



MENASA Capital Markets: Going Forward

MENASA Forum Plenary Debate

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Agenda

Towards Emerging Markets: Changing Economic & Financial Geography

New Financial Architecture & End of the Hub-Spoke Model

The Future of Regional Capital Markets

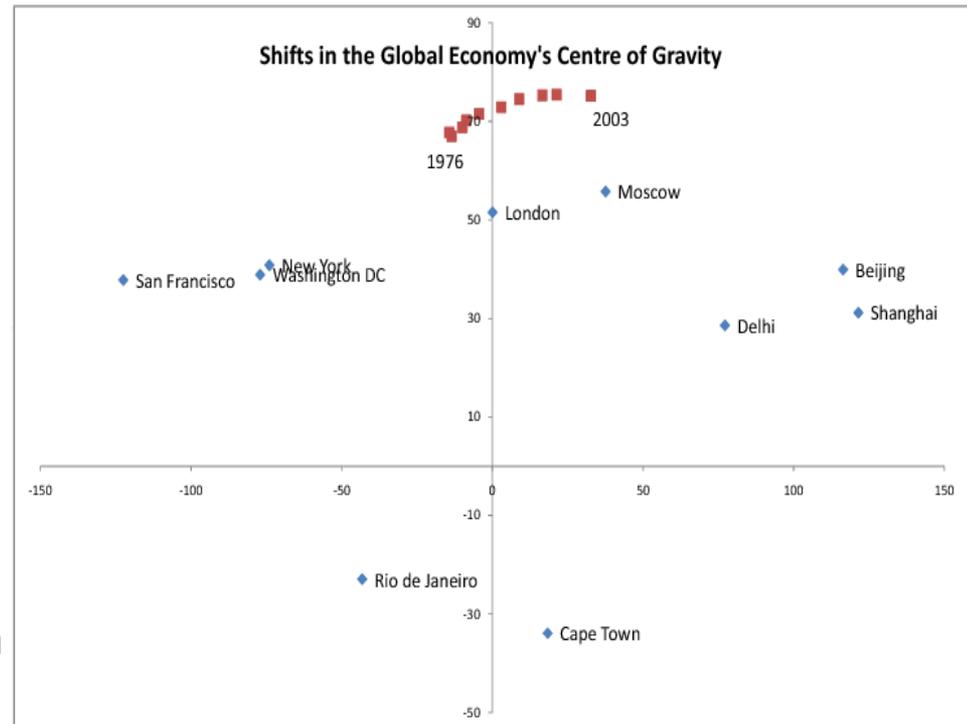
Need for Developing Local Currency Markets

DIFC's Transformational Role

Emerging Markets: Changing Economic Geography

Emerging markets have contributed 2/3 of global growth since 2002.

- The world's economic centre of gravity in 1976 was a point West of London, somewhere towards the middle of the Atlantic Ocean.
- But in the 30 years since then, that centre of gravity has drilled 1800 km - one third of the planet's radius - away from the US & towards the East. Epicentre between Dubai & Shanghai !
- Interestingly, evidence shows **geographical shift accelerated in 1991 & 2001 - each time the US was in recession!**
- In less-turbulent times, between 2002 and 2007:
 - ✓ China's average contribution to world economic growth approached 66% that of the US;
 - ✓ China and India's together, almost 85%;
 - ✓ East and Southeast Asia's, more than 130%.



Emerging Markets: Changing Financial Geography

- The new economic geography is reflected in the evolution of capital markets
- The crisis will contribute to eradicate the hub-spoke model centred on London and New York giving impetus to a transition to a polycentric, spider web model

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009(E)
World Market Cap	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
United States	46%	47%	50%	47%	45%	43%	39%	36%	31%	33%	28%
Rest of Developed	46%	45%	41%	42%	44%	44%	44%	44%	41%	41%	41%
Emerging Markets	8%	8%	9%	11%	12%	13%	16%	20%	28%	26%	32%
BRIC	2%	3%	3%	3%	4%	4%	6%	9%	17%	15%	19%
Rest of Emerging	6%	5%	6%	7%	7%	9%	11%	10%	11%	11%	13%
of which GCC	0.3%	0.3%	0.4%	0.9%	0.9%	1.3%	2.5%	1.3%	1.7%	1.6%	1.2%

New Financial Architecture & End of Hub-Spoke Model

Nearly two-thirds of the increased financial stress in MENA countries following the Lehman shock is attributable to direct or indirect spillovers from financial stress in advanced economies. (IMF, WP/10/8, K. Moriyama, Jan 2010)

We need to design and move to an architecture of networked financial markets - a more stable and sustainable **“spider - web”** model.

