DIFC | Dubai International Financial Centre

GCC's Economic Renaissance and the Outlook for the Middle East

CFA Middle East 2008 Conference series:

April 1, 2008

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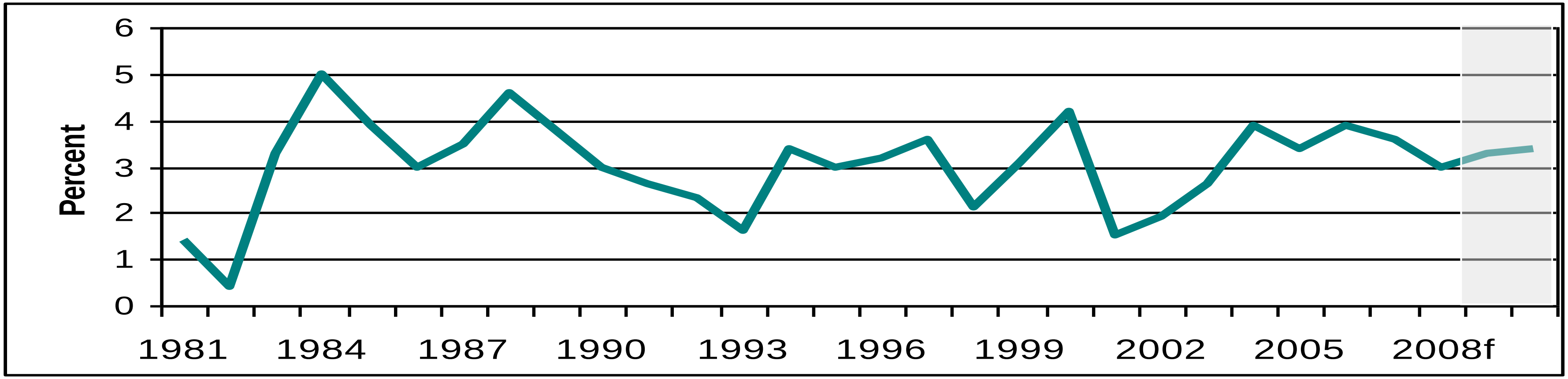
- **Oil, & Macroeconomics**
- **Fundamentals I: Investment, Infrastructure & Productivity**
- **Fundamentals II: Demographics, Migration & Remittances: Growing Linkages**
- **Liquidity, Markets & Volatility**
- **Policy Challenges**
- **Outlook**

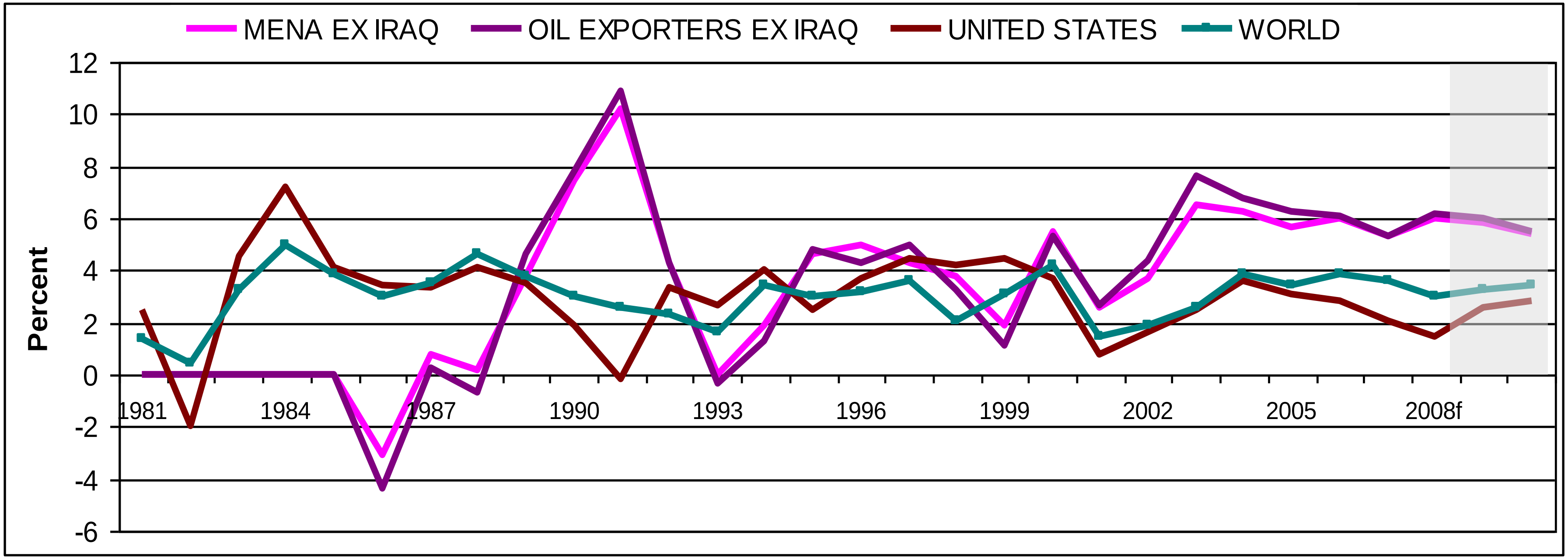
A ME/GCC Economic & Financial Renaissance

- **MENA has achieved above trend economic growth rates:**
  - **Average real GDP growth 6.2% over 2004-2007 vs. 3.7% in 1998-2002**
  - **Strong fundamentals and macroeconomic conditions characterized by large twin current account & fiscal surpluses and declining levels of public debt.**
  - **Oil export receipts reached $381bn in 2007, up 8% from 2006**
  - **Growth resurgence has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity**
  - **Sustained by strong Global growth led by Emerging Markets**
- **Economic reforms, diversification and state divestment & privatisation: non-oil growing faster than oil sector**

- **Positive demographics & migration sustaining low labour costs & output growth**
- **Shift in the pattern of public spending and investment: more inward and intra-regional approach to investment**
- **Private sector is leading and driving regional economic integration of markets, FDI, Tourism, labor flows**
- **Emergence of multinationals: DP, Etisalat, Emaar, Mittal, Orascom, MTC…**
- **Diversification and growth of non oil revenues**
- **Growth of Shari'a compliant finance**

