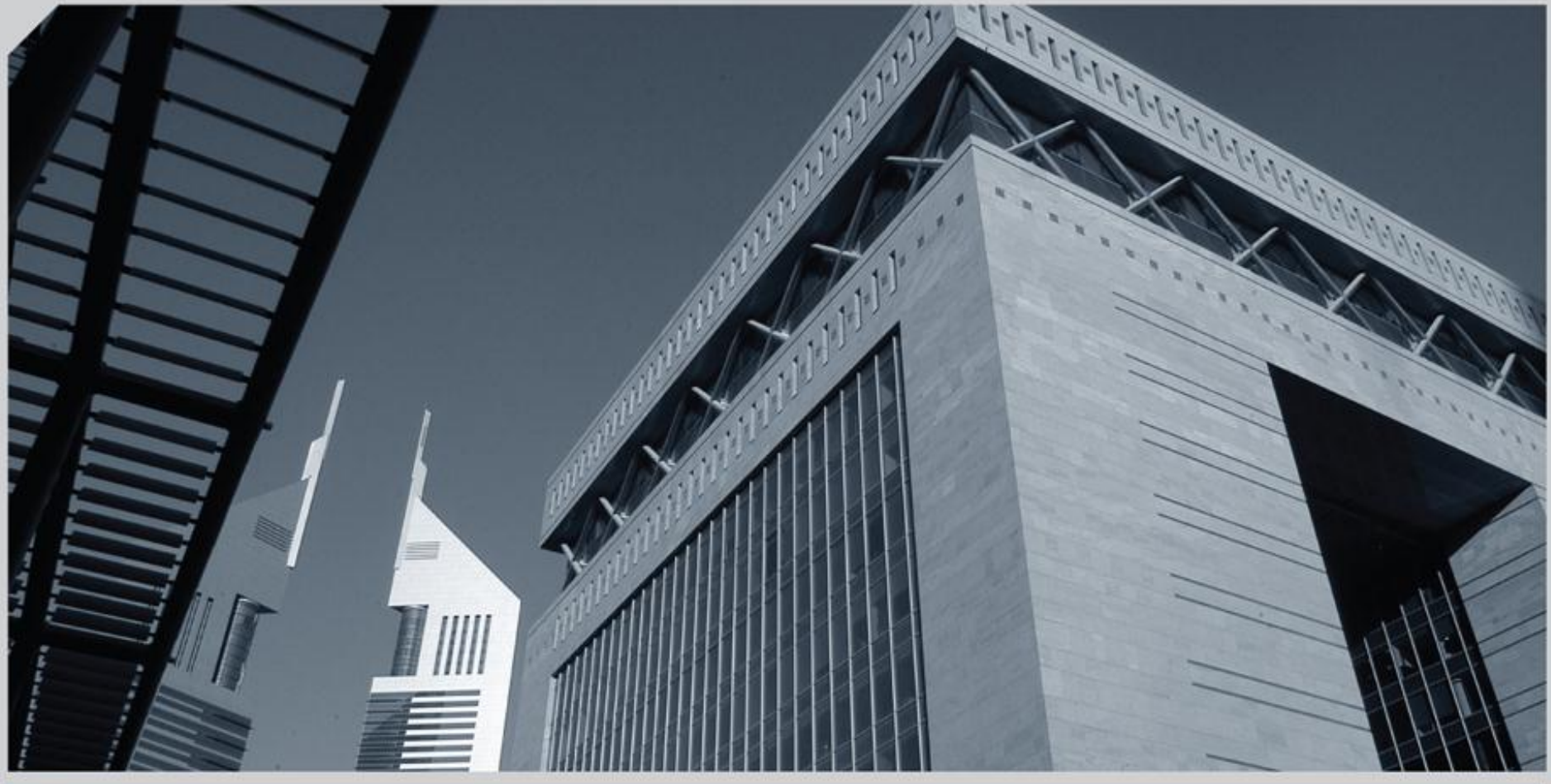

MENAT: Vulnerabilities, Promise & Transformations

- Presentation at the GE Leadership and Global Strategy Event

Dr. Nasser Saidi,
Chief Economist, DIFC
21st June 2012

Dubai International Financial Centre
DIFC

Agenda

- MENA Outcomes & Prospects
- Lessons from Transitions
- MENA Vulnerability Index
- Transformations, Opportunities & Outlook

