FINANCIAL CLIMATE:
CREATIVE DESTRUCTION & OPPORTUNITIES FOR DIFC

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Overview

- The risk of a global financial meltdown has been avoided for now thanks to massive government rescue plans
- Volatility however will persist for the months to come with bad and good news
- Conjunction of financial crisis, housing bust and credit crunch portends deep recession in the US and UK
- Emerging markets and the GCC have been so far more resilient, but the shock has been too forceful to be offset by domestic factors
- However the Gulf and DIFC could be among the long term gainers in this process, if business , governance and transparency are improved and a more coherent policy response is framed over the next weeks and months

Analysis Global Situation

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- **Despite a historic coordinated intervention of all major central banks and a series of unprecedented, wide ranging and extensive government intervention the financial sector remains fragile and a return to normality is slow. Damage assessment is still underway**
- **Authorities, financial intermediaries and corporations are bracing for at least three quarters of deep recession and widespread weakness until end 2009 as the credit crunch spreads to the real economy. Forecasts have been corrected sharply downwards from even a few weeks ago.**
- **Lower consumption, cuts in investment projects and corporate downsizing in the wake of sharply reduced credit availability will in all likelihood prevail until the deleveraging comes to an end and trust in financial markets is restored.**
- **At present nobody can be sure for how long markets will remain dysfunctional and what results the stimulus packages will produce**

Recent IMF Forecasts

- The **world economy** is facing a major slowdown as a result of the most severe shock to mature financial markets since the 1930s. Advanced economies face several quarters of recession.
- On an annual basis, **global growth** is expected to moderate from 5.0% in 2007 to 3.7% in 2008 and 2.2% in 2009.
- For **advanced economies** growth would be negative at -0.3% in 2009 (a downward revision from 0.5% made less than a month ago).
- **Emerging economies** have thus far been less affected by the shocks, with many commodities exporters benefiting from improved terms of trade. But they will also feel the effects of tightening credit and reduced demand. Accordingly, their real GDP growth is expected to slow from around 8% in 2007 to 5.1% in 2009 (revised down from 6.1% in the October WEO).
- These figures essentially indicate that the world is facing a simultaneous recession never experienced in peace time

World Growth in Detail

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	2006	2007	2008f	2009f
World output	5.1	5.0	3.7	2.2
Advanced economies	3.0	2.6	1.4	-0.3
United States	2.8	2.0	1.4	-0.7
Euro area	2.8	2.6	1.2	-0.5
Japan	2.4	2.1	0.5	-0.2
United Kingdom	2.8	3.0	0.8	–1.3
Other advanced economies	4.5	4.7	2.9	1.5
Newly industrialized Asian economies	5.6	5.6	3.9	2.1
Emerging and developing economies	7.9	8.0	6.6	5.1
Developing Asia	9.9	10.0	8.3	7.1
China	11.6	11.9	9.7	8.5
India	9.8	9.3	7.8	6.3
ASEAN–5	5.7	6.3	5.4	4.2
Middle East	5.7	5.9	6.1	5.3
Western Hemisphere	5.5	5.6	4.5	2.5

Source: IMF WEO Database

Resilience in the GCC

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GCC: Main Economic Indicators	2006	2007	2008f	2009f
Nominal GDP ($ bn)	731	821	1098	1036
Hydrocarbon GDP ($ bn)[1]	368	409	613	479
Nonhydrocarbon GDP ($ bn)	363	412	485	557
Real GDP (% change)	5.8	5.2	5.7	4.2
Hydrocarbon	1.8	1.1	4.0	1.0
Nonhydrocarbon	8.1	7.5	6.4	5.4
Inflation (average)	4.8	6.8	11.8	8.5
Current account bal. ($ bn)	211	206	342	155
% GDP	29	25	31	15
External debt (% GDP)	20	27	38	31
Foreign Assets ($ bn)	933	1244	1467	1605
% GDP	128	152	134	155
Fiscal balance (% GDP)	22	19	23	13
Oil price (Brent; $/barrel)	66.3	72.6	105.3	75.5
Oil production (mbd)	15.9	15.4	16.0	15.7
Gas production (mboe/d)	3.8	4.0	4.4	4.8

f = IIF forecast

[1]Refers to crude oil and natural gas.