- Where there is not a small number of financial centres intermediating and reallocating the entire world’s savings.
- Rather, there are numerous international financial centres across the globe that have the capital market depth & regulatory sophistication to absorb excess capital from their own regions, as well as from elsewhere.
- Such a model will prevent the enormous accumulation of savings in just one or two financial centres, creating an unstable sloshing of large waves of capital.

The move from New York/ London to the “-ai” markets – Dubai, Mumbai, Shanghai!

Financial Regulatory Revamp

General lessons for Financial Regulatory Revamp:

- Markets are not self regulating and rules are rarely self enforcing
- Leverage must be capped
- Liquidity must be preserved
- Regulation must be enforced with effective action not tick box approach

IIF's comments to the latest Basel Committee on Banking Supervision proposals covers:

- ✓ Cumulative Impact Assessment and Timing: design & calibration of the proposals needs to be based on assessment of their cumulative impact, with full consideration of the interdependencies among the proposed measures.
- ✓ Capital Composition: improving the composition of banks' capital is necessary. However, the proposed rigid definition of capital will have a significant impact on firms' lending.
- ✓ Leverage: The proposed gross leverage ratio (disregarding all risk mitigation) would result in an overstated and misleading view of firms' economic risks, leading to disproportionate constraints on lending.
- ✓ Counter-cyclical Measures: a combination of risk management, forward-looking provisioning and capital tools is needed to address pro-cyclicality.
- ✓ New Liquidity Framework: The current proposal fails to consider market effects, for example, in defining eligible assets.

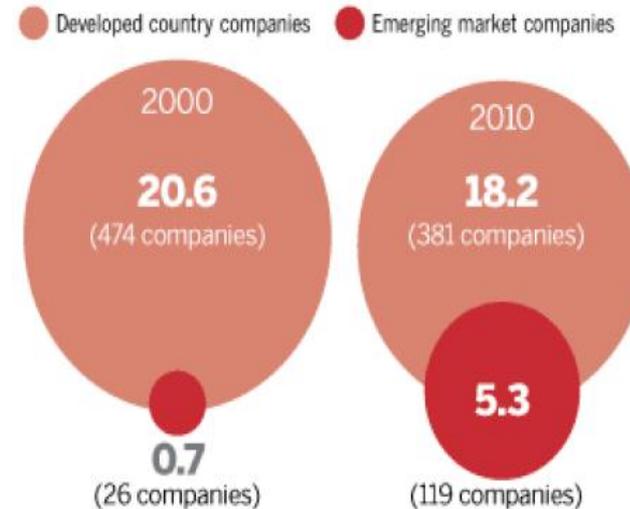
Growing South-South relations

- Emerging markets have contributed 2/3 of global growth since 2002.
- US& UK had expanded as capital exporters; now it's the turn of the EMEs.
- Wealth in the EMEs suffered a setback in 2009
- HNWI financial wealth is expected to recover to \$48.5 trn by 2013; Asia-Pacific will overtake North America as the largest region for HNWI financial wealth
- Shift from West to East is obvious; domestic demand is the key differentiating factor
- Most visible recently : Corporate Acquisitions
- For the first time (2009) takeovers by emerging world companies of developed world groups: \$105bn > takeovers going the other way at \$74.2bn, according to Dealogic.

=> ***Terms of trade b/n developed & emerging market groups are changing, with power shifting to the emerging world.***

The pendulum swings

Market capitalisation of FT500 companies (\$'000bn)



Emerging market M&A deal value (\$bn)



Sources: Dealogic; FT research

What Lies Ahead? Looking to the Future

- About 2/3-rds of the world's proven oil reserves are located in this region.
- Oil reserves are estimated at over 37 trillion USD (see DIFC Economic Note # 4 on www.difc.ae)
- Gone is the era of recycling petro-dollars: these resources are now, for the first time, not amassed into foreign bank accounts but used domestically
- The diversification drive implies extracting energy resources and transforming them into the platform for the development of a XXI century knowledge based economy.

