MENA's Economic Renaissance and its Sustainability

GE Annual Corporate Executive Council Conference for Middle East & Africa

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MENA Renaissance & Sustainability

- **Structural Change & Drivers of Economic Growth**
- **Liquidity, Markets & Volatility**
- **Governance**
- **Prospects & Challenge of Financial Markets**

MENA Economic and Financial ‘Renaissance’

- MENA has achieved above trend average real GDP growth 6.2% over 2003-2007 vs. 3.8% in 1998-2002.
- Growth 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 of markets, FDI tourism, labour flows
- Region’s companies are becoming multinationals: Emaar, Orascom, Etisalat, MTC, Dubai Ports, Mittal…
- Growing private sector participation in infrastructure in GCC
- Infrastructural investment: estimated value of projects planned or under development in the Gulf exceeds USD 1.6 trillion.
- Greater regional economic integration (GCC Monetary Union in 2010 (?), lower trade barriers Greater Arab FTA)
- Economic reforms, diversification and state divestment & privatisation: non-oil growing faster than oil sector
- Positive demographics & migration sustaining labour & output growth

World Real GDP Growth @ 30 Year High & Less Volatile

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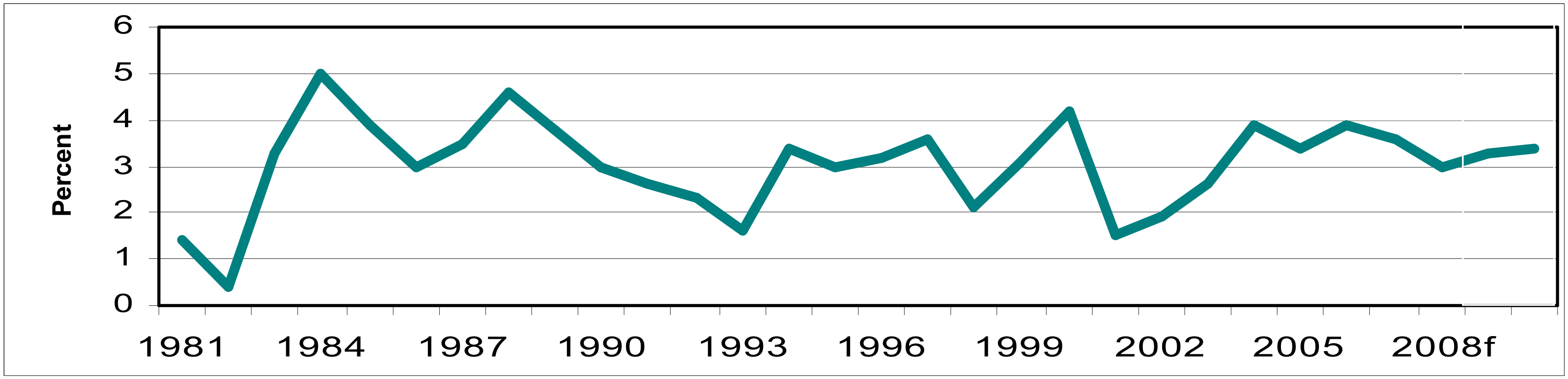
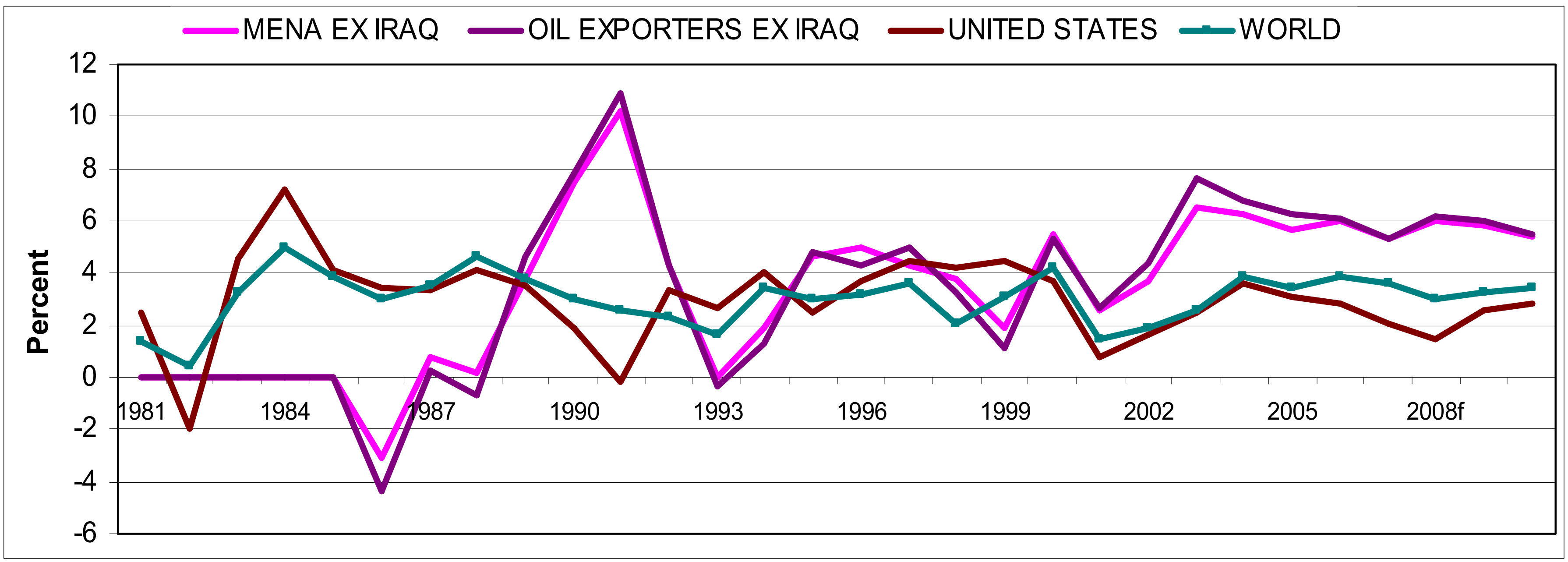




Source: EIU, February 2008

Investment, Infrastructure & New Linkages

- Forecast EM infrastructure investment: Asia 67% of total, with China and India 43% and 13% of total; Russia 10%; Brazil 5%, Middle East 4%

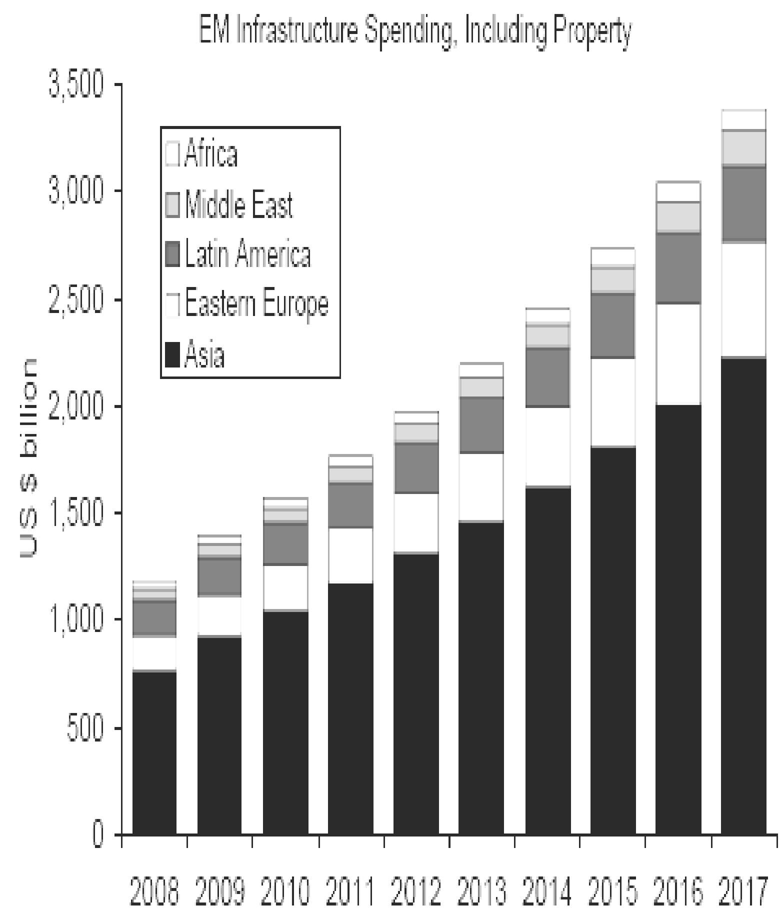
Infrastructure drivers:

- 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

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



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

Gulf Infrastructure Projects (Millions USD)

(Source: MEED)

	28-Jan-08	28-Jan-07	% change, pa
Bahrain	27,821	33,155	-16.1
Kuwait	274,597	213,225	28.8
Oman	51,023	41,106	24.1
Qatar	156,192	132,325	18
Saudi Arabia	400,882	312,451	28.3
UAE	717,223	486,422	47.4
GCC total	**1,627,738**	**1,218,684**	**33.6**
Iran	151,685	103,213	47
Iraq	33,465	28,460	17.6
Regional total	**1,812,888**	**1,350,357**	**34.3**

Demographics, Migration & Transmission Effects

- Demographics & migration sustaining low labour costs & 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.
- Reverse 'Brain Drain' & ↑ **expenditure on human capital**

- 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'

Migration and Remittances

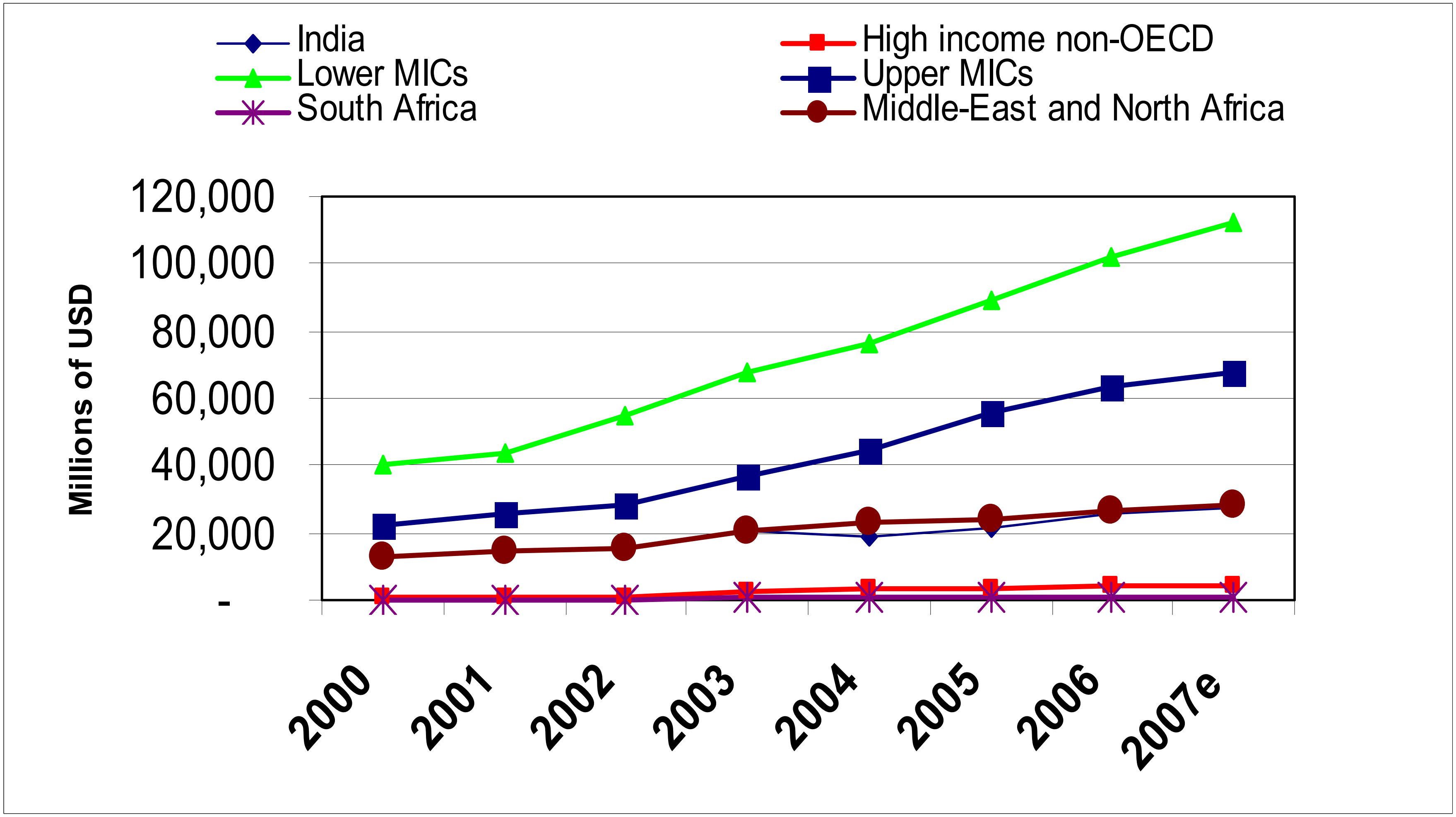
- **Higher growth in the oil producers has been transmitted to the labour exporting countries of the SAMEA region (Egypt, India, Lebanon).**

- **Officially recorded inward remittance flows worldwide have risen from an estimated $131.5billion in 2000, to more than $231billion in 2004 and $317billion in 2007e (versus 12.9, 23.1, and 28.5 billion USD for MENA).**

- **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%), and world's top 2nd remittance sender (18.2%).
- **India-UAE** is top migration corridor for high-income non-OECD countries. **India-Saudi Arabia**, and **Egypt-Saudi Arabia** come in 2nd and 3rd places.
- **Official remittances represent only a fraction of total remittances**
- **Remittances growing , more stable than capital flows, FDI or ODA**

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

Inward Remittance Flows



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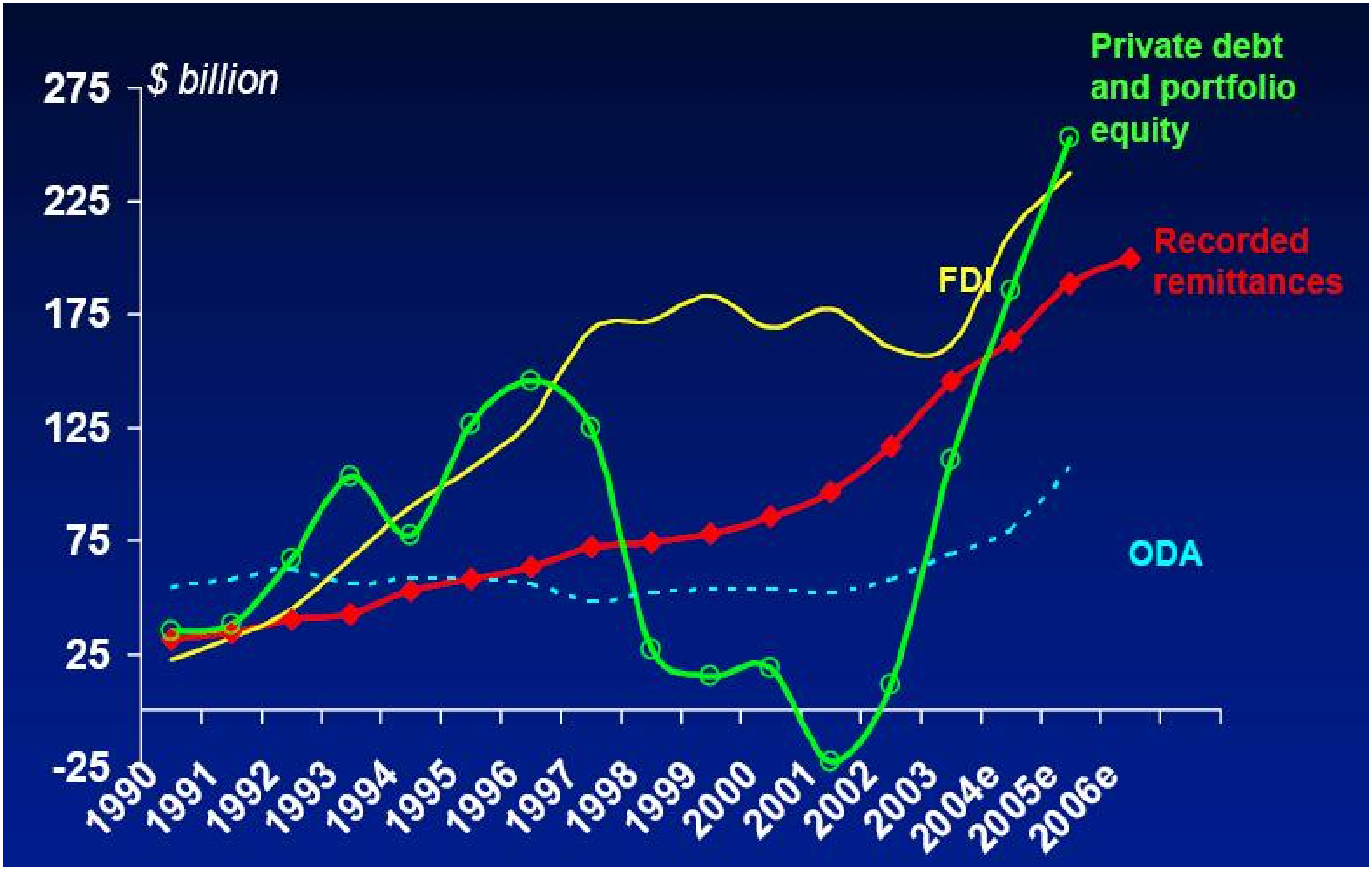
Remittances growing; more stable than capital flows, FDI or ODA