Banking sector in GCC

- GCC Banks remain well capitalized and profitable, with NPL below 5% of the total.
- Liquidity problems were caused mostly by an outflow of speculative capital betting on a currency revaluation and by the seizure of international money markets
- While cost of wholesale funding has increased, the region has no shortage of capital and its creditworthiness is solid
- However, IIF estimates that international banks have provided between 20% and 50% of project financing with the highest share in the UAE. In June 2008 foreign liabilities of the UAE stood at USD 88 from 23 billion at end 2005.

Break Even Oil Prices

(In U.S. dollars/barrel)

Algeria	56	Kuwait	33
Azerbaijan	40	Bahrain	75
Iran[1]	90	Oman	77
Iraq	111	Qatar	24
Kazakhstan	59	Saudi Arabia	49
Libya	47	United Arab Emirates	23
Average MCD	57	Average GCC	47

Source: IMF staff estimates and projections.

[1] Fiscal year 2008/2009.

Infrastructure investment

- Growth in the EMEs has a close correlation with investment. Investment as a % of GDP has grown at a faster pace in the emerging economies and infrastructure investment especially has helped create a structural change in the EMEs.
- International investment portfolios can hence benefit from the important role of infrastructure investment in the emerging markets.

Overall Implications for the DIFC

- Negative:
  - The world financial sector will undergo a period of extensive retrenchment, restructuring and re-capitalisation
  - Organic growth cannot be taken for granted; actually a process of consolidation of banks and financial institutions -- including in the UAE and the Gulf -- will affect the number of current employees in the DIFC => Growth can come only as a result of expanding market shares
  - Cost cutting and consolidation will continue throughout 2009; some of our clients might decide to close their office at the DIFC as the deal flow stagnates or drops
  - IPO activity has stalled, although M&A might pick up
- Positive:
  - The GCC remains one of the few areas where capital is still available and banks are strong, so it is likely that a sizeable portion in the global restructuring might involve GCC institutions
  - Emerging markets companies will be seeking investors outside the traditional financial centers
  - Investments by SWF in top global banks will increase the visibility of the Gulf in the boardrooms
  - Regulatory environment is perceived as being rather conservative
  - The crisis will probably speed up the launch of the GCC single currency

DIFC Strategy needs to be updated

DIFC

- Dubai Strategic Plan 2015 is increasingly out of date and needs to be revised. We must offer the Dubai government to redraft it based on solid research, analysis and statistical data
- The need to boost trading volumes is critical to the survival of the DIFC; listing of stocks, derivatives and bonds must be the overriding task for the next 12 month.
  - Stocks can be attracted by facilitating dual listing of companies (e.g. MoUs with other Stock Exchanges) and by launching a market with lighter listing requirements such as AIM
  - A fixed income market cannot be developed without a decisive boost from the government and the central bank. A lobbying effort must be launched with the objective of starting a medium term plan for government securities issuance (and possibly government entities) in conventional and Islamic securities.
  - Derivatives trading should start as announced and commodity contracts need to be expanded
- Fixed income securities are required both to stream line the Dubai Inc. exposure and to offer a liquid market in view of the GCC currency union. Missing this opportunity would be a fatal mistake.
- Insurance market and Takaful products need to be given a more decisive boost

DIFC Areas for Action

1. Develop Bond Market to serve Governments and Corporates of the region
2. Engage with International financial Institutions, including WB, EDB, ADB, AFDB, ISDB to issue securities in the DIFC. IFC will be issuing a Sukuk out of DIFC.
3. Legal infrastructure for market completeness and growth:
    1. Securitisation
    2. Securities lending
4. Merge DIFX and DFM to provide breadth, depth, liquidity
5. Set up an Second tier market designed for small and midsized companies, with simplified listing rules and ongoing obligations

DIFC needs a shift to a pro-active role

- DIFC strategy cannot be primarily aimed at providing office space for companies
- DIFC would need to advise the Dubai and UAE governments on the benefits of fostering the right environment for project financing, mortgage market and fixed income markets
- Constant contacts should be maintained with other governments in the GCC and the DIFC region. Sporadic events or personal meetings need a constant follow up. Business proposals need to be developed and marketed aggressively
- A concerted effort should be made to attract Free Zone companies to seek financing at the DIFC. We need to organize seminars on a regular basis between FZ entities and our clients
- A series of heavy and mostly unnecessary regulatory measures are likely to be taken in the US and UK affecting hedge funds and private equity. We could develop an efficient regulatory environment to draw these entities to the DIFC
- The Dubai government could launch a pension scheme for expatriates which could be attractive also for expatriates in other GCC countries