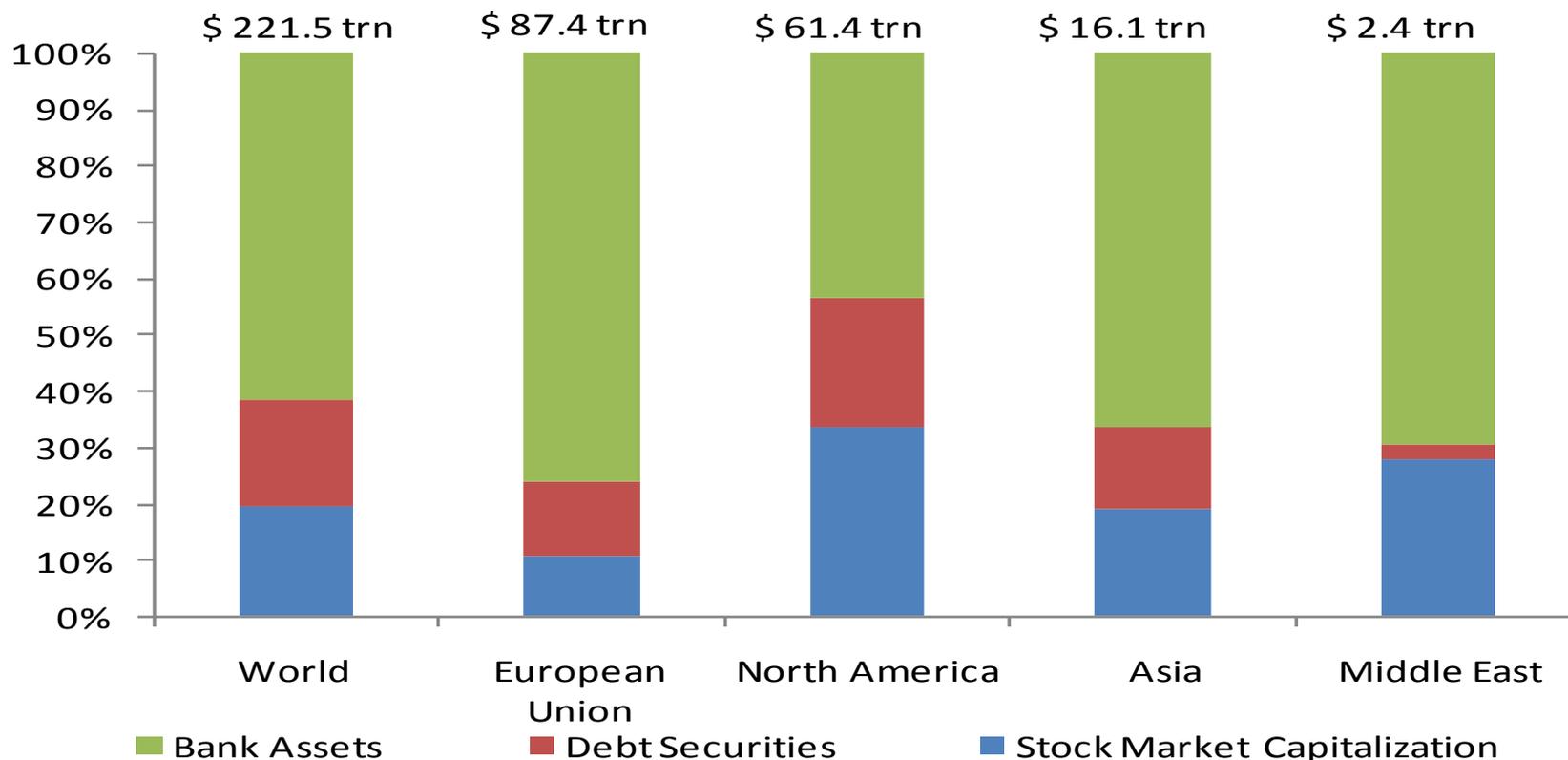
What Lies Ahead? Looking to the Future

- What additional measures are needed for capital markets?
 - ✓ ***Integration of capital markets: starting with the equity markets of UAE***
 - ✓ ***Need to develop local currency debt markets***
 - ✓ ***Creation of a second-tier market for family-owned, small and medium enterprises, the most dynamic of which are located in the free zones***
 - ✓ ***Strengthen market resilience***
 - ✓ ***Engage in design of new International Financial Architecture, policy & regulation***
 - ✓ ***Institutionalize and build economic policy capacity***
 - ✓ ***Increased transparency & disclosure***

Financial Depth Across Regions: Undeveloped Markets

- In the MENASA region, capital markets are dominated by bank assets and equities
- Debt securities make up only 2.7% of the Middle Eastern capital markets!

