Issue: 56

Date : 7 May 2017

Our Economy & the World

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ECES
The Egyptian Center for Economic Studies

Our Economy & the World

Key Global Developments

Merkel sees EU, Gulf states making progress on free trade deal

Reuters

German Chancellor Angela Merkel said she hoped the European Union and the six Gulf Cooperation Council (GCC) countries can finally complete a free trade agreement and that she would discuss the issue with Abu Dhabi's crown prince.

Germany, which relies on foreign trade for half its gross domestic product, fears that the protectionism backed by U.S. President Donald Trump and the fallout from Britain's vote to leave the EU posed global economic risks.

"I'll be talking with Crown Prince Sheikh Mohammed bin Zayed al-Nahyan about this question," Merkel said on Monday before her meeting. "The issue at hand is how to intensify the economic relations between the two regions".

On a trip to Saudi Arabia and Abu Dhabi, Merkel told reporters that the economic relations between the two regions needed to be strengthened. She said she had also discussed the issue on Sunday on her visit to Saudi Arabia.

"I made it clear that a free trade agreement with the Gulf states would be of great interest from a European point of view," Merkel said during her visit to Jeddah on Sunday.

She noted that the EU had made a new offer for an agreement but that the GCC states had not yet responded. Merkel said she had talked to King Salman about the issue on Sunday evening.

Trade between the EU and GCC amounted to 138 billion euros in 2016, according to the EU. Exports from EU countries to the GCC were worth 100 billion euros and imports to the EU were worth 38 billion. Two-way trade has been growing steadily in the last decade.

In March, Gulf officials said the six GCC states were pressing for an early agreement on free trade with Britain to secure preferential arrangements after Brexit and could have a draft agreement ready within months.

GCC states are trying to diversify their economies and boost non-oil trade after more than two years of low global oil prices that have hurt their finances. They export mainly oil, gas and related products to Western economies while importing a wide range of goods and services.

Developing countries lost more than $ 900 billion due to illicit capital flows

Argaam

In 2014, illicit outflows were estimated to have drained $620 billion to $970 billion from developing economies, according to the Washington-based think-tank Global Financial Integrity (GFI).
GFI said in its recently released report that illicit inflows were put at around $1.5 trillion in that year.
It shows that combined, illicit outflows and inflows amounted to 14.1 to 24 percent of total developing country trade from 2005 to 2014.
Sub-Saharan Africa still leads all regions for illicit outflows as a percentage of GDP.

Trump weighs breaking up Wall Street banks, raising gas tax

Reuters

U.S. President Donald Trump said he was actively considering breaking up big banks, Bloomberg Television reported.
Trump's comments could give a push to efforts to revive the Depression-era Glass-Steagall law that separated commercial lending from investment banking. Reviving such a law would require an act by Congress.
"I'm looking at that right now," Trump said on Monday in an interview with Bloomberg News in the Oval Office. "There's some people that want to go back to the old system, right? So we're going to look at that".
While campaigning for president, Trump had expressed support on the campaign trail for a "21st-century Glass-Steagall".
White House spokesman Sean Spicer told a news briefing that Trump had expressed interest in the issue and had been briefed on it by Treasury Secretary Steven Mnuchin but was not ready to discuss it publicly.
"We're not at a point where we're ready to roll out details of that yet," Spicer said. "He is actively looking at options and considering things".
One of Trump's top economic advisers, Gary Cohn, director of the National Economic Council, reiterated Trump's support for the concept during a private meeting with lawmakers on April 6, a White House spokesperson told Reuters.
President Donald Trump said on Monday he would consider raising the federal tax on gasoline to fund infrastructure development, Bloomberg News reported.

"It's something that I would certainly consider," Trump told the news agency in an interview on Monday. "The truckers have said that they want me to do something as long as that money is earmarked to highways". White House spokesman Sean Spicer told a news briefing that Trump had expressed interest in the issue and had been briefed on it by Treasury Secretary Steven Mnuchin but was not ready to discuss it publicly. "We're not at a point where we're ready to roll out details of that yet," Spicer said. "He is actively looking at options and considering things."

