

MENA: Building Financial Markets to Sustain Growth

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Agenda

- Drivers of Economic Growth & Structural Change
- MENA and the GCC Economic and Financial Renaissance
- DIFC role in creating a regional financial market
- Mainstreaming the nascent Shari'a compliant finance market



A MENA Economic & Financial Renaissance?

- MENA has achieved above average growth rates sustained by
 - Average real GDP growth 6.2% over 2003-2005 vs. 3.7% in 1998-2002 by supported by favorable global developments (high growth, low inflation and interest rates)
 - Growth boom has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity and ↑ in productivity growth
- Private sector is leading and driving regional economic integration
- Accumulation of assets & international reserves leading to a tripling of international reserves between 2002 and 2006: \$188.7bn (2002) to \$517.7bn (2006)
- Inflation higher, but limited pass-through of higher oil prices to consumers



A MENA Growth Resurgence and Economic Renaissance?

- Positive demographics & migration sustaining labour & output growth
- Transmission effects:
 - Higher incomes of migrant populations
 - ↑ Labour flows to oil exporters → ↑ remittances to labour exporting countries
 - Portfolio investment
 - FDI
- Current account surpluses running at **20-25% of GDP** much of which is being recycled back into regional economies



A MENA Growth Resurgence and Economic Renaissance? (Cont'd)

- Fiscal Policy:
 - Oil producers policy reaction has been fiscally conservative: $\frac{2}{3}$ of higher oil revenues have been saved
 - Fiscal position of GCC remains in surplus for an oil price in the range of \$35-\$38
- Surge in Shari'a compliant banking & finance



Increase in Wealth and Permanent Income

- Value of oil wealth of oil exporters increased by an estimated **\$40 trillion** between 1995 and 2005
- Permanent Income increase of some \$850 billion at a Real Rate of 3%
- Real exchange rate appreciation
- Rise in prices of non traded goods & services
- 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
- Increased liquidity resulted in an investment driven boom:
 - **Real estate boom and asset price appreciation**
 - **Stock market boom**
 - **Credit market boom**



Real Oil & Non-Oil GDP Growth for Oil Exporters (Annual %)

	Average 1998–2002	2002	2003	2004	2005	Est. 2006	Proj. 2007
Non-Oil GDP							
Oil exporters	4.4	6.3	6.4	6.5	6.9	6.8	6.2
Algeria ¹	3.7	5.3	6.0	6.2	5.1	5.5	6.0
Azerbaijan	4.2	10.5	15.2	13.5	8.4	9.6	7.0
Bahrain	4.4	6.0	8.3	8.6	9.0	8.0	7.0
Iran	4.7	7.8	6.6	5.9	5.8	5.4	4.8
Iraq	4.1	0.2	-40.2	14.9	12.0	10.0	10.0
Kazakhstan	7.6	7.6	8.8	8.4	11.0	9.4	8.8
Kuwait	6.1	13.6	10.0	5.3	6.8	6.9	6.3
Libya ²	3.1	4.7	2.5	4.1	4.5	4.0	3.5
Oman	4.5	5.1	6.0	9.7	9.3	8.0	6.3
Qatar	4.9	7.7	5.3	8.0	7.7	7.2	6.9
Saudi Arabia	3.2	3.7	3.7	4.6	6.8	7.8	7.6
Syria	4.0	3.0	3.9	5.0	5.5	5.5	6.1
Turkmenistan	17.6	16.9	17.7	16.2	9.7	8.9	8.9
United Arab Emirates ²	7.0	7.7	11.2	12.6	11.0	10.5	6.6
Oil GDP							
Oil exporters	1.5	1.8	10.4	4.7	4.8	5.5	5.1
Algeria ¹	3.4	3.7	8.8	3.3	5.6	3.5	3.0
Azerbaijan	20.0	3.6	0.7	2.5	65.3	52.6	49.9
Bahrain	7.3	1.3	1.1	-11.5	-7.6	0.3	0.3
Iran	0.6	5.1	7.7	3.4	2.5	5.0	5.1
Iraq	13.4	-13.6	-42.3	74.2	-1.1	0.0	17.5
Kazakhstan	17.3	22.4	11.6	15.4	2.3	2.9	2.2
Kuwait	-2.7	-7.9	19.8	7.7	11.3	5.2	2.0
Libya ²	-1.3	-0.4	26.9	5.6	1.4	7.1	6.7
Oman	2.1	-2.1	-5.9	-3.2	0.3	4.6	4.2
Qatar	9.8	7.1	6.3	13.5	5.6	6.4	3.2
Saudi Arabia	-1.8	-7.5	17.2	6.7	5.9	1.6	4.1
Syria	-1.3	5.8	-7.3	-3.0	-6.5	-5.7	-6.7
Turkmenistan	22.2	5.4	11.3	-1.7	7.7	10.0	10.0
United Arab Emirates ²	-1.3	-7.6	13.6	2.9	2.1	14.1	3.5

