkel called for increasing aid to many African countries at a time Germany remains the first European economy and a favorite destination for asylum seekers.

The goal of these efforts is to reduce the flow of migrants trying to reach Europe to escape poverty and conflict. Since the beginning of this year, more than 300 thousand migrants crossed the Mediterranean, most of whom came from sub-Saharan Africa, according to the UN High Commissioner for Refugees.

In order to stem the flow of migrants from Africa, Merkel has made efforts to reach agreements similar to the agreement signed between the EU and Turkey in March, which sets out that Turkey should stop migrants from using its territory as a platform to migrate to Greece in return for 3 billion euros in aid.

Merkel said in September that a similar agreement should be signed with Egypt and with other African countries.

Berlin has pledged to provide 10 million euros in military assistance to Niger, the main country of transit for migrants, and 17 million euro in aid for development, which are modest amounts compared to the «Marshall Plan» called for by Mahamadou Issoufou.

Implications for Egypt:

This African vision coincides with the Egyptian government's initiation of a policy of spending rationalization, which is seen as an important step toward reducing the budget deficit on one hand and increasing the chances of directing state resources to priority activities, particularly education and health, and improving resource allocation.

Currently, savings in the short term can be secured through cutting down on spending on foreign missions, reducing the number of advisers in the civil service, developing a system for managing government's current expenditure, rationalizing spending on energy and water in state bodies, improving maintenance to reduce the need for replacement with new products, and fixing the system of rewards and incentives, and linking it directly with production. The government's spending rationalization plan must be translated into action to control the budget deficit, without affecting budget items, such as wages, investments, and commodity and service requirements.

However, it is necessary to change the current approach of preparing the budget to start implementing program and performance budgeting on a number of budget entities and ministries, linking budget implementation to targeted economic performance indicators. It is also possible to secure real savings from subsidies, if the relevant mechanisms are rationalized, especially through better targeting, reducing waste that results from inaccurate data, which will improve the subsidy system and reflect positively on citizens' lives.

The state budget shows increased spending on a number of items such as wages and debt servicing. This reduces the fiscal space, that could otherwise be directed to spending on health, education and scientific research. The growing budget deficit is mainly due to the fact that the budget included exaggerated revenues at the time of its drafting with regards to tax revenues in spite of the relative economic slowdown caused by internal and external factors.

To achieve its objective, rationalization should be extended to include entities and holding companies, and their affiliates in the context of an ambitious economic program that aims to increase revenues, reduce spending, improve the business environment and encourage the private sector.

Special Analysis

Mideast M&As Reach $37.4bn during First Nine Months

Thomson Reuters

The world's major source of intelligent information for businesses and professionals, Monday released the quarterly investment banking analysis for the Middle East region.

According to estimates from Thomson Reuters/Freeman Consulting, Middle Eastern investment banking fees reached $580.7 million during the first nine months of 2016, an 11 percent increase compared to fees recorded during the same period in 2015.

Nadim Najjar, MD, MENA, Thomson Reuters, said: “The value of announced mergers and acquisitions (M&A) transactions with any Middle Eastern involvement reached $37.4 billion during the first nine months of 2016, 19 percent more than the value recorded during the first nine months of 2015 and the highest first nine-month total in the region since 2010.”

“Middle Eastern equity and equity-related issuance totaled $1.5 billion during the first nine months of 2016, a 72 percent decline from the first nine months of 2015 and the slowest opening nine-month period for equity capital markets issuance since 2004.

Bolstered by a record-breaking second quarter, Middle Eastern debt issuance reached $43.8 billion during the first nine months of 2016, a 75 percent increase compared to the value raised during the first nine months of 2015 and the strongest first nine months for DCM issuance since records began in 1980,” he said.

About investment banking fees, Najjar added that fees generated from completed M&A transactions totaled $158.3 million during the first nine months of 2016, a 23 percent decrease compared to a year ago and the slowest first nine months for M&A fees in the region since 2012.
Equity capital markets underwriting fees declined 64 percent to $29.1 million, marking the slowest first nine-month period since 2009, while debt capital markets fees increased 64 percent to $83.2 million.