El-Erian: The stock market is hitting record highs, the bond markets are raising concerns

While the stock market is hitting record highs, the bond markets are raising concerns, El-Erian said Monday at the Milken Institute Global Conference held at the Beverly Hilton.

“The optimism is off the charts according to the stock market but the geopolitics are a real concern,” he added. “So I think part of the puzzle is how can we have all these contradictions together and how does optimism prevail over these other signals?”

On the Federal Reserve: “We need the Fed to normalize. The unintended consequences of running unconventional policies for too long can become a problem in itself.”

He expects two more interest rate hikes this year, for a total of three.

EY survey shows 43% of MENA respondents see fraud as problem

Al-Qabs (Kuwait)

Despite sporadic progress in tackling bribery and corruption across Europe, the Middle East, India and Africa (EMEIA), 43 percent of MENA respondents to the biennial EY EMEIA Fraud Survey still perceive it to be a problem in their country.

The report, ‘Human instinct or machine logic – which do you trust most in the fight against fraud and corruption?’ surveyed 4,100 employees from large businesses in 41 countries across EMEIA.

Senior management are failing to foster a culture of ethical behavior finds the survey: 57 percent of MENA respondents do not believe that management has emphasized the importance of high ethical standards.

Nevertheless, 48 percent of respondents believe that regulation has had a positive impact on deterring unethical behavior, a significantly higher percentage than global respondents (28 percent), with 83 percent of MENA respondents agreeing that the prosecution of individuals would help deter fraud, bribery and corruption by executives.

Despite the fact that whistleblowing hotlines are now considered an important part of a company’s compliance program, only 21 percent of MENA respondents were aware of such a channel in their company, while 50 percent would refrain from reporting an incident due to concerns about career progression.

China leverage rising at 'alarming pace': central bank official

Argaam

China's level of leverage is rising at an "alarming pace," particularly in the finance sector, a senior central bank official said in a commentary, amid growing concern by the country's senior leaders over financial security.
The official Xinhua news agency on Monday cited Xu Zhong, head of the People's Bank of China's (PBOC) research bureau, as saying the country needed to deleverage at a "proper pace" to reduce financial sector debt and avoid systemic financial risk.
"China's overall leverage level is reasonable but is rising at an alarming pace, especially in the financial sector," Xu said, adding that high levels of stimulus spending from government paired with poor corporate management and financial supervision were key factors causing rising levels of leverage.
He added the government should stick to "prudent and neutral" monetary policy, reduce emphasis on economic growth targets, and improve corporate governance so authorities did not have to step in so frequently to help companies out

Implications for Egypt:

New global trends indicate that major economic entities are seeking to take internal and external measures to counter global and regional economic developments. Germany's consideration of a free trade agreement between the EU and the Gulf states shows that Germany's external vision has changed in light of fears of disintegration of the EU. This coincides with the decline in European growth rates and rising calls to accelerate the implementation pace of Britain's exit from the EU, which along with the results of France's election will exercise additional pressure on European financial markets and subsequently on their ability to increase growth rates in the short term.

It is also clear that the continued US trend in bringing about internal economic changes may lead to the transfer of some of the problems that the US economy is suffering to the rest of the world. This could lead to deepening current problems, especially that China, as a driving force of economic growth, is witnessing worrying growth in corporate debt along with slow economic growth.

The impact of international economic developments on the Egyptian economy has not yet fully realized. However, it is important to note that this situation is likely to change in the light of Egypt's current economic reforms and increased growth opportunities, especially in light of the slowdown in the formation of economic blocs with African and Arab countries.

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From the International Press

Emerging Markets File More Patents than the West

Al-Borsa

The number of patent applications filed by emerging market countries has overtaken those filed by the developed world for the first time.

The 12 leading EM nations applied for 1.49m patents in 2015, outstripping the 1.48m in developed market countries, according to figures from the World Intellectual Property Organisation, collated by Comgest, a Paris-based asset manager.