World Real GDP Growth @ 30 Year High & Less Volatile

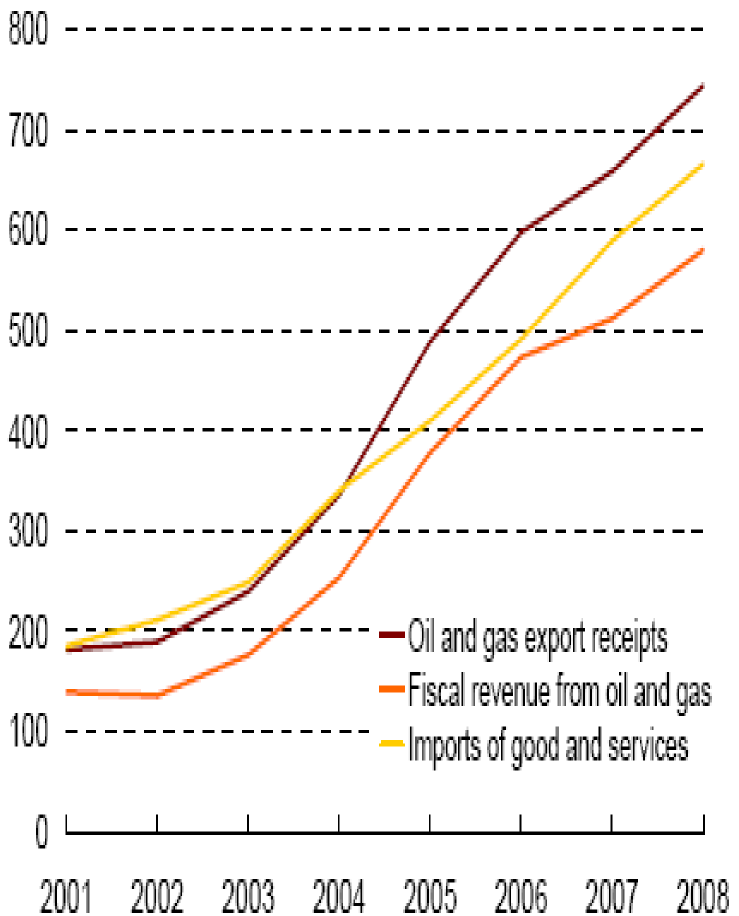


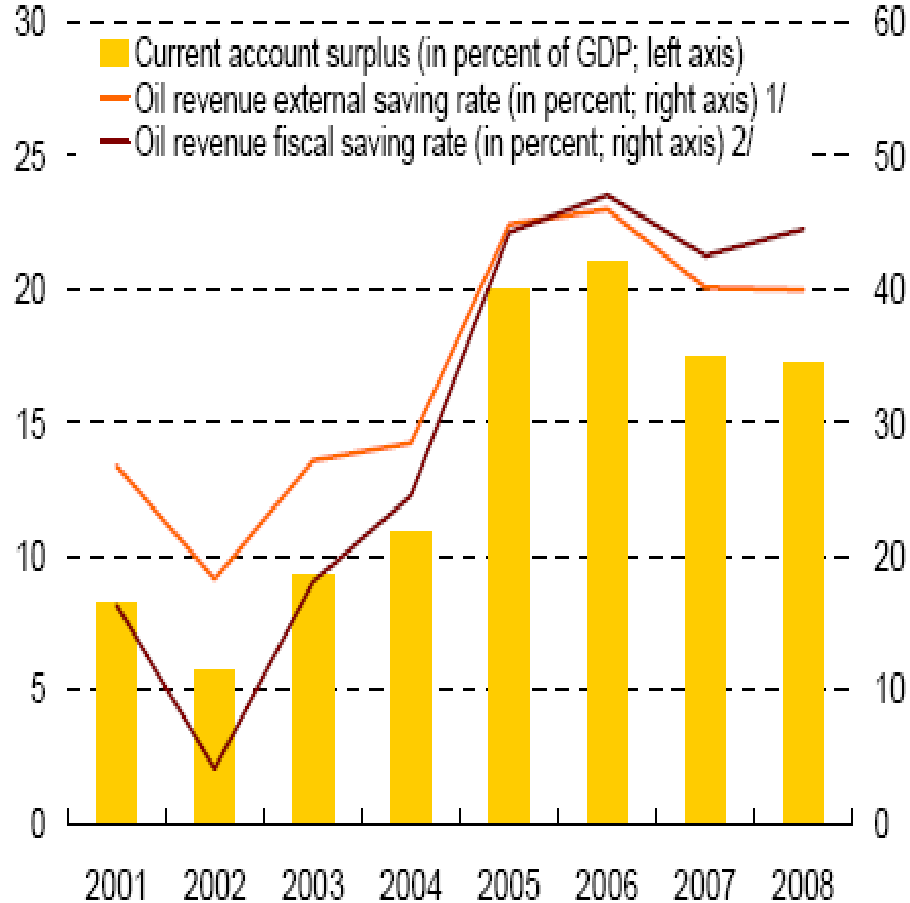


Source: IMF, IIF, EIU, February 2008

Oil and Gas Exports

Region's oil and gas exports receipts look set to rise to near $800 billion in 2008 with current account surpluses running at 20-25% of GDP.

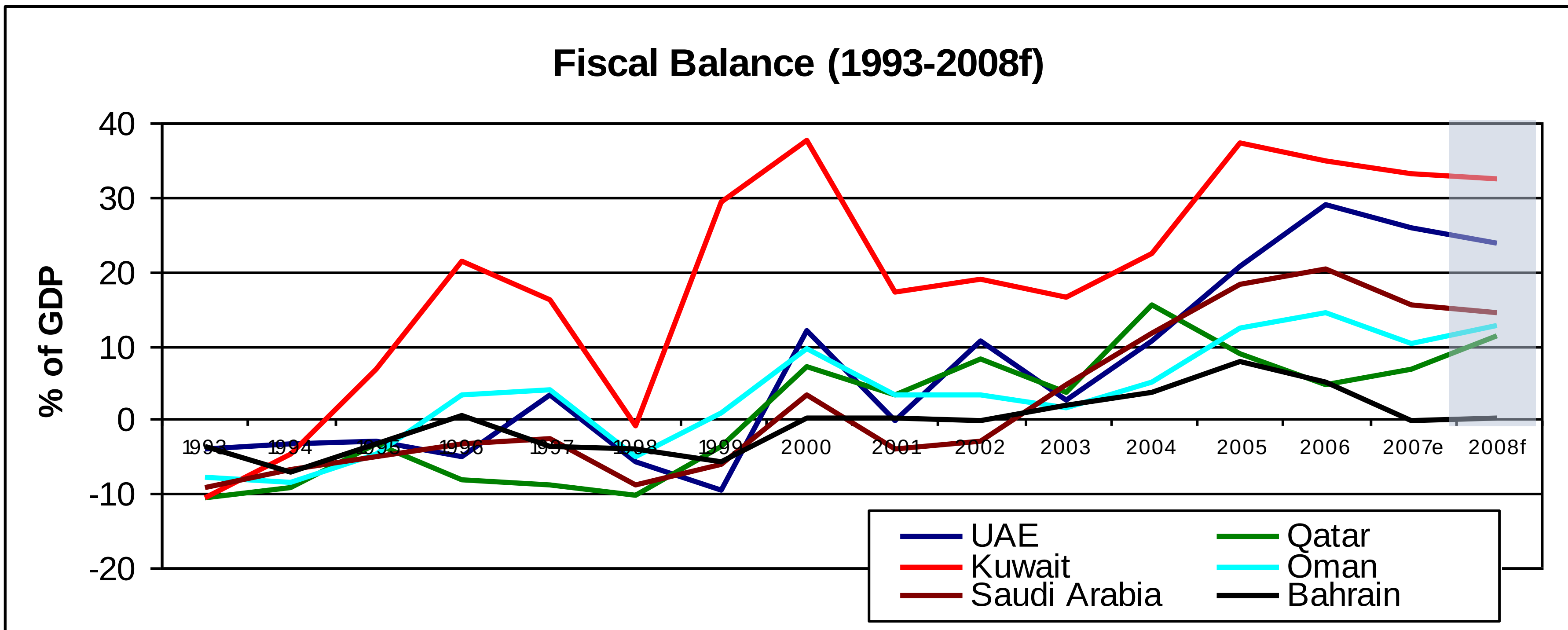




Source: IMF, REO October 2007

Large Fiscal Surpluses

- Oil producers policy reaction has been fiscally conservative: 60% of higher oil revenues have been saved.
- Substantial fiscal surpluses (19% of GDP in 2007) even as spending has picked up
- Fiscal position of GCC remains in surplus for an oil price in the range of $35-$38
- Investment policies less dependent on oil revenues



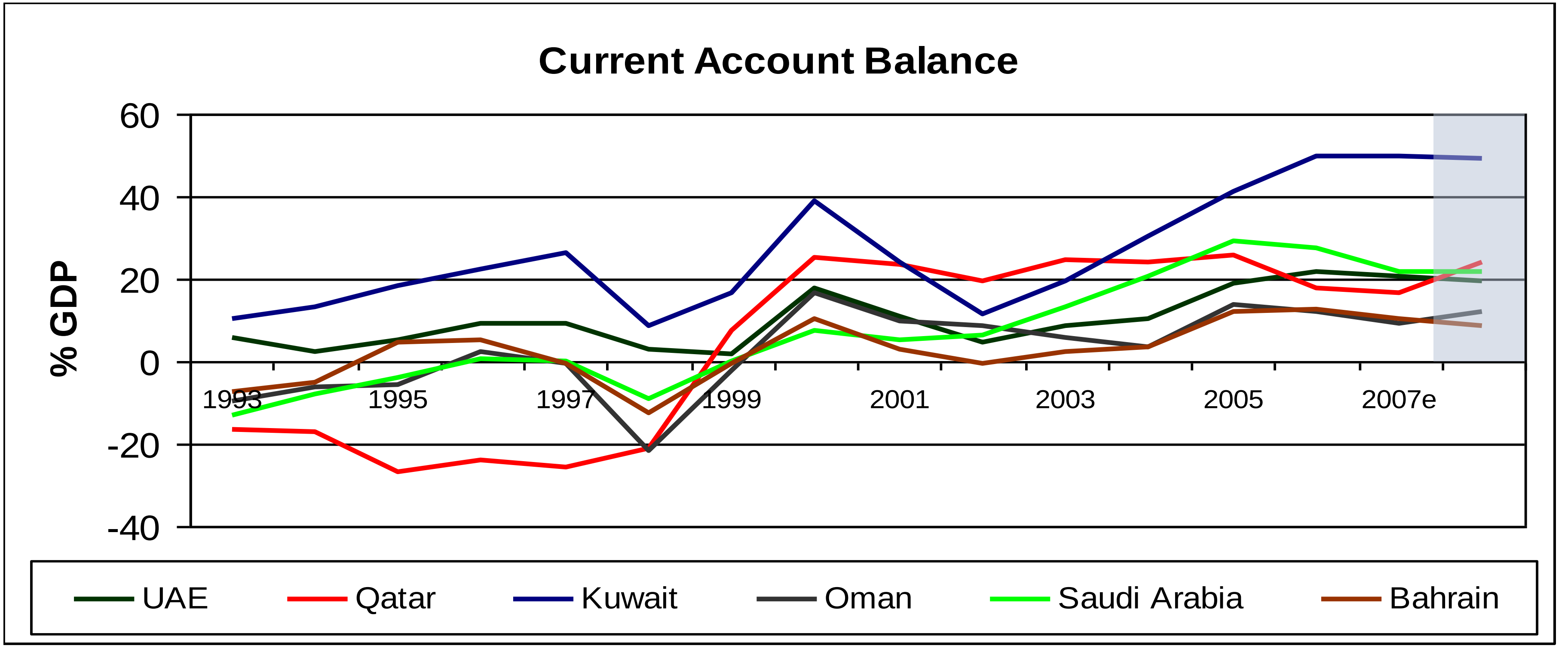
Source: IIF

Current Account Surpluses and Build Up of Foreign Assets

- **Current account surpluses running at 25-30% of GDP; increased recycling back into regional economies**