MENA Regional Outlook

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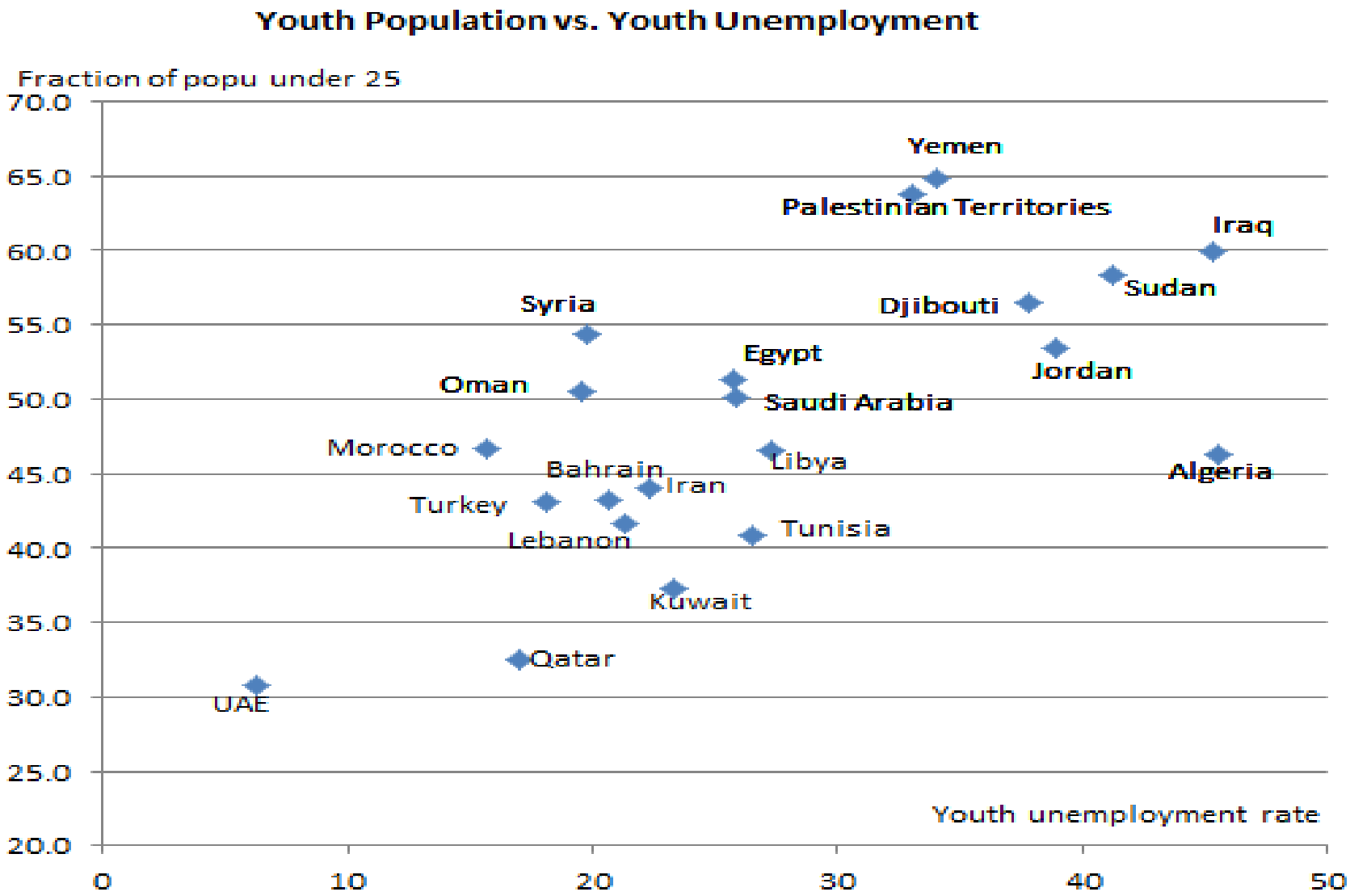
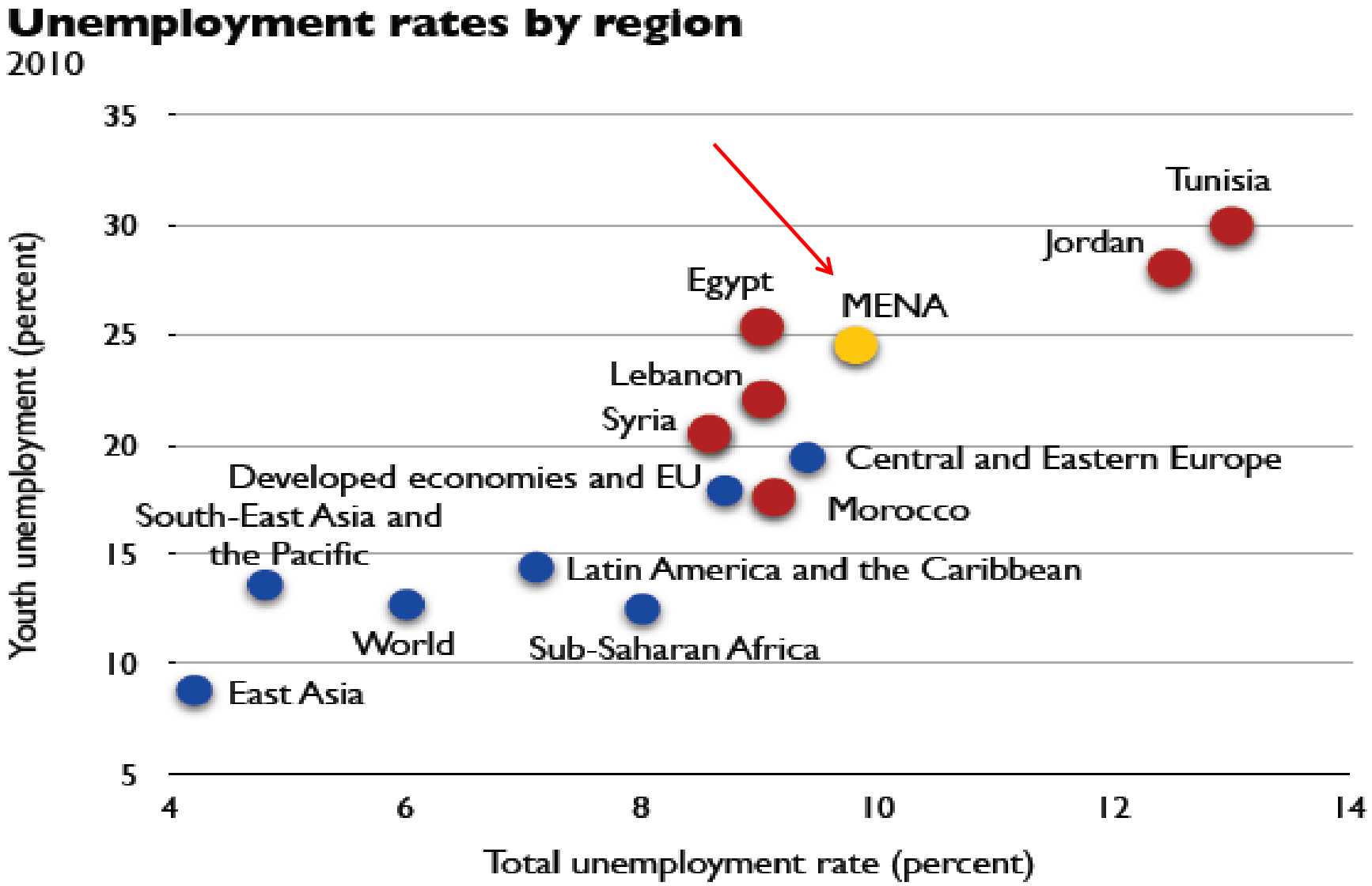
- **MENA growth** is expected at 4.2% in 2012 compared to 3.5% in 2011 but with wide **disparity** in prospects between oil exporters & oil importers.
- On-going turmoil in the region highlights the need to ensure that economic growth is both ***inclusive*** and generates ***trickle-down*** benefits
- Social unrest has spurred **an increase in social transfers** => for oil exporters, government budgets are increasingly dependent on continued high oil prices
- **Risks:** internal challenges within Middle East + geopolitical risks associated with Iran + large potential spillovers from Eurozone Crisis
- **External challenges** from two main sources: oil prices & trade/banking/financial linkages with Europe