The figures are a far cry from 2004, when the 12 emerging market countries, which account for the vast majority of developing world filings, made just 372,000 applications, 29 per cent of the 1.3m made by the advanced world.

"This signals the dawn of a new age of innovation as EM economies start to shake off their image as purely centres for low-cost manufacturing for companies in developed markets," said Emil Wolter, co-head of Comgest's global emerging markets team.

The surge in emerging markets has been led by China, where 1.1m patent applications were lodged in 2015, according to the WIPO data, a 745 per cent rise from the 130,000 of 2004, ahead of South Korea, with 214,000 applications.

A number of other emerging nations have also seen strong growth, albeit from a low base. Turkey saw 5,841 applications in 2015, a rise of 537 per cent since 2004, with Vietnam up 252 per cent to 5,033 and India 161 per cent to 45,658.

In contrast, Japan has seen applications fall by a quarter over the same period (to 319,000), while those in Europe have risen just 16 per cent (to 520,000). Even though the US has seen more rapid growth of 65 per cent (to 589,000) overall, the developed world has seen its annual tally rise just 17 per cent since 2004.

"There has been a very sharp rise in the number of emerging market filings," said Mr Wolter. "Significant catch up has taken place, as developed markets have stagnated over recent years and China and a number of other countries have just exploded.

"Some East Asian countries are blowing the doors off, the benefits of education are really coming through. [Venture] capital invested in early stage businesses and ideas in emerging markets is exploding."

The patent pattern is reflective of the trend that has seen information technology rise to become the largest single sector in the MSCI Emerging Markets Index, accounting for 24.5 per cent of stock market capitalisation, up from 16 per cent at the end of 2004 and well ahead of the 16.4 per cent of the developed-world heavy MSCI All Country World Index.

Many emerging market countries have significantly increased their spending on research and development in recent years, with R&D in China equivalent to 2.05 per cent of its gross domestic product in 2014, up from 0.57 per cent in 1996, according to data from UNESCO. South Korea saw a rise from 2.24 per cent to 4.29 per cent over the same period, double the world average of 2.15 per cent.

Chinese companies such as Baidu, Huawei, Tencent, Didi Chuxing and Alibaba have forced themselves onto a list of the world's 50 smartest companies compiled by the MIT Technology Review, alongside Coupang of South Korea and Nigeria's Africa Internet Group.

China also accounts for more active trademarks than any other country, some 10.3m, according to the WIPO.

However, despite the undoubted progress made by many emerging markets, there are reasons to question the quality of some of the region's technological advances.

Jonathan Woetzel, a Shanghai-based director of the McKinsey Global Institute, a think tank, argues that China still has a "quality gap" with the developed world in terms of patents and other indicators of innovation, albeit a gap the country is likely to close given its spending on education and research and its annual output of around 30,000 science and engineering-based PhDs.

In the interim, he believes some of the raw data being produced may overstate China's technological progress.

For instance, in the field of artificial intelligence, Chinese research papers were cited in academic journals 2,124 times in 2015, almost twice the 1,116 of the US, in second spot.

However, the bulk of the Chinese references were "self citations", made by the journal in which the paper appeared. Once self citations are stripped out, American papers are still cited more often, although China is not too far behind, as the second chart indicates.

Mr Wolter agrees that Chinese patent applications still tend to be lower quality than those in the developed world. In particular, he says that a high proportion of emerging market patents are "process oriented" —

concerning the manufacture of a product or the materials used in it — which tend to be less prestigious or valuable than the actual product-based patents more common on the West.

“Taiwan has a lot of [process-oriented patents] as they manufacture other people’s products. Hon Hai [Precision Industry] have a huge number of patents, mostly to do with how you can put the iPhone together and assemble stuff in the most efficient way. It’s useful, but compared to actually inventing the iPhone it’s not comparable at all,” he said.

Moreover, some countries are still lagging well behind, such as India, whose patent applications were just 4 per cent of those of China in 2015, despite a comparable population.

“In absolute terms, 45,000 filings really doesn’t look impressive given the size of the country. That illustrates the challenge facing [prime minister Narendra] Modi in taking away an awful lot of privileged rent-seeking positions and encouraging more competition, which is typically what you need to inspire innovation,” Mr Wolter said.

