New Directions for the Middle East

ACT Middle East - Talking Treasury

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DIFC Dubai International Financial Centre

Agenda

A Historical Perspective

In the post WWII period three key events shaped the course of history:

1. **Suez Canal crisis in 1956 => The end of European colonial era**
2. **Fall of Berlin Wall in 1989 => The end of Soviet Union**
3. **The Great Recession in 2008 => The end of US financial empire and “unipolar” world ;**

We experienced a tectonic movement not a marginal change or a temporary crisis and we are stepping into a new world, yet to take shape

The Implications of Globalization

- Globalisation, in a deep sense, means fragmentation, reassembling and a re-distribution of power.

- The early exegesis of globalization disseminated the illusion that it would be a triumphal march for American values and economic power. In the end the process has ripped the seams of the countries (primarily US, UK) portrayed as the great beneficiaries of globalization.

- Paradoxically, so far the largest gains in relative terms have been enjoyed by China and other Emerging Markets which were expected to be the “targets” of the globalization, not the protagonists.

- As to the intellectual advocates of globalization under American aegis, the so called Neocons, who crafted and executed the war plans from the top floors of the Pentagon, today they evoke only a discredited ideology and an aura of incompetence.

The Principle of Unintended Consequences

•**Neoliberalism** which sought to limit government, and reduce its role has delivered a bloated state in which government role is pervasive in key sectors from banks to auto makers.

•The State has a greater stake in the financial system than at any time in post WW II history, with no clear exit mechanism. We have Nationalisation without Representation.

•A handful of financial institutions deemed **Too Big to Fail** have captured the State after having captured the regulators with minimal consequences for CEOs managers and Board Members that have led to the catastrophe.

•**New Weltanschaung:** the Western-centric conception of modernisation that shaped thinking and policymaking in much of the world over the last hundred years belongs in history's trash heap." *John Gray*.

•The West will no longer be the standard or the arbiter of what it means to be modern and advanced

•**Polycentric world emerging:** politics, social & ethical values, economic and financial regulation are to be redefined

World & GCC Economic Growth Outlook: delinking of Emerging Markets from Advanced economies

	2006	2007	2008	2009	2010f	2011f
World output	**5.1**	**5.2**	**3**	**-0.8**	**3.9**	**4.3**
Advanced economies	3	2.7	0.5	-3.2	2.1	2.4
United States	2.8	2	0.4	-2.5	2.7	2.4
Euro area	2.9	2.7	0.6	-3.9	1	1.6
Japan	2	2.4	-1.2	-5.3	1.7	2.2
United Kingdom	2.8	3	0.5	-4.8	1.3	2.7
Other advanced economies	4.6	4.7	1.7	-1.3	3.3	3.6
Newly industrialized Asian economies	5.6	5.7	1.7	-1.2	4.8	4.7
Emerging and developing economies	8	8.3	6.1	2.1	6	6.3
Developing Asia	9.8	10.6	7.9	6.5	8.4	8.4
China	11.6	13	9.6	8.7	10	9.7
India	9.8	9.3	7.3	5.6	7.7	7.8
ASEAN-5	5.7	6.3	4.7	1.3	4.7	5.3
Middle East	5.7	6.2	5.3	2.2	4.5	4.8
Western Hemisphere	5.7	5.7	4.2	-2.3	3.7	3.8

- ➢ Emerging markets have recovered

- ➢ Most indicators (trade, industrial production) rising faster than advanced countries

Real GDP growth (Annual change, %)

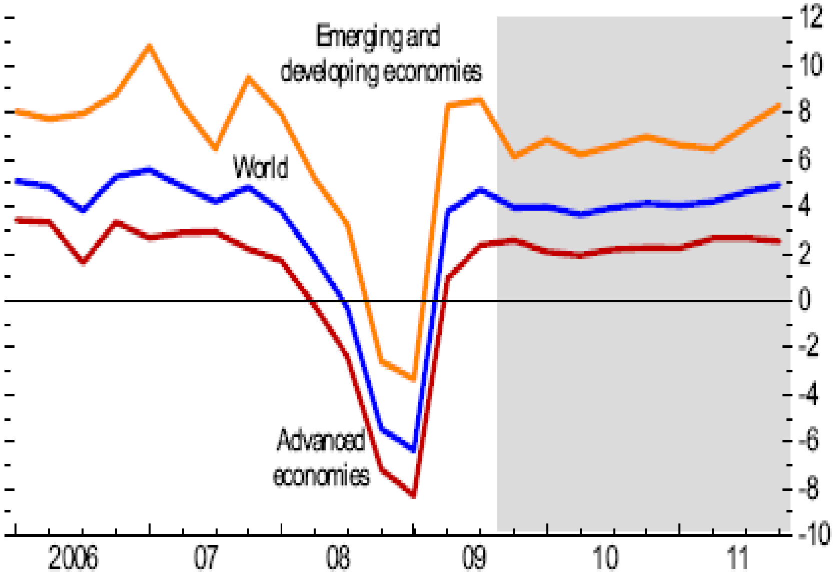
	2000–04 avg.	2005	2006	2007	2008	2009f	2010f
Bahrain	5.6	7.9	6.7	8.1	6.1	3	3.7
Kuwait	13.3	10.6	5.1	2.5	6.3	-1.6	3.2
Oman	3.2	4.9	6	7.7	7.8	4.1	3.8
Qatar	8.9	9.2	15	15.3	16.4	11.5	18.5
Saudi Arabia	3.7	5.6	3.2	3.3	4.4	-0.9	4
UAE	7.7	8.2	9.4	6.3	7.4	-0.2	2.4
GCC	**5.8**	**6.9**	**5.5**	**5**	**6.4**	**0.7**	**5.2**