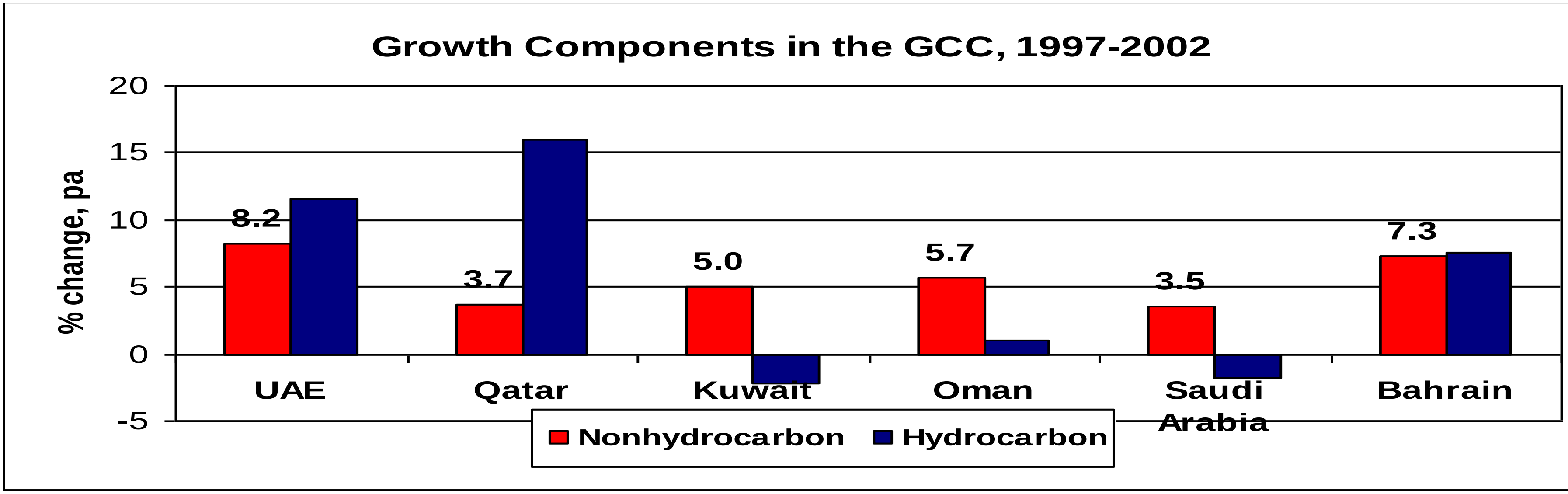
- **MENA international reserves have tripled between 2003 and 2007: $242.9bn (2003) to $776.6bn (2007) and forecast at $967.5 billion for 2008.**

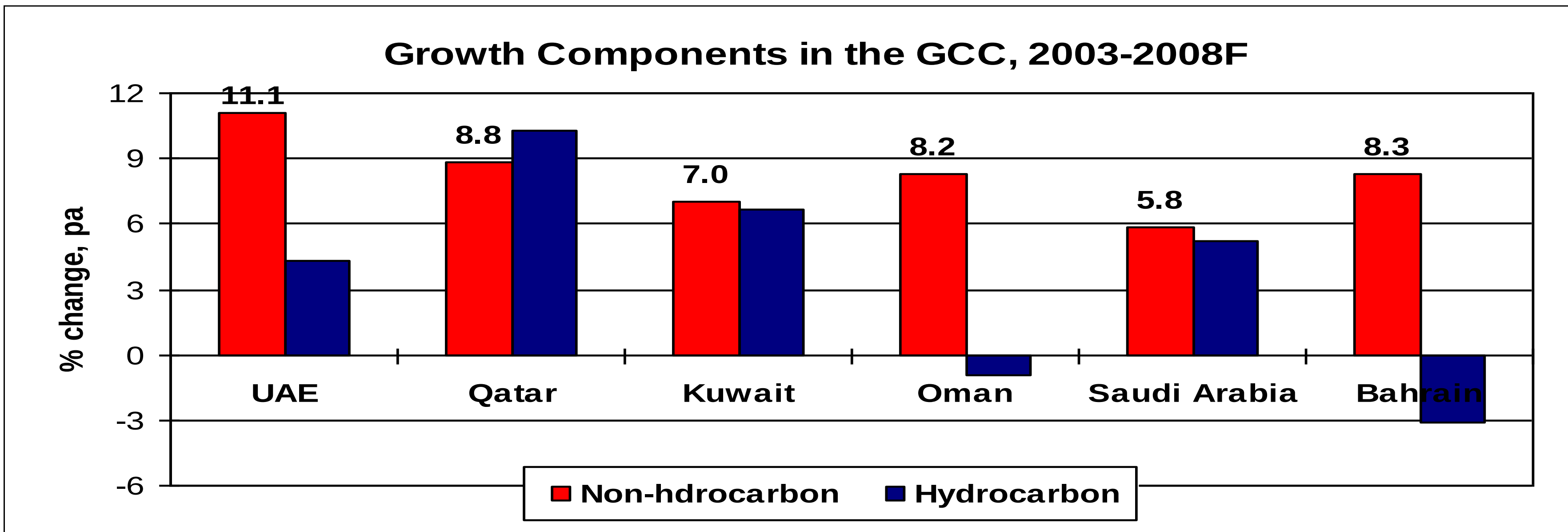
- **For GCC international reserves have quadrupled from $90.5 (2003) to $365 (2007) and forecast at $ $455 billion by 2008.**



Source: IIF

GCC Increasingly Diversified





Source: IIF

Investment, Infrastructure & New Linkages

Infrastructure drivers:

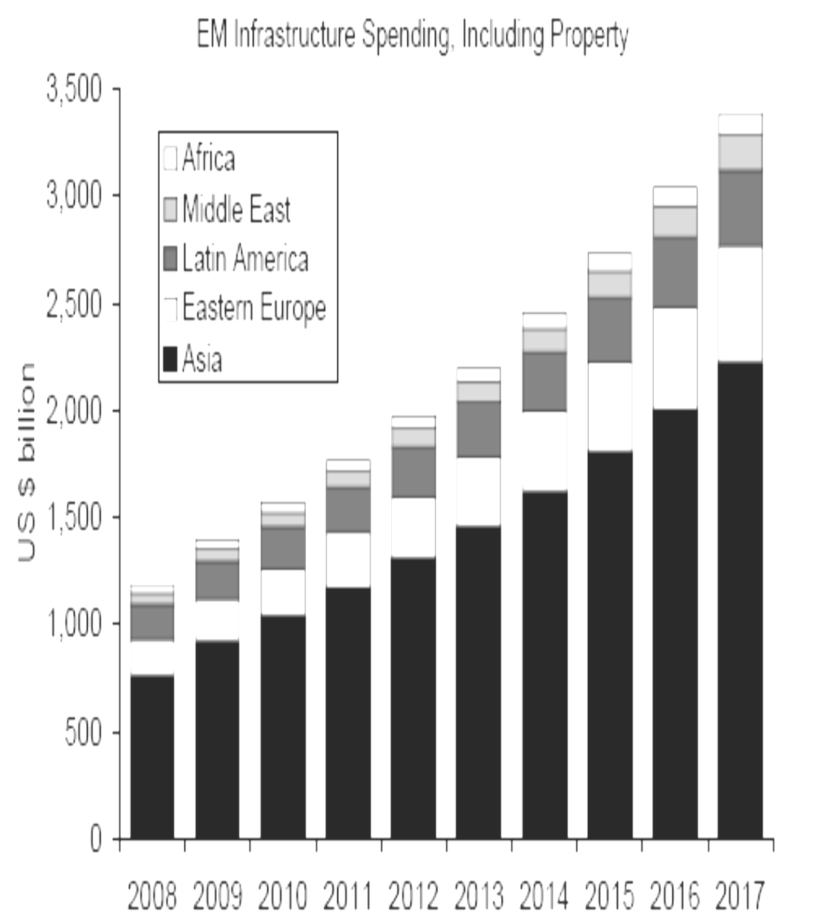
- Demographics
- Urbanisation
- Policy reforms, Increased openness and move to market-based economies

Infrastructure investment will:

- Increase productive capacity and export capacity through improved logistics
- Enable economic diversification
- Underlie economic development and higher growth
- Lead to higher total factor productivity (TFP) and labour productivity growth
- Underpin growth of financial markets

Forecast EM infrastructure investment:
Asia 67% of total, with China and India 43% and 13% of total; Russia 10%; Brazil 5%, Middle East 5%