Sources: Data provided by country authorities; and IMF staff estimates and projections.

Source: IMF MECA Outlook, May 2006

MENA Growth Prospects are strong

MENA Real GDP Growth

(Annual change; in percent)

	1998-2002 (Average)	2003	2004	2005	2006f	2007f
MENA	3.80	6.30	6.00	6.30	6.60	6.20
<i>Of which</i>						
GCC	2.50	8.50	6.60	7.1	7.20	6.10
Maghreb	3.50	6.60	5.00	4.00	5.80	4.90

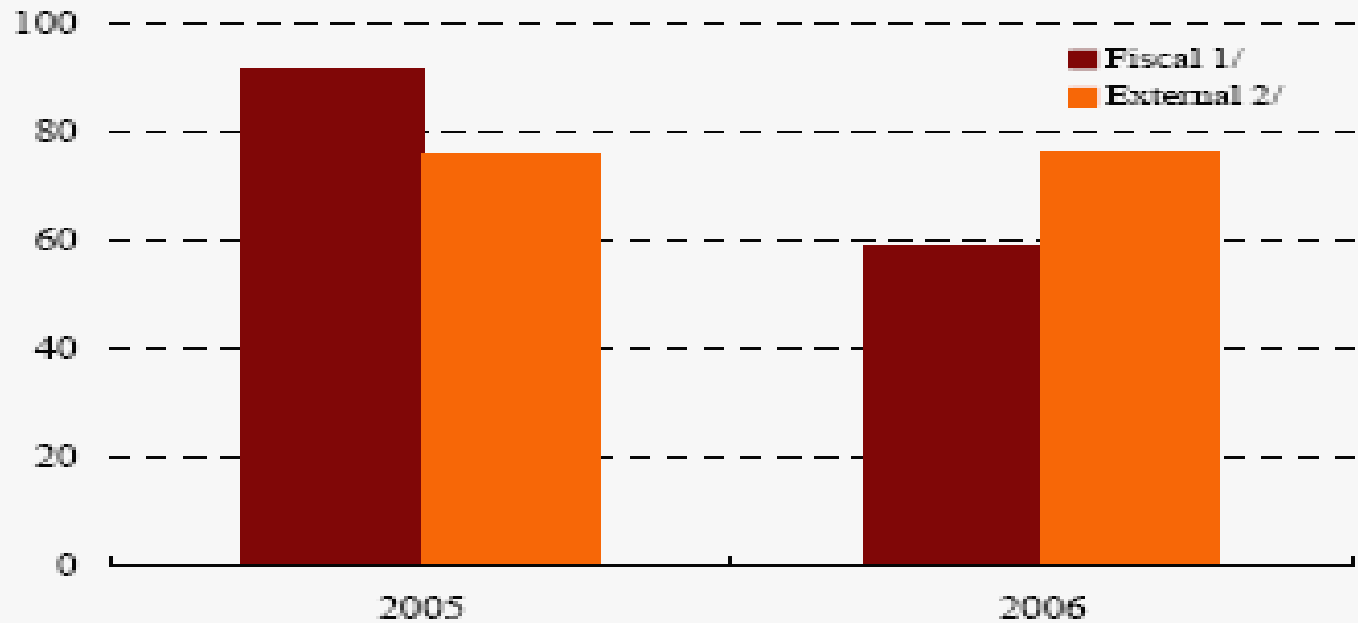
Data are at factor cost

Sources: Data provided by country authorities; and IMF staff estimates and projections.