MENA: Power of Regionalism & Networks

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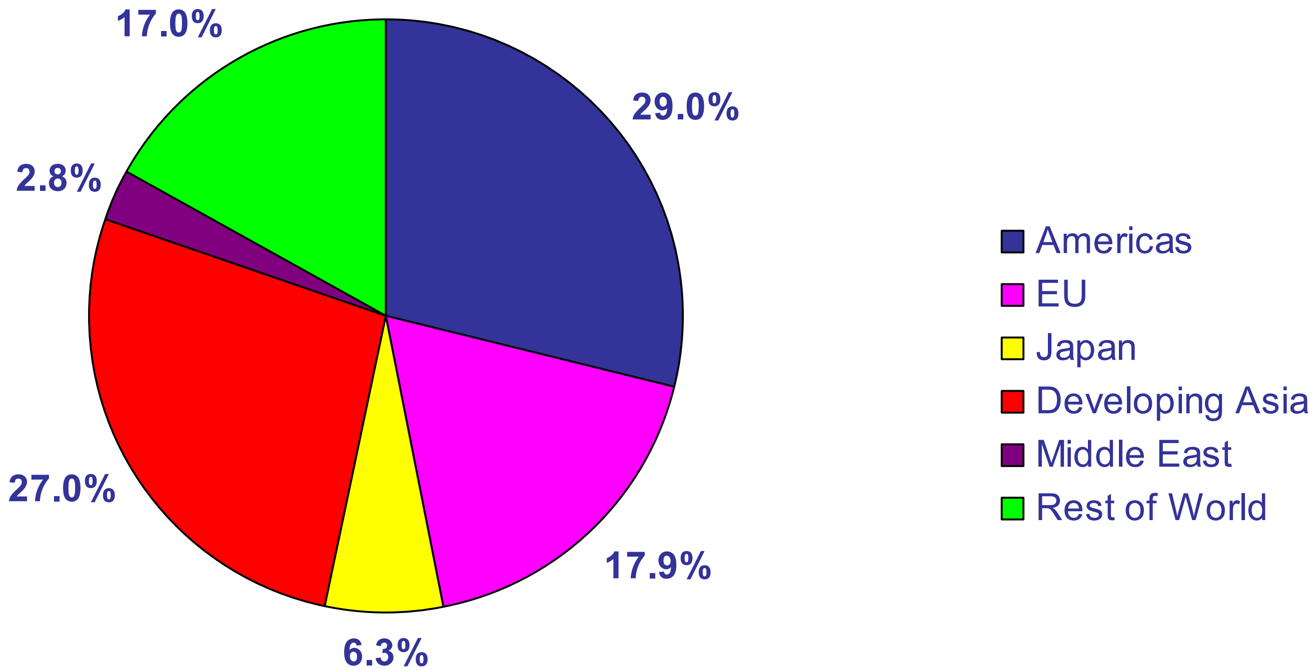
- **Location & New Geography:**
  - Increased de-linking from the US business cycle
  - MENA well located to benefit from relocation of trade & economic activity. Asia now represents about 40% of world GDP
  - Regionalism & investment in network infrastructure (power, telecoms, energy) permit economies 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

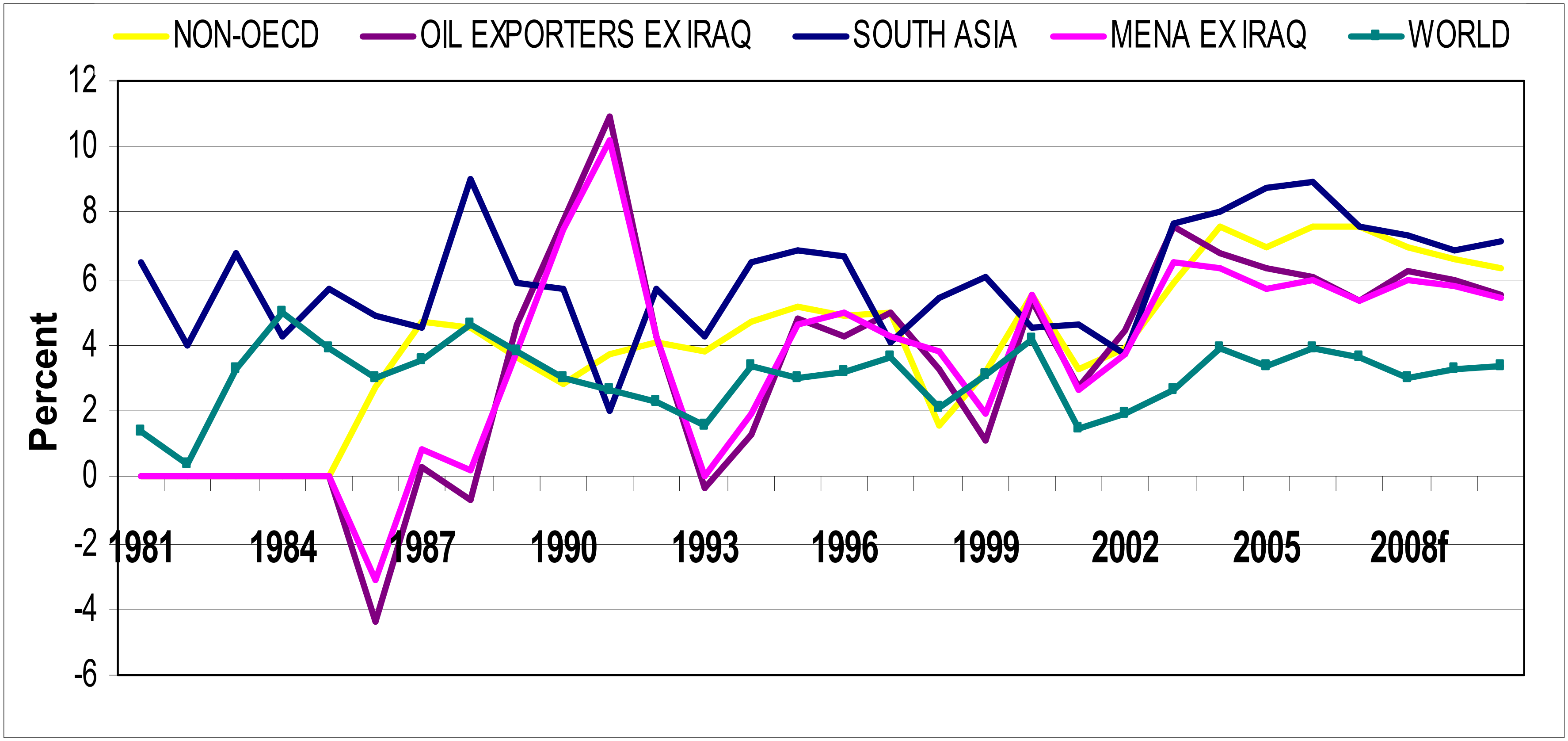
WEO Groups Share in Aggregate GDP-Based on PPP

Source: IMF WEO October 2007



* includes US, Canada, Western Hemisphere

Real GDP Growth: Actual & Forecast



- ***Real GDP growth has been strong across the Middle East with emerging market countries in South Asia to continue to lead the way.***

Source: EIU, February 2008

Increase in Wealth and Liquidity

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- Value of oil wealth of Middle East oil exporters increased by an estimated $30 trillion between 1995 and 2007
- Massive Wealth Creation:
  - Currently, the GCC region's proven oil reserves stand at 484.3 billion barrels and natural gas reserves at 41.4 trillion cubic meters accounting for 40.3% of the world's proven oil and 23% of natural gas reserves, respectively.
  - Given global energy demand growth projections, using conservative estimates for oil prices at $48/bbl, the projected cumulative oil and natural gas revenues for the GCC in the 2005-2030 period totals $5.1 trillion. [Goldman Sachs]
- Permanent Income increase of some **$550** billion at a real rate of 3%