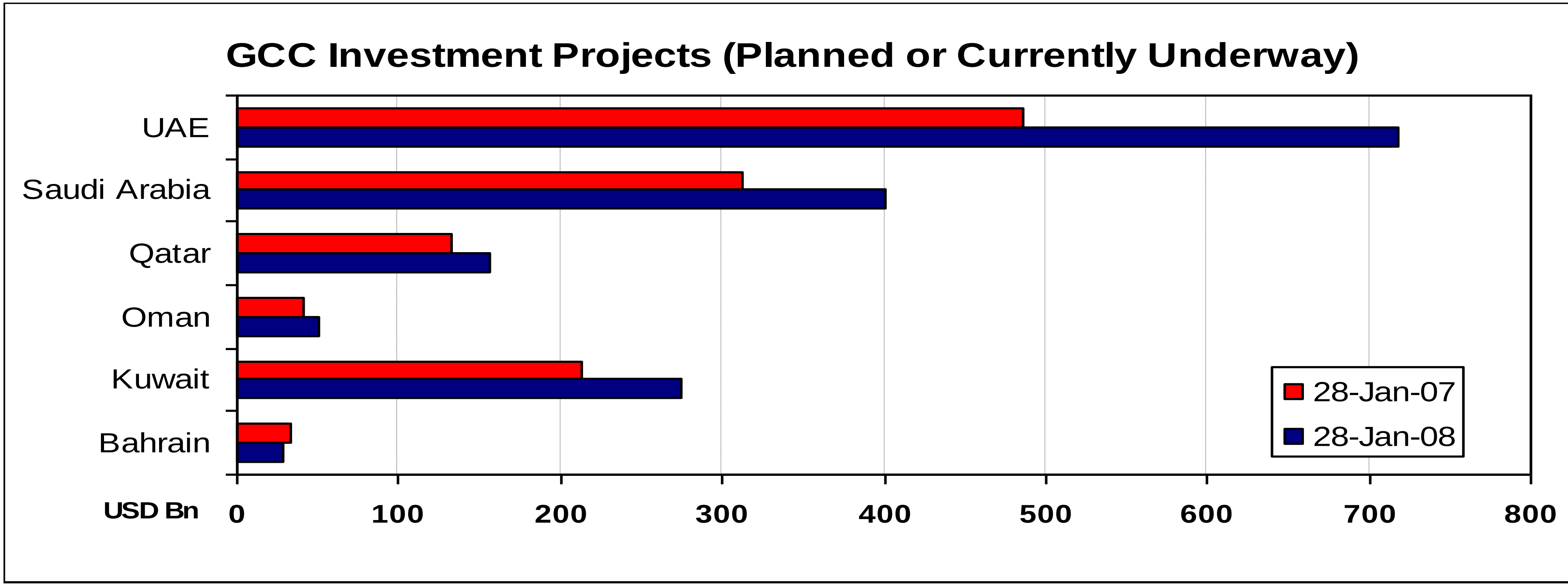
US$21.7 trillion in EM Infrastructure Spending: 2008-17e

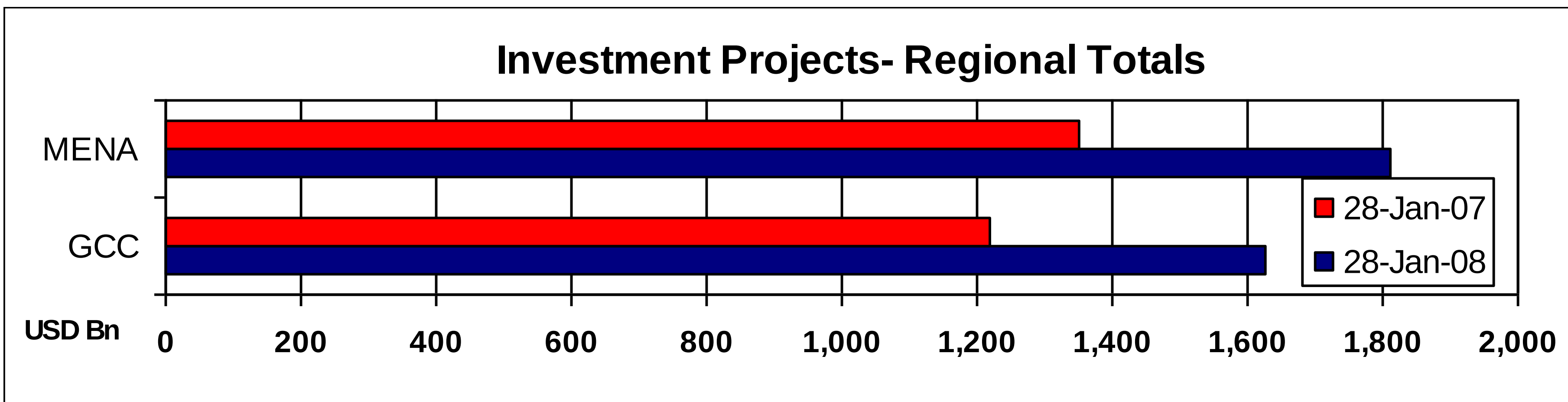


Source: World Bank, Global Insight, Morgan Stanley Research estimates

Infrastructure investments with an estimated value in excess of USD 1.7 trillion are currently under development or planned

DIFC





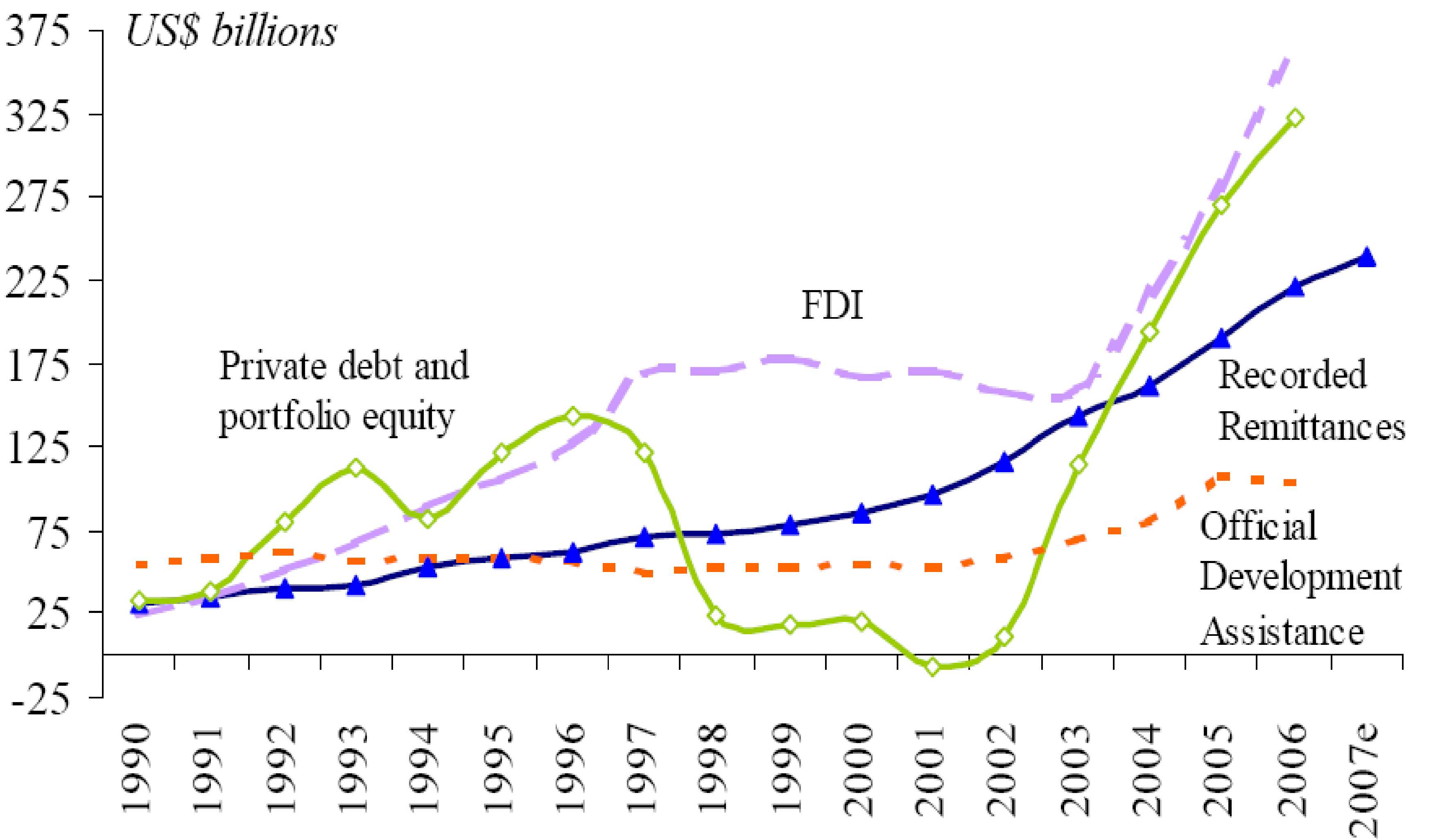
Source: MEED

Demographics, Migration and Remittances

- **Higher growth in the oil producers has been transmitted to labour exporters:** India, Pakistan, Egypt, Jordan, Lebanon, South Asia, North Africa
- **Officially recorded inward remittance flows worldwide have risen from an estimated $131.5billion in 2000, to more than $317billion in 2007e; MENA: $12.9 billion to $28.5 billion in 2007e**
- **Inward remittance flows between 12%-15% of GDP for Egypt, around 5%, for India, and more than 22% for Lebanon.**
  - **India** world's top remittance recipient with $27.0 bn in 2007, or 5.7% of GDP.
  - **Saudi Arabia**: world's top 2nd remittance sender with $15.6bn in 2006 or 5.0% of GDP
  - **Lebanon**: world's top 8th recipient of remittances in 2006 (22.8%)
  - **India-UAE** is top migration corridor for high-income non-OECD countries. **India-Saudi Arabia**, comes in 2nd place.
- **Official remittances are likely to represent only a fraction of total remittances**

Source: ***Migration and Remittances Fact book 2008, World Bank.***

Remittances growing; more stable than capital flows, FDI or ODA



Sources: *Global Economic Prospects 2006: Economic Implications of Remittances and Migration* (World Bank), *World Development Indicators 2007*, and *Global Development Finance 2007*.

