Contemporary Economic Issues Facing the GCC

@ 6th International Conference of the Middle East Economics Association

Zayed University

Dubai, March14-16, 2007

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Agenda

- Drivers of Economic Growth & Structural Change
- Economic Integration: Regional & International
- Oil, Fiscal Policy & Natural Resource Wealth Management
- Financial Markets & Corporate Governance

A GCC Economic & Financial Renaissance?

- GCC has achieved above average growth rates: average real GDP growth **7.4%** over 2003-2006 vs. **2.5** % in 1998-2002, with increased diversification of economic activity
- Sustained by favorable global developments: highest growth (5.25%) in 30 years, low inflation and interest rates, no financial crises
- Growth resurgence has been investment led with increased infrastructure investment by governments accompanied by complementary private sector investment leading to ↑ in absorptive capacity and ↑ in productivity growth
- Infrastructure investments with an estimated value in excess of USD 1.4 trillion are currently under development or planned in the GCC, India & Iran.
- Private sector is leading and driving regional economic integration in the areas of trade, services, tourism and FDI.
- Region's companies are becoming multinationals – e.g. DP, EMAAR, Etisalat, and MTC.

Demographics, Migration & Transmission Effects

- Demographics & migration sustaining labour & output growth
- Transmission effects affecting labour exporters Egypt, Jordan, Lebanon, North Africa:
  - Higher incomes of migrant populations
  - ↑ remittances to labour exporting countries
  - Portfolio investment
  - FDI
- High-skill and professional categories migration towards the oil producing countries of the GCC is more likely to be permanent as compared to the previous oil induced booms in the 1970s and early 1980s.
- Oil producers have introduced reforms to the property market and to commercial laws and regulations facilitating ownership of assets, leading to their attracting capital and people ‘voting with their feet’
- Trade & Current account surpluses running at 20-25% of GDP much of which is being recycled back into regional economies