Oil receipts generated fiscal and Current Account Surpluses

(annual change in surplus relative to change in receipts; in percent)



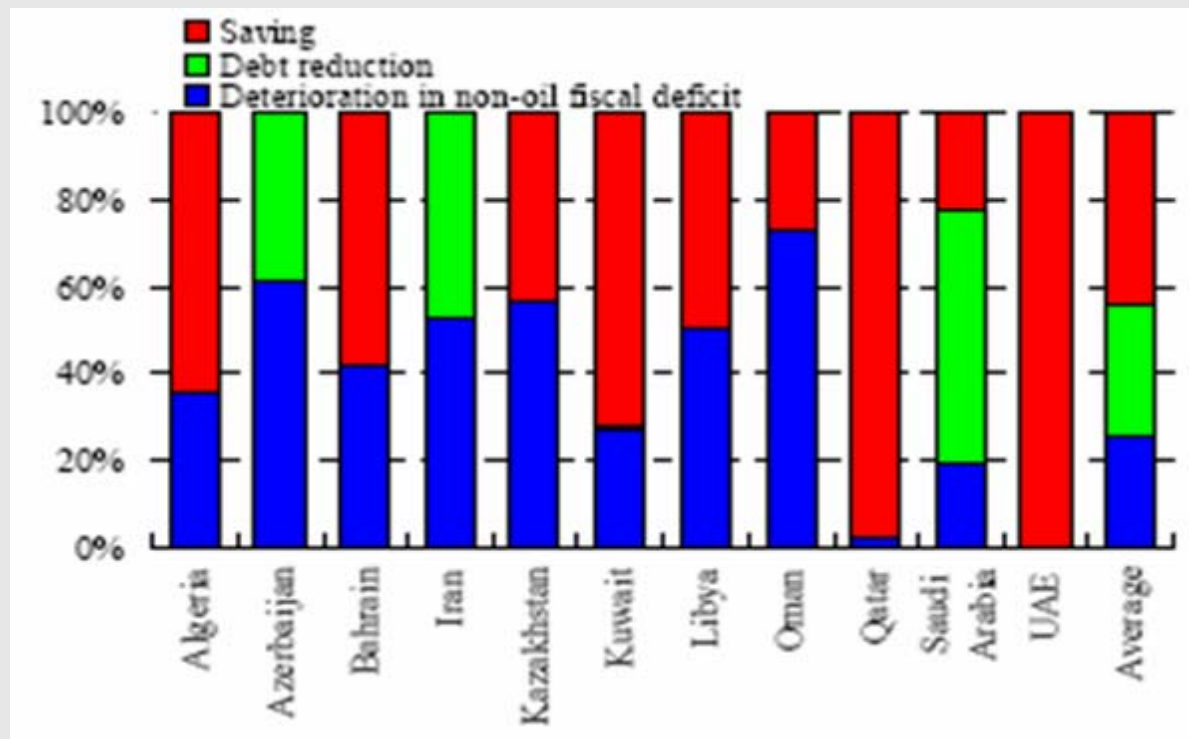
Sources: Data provided by authorities; and IMF staff estimates.

¹Overall fiscal surplus to oil fiscal receipts.

²Current account surplus to oil export receipts.

Current Account Surpluses of Oil Exporters Recycled Back Into Regional Economies: Use of Additional Oil Revenue, 2003-2005