Transmission and new Regionalism

- Transmission effects and new linkages affecting labour exporters:
  - Higher incomes of migrant populations
  - ↑ Labour flows to oil exporters
  - ↑ remittances to labour exporting countries
  - FDI
  - Portfolio investment
- Oil producers more likely to retain migrants: reforms to property rights. People ‘voting with their feet’
- Labour Force Skill Mix changing: more High-skill and professional categories
- **Reverse ‘Brain Drain’ & ↑ expenditure on human capital**
- ***Remittances leading to greater ME Economic & Financial Integration***

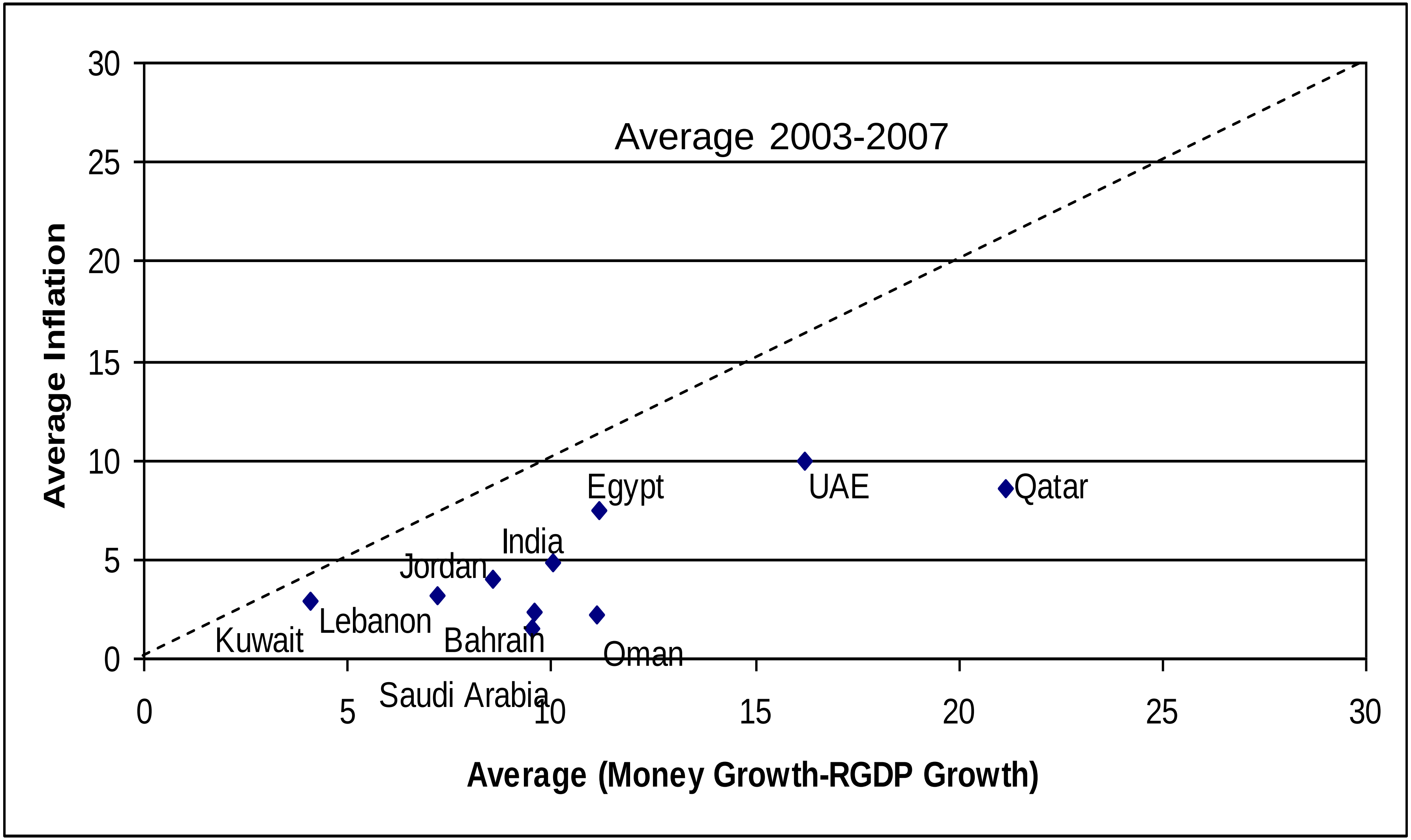
Increase in Wealth and Liquidity

Massive Wealth Creation

- Value of oil wealth of Middle East oil exporters increased by more than $30 trillion between 1995 and 2007
- Given global energy demand growth projections, using conservative estimates for oil prices at $65/bbl, the projected cumulative oil and natural gas revenues for the GCC in the 2005-2030 period totals $8.1 trillion.

- US$ Peg and Accommodating monetary policies lead 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
- Rise in inflation: prices of non traded goods & services
- Increased liquidity resulted in an investment driven boom:
  - Real estate boom and asset price appreciation
  - Stock market boom
  - Credit market boom

Money Growth and Inflationary Pressures

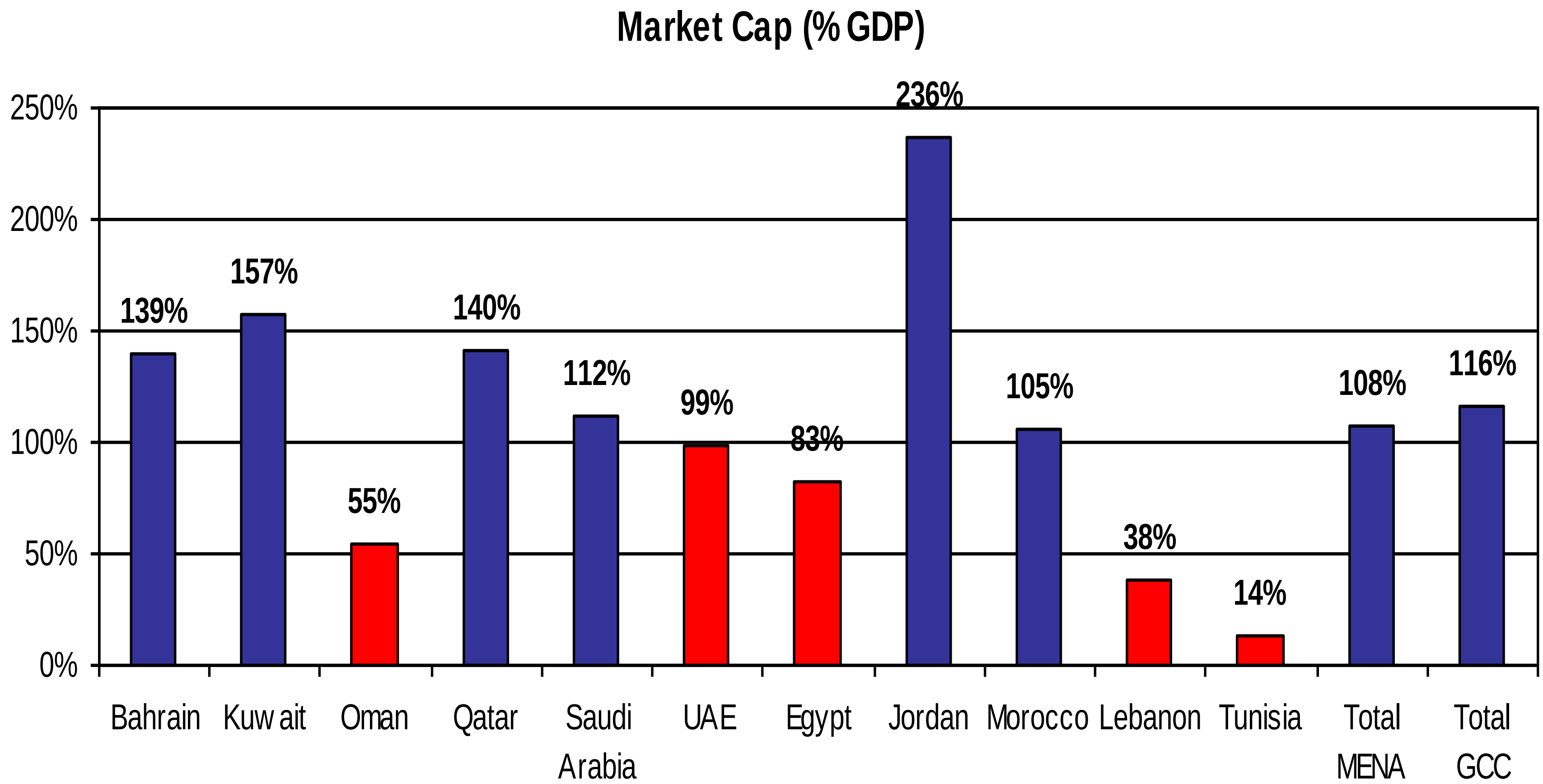


Source: DIFC Economics

Liquidity & the Stock Markets

- Growth and abundant liquidity have fuelled a spectacular resurgence of the credit and equity markets in the SAMEA and the Middle East region.
- For the GCC, market capitalization grew from less than $200 billion in 2002 to about $1,039 billion by January 2008. GCC markets out-performed emerging and developed markets.
- Stock markets grew more rapidly than the economies: market capitalization jumped from an average of some 65% of GDP in the GCC countries to 149% of GDP between 2002 and early 2008.
- The correction of the overly exuberant equity markets in 2006 came as a wake-up call for action, signalling the need for policy reforms to restore investor as well issuer confidence.
- Despite the growth in the number of companies, IPOs and higher valuations, markets remain fragmented, displaying high volatility of returns and lack of breadth, depth and liquidity.