Explosive Mix: Young & Unemployed Populations



Source: UN Population Division, DIFCA Economics

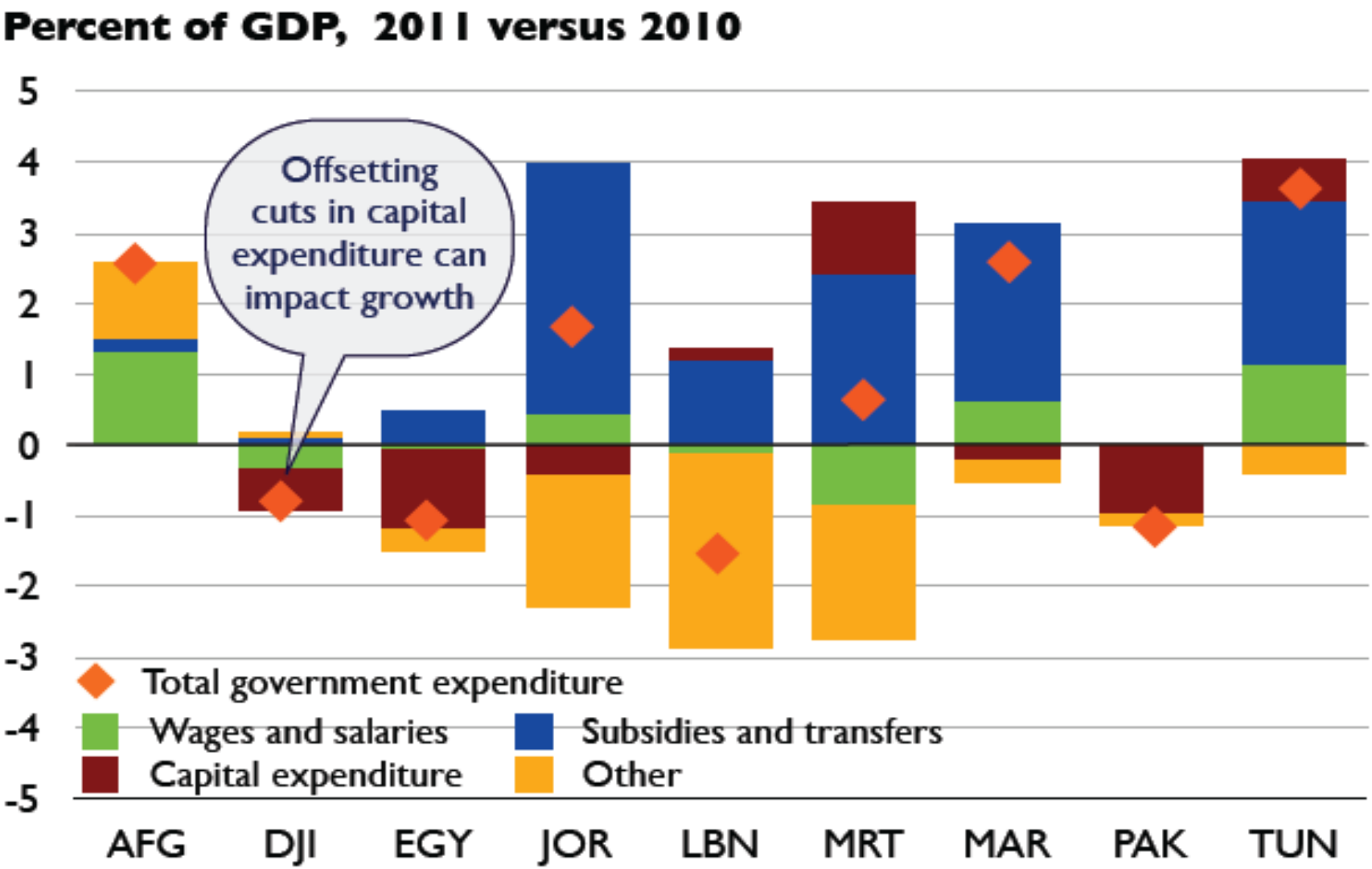
Chronically Higher Unemployment in MENA



Sources: International Labor Organization; national authorities; and IMF staff calculations.

Source: IMF REO presentation, May 2012

Policy Response: Increase Current Spending



Sources: National authorities; and IMF staff calculations.

Source: IMF REO presentation, May 2012

Transition countries: continued turmoil

DIFC

- Short-term outlook subject to unusually large uncertainties: political & security situation + growing uncertainty about external demand.
- Growth, Remittances, Tourism & FDI have declined: exacerbating high unemployment rates & budget deficits
- Fiscal expansion could further crowd out needed private investment, exacerbating the problems with job creation in the private sector.
- Transition countries have limited fiscal space: external financial assistance is required

External inflows will continue to weigh on growth

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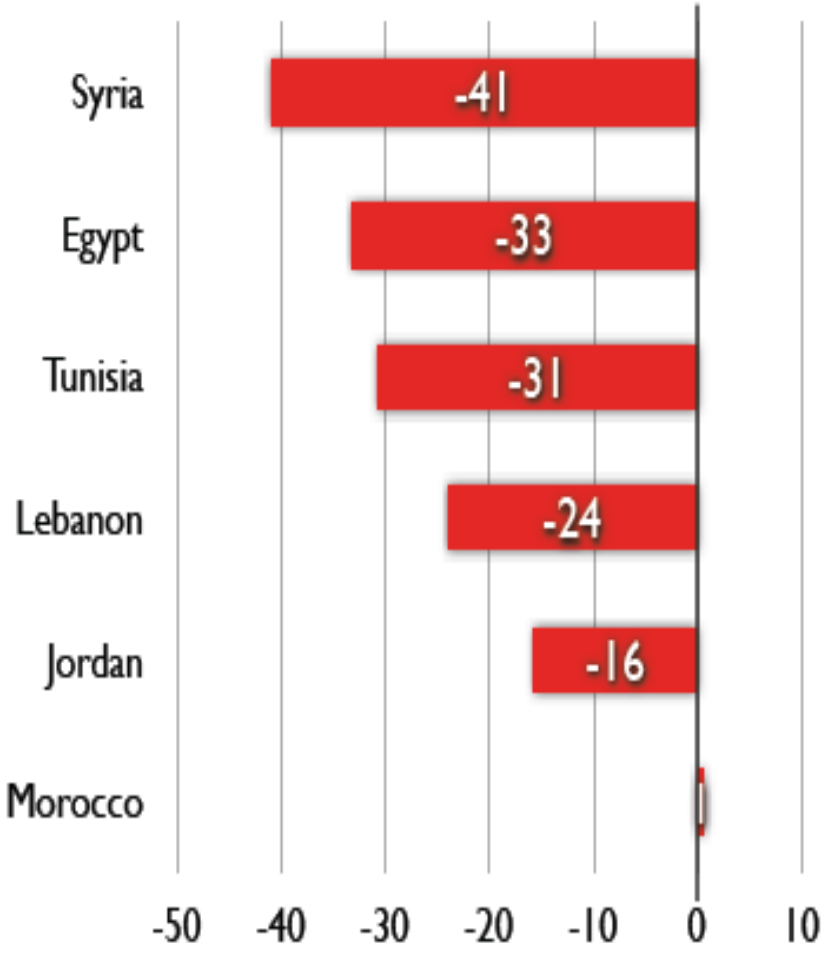
Tourism arrivals

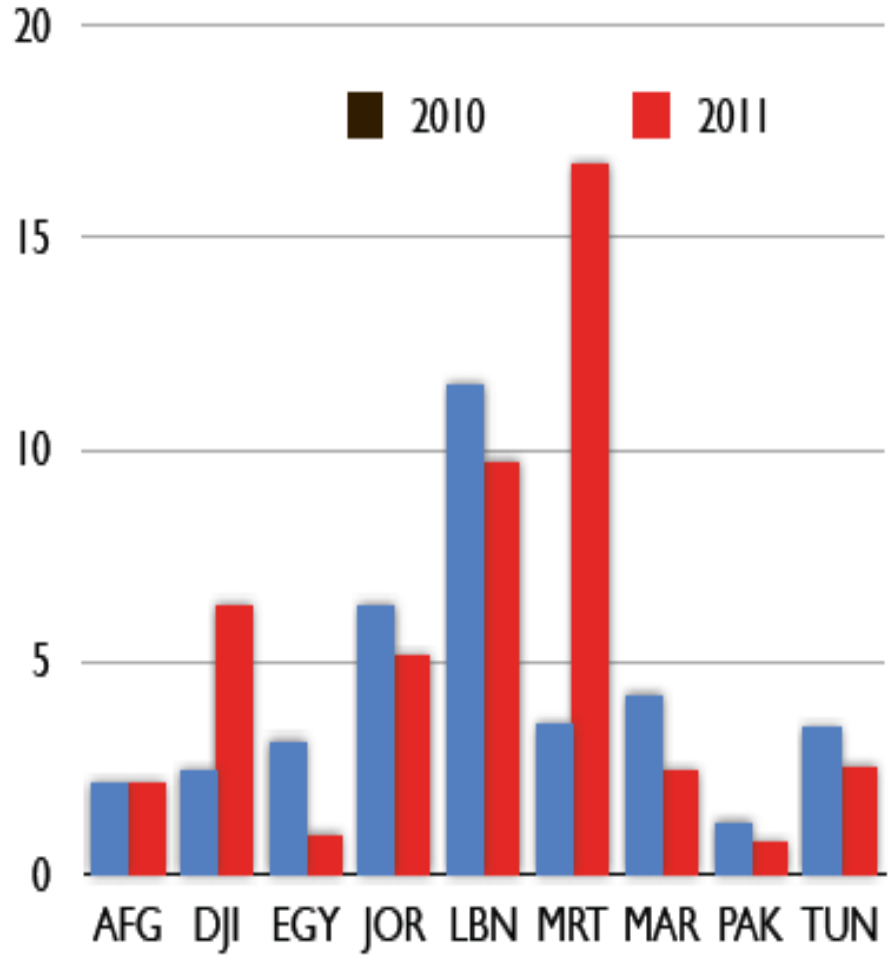
Annual percent change, 2011



Source: World Tourism Organization (UNWTO).