Syndicated lending fees accounted for 53 percent of the overall Middle Eastern investment banking fee pool, the highest first nine months’ share since 2002. Completed M&A advisory fees accounted for 27 percent of fees in the region while debt and equity capital markets underwriting fees accounted for a combined 19 percent.

Powered by syndicated lending fees, Mitsubishi UFJ Financial Group earned the most investment banking fees in the Middle East during the first nine months of 2016, a total of $36.5 million for a 6.3 percent share of the total fee pool.

Rothschild topped the completed M&A fee rankings with 12.9 percent of advisory fees while HSBC was first for DCM underwriting, up from second place a year ago.

ECM underwriting was led by Sambacapital with $13.0 million in ECM fees, or 45 percent share. Mitsubishi UFJ Financial Group took the top spot in the Middle Eastern syndicated loans fee ranking with $32.2 million in fees for 10.4 percent of the market.
As for M&A deals, the $14.1 billion merger of National Bank of Abu Dhabi and First Gulf Bank was the largest deal to be announced in the region so far this year; it is the largest domestic Middle Eastern deal of all time.

Boosted by this deal, domestic and inter-Middle Eastern M&A increased 149 percent year-on-year to $20.5 billion. Outbound M&A activity fell 24 percent from the first nine months of 2015 to reach $11.4 billion.

Overseas acquisitions from Qatar accounted for 41 percent of Middle Eastern outbound M&A activity while acquisitions by companies based in Saudi Arabia and the UAE accounted for 34 percent and 11 percent, respectively.

Inbound M&A fell 53 percent to $2.2 billion.

Financials was the most active sector, accounting for 45 percent of Middle Eastern involvement M&A, followed by Technology and Real Estate. Credit Suisse, which advised the Abu Dhabi banking merger with UBS, topped the first nine months 2016 announced any Middle Eastern involvement M&A league table. UBS ranked second.

With respect to Equity Capital Markets, six initial public offerings (IPOs) raised $811.9 million and accounted for 54 percent of first nine months 2016 activity in the region. Follow-on offerings accounted for the remaining 46 percent of activity. Samba capital took first place in the first nine months of 2016, with Middle Eastern ECM ranking with 31 percent market share.

As for debt capital markets, Qatar was the most active nation in the Middle East accounting for 36 percent of overall activity, followed by the UAE and Oman. International Islamic debt issuance increased 26 percent year-on-year to reach $28.0 billion during the first nine months of 2016. JP Morgan took the top spot in the Middle Eastern bond ranking during the first nine months of 2016 with 9.2 percent share of the market while CIMB Group took the top spot for Islamic DCM issuance with a 14.76 percent share.

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.

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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.

It is clear that European and US companies have begun looking for new resources and engaging in profitable activities, especially after facing fierce competition from the Chinese, Indian and Korean companies that began invading African markets, acquiring nearly 60 percent of such investments in Africa. Most international corporations have begun looking for alternatives in order to create new entities capable of making large profits to compensate for losses incurred due to the global financial crisis. These alternatives will serve as launching pads to other markets, particularly Africa, which has become a safe haven for these companies thanks to its mineral wealth and large consumer market.

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.

The return of confidence to the private equity sector in Egypt in light of the global economic crisis supports optimism about investment in sectors more capable of growth, such as health care, education, consumer goods, oil and gas. It is likely these sectors will benefit from plans for government spending and legislative changes. Transport, toll roads, ports and energy sectors are deemed attractive areas to investors and could bring in large investments.

In addition, scarce investment companies and acquisition-related controls on private equity firms still hamper the flow of purchase offers and may force private equity firms to reconsider how they do business, in terms of ways of searching for companies, monitoring and reporting.

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ECES
The Egyptian Center for Economic Studies

Global Financial Market Performance

Reuters/ Argaam

Chinese stock indices fell at the close of trading, but made weekly gains for the fourth consecutive time, taking advantage of the release of economic data that boosted the prospects of Chinese economic growth.

This week's data showed a rise in official manufacturing PMI to 51.2 points in October from 50.4 in September, the fastest pace of growth in two years.