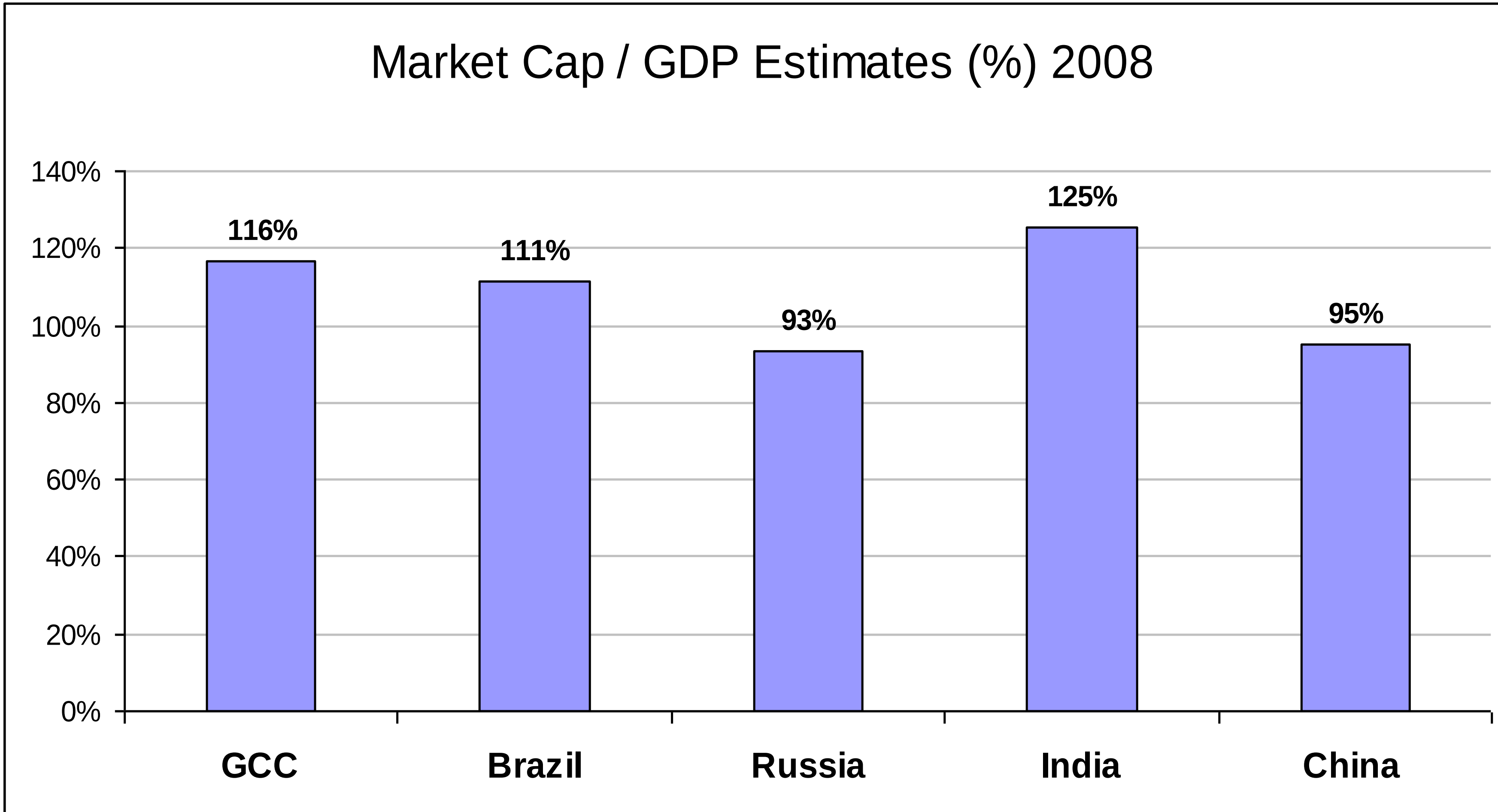
GCC Market Cap has doubled since 2002



Source: *DIFC Economics, Zawya, February 2008*

Market Cap Comparable to BRIC Countries

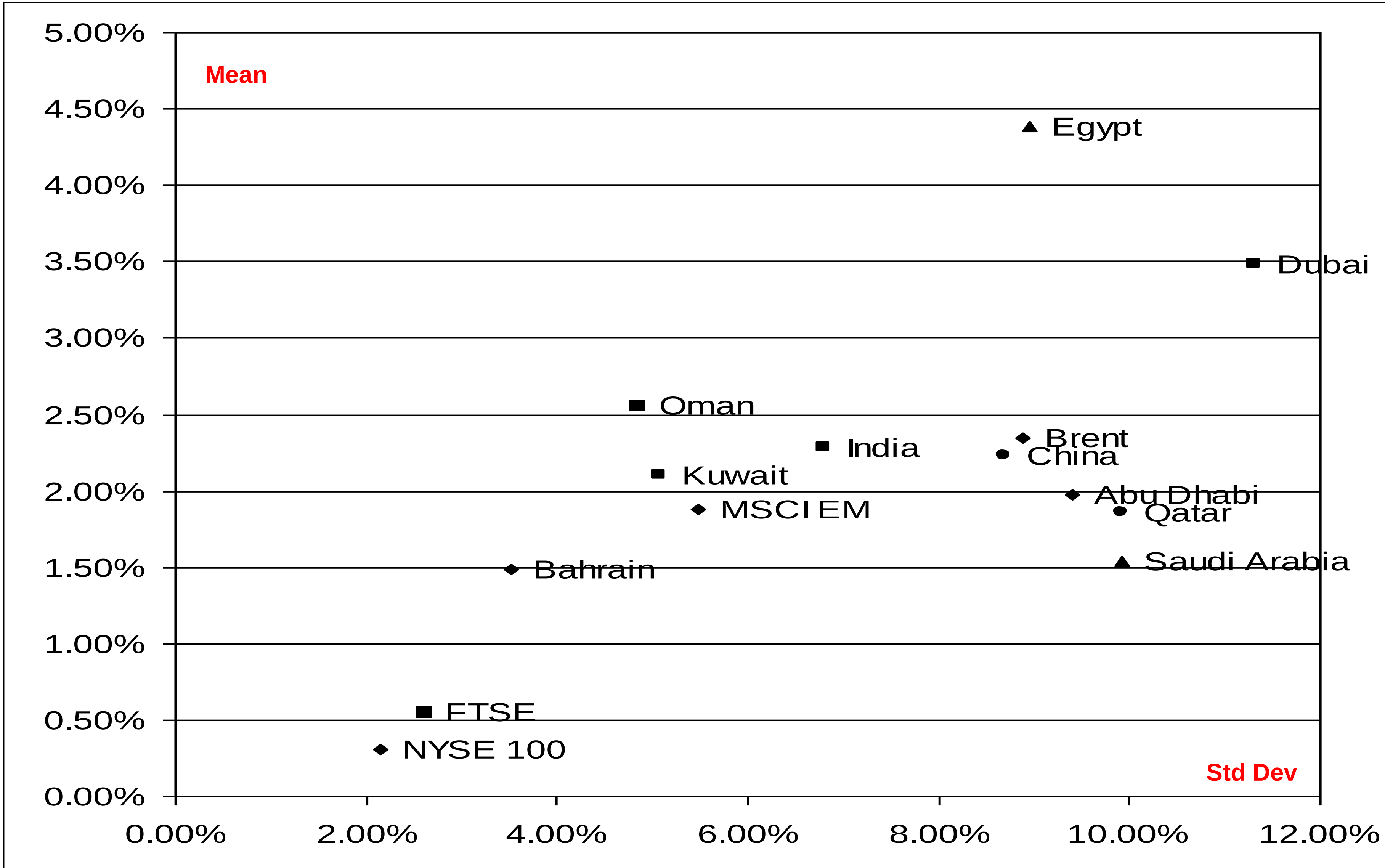
As % of GDP, GCC market cap comparable to BRIC countries



Source: SHUAA Capital, February 2008

GCC Comparative Market Returns and Risk

Monthly Return& Risk (%), Dec 2003-Feb 2008



Source: Reuters, DIFC Economics

GCC markets show low correlation with developed markets, offering potential risk diversification benefits

	Monthly Return Correlations, Dec. 2003-Feb. 2008													
	Bahrain	Kuwait	Egypt	Saudi Arabia	Dubai	Abu Dhabi	Qatar	Oman	Brent	NYSE 100	India	China	MSCI EM	FTSE
Bahrain	1.00													
Kuwait	0.55	1.00												
Egypt	0.51	0.14	1.00											
Saudi Arabia	0.35	0.31	0.21	1.00										
Dubai	0.40	0.46	0.35	0.48	1.00									
Abu Dhabi	0.38	0.46	0.11	0.45	0.76	1.00								
Qatar	0.29	0.21	0.38	0.29	0.39	0.42	1.00							
Oman	0.36	0.29	0.32	0.35	0.53	0.49	0.25	1.00						
Brent	-0.06	-0.12	0.19	0.04	-0.10	-0.10	0.24	-0.02	1.00					
NYSE 100	-0.02	-0.06	0.07	-0.18	-0.04	-0.12	0.05	-0.07	-0.19	1.00				
India	-0.04	-0.23	0.31	0.09	0.09	-0.04	0.19	0.08	0.11	0.49	1.00			
China	-0.06	-0.06	-0.10	-0.10	-0.16	-0.15	0.06	-0.15	0.08	0.40	0.23	1.00		
MSCI EM	0.15	-0.09	0.37	0.02	0.01	-0.13	0.18	-0.02	0.18	0.64	0.72	0.45	1.00	
FTSE	-0.06	-0.14	0.31	0.09	0.09	-0.06	0.27	0.07	0.19	0.69	0.68	0.26	0.71	1.00

Remark: For testing the significance of any particular instance of ρ, the 95% confidence interval is [-0.275 ; +0.275].