Foreign direct investment inflows

Percent of GDP



Sources: National authorities; and IMF staff calculations.

Eurozone Linkages & Contagion

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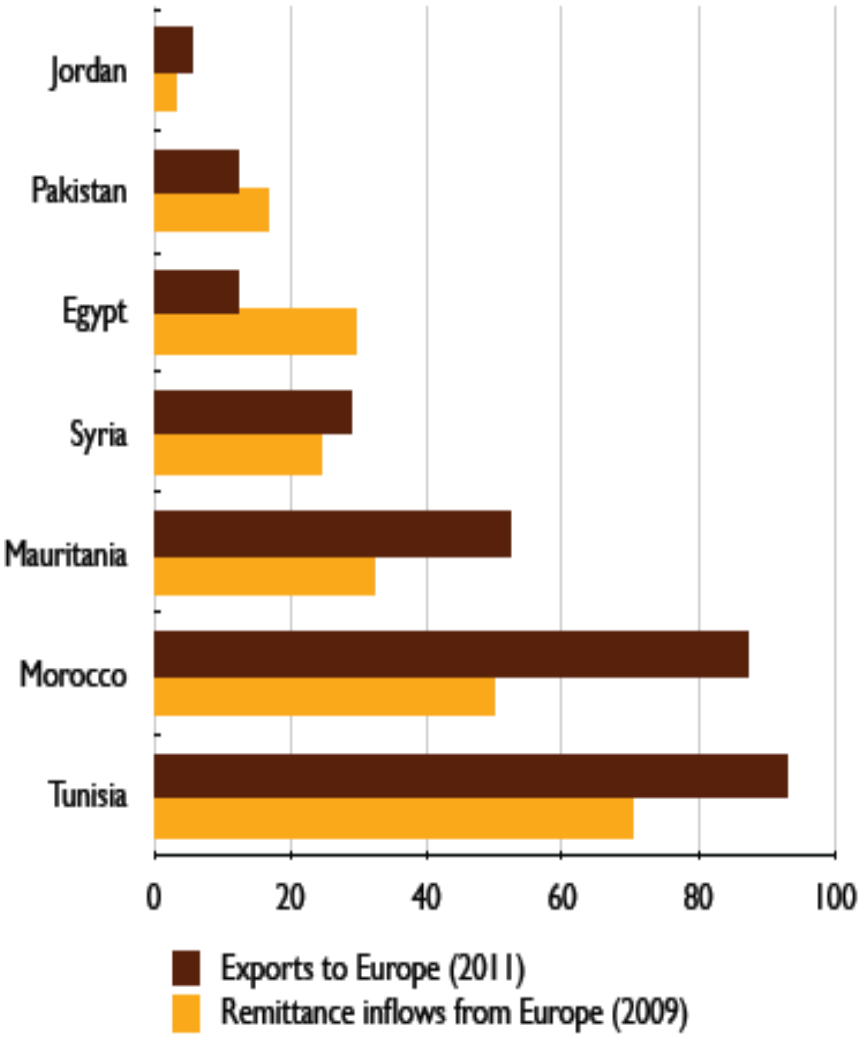
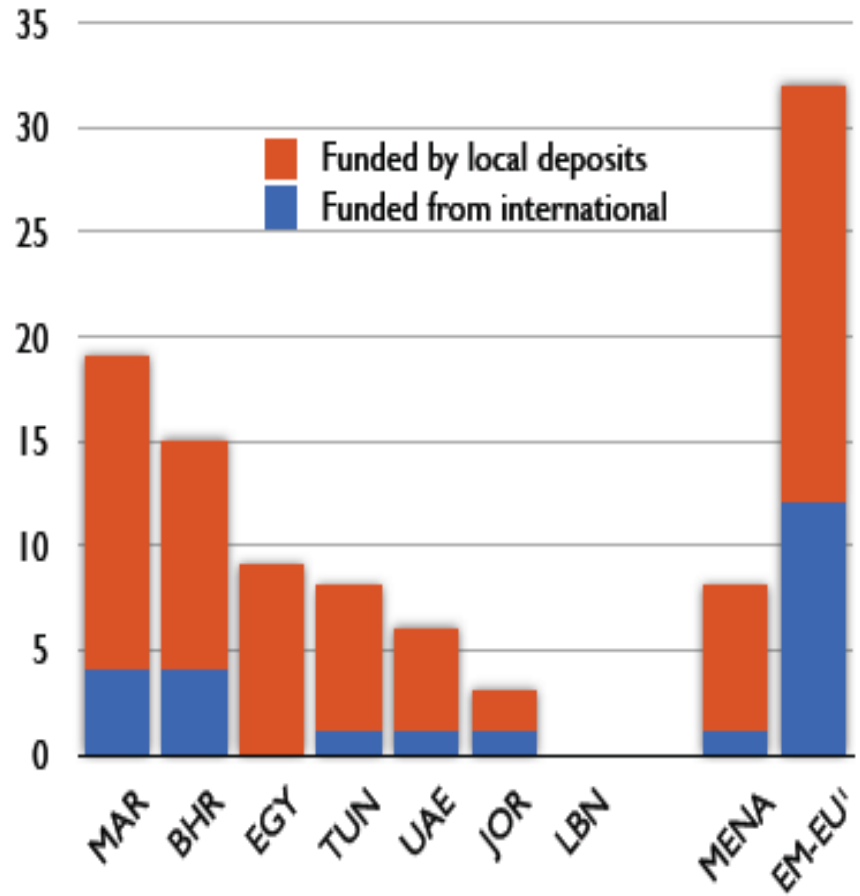
Trade and remittances linkages with Europe

Percent of total



Local currency assets of European subsidiaries and branches

Percent of GDP, 2011



Sources: Bank for International Settlements; and IMF staff calculations.
[1]Central and Eastern Europe (excluding Russia and Turkey).

