Issue: 45

Date : 12 February 2017

ECES
The Egyptian Center for Economic Studies

Our Economy & the World

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

- **Key Global Developments Over the Past Week**
- **From the International Press: India unveils budget for the poor**
- **Special Analysis: Cautious optimism to return to the M&A market in 2017**
- **An Analysis of Global Financial Market Performance and Changes in Prices of Goods and Raw Materials**

Key Global Developments

Goldman Sachs says US-China trade war would hurt both countries

Argaam

Goldman Sachs assessed the potential consequences of a trade war between the US and China, saying that such a war would hurt both economies.

In its report, the bank said that china’s annual economic growth would decrease by as much as 1 percentage point if such a war starts. The US GDP will also be affected by the decline in Chinese investments IN the US.

If President Donald Trump imposes punitive tariffs against China of up to 10 percent, the country’s exports to the US will fall as much as 25 percent. Should China retaliate, trade with the US would also suffer and its economic growth could fall by as much as a quarter percentage point

China's oil demand growth at three-year low in 2016

Reuters

China's 2016 oil demand grew at the slowest pace in at least three years, Reuters' calculations based on official data showed, the latest indication that demand from the world's largest energy consumer has diminished.

China's implied oil demand growth eased to 2.5 percent in 2016, down from 3.1 percent in 2015 and 3.8 percent in 2014, led by a sharp drop in diesel consumption and as gasoline usage eased from double-digit growth.

The slowing occurred as the economy expanded by only 6.7 percent in 2016, the slowest pace in 26 years.

Gasoline consumption was 3.6 percent higher than 2015. That compared with growth of 9.1 percent in 2015 and a 13 percent gain in 2014.

Liquefied petroleum gas usage expanded 24 percent, while kerosene demand gained 9 percent from a year ago. Crude oil demand growth also eased despite a record pace of imports in 2016.

Theresa May succeeds in avoiding amendments to Brexit Bill

Al-Arabiya Net

UK Prime Minister Theresa May succeeded in passing the Brexit bill without any amendments, after getting power from the House of Commons to proceed with Brexit negotiations.

Thanks to the Theresa's Conservatives party majority, amendments requested by the opposition to the bill, including requests for periodic government reports on Brexit developments and coordination with the governments of Scotland, Wales and North Ireland regarding negotiations, were rejected.

Japan logs biggest current account surplus since 2007

Argaam

Japan attained its biggest current account surplus since 2007, official data showed. The 26.03 trillion yen ($183.63 billion) surplus was recorded with a bounce in exports and a decline in imports.

For the whole of 2016, Japan posted a trade surplus of 6.8 trillion yen ($59.95 billion). Japanese exports often benefit from the weak yen before the dollar. US president Trump accused Tokyo of devaluing its yen.

$16trn needed for oil, gas investments by 2040

Al-Arabiya Net

A recent report by the Oil Producing and Exporting Countries, (OPEC), predicts global oil demand to increase from roughly 93mn b/d in 2015 to over 109mn b/d by 2040. In relation to natural gas, demand is set to rise from around 350bn cf/d in 2015 to 590bn cf/d in 2040.

According to the report, this positive outlook for demand requires huge investments to increase production in new areas to compensate the drop in old fields. An estimated $10 trillion in oil-related investments will be needed by 2040, and roughly $6tn for gas.

Non-OPEC supply is expected to continue its decline in 2017 due to recent lower oil price levels, but then a gradual increase to 2021 in crude production by non-OPEC is predicted.

The Secretary General of the Oil Producing and Exporting Countries, (OPEC), Sanusi Barkindo has said that from the long-term perspective, non-OPEC supply is expected to continue to rise steadily, reaching a high of 6.41 mn b/d in 2027, before dropping to 5.98 mn b/d in 2040.

The report, which was included in OPEC’s Petroleum Review, said that all these indicators point out to the fact that OPEC will be needed to fulfill much of the additional long-term oil demand. For crude, this means an estimated 8.9mn

b/d between 2015 and 2040, and for all liquids, 1.62 mn b/d. The share of OPEC crude in the global liquids supply is forecast to increase from approximately 34 percent today to 37 percent by 2040.
The report pointed out that reading the future of energy market reality in the world affirms that oil and gas will continue to play a very important role in supplying the world's energy needs, which will be an estimated 53 percent of the global energy mix by 2040.

Goldman economists see more risks for U.S. economy

Reuters

A fiscal boost to the United States is more likely in 2018 than this year, according to Goldman Sachs economists, as "the balance of risks is somewhat less positive" one month into the new year and as U.S. President Donald Trump's growth-boosting agenda could be offset by negative effects of restrictions on trade and immigration.