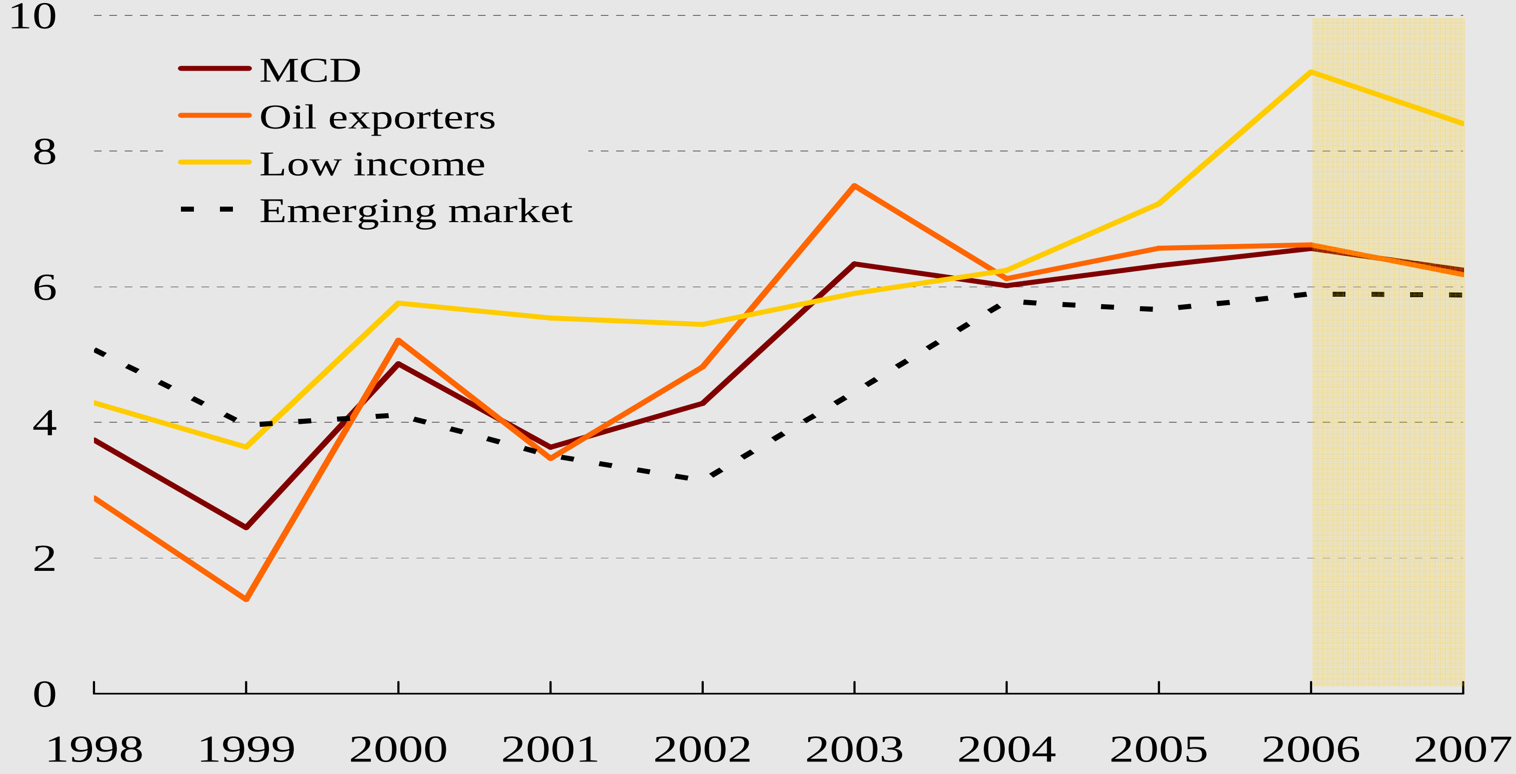
GCC Monetary Policy and Asset Markets

- Accommodating monetary policies leading to high money and credit growth rates, and financing real estate and financial market booms with spectacular gains and excess returns in equity and debt market instruments
- Inflation higher, mainly in non-traded goods & services, with limited pass-through of higher oil prices to consumers
- Real exchange rate appreciation with pegged rates
- Increased liquidity resulted in an investment driven boom:
  - **Real estate boom and asset price appreciation**
  - **Stock market boom**
  - **Credit market boom**