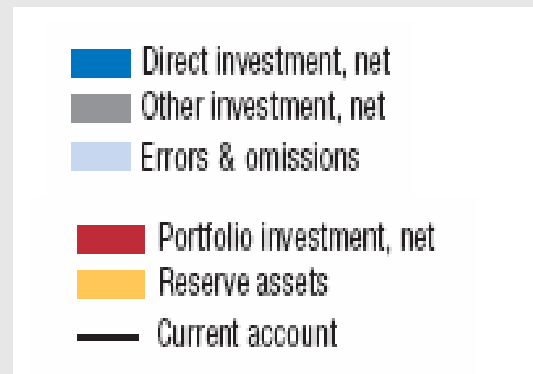
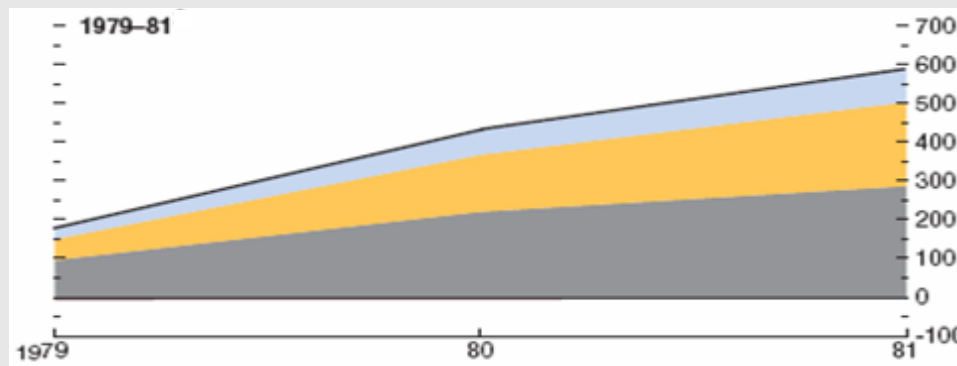
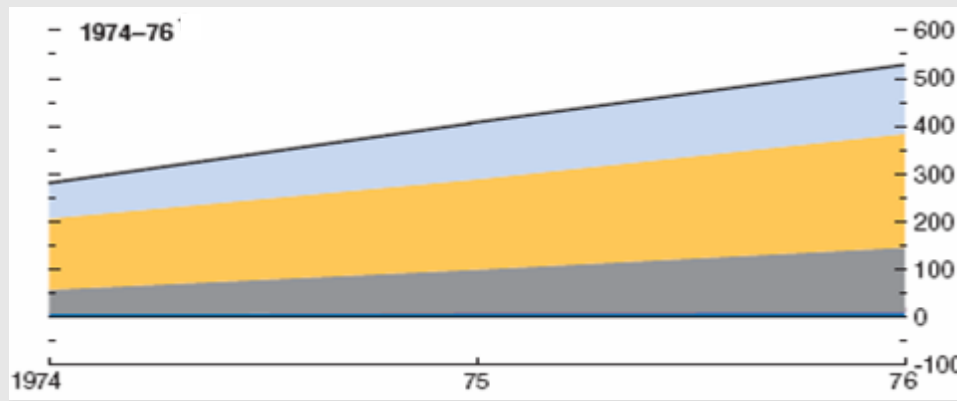
(In percent, base year = 2002)



Source: IMF Staff Estimates and Projections.

How Does Current Oil Price Shock Compare with Previous Episodes?

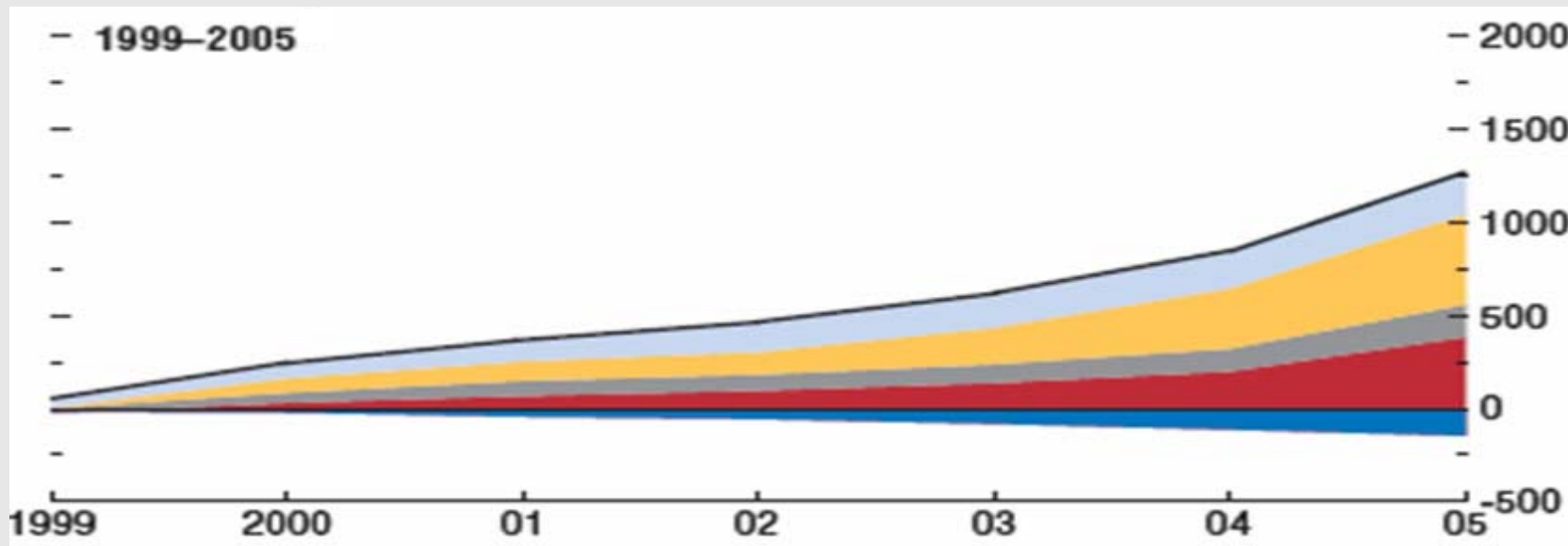
Fuel Exporters' Cumulative Current Account Balances and Capital Flows (Billions of 2005 U.S. dollars, cumulative)



