Global investment dries up in 2012

Michael Gestrin

After two years of steady gains, international investment is again falling sharply. After breaking $1 trillion in 2011, international mergers and acquisitions (IM&A) are projected to reach $675 billion in 2012, a 34% decline from 2011 (figure 1), a trend also evident in recent FDI statistics (see FDI in Figures, July 2012).

At the same time as IM&A has been declining, firms have also been increasingly divesting themselves of international assets. As a result, net IM&A (the difference between IM&A and international divestment) has dropped to $317 billion, its lowest level since 2004 (see box on back page).

Companies from all but one region have been scaling back their IM&A activities. Outward IM&A by European companies is projected to fall the most (-48%), followed by IM&A from Africa and the Middle East (-38%), and North America and Asia (both -26%). IM&A by Latin American companies is on track to increase by 130% on the back of big intra-regional deals in airlines, steel, telecommunications, and retail (table 1).

International M&A is declining three times faster than domestic M&A

The regions in which inward IM&A is projected to decline most sharply are Asia (-48%), North America (-39), and Europe (-29%). IM&A to Africa and the Middle East is expected to increase by 67%. The bulk of this international investment in this region has been directed at the energy and mining sectors.
IM&A has declined more sharply than overall M&A activity. This is reflected in the projected drop in the share of IM&A in total M&A from 35% in 2011 to 29% in 2012 (figure 2). IM&A is declining three times faster than domestic M&A, suggesting that concerns and uncertainties specific to the international investment climate are behind the recent slide in IM&A, rather than IM&A simply following a broader downward trend.

During the first collapse in international investment activity in 2008 the emerging economies showed resilience. For example, between 2007 and 2008 IM&A from the BRICS grew by 20% while global IM&A declined by 20%. This time around, the BRICS have more closely mirrored the trend. These are projected to pull back their IM&A by 24%. Nonetheless, IM&A by Brazilian companies is on track to grow by 58% and Chinese companies by 24%.
60% of Chinese international M&A is by SOEs

IM&A by state-owned enterprises (SOEs) has increased significantly in recent years (figure 3). In 2008 and 2009, IM&A by SOEs almost tripled from $51 billion in 2007 to $139 billion in 2009. During this period the share of IM&A by SOEs grew from 3% to a record 21% of the global total.

During the most recent declines, IM&A by SOEs has again started to climb, projected to reach $72 billion this year, up from $60 billion last year. As such, IM&A by government-owned entities is set to once again climb above 10% of the global total. Table 2 presents the top 10 sources of IM&A by SOEs through August 2012. China has dominated these rankings for the past three years.

Trade and investment protectionism is on the rise

The steep declines in IM&A in 2012 primarily reflect considerable uncertainty in the global economy, including with respect to the Euro area crisis, slowing growth in China, and concerns that the United States is heading for a “fiscal cliff” (see the OECD’s interim economic outlook of 6 September 2012, and “Doom and gloom, continued”, by Patrick Love). Another concern relates to spreading protectionism towards trade and investment (see latest WTO-OECD-UNCTAD reports on G20 trade and investment measures). Rising protectionism and the scope for confusion in financial markets if the Euro zone begins to split up are among those factors that might explain the specifically international nature of the sharp declines in IM&A in 2012.
How should international M&A be measured?

IM&A measures the value of completed international mergers and acquisitions. However, companies also engage in international divestments. Once these are subtracted from IM&A data, we obtain a measure of net IM&A. For example, United States firms generated $94 billion in IM&A. But they also divested themselves of $44 billion in international assets. The net addition therefore of United States firms to the global stock of international investment through IM&A is $50 billion.

In the three years leading up to the global economic crisis, net IM&A was 63% of gross IM&A. In the past three years net IM&A has fallen to 48% of gross IM&A. This highlights the double impact of the economic crisis on international investment flows. Not only do firms reduce their international investments, they also become more prone to divesting themselves of international assets.

The ranking of countries is significantly different depending upon whether gross or net IM&A is used. For example, using gross IM&A, China is the fifth largest source of international investment in 2012, behind the UK in fourth place. Once we take into account divestments by Chinese and UK companies to measure the net contribution of these countries to IM&A investment, China rises to second place and the UK falls to second last, with a negative net IM&A.

Generally speaking, net IM&A suggests that emerging markets are contributing more to investment globalisation through IM&A than does data on gross IM&A. Being newer sources of international investment, companies from the emerging markets are possibly less inclined to divest their international assets.