Source: IMF REO presentation, May 2012

Agenda

- MENA Outcomes & Prospects
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- MENA Vulnerability Index
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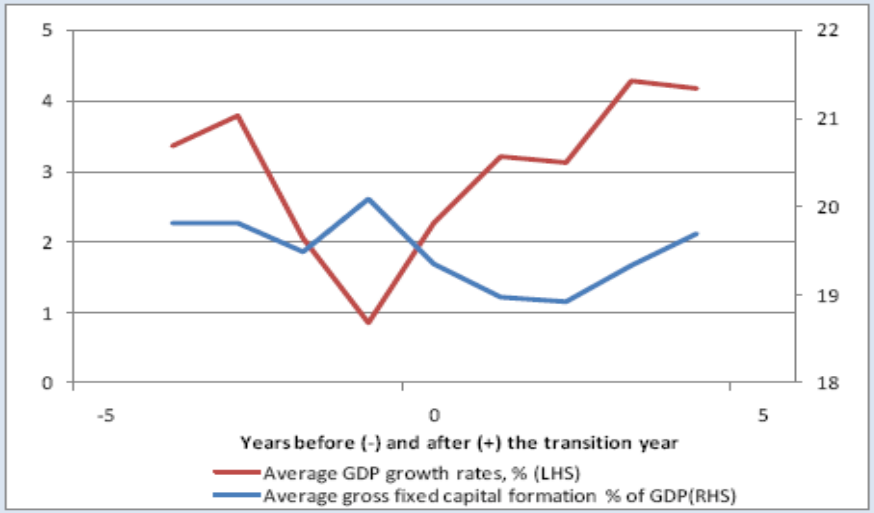
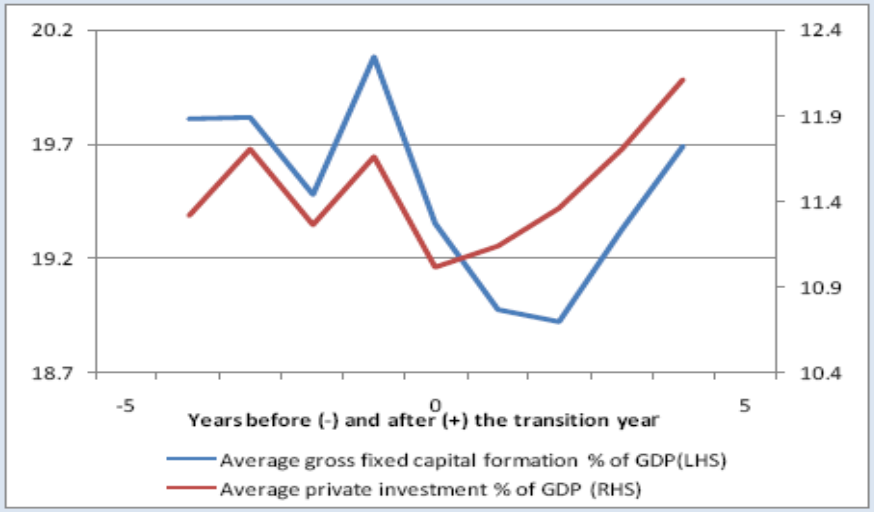
Characteristics of *Successful* Transitions

- On average growth declines by around 3% during transition, but rebounds to or above its pre-transition rate within one to two years.
- Average investment rate declines with a delay, by less than 2%, but takes at least 5 years to recover.
- Private investment bottoms out more quickly than public investment but leads the recovery.

Average growth & investment performance during a successful transition





Source: Freund and Mottaghi (2011). *Note: Mean growth performance during more than 40 successful transitions based on information in the database of the Polity IV Project, which includes an index of regime characteristics, scaled from 0 (authoritarian) to 10 (democracy). Successful transitions are those for which the index must jump by at least 5 points, and the new higher level must be sustained for at least 5 years to qualify as a transition. Thus, this data includes only countries with complete transitions. The graph records performance for a balanced panel of 42 countries with data for 11 years. See Annex Table 1 for the list of countries in the panel.

Source: MENA Economic Development Prospects, World Bank, Sep 2011

Democratisation: Lessons from Transition nations

DIFC

- **Period of Transformation for MENA**: **Transitions & their Management will affect final outcomes; path dependence**

- Determinants of democratisation scenario: evidence suggests that **higher inequality before the transition is associated with a significantly larger likelihood of violent civil conflicts** during the regime change.

- Evidence documents **significant interactions between inequality and political freedom for the quality of democracies**.

- Evidence from democratisation transitions during 1970-2003 suggests that **countries that rely less on natural resources and have lower inequality are more likely to experience non-violent democratic transitions**.

- **Lessons for Arab world**:
  - Regime shifts will follow different transition paths in different countries.
  - Level of violence which characterises the regime transition may persistently affect the future prospects of democracy

Source: Cervellati et.al (2011):"Violence, democratisation and civil liberties: The new Arab awakening in light of the experiences from the "third wave" of democratisation", voxeu.org, March.

Will Perceptions Change to Attract Investment?

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MENAT Risks & Vulnerabilities

- MENA countries face and share a number of common vulnerabilities and legacies:
  - ***Demographic***
  - ***Political & Governance***
  - ***Economic***
- **Successful Transitions Require Structural Reforms need to address each of the underlying factors leading to vulnerability**

MENAT Vulnerability Index Factor Composition

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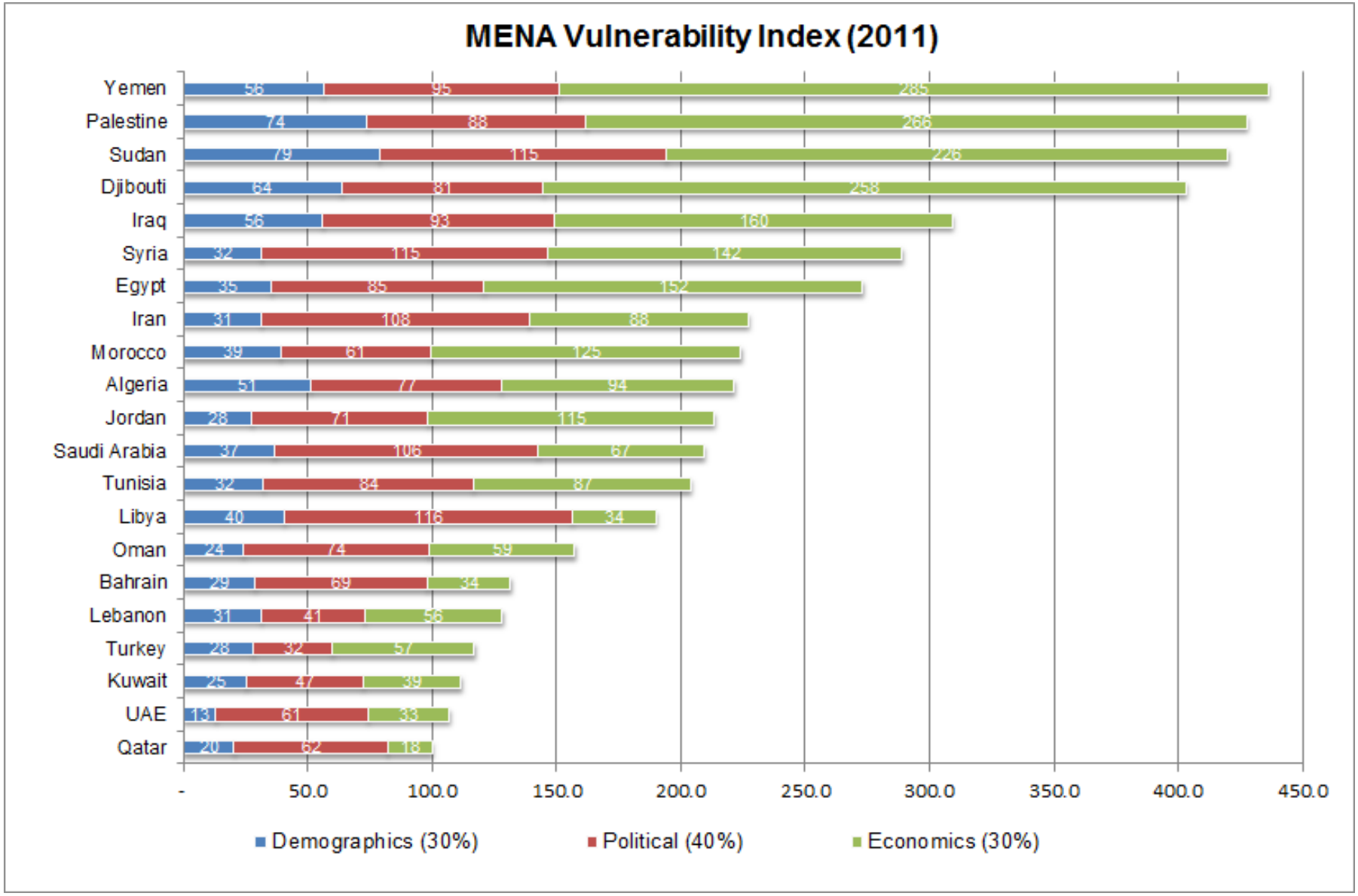
DEMOGRAPHIC FACTORS	POLITICAL & GOVERNANCE FACTORS	ECONOMIC FACTORS
Fraction of population under 25	Voice & Accountability Index	Food price inflation
Youth unemployment rate	Rankings of political rights	GDP per capita
Age dependency ratio	Rankings of corruption	Military spending as a percentage of GDP
Infant mortality rate	Rankings of civil liberties	
	Press freedom index	