Increase in Wealth and Liquidity

- Accumulation of Net Foreign Assets with cumulative Current Surpluses (2003-2007) of oil producers $934 billion (GCC $702 billion) & international reserves
- MENA international reserves have tripled between 2003 and 2007: $242.9bn (2003) to $776.6bn (2007)
- ***GCC have become 'asset based' economies***

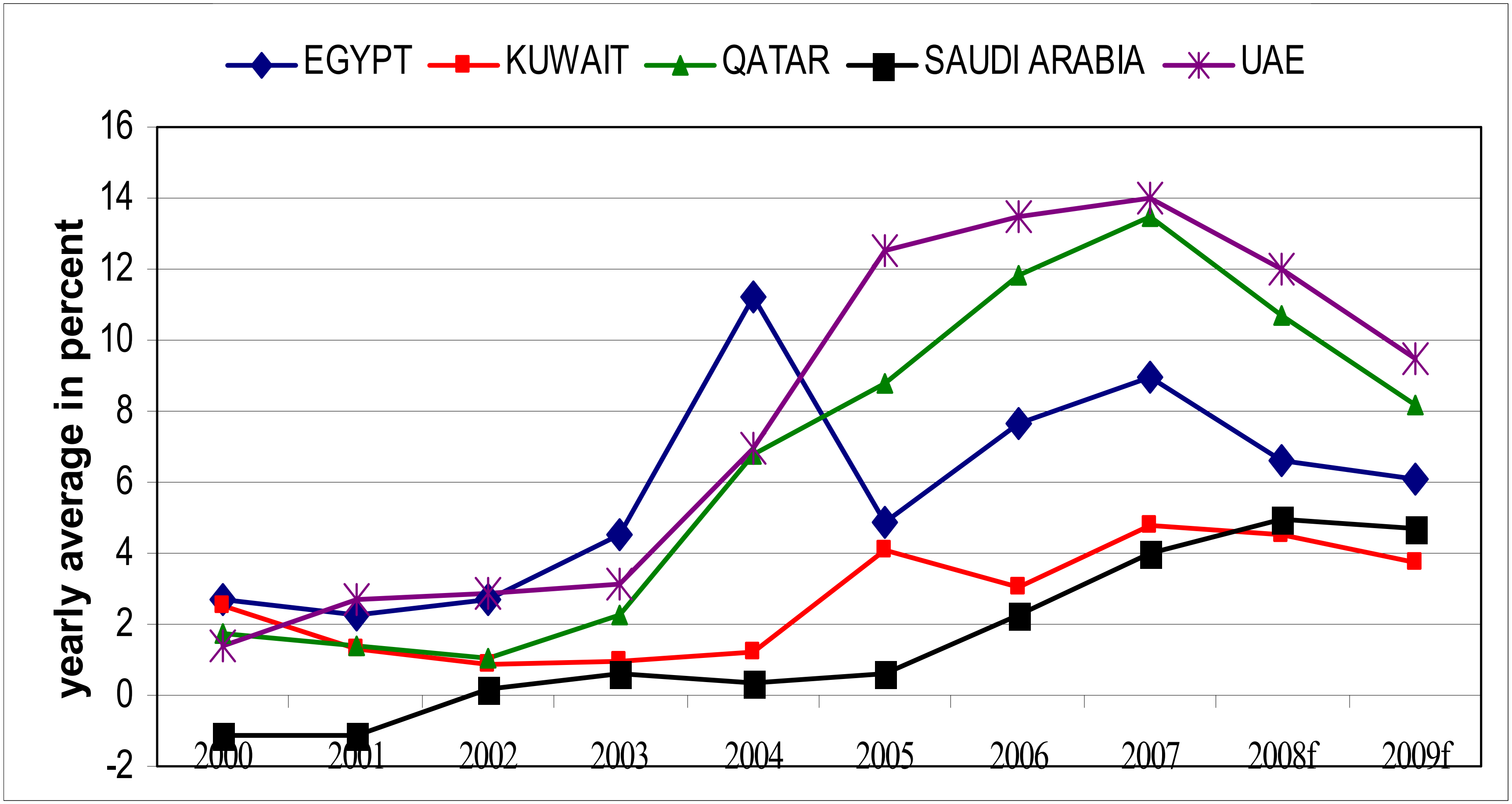
Conservative Fiscal Policies

- Fiscal Policy:
  - Oil producers policy reaction has been fiscally conservative: ½ of increased 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
- Investment policies less dependent on oil revenues

Monetary Policy and Asset Markets

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

Inflation in the GCC and Egypt



Source: EIU, February 2008.

Strong macroeconomic fundamentals imply <u>low macro risks</u>:

- **High growth rates driven by higher oil prices, 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.**

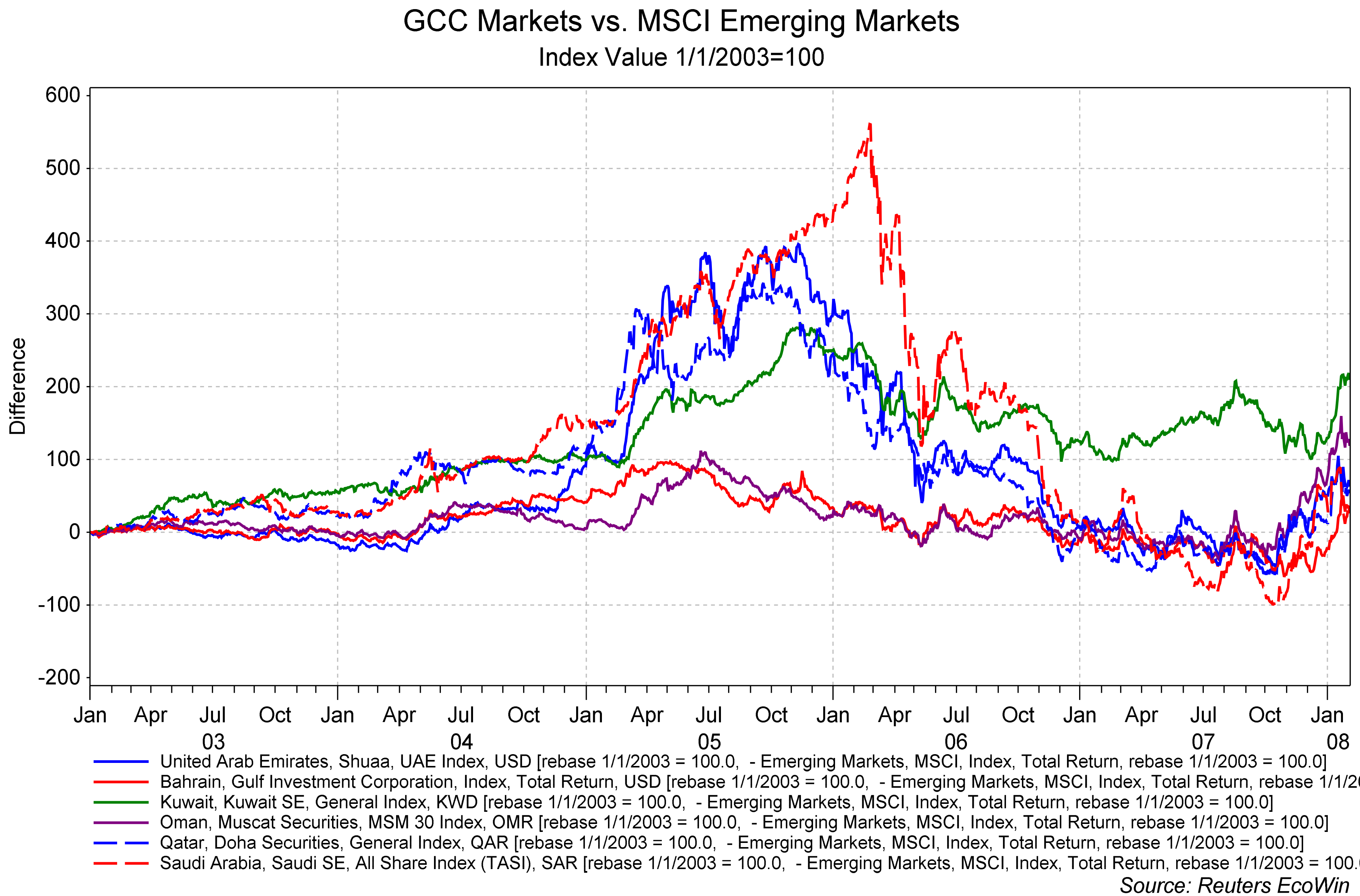
Liquidity & the Stock Markets

- 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.
- 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.