Following the election, the positive shift in sentiment among investors suggested that the probability of tax cuts and easier regulation was higher than the probability of meaningful restrictions to trade and immigration, according to the note by economist Alec Philips dated Feb. 3.

However, one month into the year, the balance of risk is "somewhat less positive in our view."

Recent difficulties that congressional Republicans have had in repealing Obamacare "does not bode well for reaching a quick agreement on tax reform or infrastructure funding," the note said.

That "reinforces our view that a fiscal boost, if it happens, is mostly a 2018 story."

Goldman said while bipartisan cooperation looked possible on some issues following the election, the "political environment appears to be as polarized as ever, suggesting that issues that require bipartisan support may be difficult to address."

Goldman also said Trump is likely to follow through on campaign promises on trade and immigration, "some of which could be disruptive for financial markets and the real economy."

Tax reform will probably "take a while to enact and will probably be scaled back relative to what House Republicans and President Trump have proposed," the note said.
Goldman said it expects a fiscal expansion of around 1 percent of GDP, largely through tax cuts starting in 2018.

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, such as the promotion of domestic production, especially among SMEs, 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.

Therefore, Egypt has to take more robust actions through economic reform packages that focus on reducing government expenditure and rationalizing consumption, encouraging certain productive sectors, and revitalizing marginalized investment economic sectors. These actions could help reduce the deficit and improve the economy.

From the International Press

India unveils budget for the poor

Asharq Al-Awsat

India unveiled a budget to help the poor with hikes in government spending and cuts in taxes as Prime Minister Narendra Modi seeks to win back the sympathy of voters hit hard by his recent crackdown on "black money".

Finance Minister Arun Jaitley announced increases in spending on rural areas, infrastructure and fighting poverty, and sought to assure lawmakers and the country that the economic impact of the government's cash crackdown would wear off soon.

Jaitley also halved the basic personal income tax rate, and cut taxes on small firms that account for 96 percent of India's businesses, while imposing a surcharge on the better off.

"This budget is yet again devoted to the wellbeing of villages, farmers and the poor," Modi said in a national TV address soon after Jaitley delivered his two-hour budget speech.

As economists polled by Reuters had expected, Jaitley raised the target for the federal fiscal deficit to 3.2 percent of gross domestic product in 2017/18 - effectively postponing the goal of bringing it down to 3 percent.

Economists, however, said that the sheer scale of the government's promises on tax cuts and spending increases cast Jaitley's higher deficit goal into doubt.

Balancing the books will depend on him hitting his target to sell 725 billion rupees ($10.7 billion) of state assets - or nearly 60 percent more than the expected proceeds this year. The finance ministry estimated that the deficit will come in at 3.5 percent this year, in line with target.

While calling India "an engine of global growth", Jaitley highlighted risks from likely U.S. interest rate hikes, rising oil prices and worries of growing global protectionism.

Modi's shock decision in November to scrap high-value banknotes worth 86 percent of India's cash in circulation has hit consumers, disrupted supply chains and hurt investment.

The worst of the cash crunch is now over, however, and Jaitley said he expected it would not spill over into the next fiscal year. Still, the finance ministry forecasts growth could dip as low as 6.5 percent this fiscal year before picking up to between 6.75 and 7.5 percent in 2017/18.

That is below the target rate of 8 percent or more that Modi needs to create enough jobs for the 1 million young Indians who enter the workforce each month.

Jaitley said that the government is considering introduction of legislative changes, or even a new law, to confiscate the assets of “economic offenders” fleeing the country to escape the reach of law.

In the recent past, there have been instances of "big time offenders, including economic offenders", fleeing the country to escape the reach of law," he said in a clear reference to Indian Businessman Vijay Mallya.

Mallya, a businessman and a parliamentarian, whose defunct Kingfisher Airlines owes more than $1 billion crore to various banks, had left India in March 2016. Mallya also co-owns the Formula One team, and banks have not succeeded so far in retrieving their accruals.

He said that the government is therefore considering introduction of legislative changes, or even a new law, to confiscate the assets of residents in the country, till they submit to the jurisdiction of the appropriate legal forum. Needless to say that all necessary constitutional safeguards will be followed in such cases, he added.

On the other hand, he announced that the Foreign Investment Promotion Board (FIPB), which was often criticized lack of speed in the implementation of projects and proposals, will be abolished.

FIPB will be abolished at the beginning of the new year, which starts April 1. He added that further liberalization of foreign direct investment is being considered, and developments will be announced in a timely manner.