Source: IMF World Economic Outlook April 2006

How Does Current Oil Price Shock Compare with Previous Episodes?

Fuel Exporters' Cumulative Current Account Balances and Capital Flows (Billions of 2005 U.S. dollars, cumulative)



Direct investment, net
Other investment, net
Errors & omissions

Portfolio investment, net
Reserve assets
Current account

Source: IMF World Economic Outlook April 2006



MENA: A More Favourable Economic Environment

- Oil price shock likely to be permanent than earlier episodes of 1973- 1974 and 1979-1981.
- In comparison to previous oil booms, region characterized by:
 - Increased focus by regional governments of spending on long-term economic development
 - Sizeable infrastructure developments around the region with an estimated value of projects planned or under development in GCC & Iran in excess of USD 1 trillion.
 - Greater intra regional trade & investments. Surplus funds recycled to rest of region through FDI. (DP, EMAAR, Etisalat)
 - Regional governments pursuing economic diversification with diminishing contribution of oil to GDP. Region's economies are diversifying at a rapid pace and this should help offset any weakness in the hydrocarbon sector.
 - Wealth repatriation as a result of high returns on investments in region and higher barriers abroad post 9/11



MENA: Fundamental Drivers of Growth & Structural Change

- **‘Demographic dividend’**: but requires investment in human capital and its quality, consistent with market requirements for skills in services, finance and new technologies
- **Diversification strategies** and structural change initiated prior to surge in oil prices and facilitated by favorable world economic developments
- **Technology & Logistics**
 - Lower communication & transport costs led to expansion in scale & scope of trade
 - ICT revolution enabling and generating structural change and higher productivity growth
 - Logistics investments allow rationalization of production through global supply chains



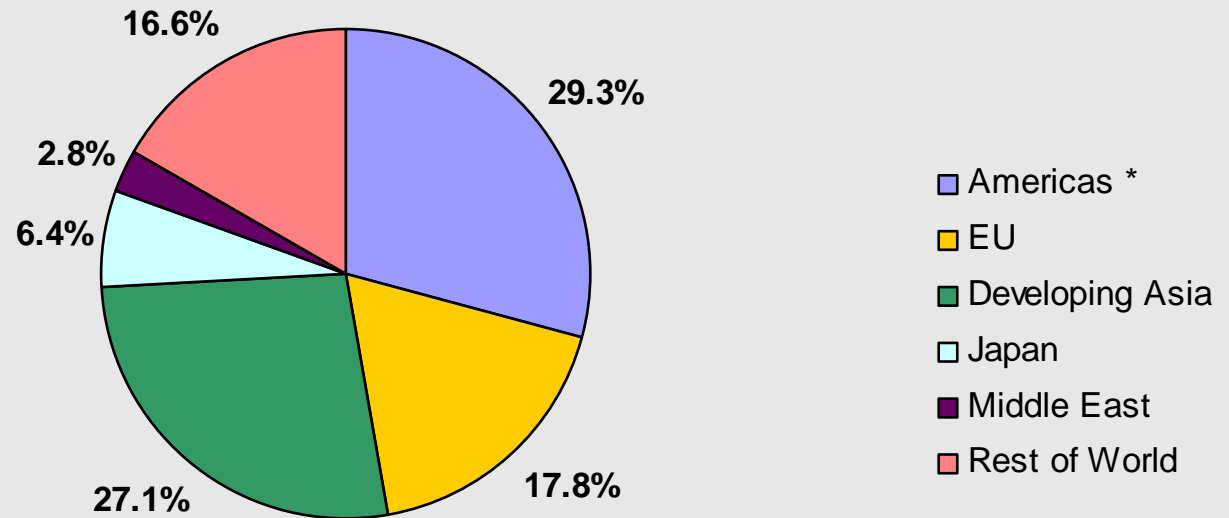
MENA: Power of Regionalism & Networks

- **Location & New Geography:**
 - Increased de-linking from the US business cycle
 - MENA 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 MENA 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 MENA's benefit