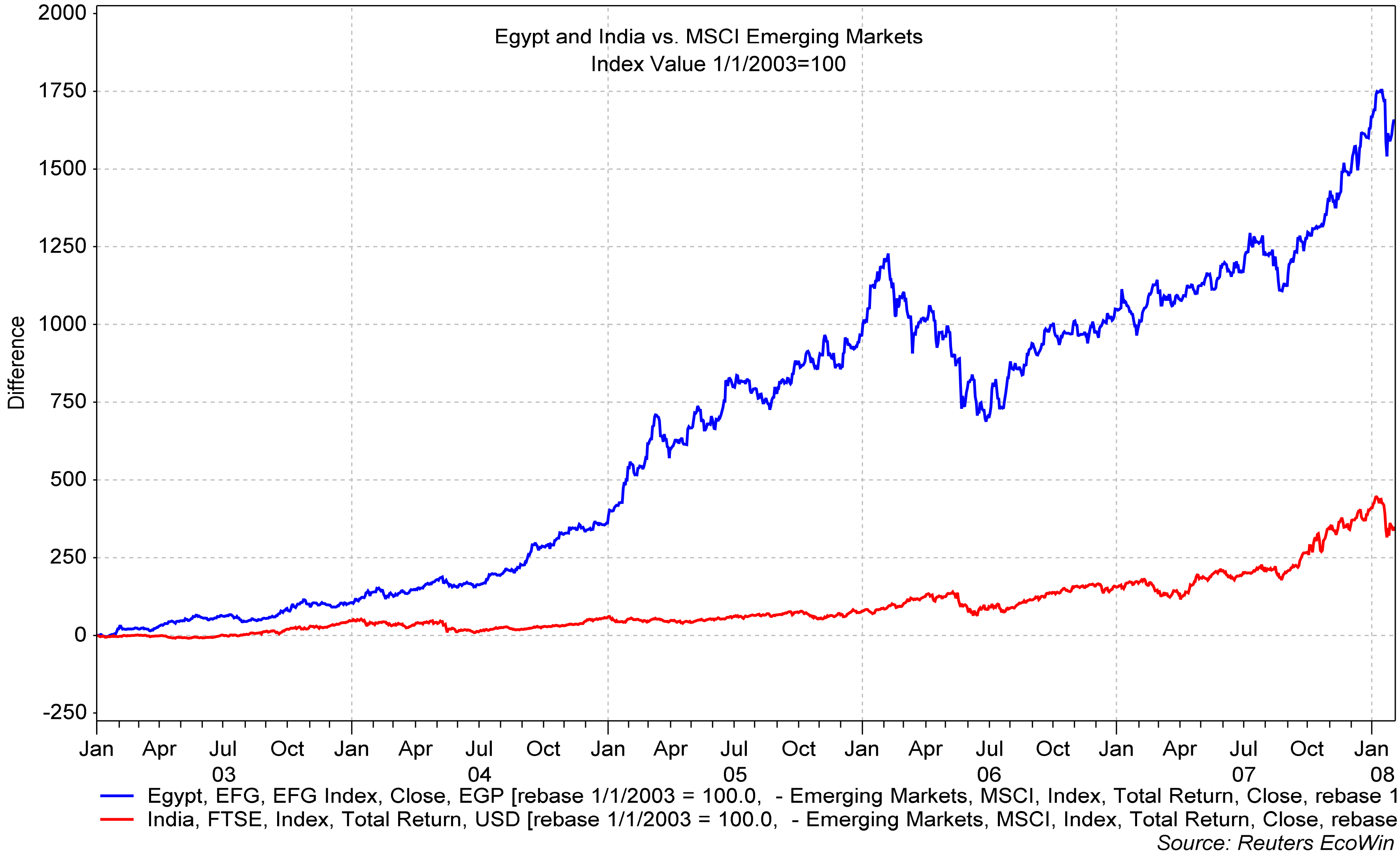
GCC Markets Recent Performance, 2002-2007

- The correction of the overly exuberant equity markets in 2006 came as a wake-up call for action, signalling the need for reform to restore investor as well issuer confidence.
- High average returns were also highly volatile: risk-adjusted returns lower than in emerging markets, developed markets or un-hedged investment in oil!
- Growth of Shari’a compliant finance