Source: Reuter's 3000Xtra, Author's Calculation

DIFC

Strong macroeconomic fundamentals imply low macro risks:

- High growth rates driven by higher oil prices, investment, diversification and economic liberalization policies imply high expected corporate profits and investment returns
- Investment-led growth with large infrastructure component →increased productivity growth & ↑private sector investment
- Expectations of GCC Regional Economic Integration: lower the cost of equity capital and lead to convergence of asset prices
- Gradual Market de-segmentation & liberalization of access to real assets and financial markets, de jure & de facto: free zones, property freehold
- Safe haven: attracting capital and elites from neighboring countries.

- **Inflation & Exchange Rate Policy**
- **Future Wealth Funds**
- **Capital Market Development**

CHALLENGE OF INFLATION

- Two sources of inflation:
  - Non-Traded Goods & Services: housing, services
  - Imported: international commodity prices, weak US$

- Inflation & GCC exchange rate peg:
  - Monetary Union in 2010 (?)
  - Misalignment of monetary policy
  - Pressure to move to currency basket
  - Adopt inflation targeting

But:

- Build central banks' monetary & exchange rate management capacity;
- Build money, debt markets
- Requires GCC policy coordination

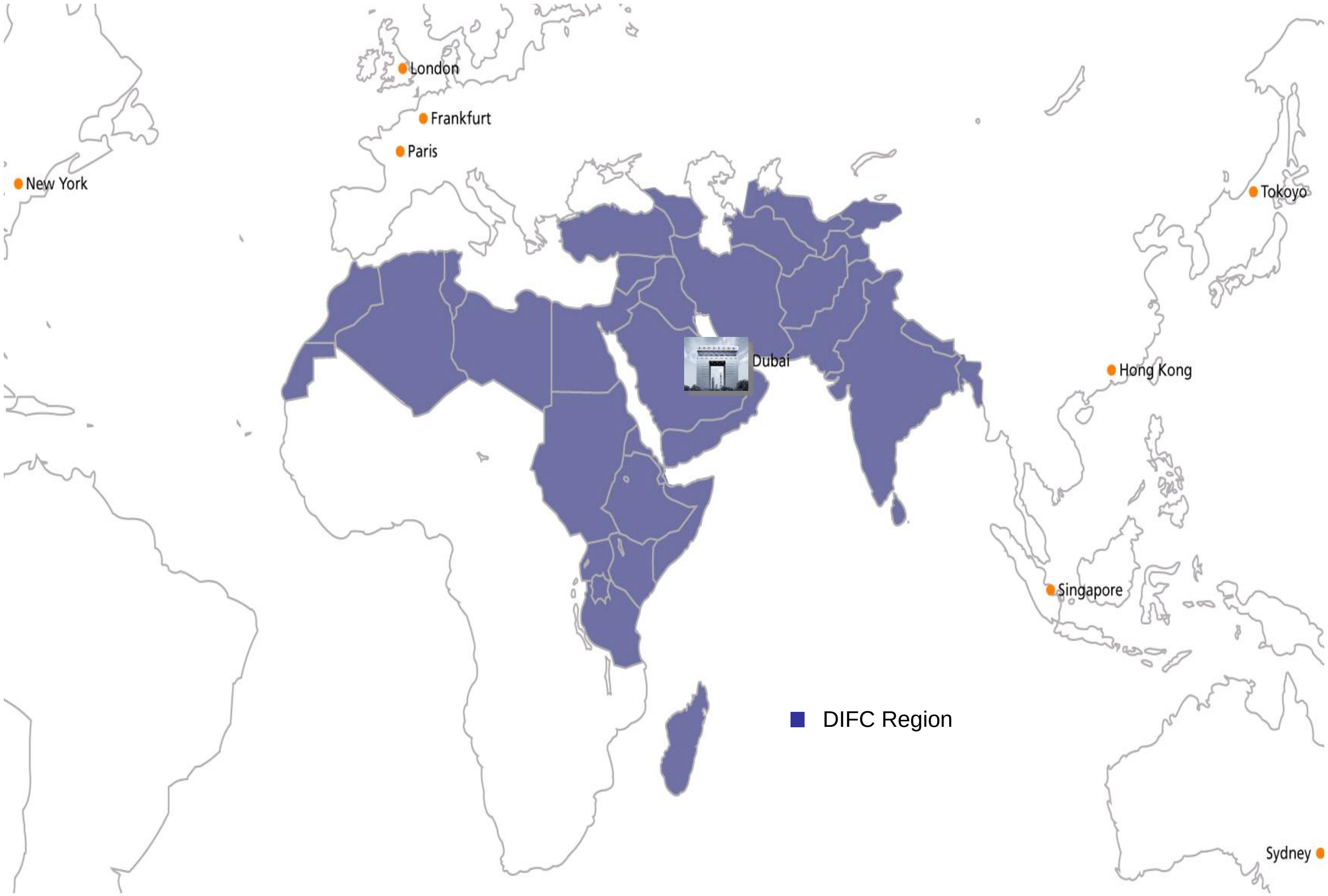
Future Generation Wealth Funds (FWFs)

- Total value of FWFs estimated by IMF at between $1.9 trillion and $2.9 trillion, growing to about $12 trillion by 2012
- Distinguish between Stabilization Funds & Intergenerational Funds
- GCC countries need to diversify against commodity price volatility and revenue risks; earn higher returns than on central bank portfolios
- FWFs allow countries to separate the management of their revenues from natural resources from their fiscal and monetary policies: act as “automatic sterilization mechanisms”
- But facing increased investment & financial protectionism
- Need cooperative solution to resolve global imbalances
- FWFs have exerted a stabilizing influence on markets by
  - Injecting capital in distressed banks => reduced contagion risk
  - Continuing to buy US government securities

The Capital Market Development Imperative

- GCC have become ‘asset-based economies’ with income from assets more important than oil & gas revenue
- Invest, Manage and Control region’s financial wealth of $2+ trillion and growing as a result of high energy prices
- Financing Infrastructure & Regional Economic Integration
- Enable & support economic and financial reforms:
  - Enable separation of oil revenue management from fiscal policy & investment
  - Lead to greater fiscal equity trough user fees & charges for infrastructure services
  - Privatisation and private sector participation in infrastructure
- Change in Global Economic Geography requires accompanying change in Global Financial Geography

Capital Market Development Imperative: the DIFC



- **Internationally-accepted common legal framework**
- **A regulated financial centre with full transparency**
- **Platform to centralise regional wealth for economic growth & development**
- **Deployment channel for new wealth**
- **Link to the international markets**

The vision of the Dubai International Financial Centre (DIFC) is to shape tomorrow's financial map as a global gateway for capital and investment.

Characteristics of the DIFC

DIFC

- **Onshore Capital Market / International Standards**
- **Designated as a Financial Free Zone**
- **Foreign Currency Denominated / Zero Tax Rate***
- **Civil and Commercial Laws of UAE disapplied**
- **Tailor made laws for the DIFC**
- **No local partner requirements**
- **Wholesale centre for Qualified Investors**