MENA Vulnerability Index (2011)



Source: DIFC Economics

Positive GCC/UAE Outlook

Source: IIF report on GCC, April 2012

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GCC: Real GDP Growth

	Overall Real GDP Growth (%)			Hydrocarbon Growth (%)			Nonhydrocarbon Growth (%)		
	2011e	2012f	2013f	2011e	2012f	2013f	2011e	2012f	2013f
GCC	**6.9**	**4.9**	**4.2**	**10.8**	**5.5**	**2.0**	**4.9**	**4.5**	**5.0**
Saudi Arabia	6.4	5.0	4.3	9.8	5.6	2.3	5.1	4.7	5.0
UAE	4.7	3.2	3.2	8.2	3.5	1.3	3.1	3.0	4.2
Kuwait	5.0	4.1	3.0	8.2	6.1	2.1	3.0	3.2	3.3
Qatar	16.2	8.3	5.2	22.8	7.9	1.7	11.6	8.7	8.0
Oman	5.4	6.4	5.7	3.2	5.0	1.5	6.4	7.0	7.5
Bahrain	2.2	3.3	4.6	4.0	4.7	5.3	2.0	3.2	4.5

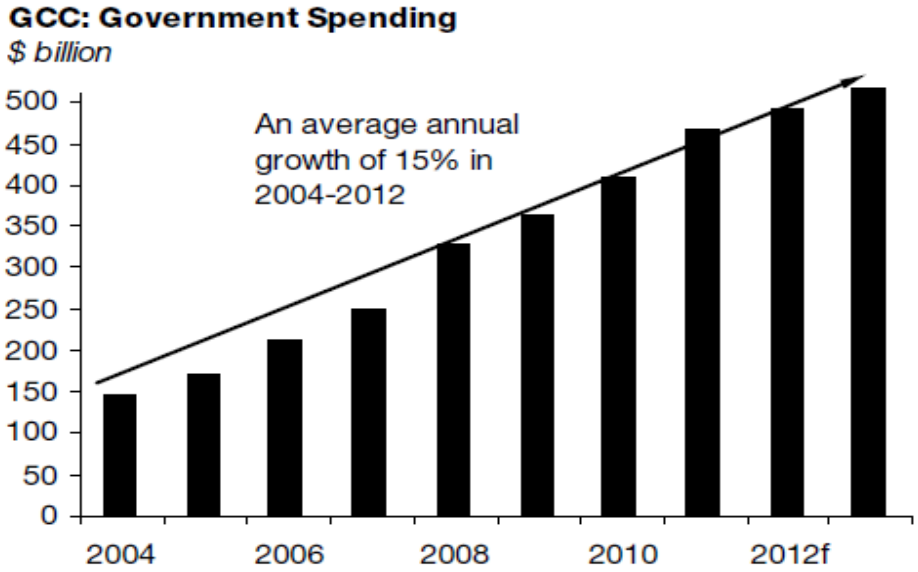
GCC: Fiscal and External Balances, and Net External Assets

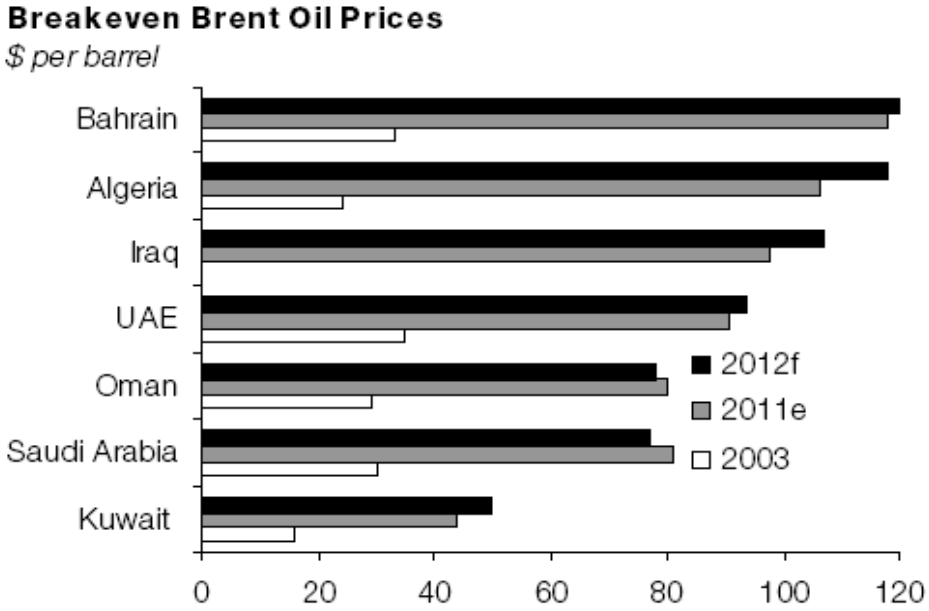
	Fiscal Balance (%, GDP)			Current Account Balance ($ billion)			Net Foreign Assets* ($ billion)		
	2011e	2012f	2013f	2011e	2012f	2013f	2011e	2012f	2013f
GCC	**11.4**	**12.0**	**7.4**	**327**	**358**	**262**	**1,605**	**1,904**	**2,139**
Saudi Arabia	12.6	15.4	9.9	154	166	119	613	736	812
UAE	4.4	4.7	1.6	38	51	34	503	565	619
Kuwait	28.1	26.1	16.9	55	58	47	396	457	515
Qatar	10.1	8.5	5.5	66	69	55	59	107	150
Oman	9.5	6.5	2.3	11	10	4	16	19	22
Bahrain	-2.1	-0.8	-3.1	3	4	3	18	20	21

*Net Foreign Assets = Foreign Assets - Foreign Liabilities.
Foreign Assets = Official Reserves + Foreign Assets of Banks + SWFs.

GCC Economic outlook: Main drivers

- Economic activity in GCC continues to be driven by **strong government spending**, financed by surging oil and gas revenues and setting the pace for private sector activity.
- Public spending since 2004 has grown at an average annual nominal rate of 15%; mainly on infrastructure & social investment plans.
- Increase in oil exports + higher fiscal revenues will offset expansionary gov't spending + Ms => wider external current account & fiscal surpluses through 2013.
- Fiscal vulnerability growing even if budget breakeven oil prices for 2012 are below the projected average Brent oil price for this year for all the GCC countries.