Increase in Wealth and Permanent Income

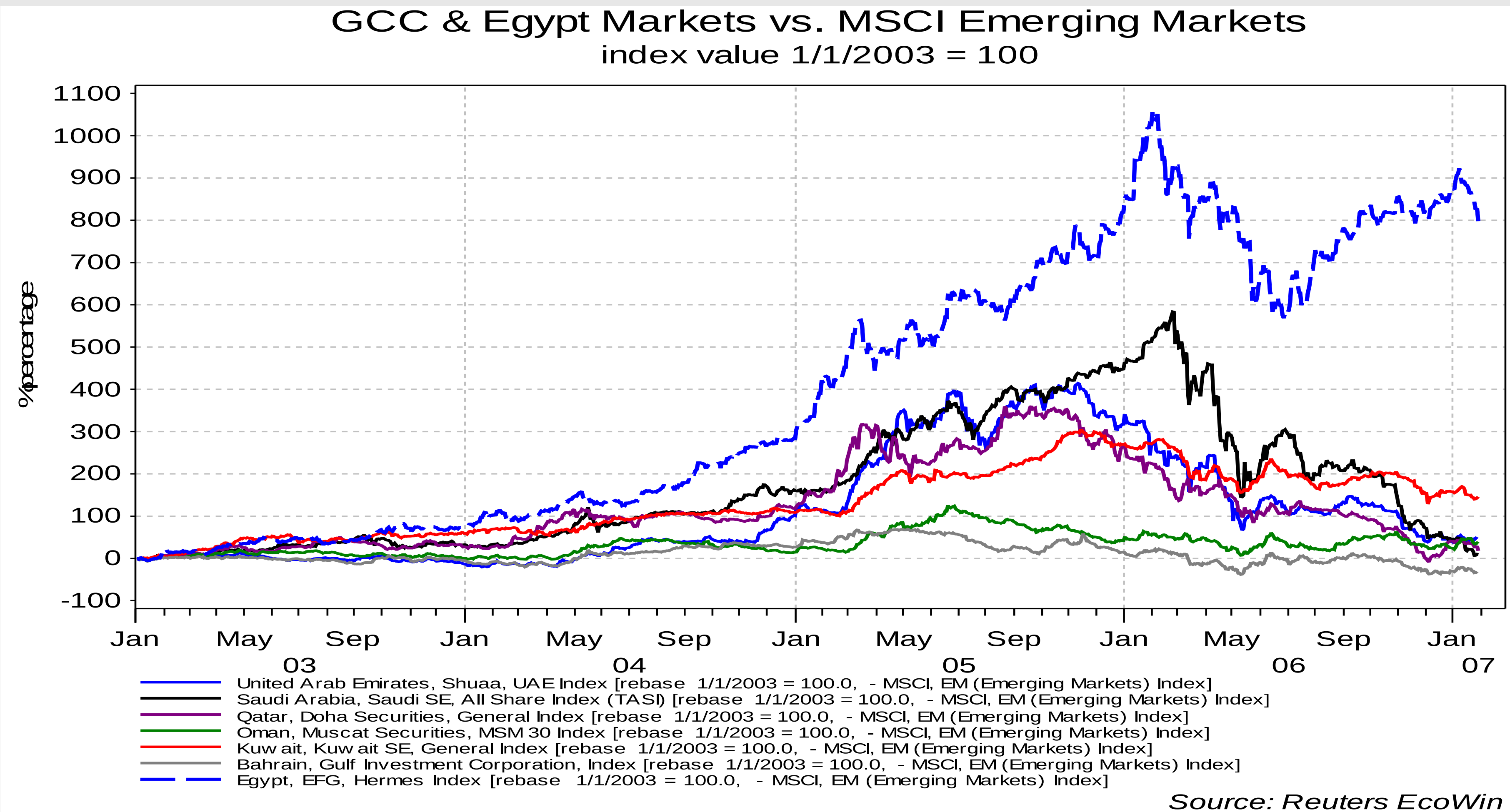
- Fiscal Policy:
  - Oil producers policy reaction has been fiscally conservative: ⅔ of higher oil revenues have been saved
  - But expenditure rapidly rising
  - Fiscal position of GCC remains in surplus for an oil price in the range of $35-$38
- Value of oil wealth of GCC oil exporters increased by an estimated **$27 trillion** between 1995 and 2006
- Permanent Income increase of some **$510** billion at a real rate of 3%
- Accumulation of Net Foreign Assets & international reserves leading to a tripling of international reserves between 2002 and 2006: $188.7bn (2002) to $517.7bn (2006)