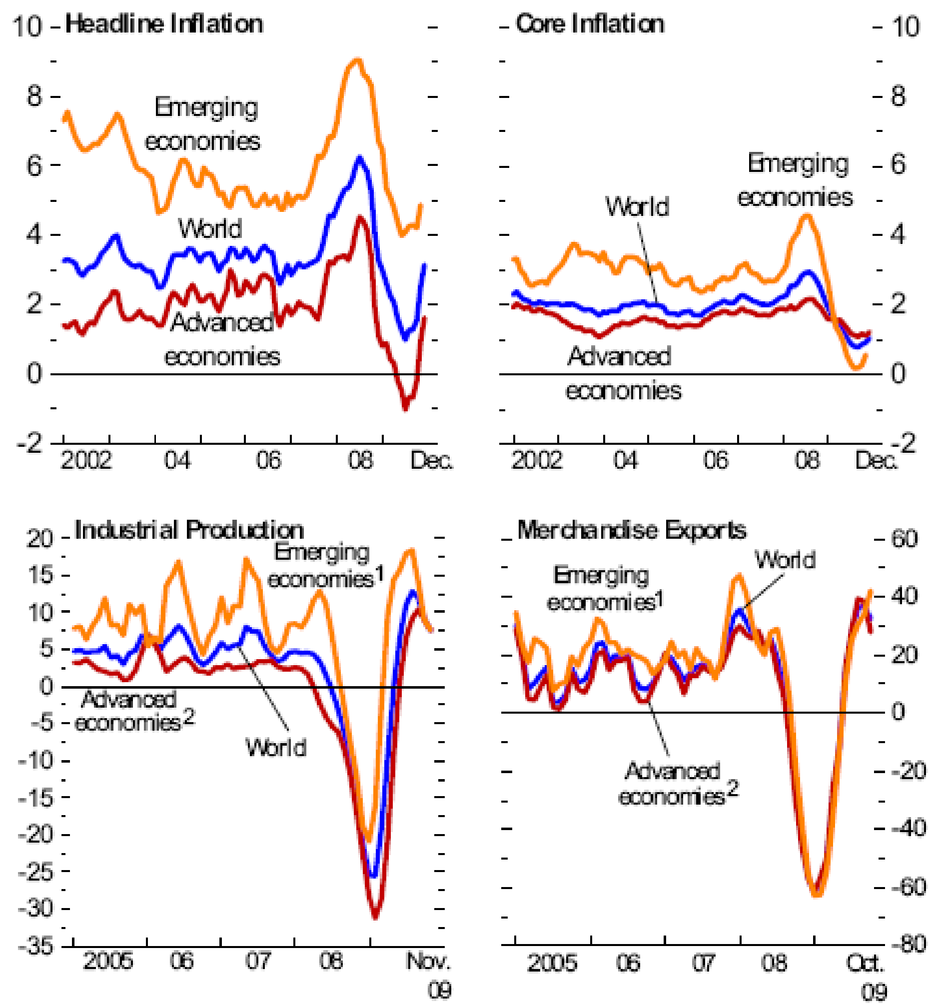
Source: IMF WEO (Jan 2010 update), REO (Oct09) , DIFC Economics