Nevertheless, he lauded the innovation of the likes of Safaricom, the Kenyan mobile telecoms operator, which pioneered the M-Pesa mobile money platform; Discovery, a South African insurer, which is using big data and behavioural nudges (such as rewards for keeping fit) to cut the cost of insurance; and Hikvision, a Chinese security equipment provider whose surveillance algorithms “are the best in the world”.

Despite this, the feed-through from rising innovation in emerging markets to stock market returns may be less than clear cut.

Recent research by Citi found an inverse relationship between patent growth and market performance in a range of EM countries since 1998. China in particular has seen rapid growth in the granting of patents but equity market returns way below those of countries with far slower patent growth, such as South Africa, Peru and South Korea.

Furthermore valuations, measured by price-to-book value, are lower in EM countries that spend a higher proportion of their GDP on R&D.

“The market doesn’t seem to want to pay for R&D, preferring to have profits now,” Citi concluded.

Implications for Egypt:

During the first international workshop on incentives for research, development and innovation held in Egypt, an emphasis was placed on the importance of applying a balanced system of financial grants and tax incentives, including both front-end and back-end systems, to encourage industrial companies and small, medium or large businesses. The recommendations also indicated that the tax credit system or super-deduction would not be effective. The system that is always effective in all institutions, whether winning or losing, or small, medium or large is the system of balances applied to expenses and revenues before profits (above the line credit), according to an applied case study.

There is a need to consider the provision of incentives for research, development and innovation, whether these incentives are tax-related or not. Promoting innovation will contribute to achieving the desirable economic and developmental progress in Egypt similar to all comparable global experiences. There is also a need to finalize the national policies and legislations necessary for innovation and that meet the requirements of different stakeholders of the science and technology system in Egypt, including researchers, businessmen, industrialists, and economic policymakers. There is also a need to design an intellectual property system that encourages innovation in Egypt.

It is also important to establish an entity responsible for encouraging development and innovation in industrial companies. Its responsibilities should encompass approval of company activities as development and innovation activities, deciding on the possibility of implementing the tax incentives system on these companies, and coordination among various parties to the system of intellectual property rights.

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Our Economy & the World

Special Analysis

Trump Cuts Spark Fears of Global Tax War

News Agencies

Donald Trump's plans to slash corporate taxes in the United States have sparked concerns of a new global fiscal race to the bottom, possibly involving a wave of negative social consequences, experts say.

In what Trump's economic advisor Gary Cohn described as "the most significant tax reform legislation since 1986, and one of the biggest tax cuts in American history," the White House plans to dramatically cut taxes for U.S. businesses and individuals, slashing the corporate rate from a top rate of 35 percent to 15 percent.

The aim, according to U.S. Treasury Secretary Steven Mnuchin, is to "bring back trillions of dollars that are offshore to be invested here in the United States" and create jobs.

Trump's goal is for the reforms to propel the U.S. economy to three percent annual growth.

But the long-anticipated overhaul — details of which remained unclear beyond a handful of headline measures — could face stiff opposition in Congress, including from some Republicans, with lawmakers sharply divided over the prospect of fueling already-rising deficits.

And the plans have also raised eyebrows at NGOs and non-profit organizations.

They could accelerate "the race to tax competition on an international level and all of us will pay the price," Oxfam spokeswoman Manon Aubry told AFP.

"When the world's most powerful country decides to slash tax revenues as much as this, a number of other countries may follow suit, bringing with it imbalances that will have enormous impacts on our societies," she said.

Falling tax revenues would make it harder for governments to pay for welfare, health care and other benefits without going too deep into the red, she said.

To make up the shortfall, governments could be tempted to hike valued-added tax, often criticized for placing a disproportionate burden on the less well-off, Aubry said.

Jean-Pierre Lieb, a tax lawyer at consultants EY, said that "the cut in corporate taxes in the U.S. will fuel tensions between countries".