WEO Groups Share in Aggregate GDP- based on PPP
Source: IMF WEO September 2006



* includes US, Canada, Western Hemisphere



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



MENA Sustaining Growth: economic & Institutional reform

- Central challenge is to use oil wealth and demographic dividend to create economic & financial incentives for sustained growth
- Economic reforms, diversification and state divestment & privatisation.
- Growing private sector participation in infrastructure across MENA countries.
- Infrastructural Developments: estimated value of projects planned or under development in the Gulf exceeds USD 1 trillion.
- Greater regional economic integration: GCC Monetary Union in 2010, lower trade barriers Greater Arab FTA
- With economic diversification and liberalisation attractive prospects exist across many sectors.



Integrated Infrastructure basis for Economic & Financial Integration

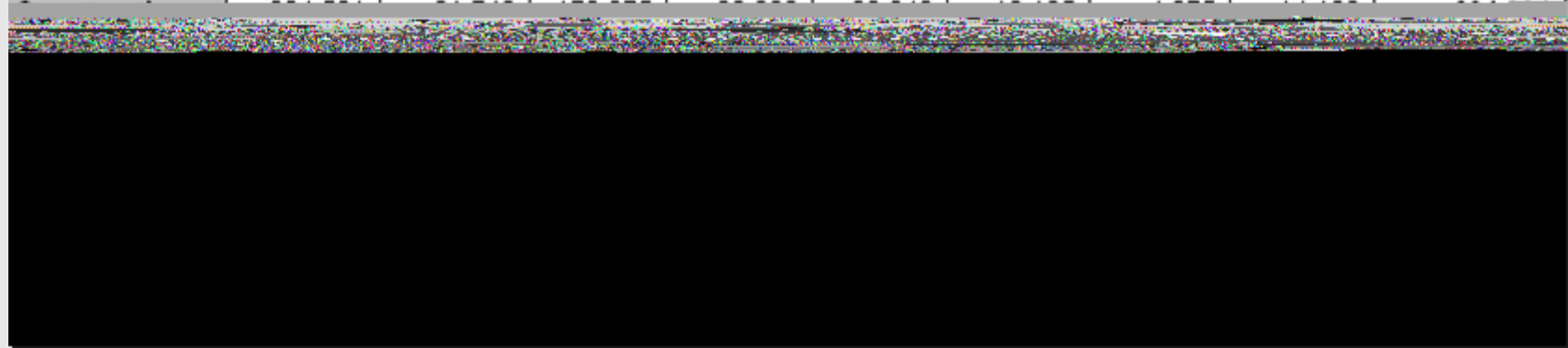
- Geography & proximity, density & intensity of traffic suggest high returns to integrated infrastructure investments: standards, policies, pricing; integrated network
- Transport: rail, road, air
- Energy: oil & gas, electricity
- Telecommunications & Infostructure (broadband+)
- Payment Networks: increased use of Euro; facilitate payments & settlements in capital markets
- Financial Market Infrastructure: integrated capital markets



Infrastructure Projects: Investment for Growth & Productivity

Projects Planned and/or Currently Underway in the Region *(Millions of USD)*

	UAE	Bahrain	Kuwait	Qatar	KSA	Oman	Iran	Iraq	Total Value
Oil & Gas	32,633	1,110	26,228	59,725	44,605	9,860	54,845	10,155	239,161



Source: Data as of May 2006, MEED Projects



Building a regional Market: DIFC Strategy

- International Standard Legal & Regulatory Infrastructure with Independent Risk Based regulator (DFSA)
- Efficient & Sound Listing & Trading Platform: DIFX
- Modern, Secure Payments Infrastructure
- Transparency & Disclosure: Accounting standards
- Corporate Governance: Hawkamah Institute for Corporate Governance
<http://www.hawkamah.org/>
- Link region's stock exchanges
- Instruments & Financial Technology:
 - Bond & Sukuk Market
 - Securitization,
 - Leasing,
 - Options & Derivatives,
 - Shari'a-compliant finance