It is noteworthy that FIPB is responsible for approving foreign direct investment applications that are worth up to 50 billion rupees ($740 million) in sectors where foreign entities are not allowed to own controlling shares, or in the areas that need approval of the government such as banking, defense and civil aviation.

Implications for Egypt:

India's budget affirms the necessity to reclassify Egypt's budget items in favor of the most needy to provide subsidy for education, health, infrastructure and social safety nets. 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. 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 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. It will also improve the state's ability not only to control subsidy targeting, but also to improve the quality of public services and administrative body. This move starts by linking all citizen transactions to the national ID card, registering citizens on the ration cards, gasoline cards, social security, taxes, and customs in the same national ID. Through citizens' database program, the persons entitled to subsidies and social protection programs can be electronically identified without the need for human intervention, hence reaching the poorest families. Following completion of the citizens' database, ration cards' subsidies as well as any other subsidies that citizens get or are eligible to get will be revisited, while linking pensions to other social security benefits.

On the other hand, the growth of tax revenues is still lower than required in the absence of a change in the mechanics of increasing revenues. Modern tools and innovative methods to attract new non-tax revenues are not used yet, and the tax system is not restructured to increase its yields.

Special Analysis

Cautious optimism to return to the M&A market in 2017

Asharq Al-Awsat

Baker McKenzie issued a statement regarding the outlook for transactions, indicating that while there is uncertainty in the short-term due to geopolitical factors, the market will be more optimistic in the years ahead.

The statement said that after a year of political uncertainty, the forecast, developed in cooperation with Oxford Economics, predicts an uptick in transactional activity over the next four years, based on a gradual pickup in global economic growth in the years ahead, with gross domestic product (GDP) rising to 2.6 percent in 2017, and 2.8 percent in 2018".

The forecast is based on the anticipation that EU and UK officials will make progress in building a new relationship in 2017, and that the new US administration adopts a pragmatic stance towards international trade and immigration, and sets out plans for fiscal stimulus. The report also expects that China will continue to manage its transition to a mature economy, the Eurozone will continue its economic recovery, the financial markets will continue to hit new highs and investor confidence will continue to rise.

Paul Rawlinson, Baker McKenzie's global chair explained: "We are clearly still in volatile times but deal-making is there to be done. Strong corporate balance sheets, cheap finance, and moderate growth across markets and key sectors all point to an improving mergers and acquisitions (M&A) run-rate later in 2017, after a cautious first quarter, and a significant uptick in 2018."

"Global M&A and initial public offering (IPO) activity slowed sharply in 2016 amid heightened economic and political uncertainty," according to Baker McKenzie. Volatility in the US stock market, growing concerns about China's economic slowdown, and dropping oil and commodity prices caused dealmakers to become more cautious. Those concerns were compounded by the UK's vote to leave the EU and the US presidential election.

Michael DeFranco, global head of M&A at Baker McKenzie commented: "We expect the environment of uncertainty to continue at least for the first quarter of this year and so the forecast predicts deal making to drop slightly in 2017 to $2.5tn from $2.8tn in 2016 as global investors wait for clarity over the UK-EU relationship, and the new US administration's policies on trade and investment."

Despite boosted stock markets following the US elections, the report warned against increased optimism regarding achieving significant recovery in transactions due to the state of uncertainty expected to prevail in 2017.

The report predicts that once greater clarity emerges, global M&A activity will pick up to reach a peak of $3tn in 2018 (lower than the $3.4tn peak in the previous forecast). Then deal making will gradually slow in 2019, dropping to $2.8tn that year and $2.3tn in 2020, as global finance becomes more expensive and valuations start to fall.

The forecast predicts IPO activity to rise modestly in 2017 from a weak 2016 and bounce back in 2018 and 2019, as companies that had postponed their listings return to public markets.

The forecast has global IPO activity rising from $133bn in 2016 to $167bn in 2017, then peak at $275bn in both 2018 and 2019.

According to Zahi Younes, Capital Markets/ M&A Partner at Baker McKenzie, based in Saudi Arabia, there is some hesitance regarding IPO activities now waiting for liquidity and improved investors' confidence. Therefore, a state of uncertainty will remain in the short-term, particularly with sustained lower oil prices. However, in the medium term the reforms carried out by the Saudi government, which include a number of privatizations, and the desire of the stock Market to increase the number of companies listed in the Saudi Stock Exchange will have a positive impact on IPO activities in Saudi Arabia.

Implications for Egypt:

The world has been seeing significant acquisition activity recently in light of troubled assets of a number of large companies following the global economic crisis.