At the moment, corporate taxes in the U.S. are the highest in the OECD countries, followed by France with a rate of 34 percent, Belgium with 33 percent and Australia with 30 percent.

The OECD average is currently around 24 percent.

But in order to become more attractive, a number of countries have decided to lower their corporate tax rates.

Britain is planning to cut its rate from 20 percent to 17 percent in 2020, a decision that pre-dates Trump's move and was strongly prompted by fears that corporations may find the U.K. a less attractive place after it leaves the European Union.

There were even plans to slash the tax rate to 15 percent to help with Brexit woes, British papers have reported, but Prime Minister Theresa May appears to have ruled out such a deep cut for now.

France, meanwhile, is poised to take its corporate tax rate from 34 percent to 28 percent in 2020. Other countries, including Italy and Israel, have similar ambitions.

"What we're seeing is a headlong rush" said EY's Lieb, pointing to the case of Hungary where the corporate tax rate is to be slashed from 19 percent to just nine percent.

But even if Trump succeeds in pushing through his planned cuts, countries such as Ireland, which have used their low tax rates to woo foreign companies like Google and Apple, still expect to remain attractive.

Ibec, Ireland's main business lobby, said that the latest proposals "could provide some competitiveness pressure for Ireland".

"Even if the U.S. succeeds in delivering a substantial rate cut, the proposition for U.S. firms to invest in Ireland remains compelling," the lobby group said.

Ireland’s finance ministry agreed.

“Ireland’s membership of the EU is, and will remain, a key factor in attracting foreign direct investment from the US and elsewhere,” a ministry source told AFP.

Nevertheless, there is sufficient doubt as to whether Trump will actually be able to get the cuts past Congress.

According to a US think-tank, the Tax Policy Center, Trump’s plans could reduce Washington’s budget by as much as $6.2 trillion over the next decade and massively push up the US public debt by $20 trillion by 2036.

Many Republicans who are traditionally opposed to increasing public debt will be unwilling to accept such an explosion in debt.

Implications for Egypt:

A report by the Office of Strategic Studies at ADS Securities noted that global financial markets are dealing cautiously with the tax cuts bill announced by the Trump administration, which has the largest tax cut in US history.

The report said that the reason behind investors' caution is that they are primarily concerned about Trump's ability to convince Congress. Second, no details and explanations were presented, which raised questions on how to offset the deficit that would result from this move that could increase US debt by US$7 trillion.

However, the Treasury Secretary said that tax cuts of this magnitude would spur companies to spend and invest, thereby achieving returns that exceed the expected deficits, generating trillions of dollars and revitalizing the national economy.

Egypt must take note that tax reduction policies relate here to attractive economies that wish to strengthen their competitive edge. However, the Egyptian situation is different. Attracting foreign investment requires special incentives and guarantees, because global investment is now looking for an integrated environment with stable legislations, clear government policies, available funding, speedy and fair litigation, an efficient exchange market, balanced labor relations, an improved infrastructure, and political and social stability.

Only countries that do not have any of the above seek to compensate for this shortfall by granting tax exemptions and free land, sacrificing their resources in the future for temporary gains.

We also emphasize that the investment law cannot solely improve the investment environment without a genuine will to create a new investment climate through radical and urgent change of a package of economic legislations. Most importantly, the corporate law, the labor law, and taxes and their regulations, in addition to clarifying funding mechanisms in the Egyptian market as well as land allocation methods and mechanisms.

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.

Global Financial Market Performance

Al-Yome Al-Sabei & Argaam

Chinese stocks fell for a fourth session in a row to close to their lowest level this year as investors worried about regulatory moves to curb corporate debt growth and speculative operations, coupled with strong pressure from falling commodity prices. At the end of the session, the benchmark Shanghai Composite fell 0.80 percent to 3,103 points, after falling below 3,100 points during the trading session, with a weekly loss of 1.6 percent.

China's commodity futures losses continued with large sell-offs by speculators coupled with tightening regulations to cool the market. In addition to falling oil prices, iron ore contracts fell by 6.8 percent after losing 8 percent during Thursday's trading, while rebar contracts fell 2.9 percent.