Real GDP growth: Actual & Forecast



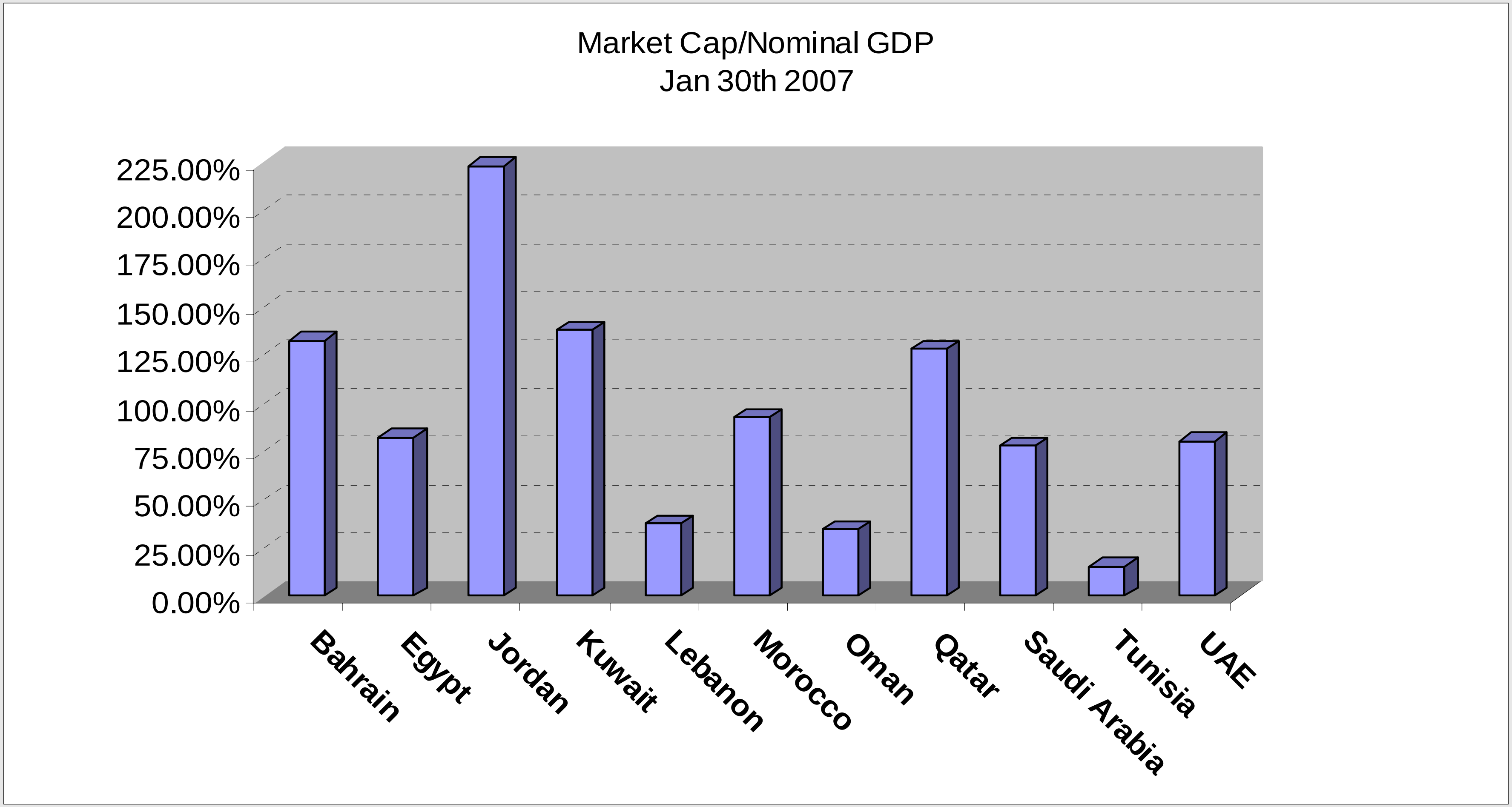
Real GDP growth has been strong across country groupings, the Middle East and Central Asia (MCD). The forecast is for a slowdown in 2007. Source: IMF