Financial Depth Across Regions



Local Debt Markets: Cornerstone of Development Policy

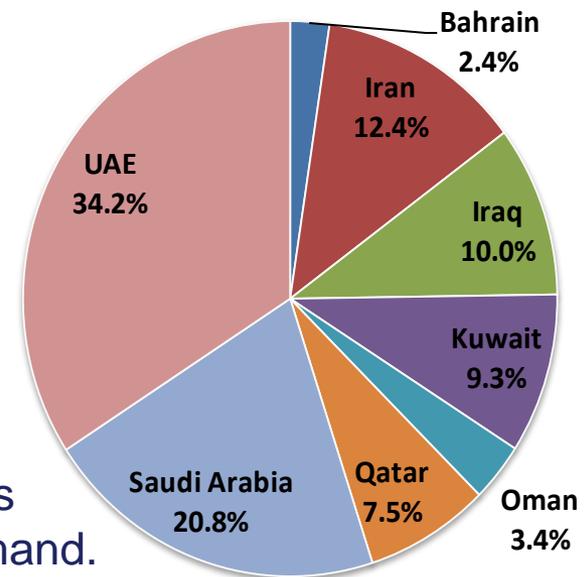
Potential drivers of MENASA Debt Market

- **Finance infrastructure** and development projects in the region
- **Corporate Debt:** Well functioning debt markets will help reduce dependence on bank finance at a time when the banking sector is in a process of deleveraging
- **Government Debt:** Diminish macroeconomic and financial vulnerability from energy price fluctuations by providing governments with an alternative source of funding to smooth out volatile revenues
- **Enable monetary policy** by providing central banks with a market to conduct open market operations & control liquidity
- **Mortgage Markets:** cornerstone of housing finance
- Provide **institutional investors** instruments that offer safe and stable long term yields in local currency