Source: IIF report on GCC, Apr 2012

GCC Banking Sector

- GCC banks remain well capitalized and profitable.
- Average **capital adequacy** ratio is above 15% for every banking system in the region.
- **NPL ratios** are in the low single digits, but remain relatively high in Kuwait & UAE (close to 8%).
- **Private sector credit growth** in UAE & Kuwait has been subdued in the past three years as banks remain cautious in light of deteriorating asset quality.
- However, **credit to nonfinancial public enterprises**, particularly in Abu Dhabi and Qatar, has been increasing at a rapid pace, reflecting some rebalancing of banks' portfolios towards safer assets.

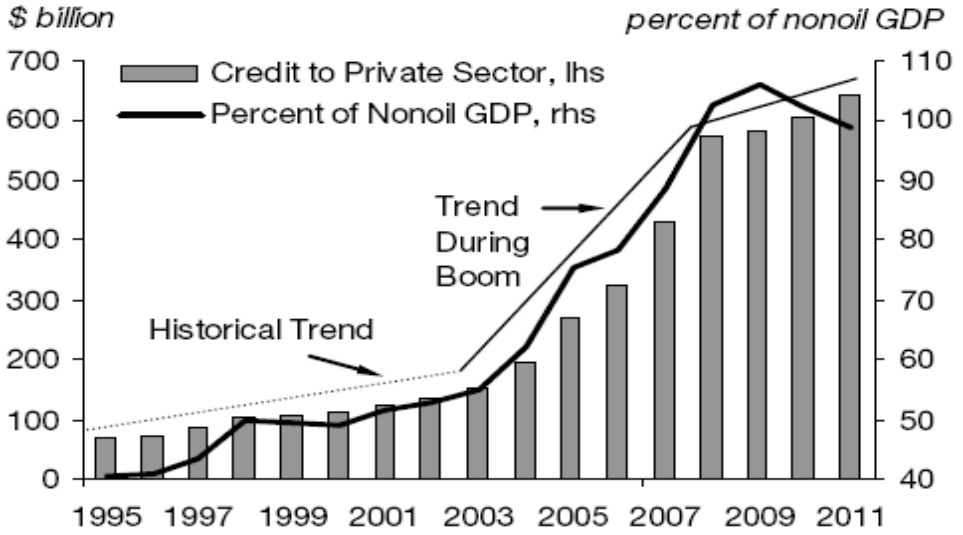
Banking Soundness Indicators

percent, latest available month for 2011

	Capital Adequacy	NPLs to Total Loans	Provisions to NPLs	Loans to Deposits
Bahrain	19.5	3.7	....	72
Kuwait	18.5	7.3	30*	111
Oman	15.5	3.3	104	103
Qatar	16.1	2.0	95	92
Saudi Arabia	17.1	2.8	130	78
UAE	20.8	8.0	84	100
Russia	17.2	8.0	100	110
Kazakhstan	17.8	25.3	31	126

*For Kuwait, specific provisions as % of nonperforming loans (NPLs).

GCC: Consolidated Credit to the Private Sector



Source: IIF report on GCC, Apr 2012

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Key Strategic Investment Sectors

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As the region gradually returns to pre-Global Financial Crisis/Great Contraction growth path, the following **sectors** are likely to lead the transformation:

(a) Demographics: Fast-growing, young populations imply greater need for social investments including **public utilities**, **health, housing and education** sectors

(b) Infrastructure & Logistics

(c) Renewable Energy

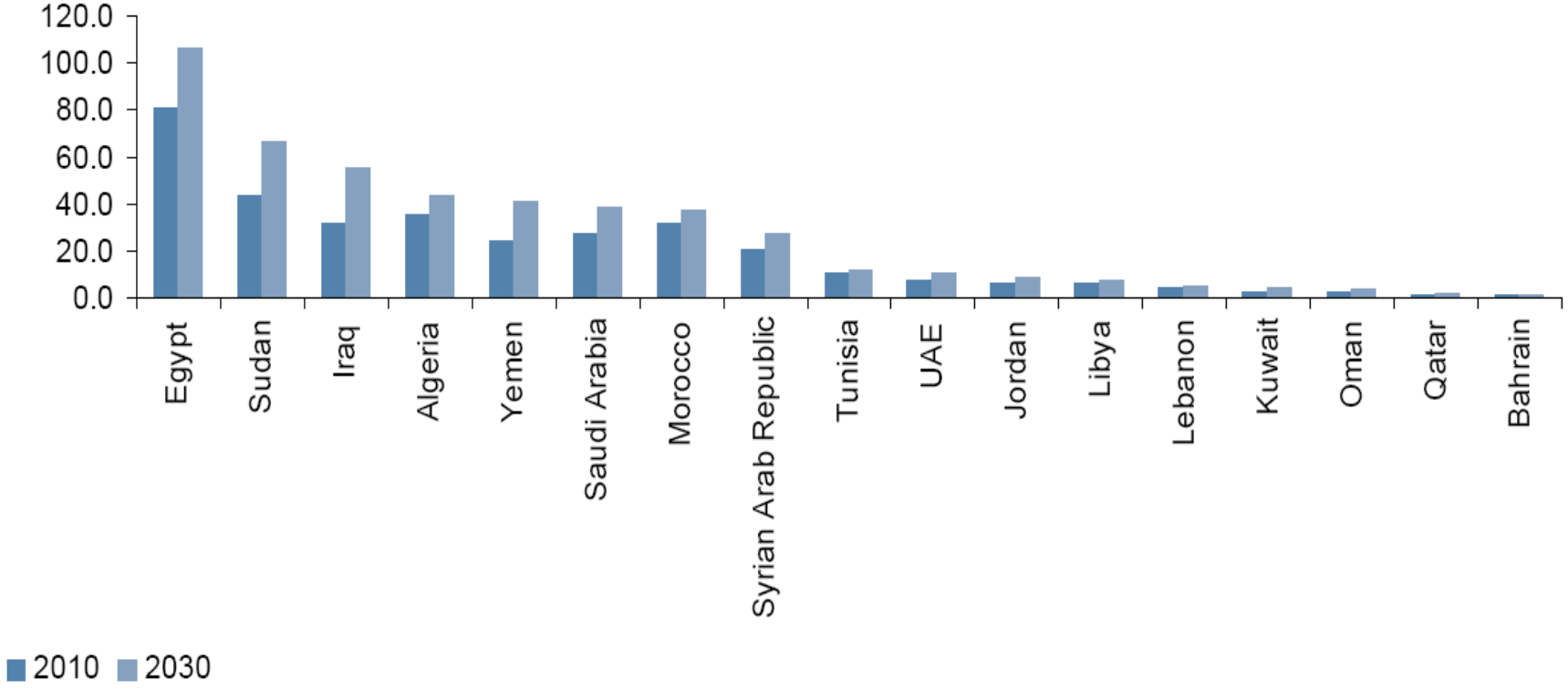
(d) Investment in Financial Services & Access to Finance

(e) Hard & Soft Infrastructure Investments for increased integration into New Silk Road Global Value Chain

Demographics: Immense Potential

- UN expects overall MENA population to grow by an average 1.5-2.0% per year between 2010 & 2030, from about 340m to more than 470m.
- Egypt, Sudan, Iraq stand out (larger proportion of their population are very young) => Increased need for health, education, housing etc.