GCC & Egypt Stock Markets performance

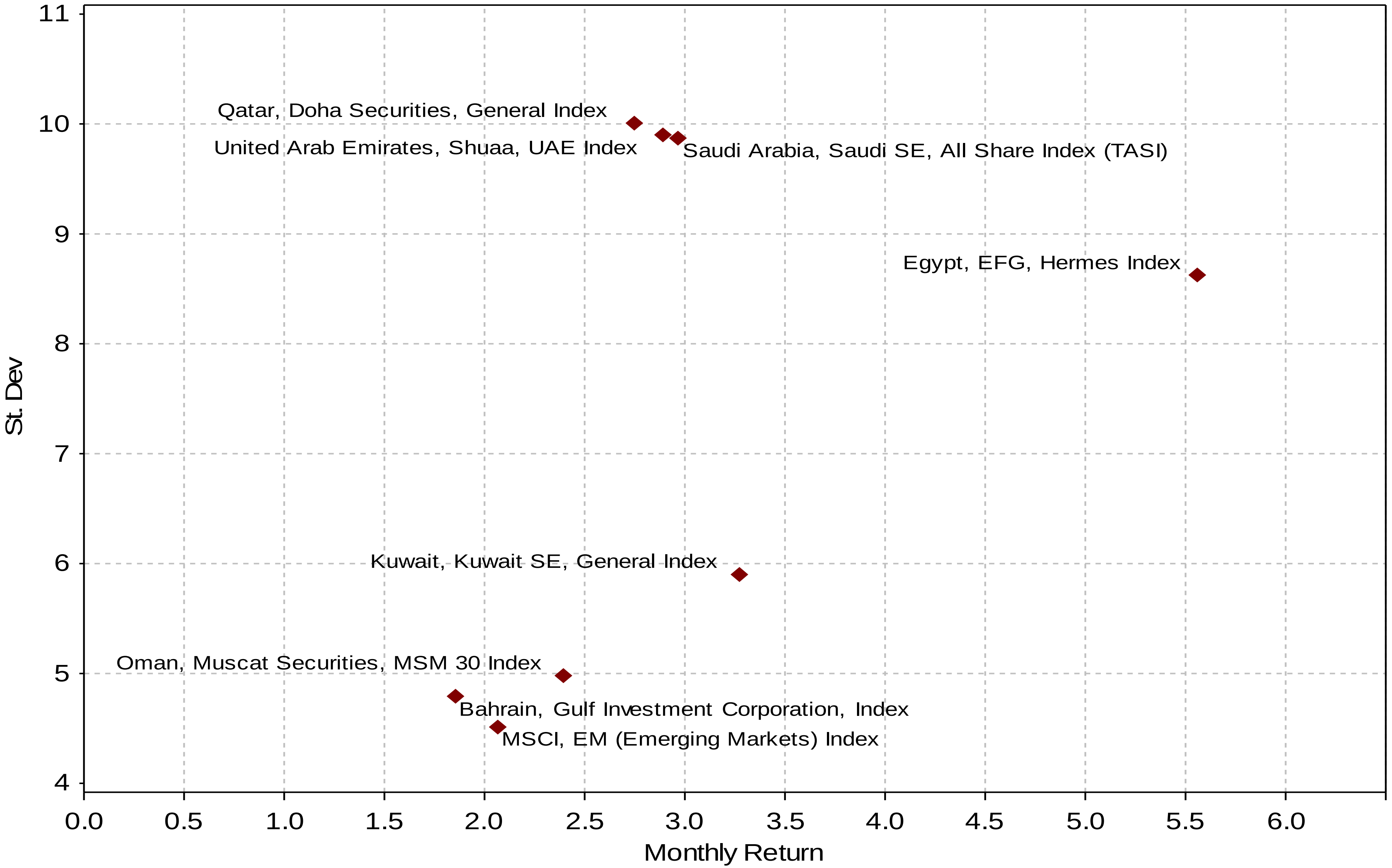


Source: Reuters EcoWin

Stock Market Capitalization



Markets Risk/Return

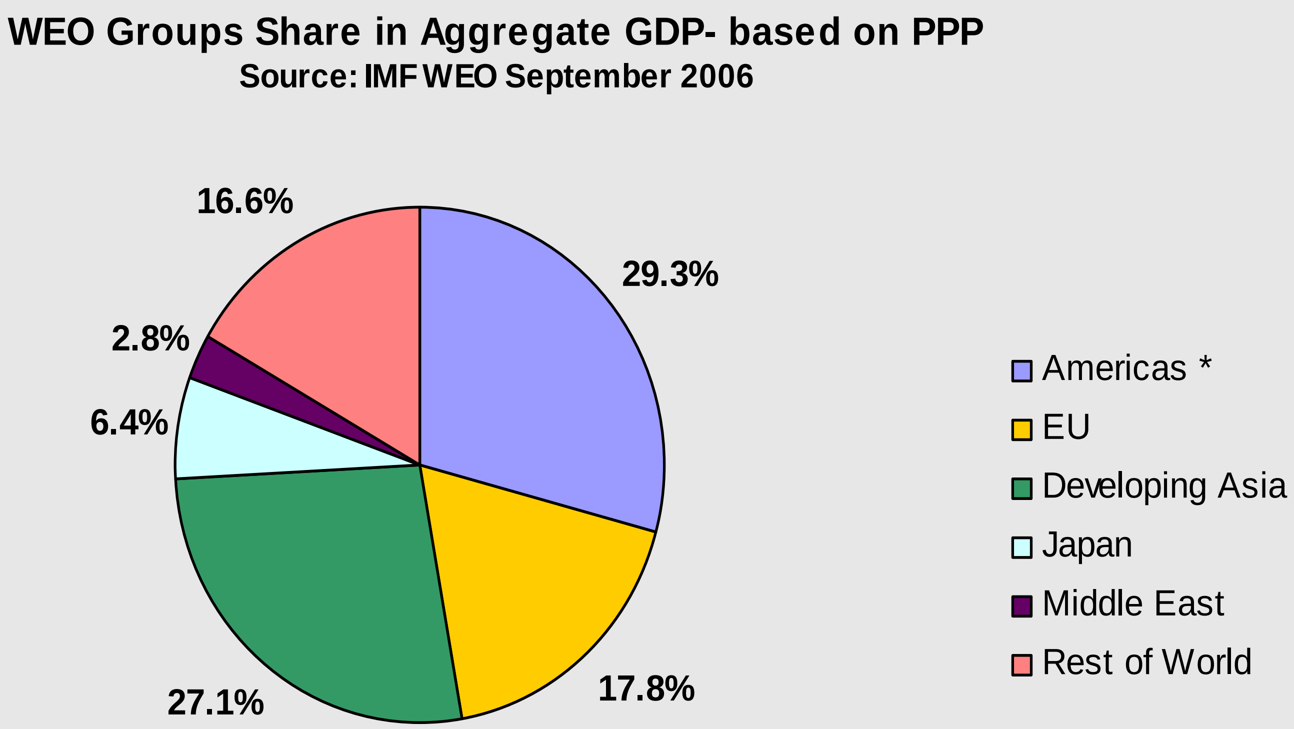


Source: Reuters EcoWin

GCC: Power of Regionalism & Networks

- **Location & New Geography:**
  - Increased de-linking from the US business cycle
  - GCC well located to benefit from relocation of trade & economic activity. Asia now represents about 40% of world GDP
  - Regionalism & investment in network infrastructure (power, telecoms, energy) permit economies of scale and scope in output and trade
  - Liberal Trade policies has increased openness through multilateral (WTO) and bilateral FTAs
- But lack of GCC Financial Sector development is now a barrier to sustained growth and competitiveness
- **Financial sector can and should be an engine of growth**
  - ‘Bank the Demographic Dividend’: allow populations to have access to finance
  - Finance Infrastructure: physical, human, social

A New Economic Geography is emerging to GCC's benefit



* includes US, Canada, Western Hemisphere

GCC Sustaining Growth: Economic Issues

- Central challenge is to use oil wealth and demographic dividend to create economic & financial incentives for sustained growth and job creation
- Economic reforms, diversification and state divestment & privatisation.
- Growing private sector participation in infrastructure in GCC
- Greater regional economic integration:
  - GCC Monetary Union in 2010,
  - Expand trade liberalisation to include services
- With economic diversification and and liberalisation attractive prospects exist across many sectors.