The private industrial purchasing managers index "Caixin" rose to 51.2 points from 50.1 points. The purchasing managers' index for the service sector also rose to 52.4 points from 52 points, its highest level in four months

Chinese stocks came under downward pressure this week, with the decline in global markets as a result of uncertainty about the US election. At the end of trading, the "Shanghai" Composite Index fell 0.1 percent to 3,125 points, but made a weekly gain of 0.7 percent.

The Japanese stocks fell at the close of trading, with the losses of electronic companies, despite a drop in the yen's value against the dollar and positive economic data.

The "Nikki" service PMI rose in Japan to 50.5 points in October from 48.2 points. A reading over 50 reflects activity growth, while below that level indicates contraction**.**

This comes with continued concerns of local investors about the US presidential election next week and its outcomes, especially with the progress of the republican candidate, Donald Trump in some recent opinion polls compared to his democratic rival Hillary Clinton.

The Mazda share dropped by 5.1 percent to 1,570 yen after the company cut its forecast for full-year earnings by about 13 percent.

At the end of trading, the Japanese "Nikki" index fell 1.35 percent to 16,905 points, while the "TOPIX" index fell 1.55 percent to 1,347 points**.**

US stocks also fell during Friday trading for the ninth session in a row - the longest streak of losses since 1980 - giving up previous gains, amid concerns among investors ahead of the presidential election next week, with the continued evaluation of the monthly employment report. Major indices posted weekly losses.

The Dow Jones industrial average fell by about 42 points to 17,888 points, after gains of about 50 points. The Nasdaq index fell (-12 points) to 5,046 points, while the benchmark S&P 500 fell (- 3.5 points) to 2,085 points**.**

On a weekly level, the "Dow Jones" recorded losses of 1.5 percent, the broader "S&P 500" recorded losses of 1.9 percent, while "Nasdaq" recorded losses this week by 2.8 percent.

In the European markets, "Stoxx Europe 600" dropped by 0.9 percent or by about 3 points to 328.7 points, and scored 3.6 percent in weekly losses, the largest since February.

The British "FTSE 100" index dropped (-104 points) to 6,686 points, the German "DAX" index fell (-72 points) to 10,253.6 points, while the French "CAC" index fell (-38.5 points) to 4,373 points.

On the other hand, gold futures for December delivery increased at settlement by 0.1 percent or by $1.20 to $1,304.50 an ounce, and made gains this week by 2.2 percent.

In the oil markets, the US "NYMEX" fell by 1.3 percent or by 59 cents to close at $44.07 a barrel, the lowest close since September 20, recording a weekly loss of 9.5 percent, the largest since mid-January. "Brent" also fell 1.7 percent, or by 77 cents to close at $45.58 a barrel, the lowest close since the beginning of September, and recorded losses this week by about 8 percent.

About economic data, the monthly employment report showed that the US economy added 161 thousand jobs in October, and a drop in unemployment to 4.9 percent from 5 percent.

US Monthly Employment Report				
	Forecasts	**Previous**	**Current**	**Change**
Number of jobs (thousand)	175	191	161	(30)
Unemployment (%)	4.9	5	4.9	0.1%
Average wage per hour ($)	--	--	25.92	0.4%
Number of weekly working hours	--	34.4	--	--

Implications for Egypt:

Most global indices edged downward over continued concern by local investors about the outcome of the US presidential election scheduled next week. Republican candidate Donald Trump was recently ahead of rival democratic candidate Hillary Clinton in some polls. However, Egyptian stock indices witnessed an upward trend during the elapsed trading week supported by the historic decision of the central bank to liberalize the exchange rate and the introduction of new economic reforms that bring Egypt closer to obtaining the IMF loan. Nevertheless, trading rates still indicate the presence of idle liquidity willing to invest in the stock market if conditions improve in the coming period.

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 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 Egyptian government. The Egyptian Stock Exchange needs more government attention to complete its development, and improve its legislative institutional framework. This requires speeding up the amendment of the Capital Market Law No. 95 of 1992 as well as modifying the Presidential law governing the institutional setup of the stock market to allow more investment flexibility and strengthen the supervisory tools and increase the number of investment instruments available for trading.