Population in 2010 and 2030 across the MENA region



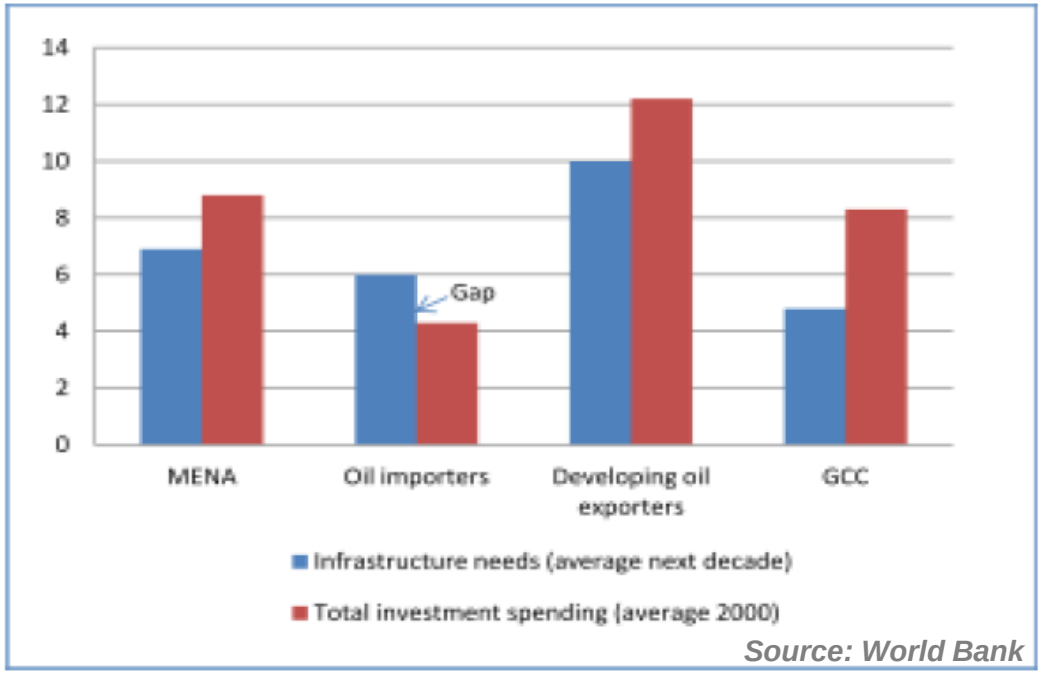
Source: United Nations

MENA Infrastructure requirements

- Annual infrastructure needs in the range of USD 1250 - 1500bn & a financing gap in the range of USD 175 - 700bn in **developing** nations
- WB estimates **MENA's** infrastructure investment and maintenance needs through 2020 at $**106bn per year** or 6.9% of the annual regional GDP, with a **$60bn financing gap**
- Developing oil exporting countries will need to commit about 11% of their GDP annually (USD 48bn) on improving and maintaining their national infrastructure endowments, while the oil importing countries need about 5-6% of their GDP

- Investment and rehabilitation needs are especially high in the **transport sector**, particularly roads, and the **electricity** sector, jointly accounting for almost half of total needs.
- Fulfilling the **electricity needs** alone would require **3% of the yearly regional GDP**.

Infrastructure Needs & Financing (annual, % of GDP)



Source: World Bank

Renewable Energy: Depleting oil + Rising Subsidies

DIFC

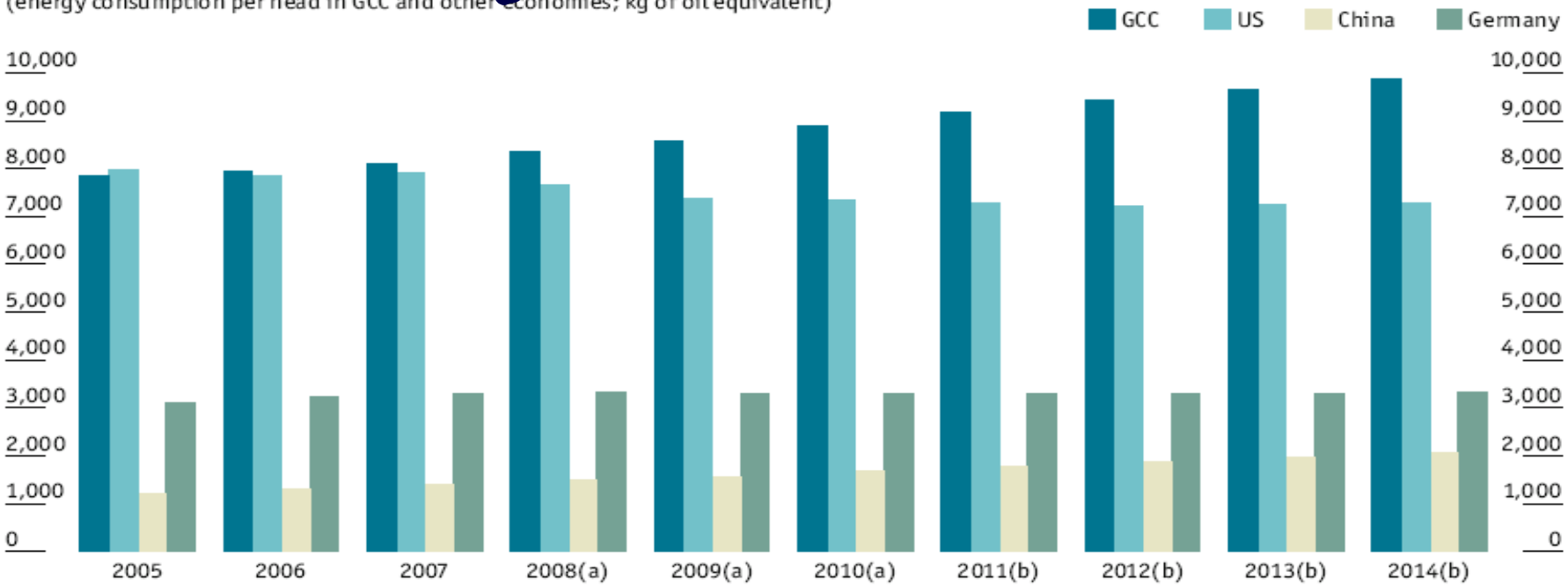
Kuwait will have exhausted all its oil savings by 2017 if it keeps on spending money at the current rate - IMF Article IV

Bottomline: Move To Clean Energy Is Imperative For MENA

"If no efficiency improvements are achieved, and the business is as usual, the oil availability for exports is likely to decline to less than 7 million barrels per day by 2028, a fall of 3 million barrels per day while the global demand for our oil will continue to rise" - CEO, Saudi Aramco

Energy-guzzlers

(energy consumption per head in GCC and other economies; kg of oil equivalent)



(a) Estimates. (b) Forecasts.

Source: Economist Intelligence Unit.

10 Transformations for the Arab countries

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Arab countries need to own & achieve their own transformation - need an Arab Renaissance and a new Development paradigm:

1. **Political & Governance transformation**
2. **Educational transformation to remedy the weak link between education & economic growth, income distribution & poverty reduction**
3. **Transform Role of Women: if FLFP were same level as in OECD (60%) we could increase GDP by 20-25%!**
4. **Shift in trade, investment & financial policies towards Asia and EMEs: integrate into New Silk Road**
5. **Regional Economic Integration: infrastructure; trade & investment; payment systems; financial markets**
6. **Economic diversification**
7. **Transformation of Role of the State and greater Private sector role**
8. **Develop Local Currency Financial Markets =>Access to finance for SMEs, FOEs**
9. **Build Capacity & Institutions for Economic & Financial Management**
10. **Fiscal reform: revenue diversification/ Expenditure rationalisation**

Thank You!

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