Growth of Islamic Finance Dependent on Building Markets

- Challenge is access to Shari'a compliant FS
- Greater Standardisation & regulatory & legal alignment
- Improvement & harmonisation of Shari'a regulatory compliance process
- Issuance of tradable Shari'a compliant financial instruments
- Creating liquidity for a secondary market for Shari'a compliant financial instruments
- 'Lender of last resort' function
- Creating "breadth, depth & liquidity"
- Set-up Corporate Governance framework for Shari'a compliant institutions and FS



Shari'a compliant finance: product availability

- Funds generally mandate or institution focused: limited development of retail collective investment instruments
- Despite popularity, retail real estate funds have limited accessibility
- Sukuk funds have yet to take off: supply remains limited and institution focused
- Alternative investment instruments including derivatives and hedge funds are untested, nascent and require Shari'a compliance assessment and approval



Prospects for Islamic Finance

Sukuk:	US\$ 15 billion
Islamic Assets:	US\$ 500 billion
Islamic Funds:	US\$ 350 billion
Annual Growth Rate:	20% p.a.

- Shari'a compliant institutions now account for about 25% of banking & financial system in UAE, Bahrain.
- Oversubscription of Sukuk to date indicative of liquidity, demand and huge potential.
- Opportunity for Islamic structured products to support project financing needs
- Opportunity for structuring leasing transactions relating to construction equipment, oil & gas, aviation, marine & cargo among others
- Prospects within Shari'a- compliant securitization
- Opportunities within real estate investments, REITS and mortgage market

Source: various

Shari'a compliant finance: product availability

- Overall size estimated at some US\$850 billion made up of (in descending order):
 - Morabaha transactions
 - Shari'a compliant funds
 - Retail Finance products
 - Sukuk



Islamic finance requires sound financial markets

Common Harmonized Framework
& Policy

Institution Building

Market Structure Reform

Instrument & Financial Technology

Legal & Regulatory Infrastructure

Resulting in growth based on market creation not transaction related!



DIFC & Shari'a compliant Finance

- DIFC aims to be the global market for Shari'a compliant finance
- DIFC has set clear procedures for authorising Shari'a compliant institutions
- DIFC/DFSA/DIFX have streamlined listing of Shari'a compliant financial instruments
- DIFC has set-up an Islamic Finance Advisory Council (IFAC)
- Aim is to provide the main regional platform for a secondary market in Sukuk and Shari'a compliant funds
- DIFC is home to largest Sukuk market: more than US\$3.5 billion
- Creation of a Government Sukuk market:
 - Financing infrastructure
 - Mainstreaming as public finance instrument
- Creation of Shari'a based mortgage market to support housing finance



DIFC Investment Funds Regime: Collective Investment Schemes

Collective Investment Law- DIFC Law no. 1 of 2006

- DFSA issued legislation to regulate the managed funds industry within the DIFC.
- Legislation permits both the domicile of funds in DIFC and or distribution of existing foreign funds (both public and private funds).
- Flexible legislation permits a variety of recognised investment vehicles
- Regulation of fund operators rather than fund, leaving room for product innovation.
- Permits the operation of various types of funds including but not limited to: property funds, Islamic funds, hedge funds, private equity funds, fund of funds.
- Permits appropriate delegation and outsourcing
- DFSA funds regime in compliance with IOSCO Principles for Collective Investment Schemes.



DIFC Investment Funds Regime: REITs

The DIFC Investment Trust Law- DIFC Law no. 5 of 2006

- Legislation permitting setting up Collective Investment Funds in the form of an **Investment Trust**.
- Rules to permit the operation of REITS within the DIFC have also been introduced.
- REITS have become the most favoured method for attracting public ownership in property investments.
- They provide a convenient form for listed and tradable property ownership with transparent pricing and liquidity.
- Under these Rules it will be possible to issue REITS for the first time in this region, utilizing the facilities of the DIFX. It will add a significant new dimension to the UAE's property market.



Building Markets to Sustain MENA Growth

Renaissance MENA:

- A Time for Vision
- A Time for Action
- A Time for Architects and Builders



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