* 50 Years and Renewable

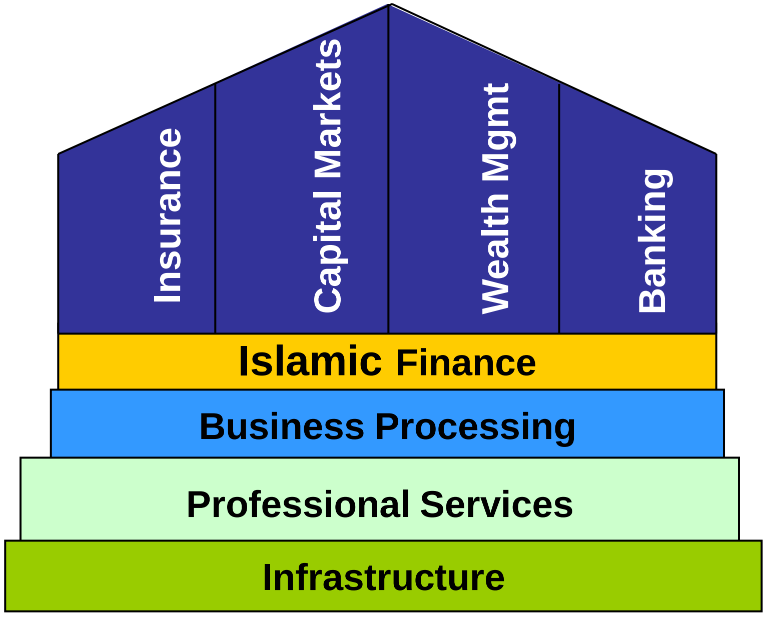
DIFC- Core Divisions

DIFC

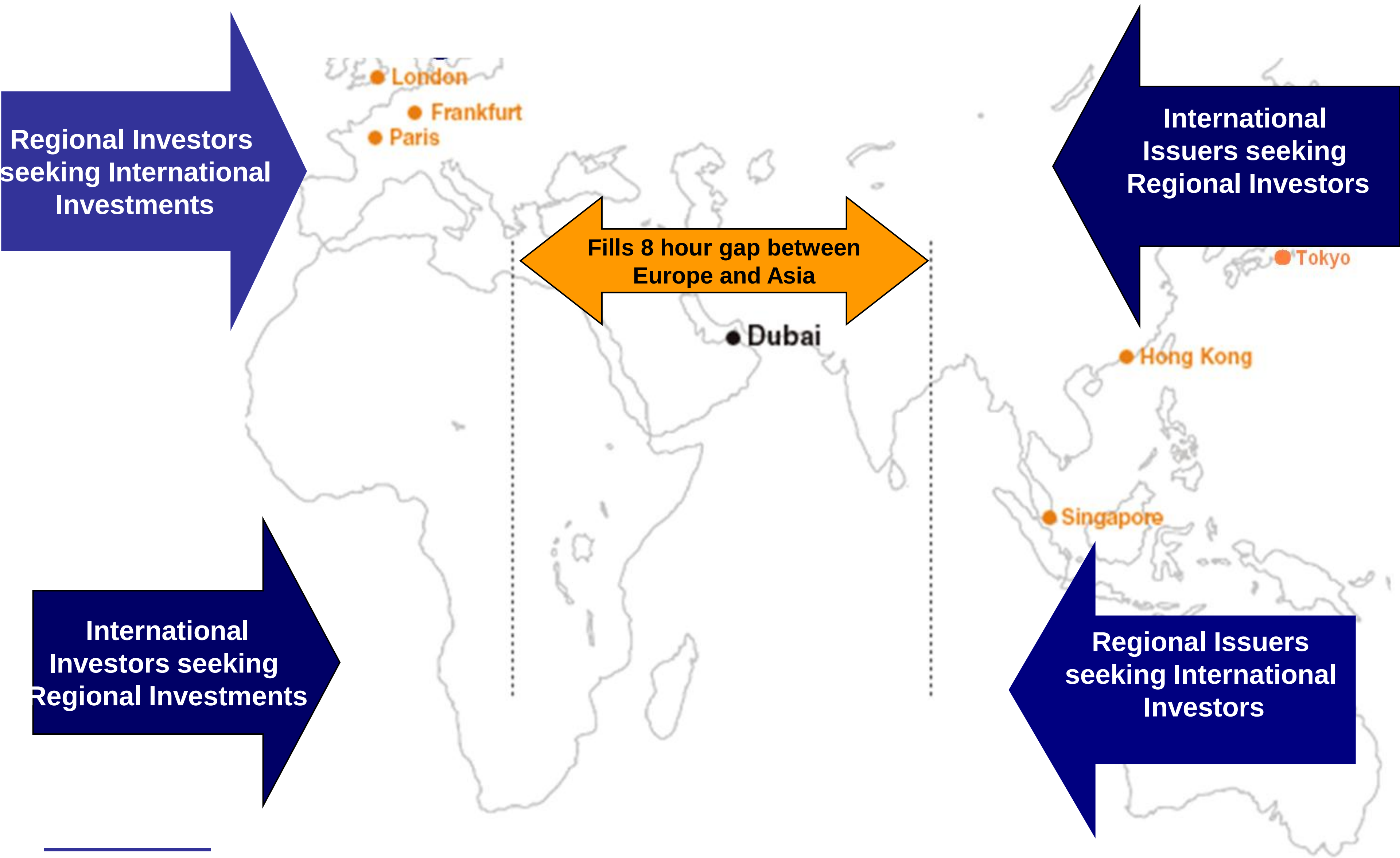
DIFC Authority	DIFX	DFSA	DJA	ROC	DIFCI
DIFC Authority	***Dubai International Financial Exchange***	***Dubai Financial Services Authority***	***DIFC Judicial Authority***	***Registrar of Companies***	***DIFC Investments***
Responsible for the strategic development of the Centre.	Integrated world class trading platform	Rule-Making and Policy Development Licensing and registration of DIFC Participants Supervision of DIFC Participants Enforcement of legislation	An independent court with exclusive civil and commercial jurisdiction.	Responsible for incorporating and registering all the companies that operate within the DIFC, and for administering the Companies Law and Regulations.	Responsible for all non public admin activities such as the operation and management of any current and future subsidiaries.

DIFC: Integrated Banking & Financial Services

- **Banking & Brokerage Services**
- (Investment Banking, Corporate Banking & Private Banking)
- **Capital Markets**
- (Equity, Debt Instruments, Derivatives and Commodity Trading)
- **Wealth Management**
- (Family Office, Trust Services)
- **Islamic Finance**
- **Fund Registration & Domiciliation**
- **Insurance & Reinsurance**
- (Takaful/Retakaful, Captives)
- **Business Processing Operations**
- **Professional Services**



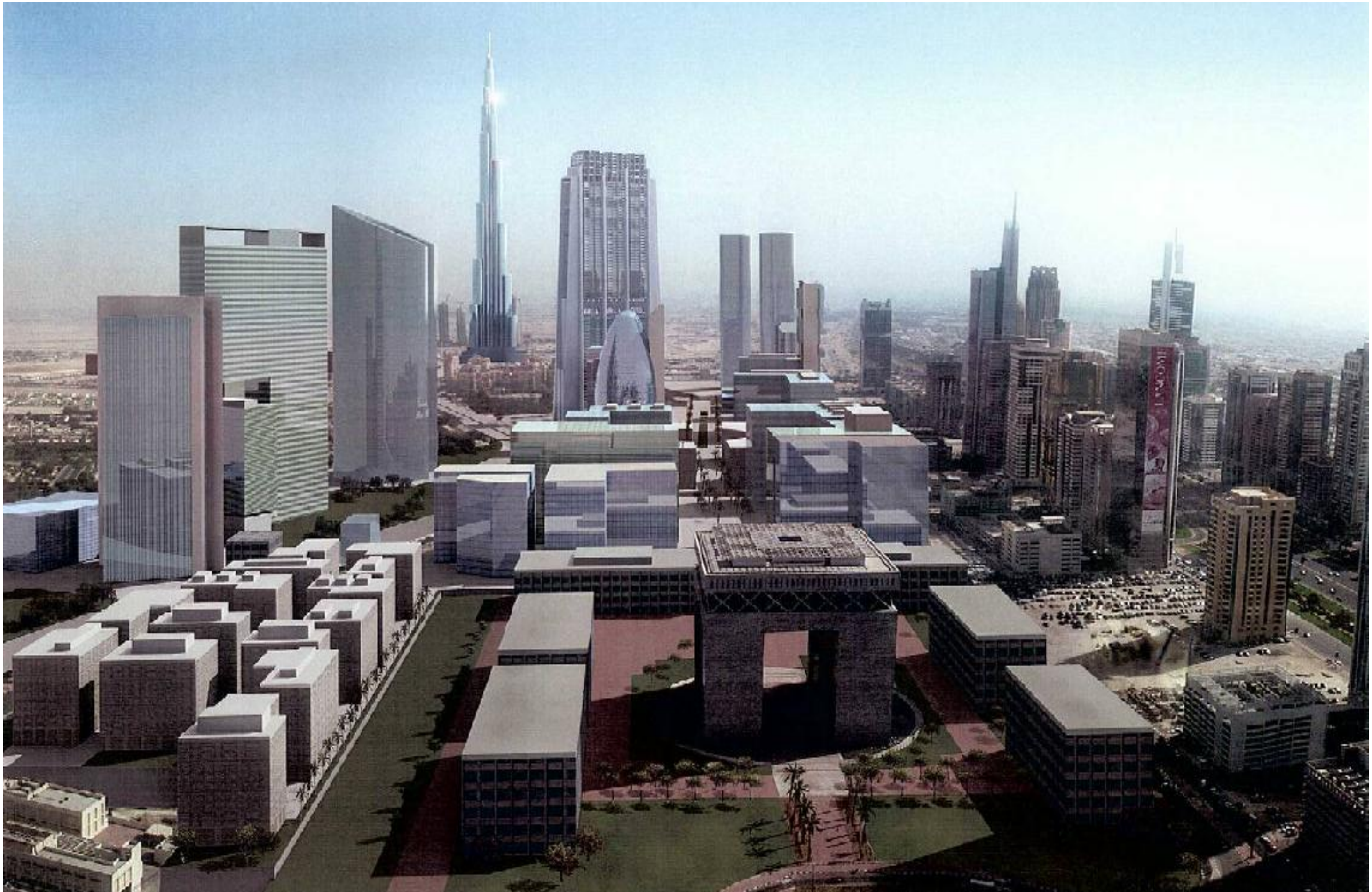
CAPITAL MARKET IMPERATIVE: Dubai International Financial Centre



ME/GCC Economic Outlook

- Continued high growth is forecast in 2008: ME/GCC at 6.2% with oil exporters (including Central Asia) growing at 6.8% and GCC at 5.8%
- Growth is investment led with strong private sector participation and record FDI levels.
- Investment is leading to diversification, increase in productivity and absorptive capacity.
- Inflationary pressures continue: from 8.8% in 2007 to 8.2% in 2008 for MENA and from 5.1% to 4.9% for GCC
- External position positive with MENA current AC surplus at 15.4% for 2007 and forecast at 14.8 for 2008; for GCC countries surpluses are running at 25.4% of GDP for 2007 and 24.8% in 2008.
- Surpluses are being recycled back into regional economies leading to greater regional & international economic integration. Cumulative current account surplus for the GCC countries is expected to grow to $954.6 billion by 2008.

Sheikh Zayed Road, Circa 1990



GCC's Economic Renaissance and the Outlook for the Middle East

A Time for Vision
A Time for Action
A Time for Architects and Designers
A Time for Builders & Investors

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