GCC Policy Challenges

- Undertake and maintain economic and financial policy reforms
- Adjustment to higher oil prices: increase pass-through, reduce subsidization and create social safety nets
- Invest in infrastructure and human Capital
- Invest in and Accelerate pace of Regional & International Economic Integration to create markets: infrastructure, policy harmonization, institutional structures
- Management and Governance of oil wealth: develop MENA financial markets and undertake FDI
- Divorce oil wealth and its management from fiscal policy
- Monitor and manage balance sheet risk of banking and financial system resulting from exposure to real estate and asset markets
- Focus on Financial Market development for economic growth and development

DIFC and Role of Financial Sector Development for MENA & GCC

- Invest, Manage and Control region's financial wealth of $2 trillion and growing as a result of high energy prices:
  - Strategic issue: security and safety of assets
- Financing Infrastructure & Regional Economic Integration
- Develop new markets and instruments:
  - Shari'a compliant financial sector & market
  - Bond market
  - Leasing
  - Securitisation
- Enable & support economic and financial reforms:
  - Enable separation of oil revenue management from economic policy
  - Privatisation and Private sector Participation in Infrastructure
  - Housing Finance & Mortgage markets

Sustaining Growth: Build Financial Markets & Address sources of Systemic Risk

1. Legal & Regulatory Infrastructure
2. Independent Capital Market & Regulatory Authorities
3. Privatization of Stock Markets
4. Instruments & Financial Technology:
    1. Securitization, Leasing, Options/Derivatives,
    2. Shari'a-compliant finance
    3. Modern, Secure Payments Infrastructure
5. Market Structure Reforms & Institution Building:
    - Credit Registries,
    - Companies Houses
    - Insolvency frameworks
6. Transparency & Disclosure: Accounting standards
7. Corporate Governance:
    - Hawkamah Institute for Corporate Governance

Table 5: Comparison of Corporate Governance Frameworks in the GCC with IIF Guidelines

(on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Minority Shareholder Protection	2.0	4.0	3.0	2.5	3.5	2.5
Voting Rights	1.5	3.5	3.5	2.5	2.0	3.5
Firm/Capital Structure	1.5	4.5	1.0	2.0	5.0	2.0
Shareholder Meetings/Other Rights	3.0	3.5	3.5	3.0	3.0	2.5
Structure and Responsibilities of the Board of Directors	2.0	1.5	3.5	1.5	2.0	1.5
Board Structure	1.0	1.5	3.5	1.5	1.0	1.0
Disclosure	4.0	3.5	5.0	1.5	4.0	3.5
Others	1.0	0.5	2.5	0.5	2.5	0.0

Comparison of CG frameworks in the GCC Countries with IIF Guidelines
(on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Accounting and Auditing	2.0	2.5	4.0	2.0	2.5	2.0
Standards	3.0	3.5	3.5	3.0	3.5	2.5
Audit Committee	0.5	0.0	5.0	0.0	0.0	0.0
Transparency of Ownership and Control	2.5	3.5	3.5	1.0	4.5	2.5
Regulatory Environment	2.0	2.0	4.5	2.5	2.5	2.0
OVERALL ASSESSMENT	**2.0**	**3.0**	**3.5**	**2.0**	**3.0**	**2.0**

Improving performance: Recommended GCC CG Reform Measures

- ✓ Develop a strong regulatory structure by clearly separating and defining the roles of the regulator and the stock exchange
- ✓ Increase effectiveness of regulators by making them fully independent of government
- ✓ Issue meaningful corporate governance codes and require

- ✓ Adopt IFRS for all listed companies
- ✓ Promote training programs for directors of listed companies
- ✓ Promote investor education and enhance public awareness of good corporate governance principles and practices
- ✓ Introduce corporate governance best practices for state-owned and family-owned companies
- ✓ Grant foreign investors full access to equity markets and promote shareholder activism by foreign and domestic institutional investors and the media
- ✓ Create a regional level corporate governance task force to promote convergence and harmonization of laws and codes among GCC countries

GCC: a time to build, to invest and to integrate

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March 14, 2007