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 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, 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

Japanese stock indexes rose at the close of trading, with the decline in the yen against the dollar at the end of the session. The Japanese "Nikki" index rose by 2.50 percent to 19,378 points, posting weekly gains of about 2.4 percent, the strongest since early December. The "TOPIX" index rose by 2.20 percent to 1546 points.

Chinese stock index rose at the close of trading for the third session in a row, marking the best weekly gain in about a month and a half, following trade data that exceeded expectations and reinforced the likelihood of increased demand for commodities in China.

At the end of the session, the "Shanghai" composite index rose 0.40 percent to 3196 points, registering a weekly gain of 1.8 percent, the best since November 25.

Official data showed a rise in Chinese exports by 7.9 percent in January compared to what it was during the same month a year earlier, and imports rose 16.7 percent, while expectations pointed to a growth of 3.1 percent and 10 percent respectively.

China's trade surplus also rose in January to $51.35 billion from $40.82 billion in December, compared to expectations of $50 billion.

US stocks rose during Friday trading backed by the positive performance of the energy sector in conjunction with the recovery in oil prices as well as continued optimism regarding president Donald Trump's statements about the upcoming tax reforms. Major indexes posted a closing record high for the second session in a row.

The "Dow Jones" Industrial Average rose 97 points to 20,269 points, and the broader "S & P 500" index rose (+8 points) to 2316 points, while the "Nasdaq" index rose (+19 points) to 5734 points.

On the weekly level, the "Dow Jones" industrial index was up 0.9 percent, and "Nasdaq" index gained 1.2 percent, while S & P 500 index posted a weekly gain of 0.8 percent.

In the European markets, the "Stoxx Europe 600 index" rose 0.1 percent, or 0.6 points, to 367.39 points, the highest level since January 26, and achieved a weekly gain of 0.9 percent.

The German "DAX" index rose (+24 points) to 11667 points, the British "FTSE 100" index rose (+29 points) to 7258 points, while the French "CAC" index rose (+two points) to 4828 points.

On the other hand, Gold futures for April delivery settled down 0.1 percent or 90 cents to $1235.90 an ounce. The yellow metal recorded a weekly gain of 1.2 percent.

In the oil markets, the US "NYMEX" rose 1.6 percent or 86 cents to close at $53.86 a barrel, the highest close since the beginning of this month, posting a weekly gain of three cents only. Crude "Brent" rose by 1.9 percent, or $1.07, closing at $56.70 a barrel, but made weekly losses of 0.2 percent.

With regard to economic data, US import prices rose 0.4 percent in January, while the "Michigan/ Reuters' consumer confidence index fell to 95.7 points in February.

Implications for Egypt:

Ongoing concerns in the global financial markets were reflected in the report issued by ADS Securities' Office of Strategic Studies. According to the report, the financial markets are awaiting completion of US president Donald Trump's program and implementation mechanisms, including approvals by government agencies, such as the Congress and others, on the officials he appointed.

The report added that Investors are looking forward to more clarity about the possibility of implementing Trump's decisions, and the nature of challenges that may arise or hinder such implementation.

It pointed out that Trump's programs require a number of complementary factors including legal, taxation and labor factors as well as currency value and others, which must be provided to enable Trump accomplish the economic plans he promised.

The report also pointed out that the legal integration process is one of the most significant factors that will support Trump's plans and programs. Trump wants to issue the twenty first century version of the Glass-Steagall Act that would combine with the Dodd-Frank Act.

Global markets are closely monitoring policy developments and expected decisions from the administration of US President "Donald Trump" after the official inauguration. There are also the Brexit developments, in addition to concerns about a possible new currency war or a trade war between China and the US.

For its part, the Egyptian Stock Exchange posted during this week's trading a gain of about LE11.9 billion in market capital, which reached about LE 634.2 billion compared to LE 622.2 billion in the previous week, a rise of 1.9 percent.

The Egyptian Stock Exchange's weekly report noted a collective rise in its main market indexes. The main index of the Egyptian Stock Exchange (EGX 30) jumped about 2.41 percent to 13,115 points. Secondary market indexes also tended to rise. EGX 70 for small and medium stocks increased by about 6.11 percent to close at 524 points, while the broader EGX 100 rose by about 4.66 percent, to reach 1259 points. EGX 20 also rose about 0.09 percent to close at 11999 points.

Implications of the global economic situation for the Egyptian Stock Exchange trading are limited due to its association with the domestic economic variables, on top of which the changes in the exchange rates and developments in the economic reform program.