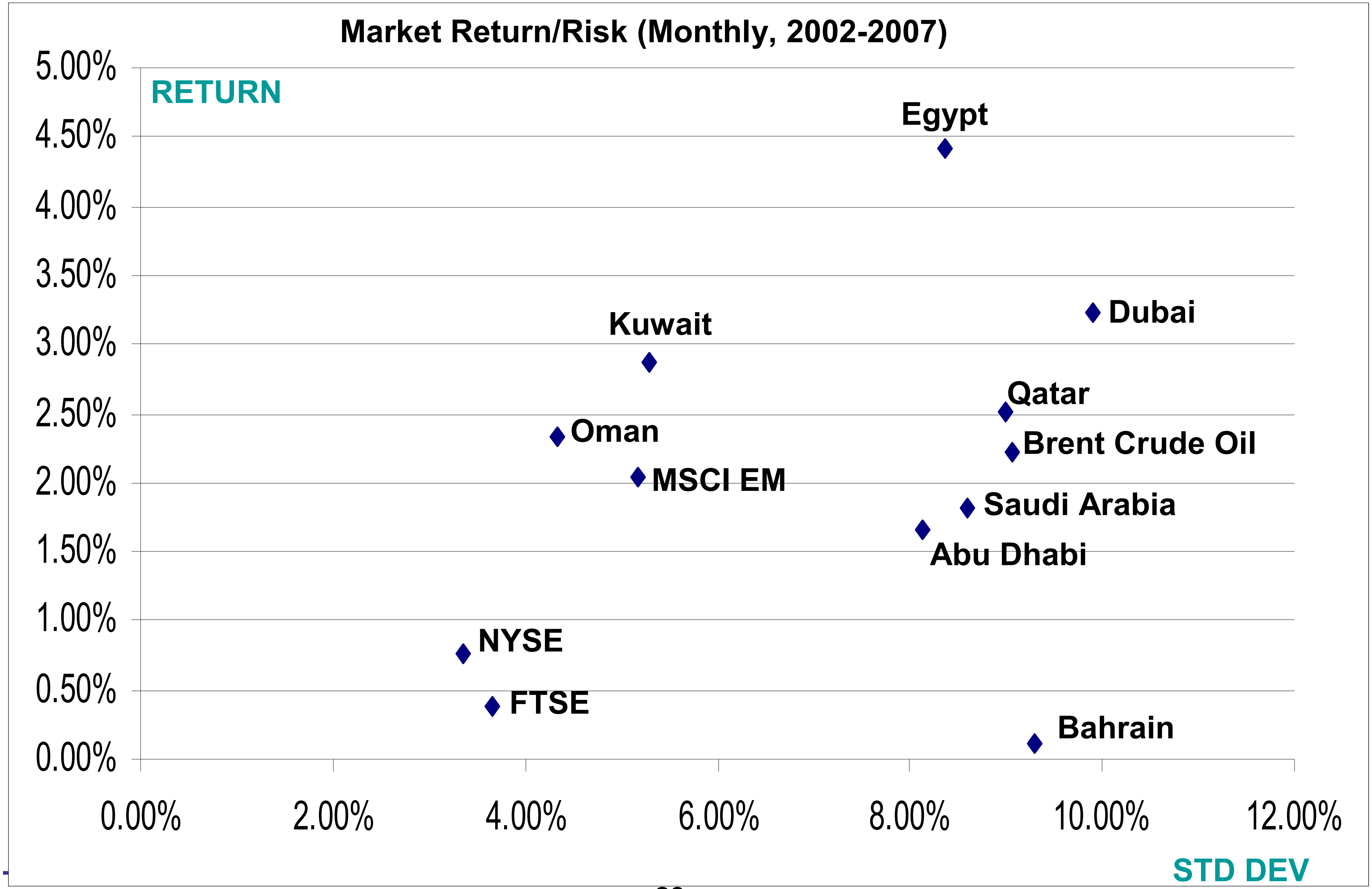
GCC's Stock Market Performance



Egypt and India's Stock Market Performance



Capital Markets: Strong Fundamentals but High Volatility



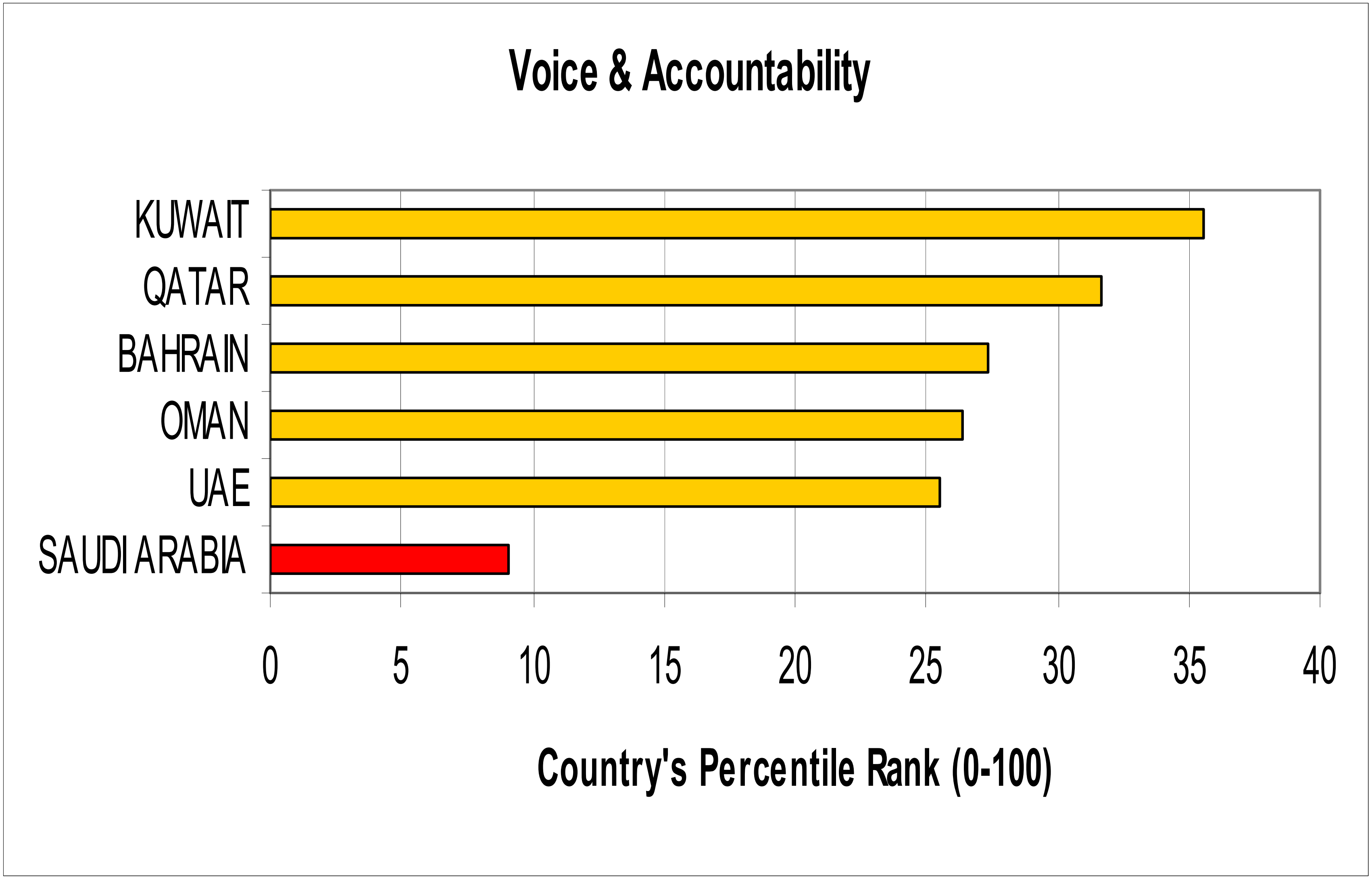
ME/GCC Economic Outlook

- ME/GCC and Central Asia are living an 'economic renaissance' with above trend growth.
- 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 an increase in productivity and absorptive capacity.
- Inflation rate is forecast to decline from 8.8% in 2007 to 7.7% in 2008 for MENA and from 4.5% to 3.9% 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.
- 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.

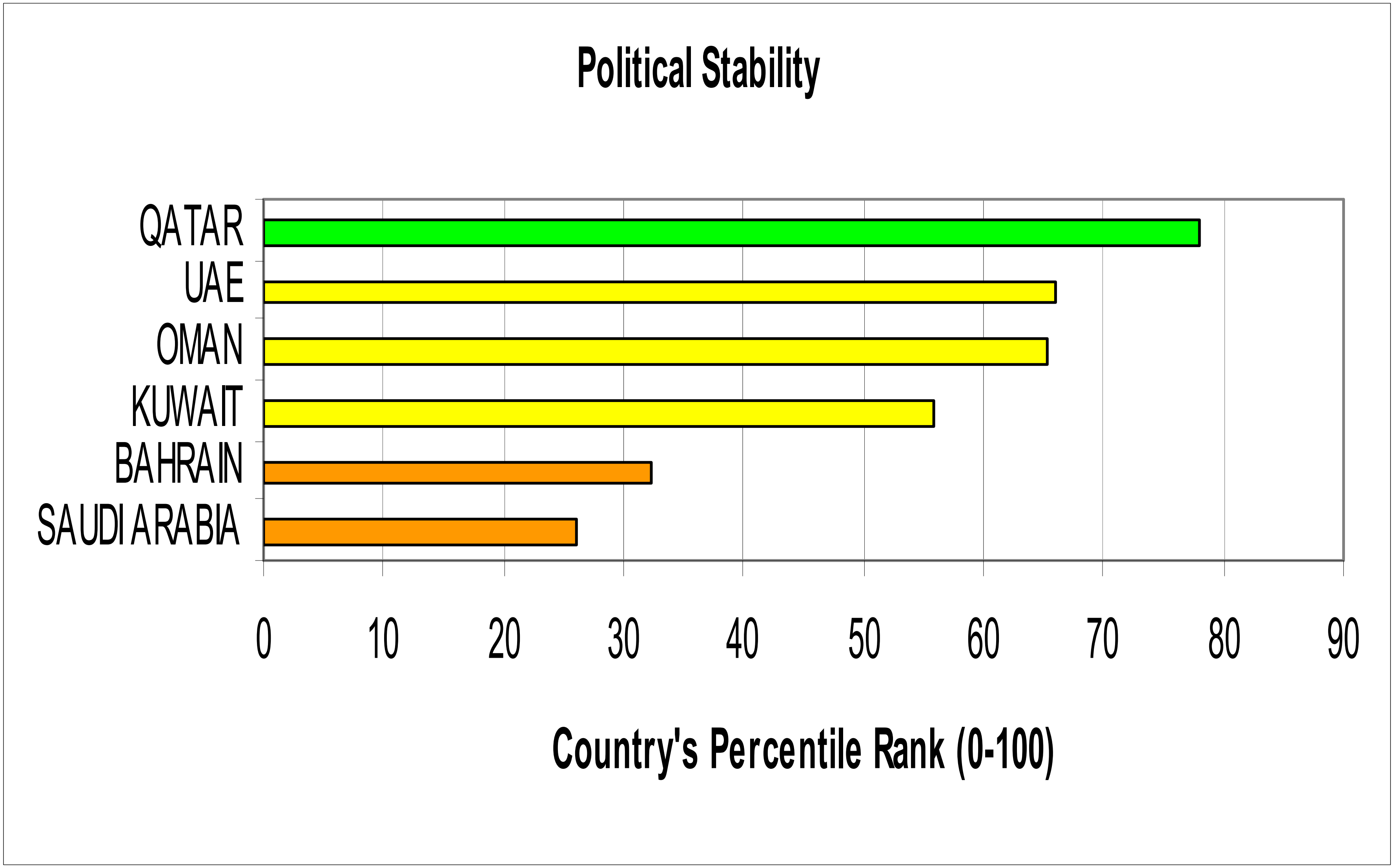
Dimensions of Public Good Governance
(Source: World Bank)

- Voice and accountability
- Political stability; No violence or conflict
- Government effectiveness
- Control of corruption
- Regulatory quality
- Rule of law