Local currency bond markets are a cornerstone of development strategy

Infrastructure Investments

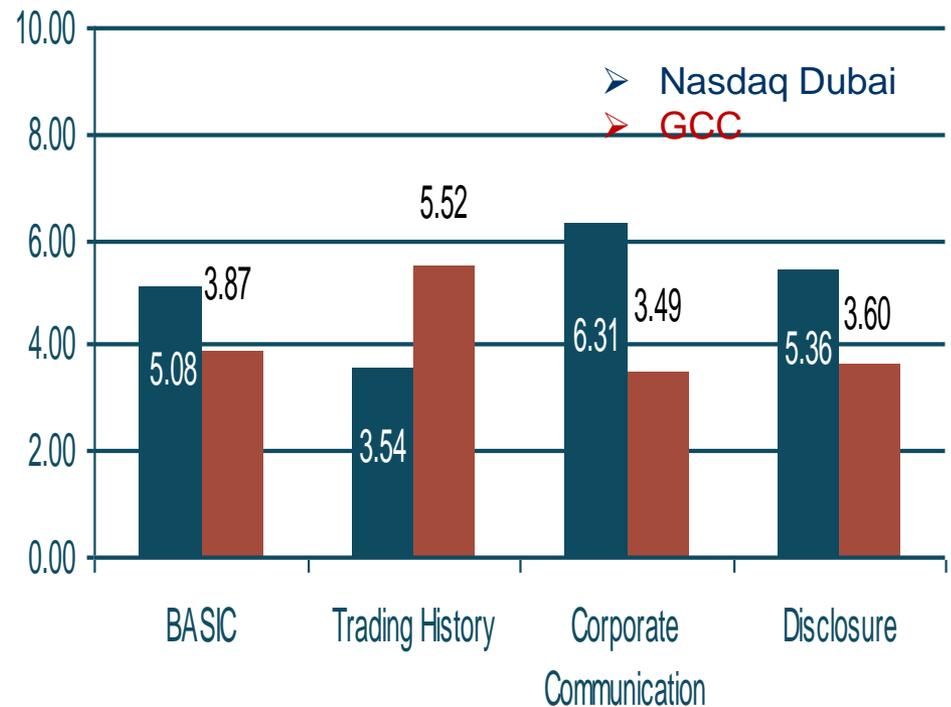
- There are essentially **two epicentres in MENASA** : GCC & India
- Massive infrastructure investment by GCC countries has been a major factor & contributor to recent (2003-2008) economic growth, productivity gains, increased private sector investment and diversification.
- As of Apr 26, 2010, MEED Projects estimates value of projects planned and underway in the Gulf region at \$2.26trn.
- India is the second hub, with close to 500 bn in planned Infrastructure Development till 2012.
- **Complementarity on both production & financing side:** GCC are resource-based, K exporters with abundant liquidity; India & others might require this to meet their infrastructure demand.
- Infrastructure spending continued despite the financial crisis: helped stabilize economies, avoid contagion effects from credit crunch & sustain growth.
- It is imperative to accelerate the pace on infrastructure & network projects that foster **regional integration**



Transparency & Disclosure

One of the important lessons that came out of the global financial crisis was the need for increased transparency and disclosure – both at company and product level.

- The continuing reporting requirements of DIFC-listed companies results in high levels of transparency and disclosure.
- The BASIC report was developed by The National Investor and Hawkamah, (www.tnihawkamahresearch.org/), providing systematic insight into a number of essential parameters (including transparency & disclosure) which constitute the backbone of Corporate Governance
- NASDAQ-Dubai companies, which were included for the first time, came in as BASIC leaders compared to regionally listed companies.
- Nasdaq Dubai companies scored some 31% higher on than the GCC average.



Risks to Recovery

1. The fiscal crisis in major economies, USA, euro area, Japan

- i. Inflationary pressure build up
- ii. Crowding out of private investment => drop in productivity
- iii. A weak recovery is not sufficient to generate enough resource to repay the fiscal debt => the Japanese syndrome spreads
- iv. Pension systems' liabilities (and the health care reform cost in the US) become unsustainable

2. The persistence of current account imbalances

- i. Developed countries try to continue living beyond their means
- ii. China and Germany persist in their mercantilist approach

3. A property bubble in China

4. Indecision over a new financial regulation framework

- i. Different country approach lead to intensification of regulatory arbitrage
- ii. Re-emergence of the shadow bank
- iii. Too big to fail or too interconnected to fail issues remain unaddressed

Structural Reforms

- 1. Bankruptcy Law Reforms**
- 2. Corporate Governance**
- 3. Property Law**
- 4. Company Law/FDI Law reform: majority ownership**
- 5. Market Information Infrastructure: central credit reporting; companies' house**
- 6. Regulatory compliance**

Transformational Role of the DIFC

DIFC has achieved **critical financial mass**: it has in place a sophisticated framework of laws, regulations & governance, modeled on international best practices

- ✓ Provides market infrastructure for GCC bloc to emerge as economic and financial hub for MENASA region
- ✓ Provides comprehensive platform for listing, IPOs, privatization, project finance, securitization
 - Opportunity for companies to tap into regional liquidity
 - Conglomerates may use regional capital markets to raise funds via primary & secondary listings
 - Establish vehicles (eg. PE funds): give regional investors exposure to MENASA markets
- ✓ Lower access barriers to financial services
- ✓ Lead integration of financial markets: starting with DFM + Nasdaq-Dubai
- ✓ Develop Regional Debt Market
- ✓ Build payment system infrastructure for \$ and Euro payments

Change in Global Economic Geography requires accompanying change in Global Financial Geography