The already shaky Chinese investor sentiment was hit by a fresh blow on Thursday after six government agencies pledged to curb the rapid growth of local government debt by increasing control over projects where they pump money.

US stocks rallied on Friday, bolstered by the energy sector, as oil prices rebounded in addition to investor optimism after the release of the monthly jobs report with strong data, and key indexes posted weekly gains. The Dow Jones Industrial Average rose 55 points to 2,1007 points, the Nasdaq rose 25 points to 6,100 points, while the broader S&P 500 index gained 10 points to 2,399 points. On a weekly basis, the Dow Jones gained 0.3 percent, while Nasdaq gained 0.9 percent, while S&P posted weekly gains of 0.6 percent.

In Europe, STOXX Europe 600 rose 0.6 percent to 394.5 points, its highest level since August 2015, and the benchmark index recorded weekly gains of 1.9 percent. The FTSE 100 index rose by 72 points to 7297 points, the German DAX rose 69 points to 12,716 points, while France's CAC rose 59 points to 5,432 points.

Meanwhile, gold futures for June delivery fell by 0.1 percent or $1.70 to $1226.90 an ounce, and the precious metal recorded weekly losses of 3.3 percent, the largest since the week ending November 11, 2016.

In the oil markets, NYMEX rose 1.5 percent or 70 cents to close at $46.22 a barrel, while posting weekly losses of 6.3 percent. Brent rose 1.5 percent or 72 cents to close at $49.10 a barrel, with a weekly loss of 5.6 percent.

In terms of economic data, the US economy added 211 thousand jobs in April compared to expectations of adding 190 thousand, and the unemployment rate fell to 4.4 percent from 4.5 percent.

US Jobs Report				
	Expectations	**Previous**	**Current**	**Change**
No. of jobs (000)	**190.000**	**79.00**	**211.00**	**132**
Unemployment (%)	**4.6**	**4.5**	**4.4**	**(0.1%)**
Average hourly wage (US dollar)	**--**	**26.12**	**26.19**	**0.7**
Work hours per week	**--**	**34.3**	**34.4**	**0.1**

Implications for Egypt:

A report by the Office of Strategic Studies at ADS Securities noted that global financial markets are dealing cautiously with the geopolitical developments taking place in the world such as North Korea's tensions with the US and the French elections on Sunday, May 7, 2017.

The report noted that despite the US Federal Reserve's meeting and its decision to keep interest rates unchanged, and its signal that inflation has almost reached the Fed's target, the labor market is continuously improving, pushing expectations of a rate hike from 70 to 90 percent for June 2017. This has had a positive impact on the US dollar, but geopolitical developments and the ability of the US president to implement his economic programs remain the main issue that pressures markets that are also affected by developments.

Meanwhile, market capitalization of the Egyptian stock exchange gained EGP 4.4 billion during the week closing at EGP 659.443 billion.

Market capitalization of the Egyptian Stock Exchange has gained about 4.3 billion pounds, at the end of Thursday trading, to close at EGP 659.443 billion, amid a collective rise of all indices.

The total value of transactions traded on the Egyptian Stock Exchange reached EGP 745 million during Thursday's trading session. Trading by Egyptian and foreign individuals and Egyptian and Arab companies posted net sales of EGP 76.1 million, EGP 1.6 million, EGP 14.2 million and EGP 25 thousand, respectively. Trading by Arabs and foreign institutions posted net purchases of EGP 5.1 million and 86.7 million, respectively.

"EGX30" index rose by 0.84 percent to close at 12,709 points and "EGX 50" by 0.47 percent to close at 2,031 points, and "EGX 20" by 0.81 percent to close at 11,825 points.

The index of medium and small companies, "EGX70", rose by 1.04 percent to close at 592 points, and the broader "EGX 100" index by 1.07 percent to close at 1,360 points.

The impact of lack of investment incentives, anticipation of monetary policy trends and the resolution of the situation regarding taxes on stock exchange transactions continue to push the stock exchange towards horizontal movements amid a significant shortage of investment liquidity.