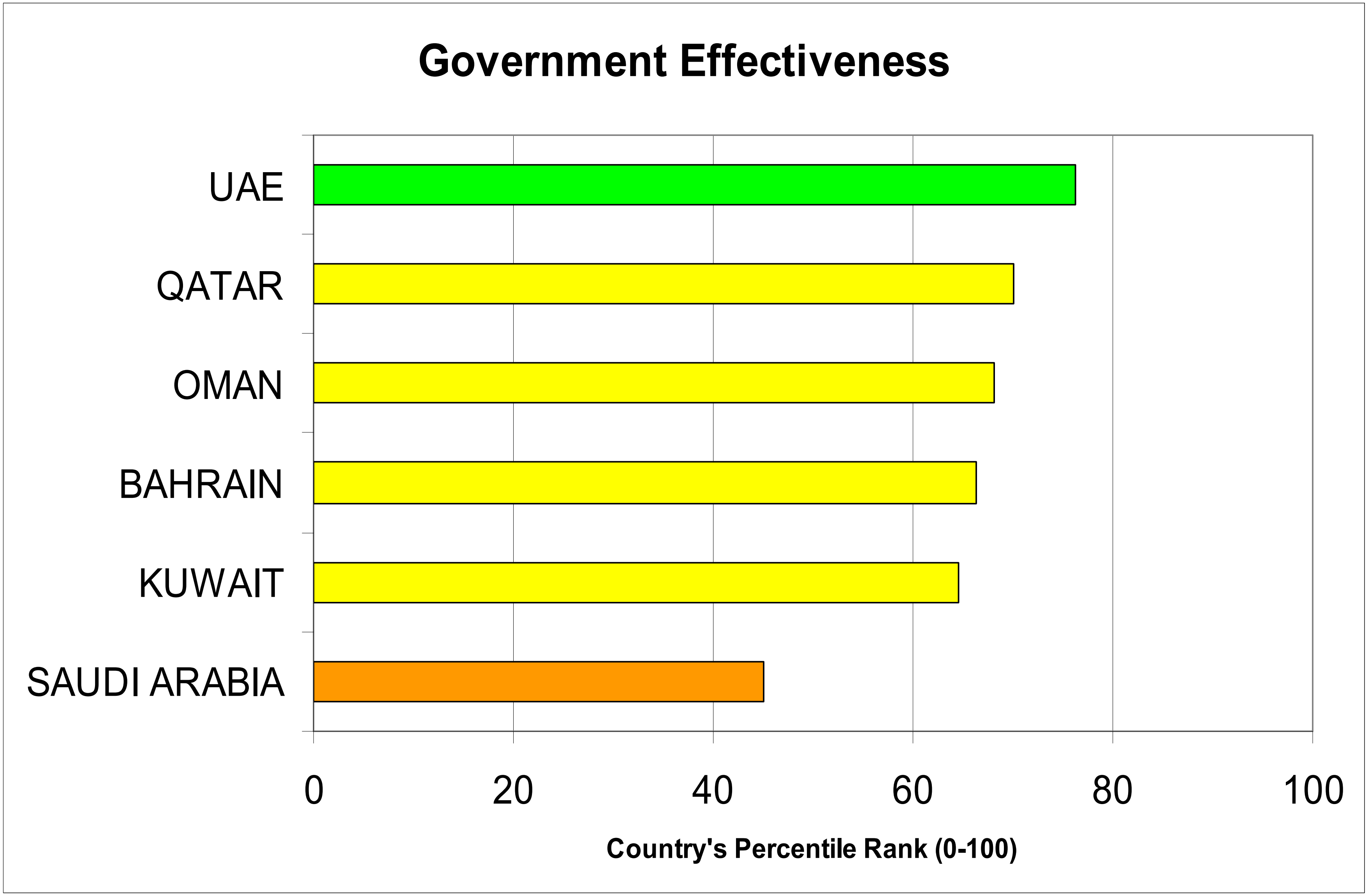
Governance: Voice & Accountability



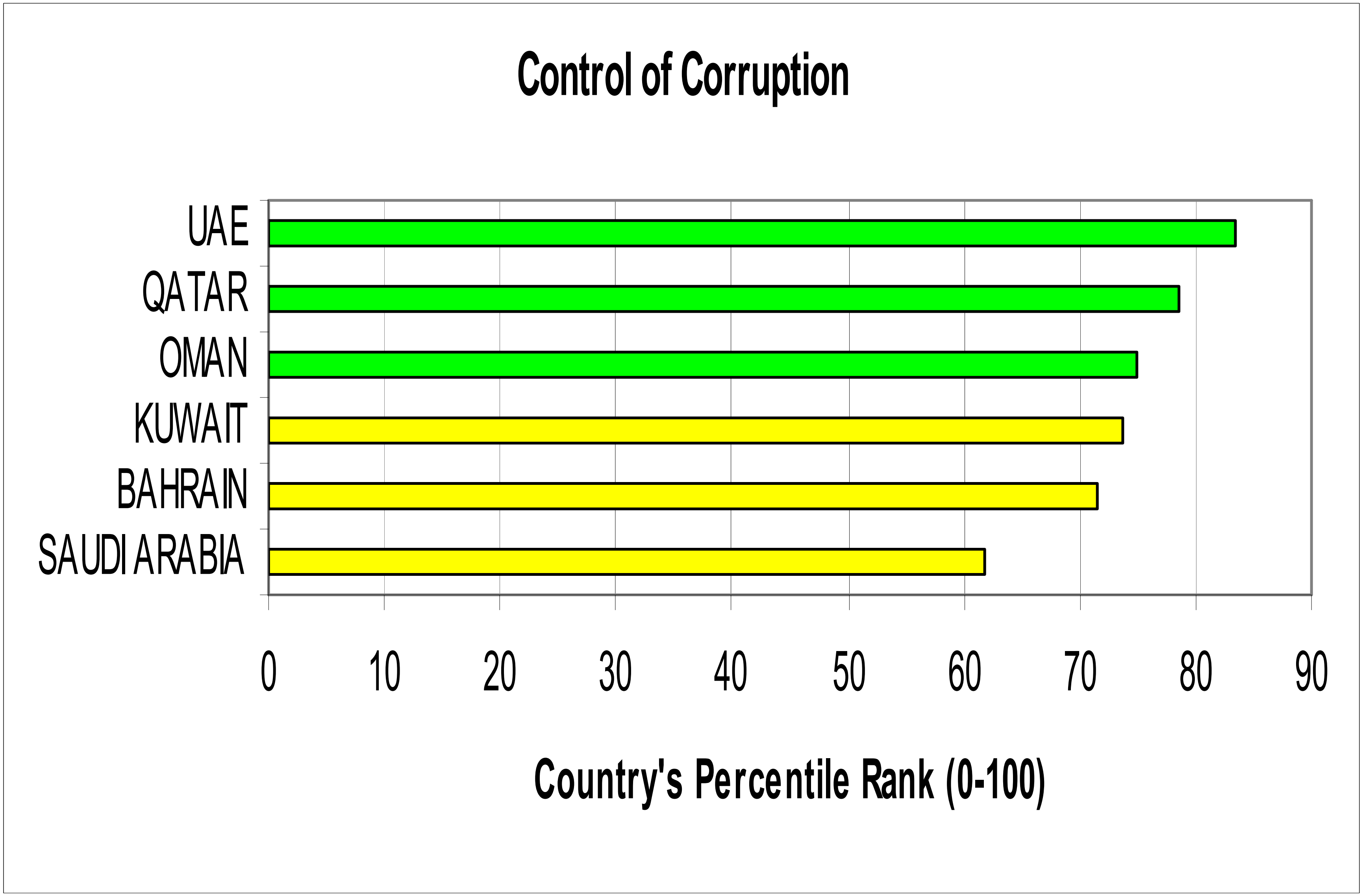
Governance: Political Stability



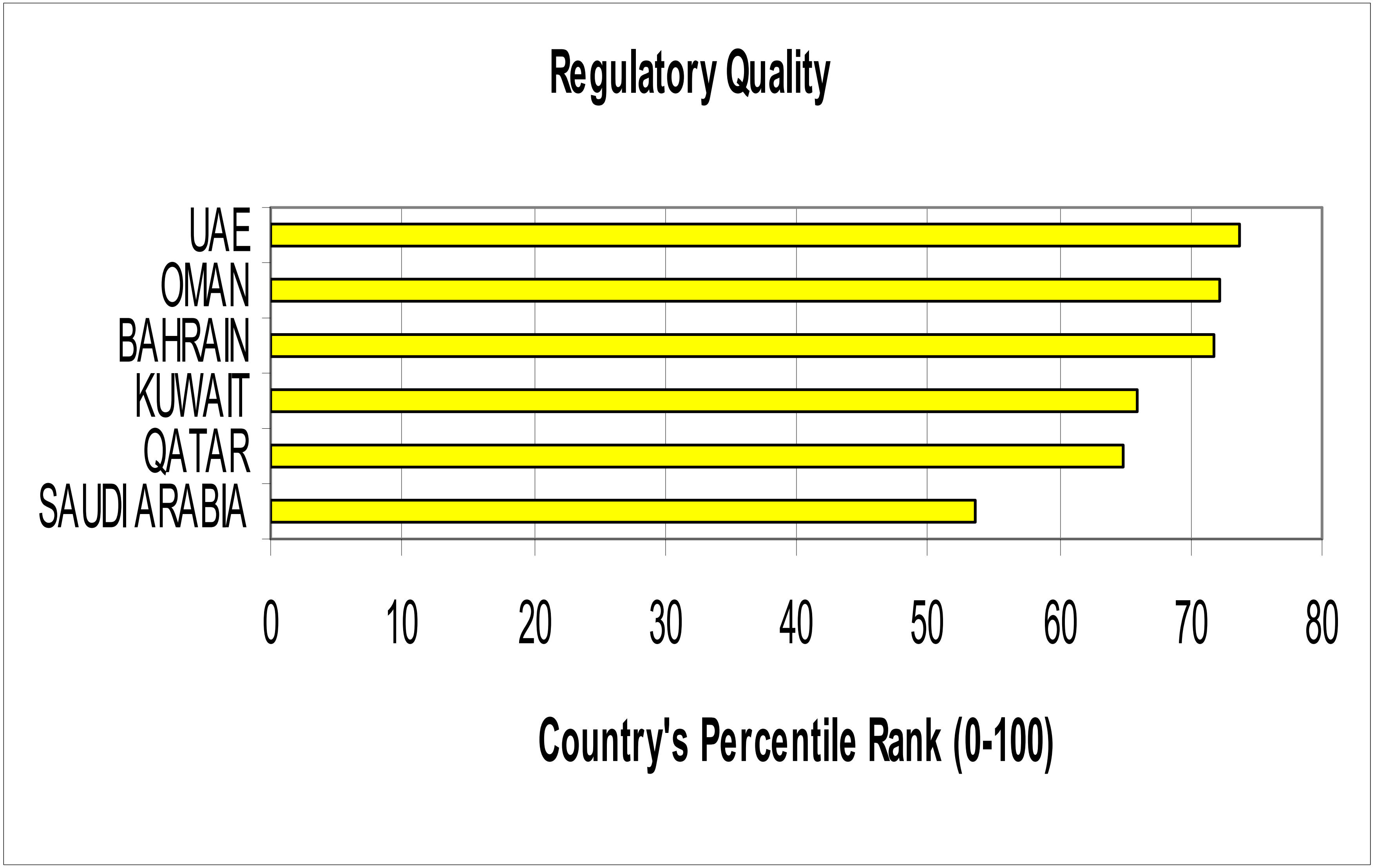
Governance: Government Effectiveness



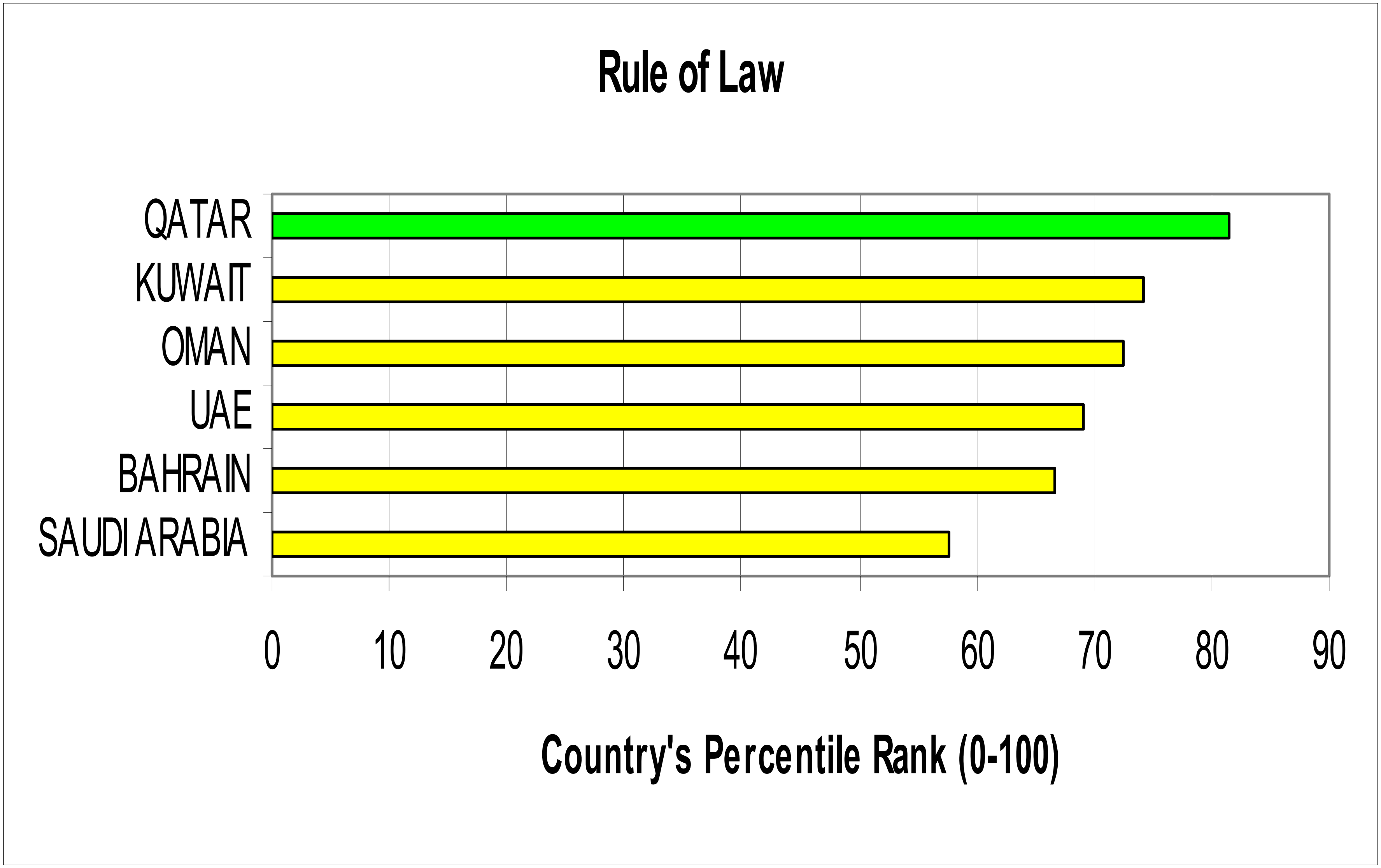
Governance: Control of Corruption



Governance: Regulatory Quality



Governance: Rule of Law



ME/GCC Risks and Prospects

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- Security issues and geo-political instability are a source of risk
- A global slowdown induced by slower growth in the US is likely to have less of an effect than in previous business cycles. The world's economic geography has changed with its 'epicenter' moving towards Asia.
- Lower oil prices along with increased government spending may reduce the current account surpluses of the oil producers; however, this is not likely to have a substantial impact on investment spending or on government budget surpluses, as long as oil prices remain above $38 to $40 per barrel.
- High levels of liquidity available and growth of Islamic finance imply lower sensitivity of local asset markets to movements in global interest rates
- Increased Regionalism, Diversification, Infrastructure investment, Openness and growing Linkages to Asia are resulting in progressive de-linking from US-EU business cycles

Financial Sector Development is Central Challenge for Region

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- Change in Global Economic Geography requires accompanying change in Global Financial Geography
- Time to build the linkages and stronger economic integration within ME/GCC and with Asia
- Invest, Manage and Control region's financial wealth of $2+ trillion and growing as a result of high energy prices:
  - Financial sector can be an engine of growth
  - Strategic issue: security and safety of assets
- Financing Infrastructure & Regional Economic Integration
- Develop new markets and instruments
- Enable & support economic and financial reforms:
  - Enable separation of oil revenue management from fiscal policy & investment
  - Privatisation and Private sector Participation in Infrastructure
- DIFC aims to play a central role in MENA's Renaissance

MENA RENAISSANCE & CAPITAL MARKETS:
A Time for Vision
A Time for Action
A Time for Architects and Designers
A Time for Builders & Investors

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