An Overview on Relative Recovery Strengths

Global Growth Indicators

Real GDP growth



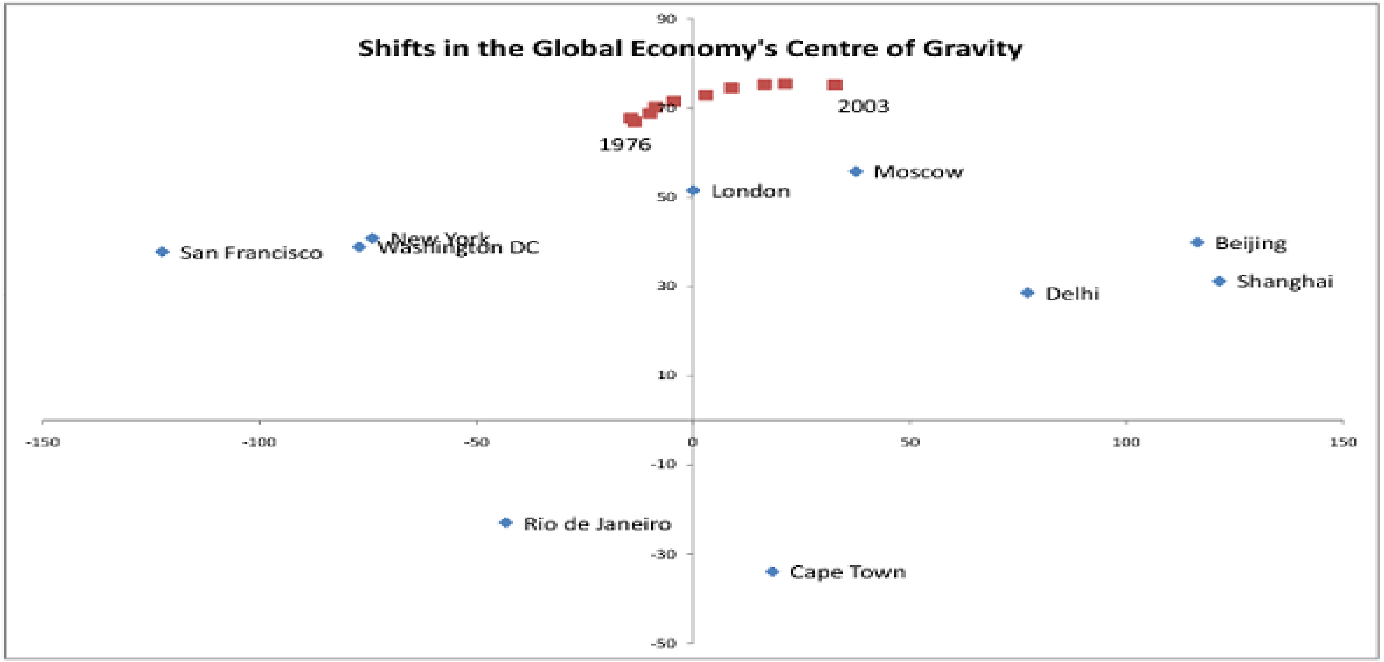


Source: IMF WEO update, January 2010

The New Economic Geography

The development showed in the previous slide are part of a long trend started in the late ‘70 and accentuated in the ‘90s.T

The Global Economic Barycenter is now in South Western Siberia. Every crisis (1991, 2001) has accelerated the shift to the East, as Emerging markets have contributed 2/3 of global growth since 2002.



Source: Quah, D.“THE SHIFTING DISTRIBUTION OF GLOBAL ECONOMIC ACTIVITY” LSE Working Paper, October 2009

The New 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%

Source: Standard & Poors

New Global Governance Framework

•**New role of G20 and Emerging Markets:** G-20 emerged as the key economic grouping during the financial crisis, encompassing a wider range of countries including key emerging economies needed to tackle global issues, foremost the imbalances of current accounts. The G7 has been sidelined as little more than a coordination group in between G20 meetings.

•**Developing economies** have been pushing for institutional reform of groups like the IMF, G7 and the Financial Stability Board (FSB) to incorporate the new balance of economic power. But they need to be more proactive and shape a vision for Global Governance

•**Tests:** what is the vision of the G20? Which countries will drive it?

- •Leadership: a fig leaf for G2?
- •Cooperation: financial stability, global warming, currency manipulatoin
- •Decision making method: drafting the agenda, taking decisions, sharing burden
- •Implementation: institutional engagement (IMF, World Bank, BIS) new actors?

Lessons Learnt (?) from the Financial Crisis

•**Contagion & Spillover effects**:

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

Some Lessons:

1. Strengthen Corporate Governance, Transparency & Disclosure
2. Strengthen Financial Sector Regulation & Regulatory Capacity
3. Design & introduce Financial Safety Net
4. Strengthen Market Resilience
5. Institutionalise and Build Economic Policy Capacity
6. Engage in design of new International Financial Architecture, Policy & Regulation
7. Develop Local Currency Money and Debt markets

Priorities for the GCC in a Poly-Centric World

•**Greater Regional Integration and policy harmonisation** is required in trade, labour mobility, electricity market, environmental issues, financial regulation, statistical data

•**New institutional structures:** ME Development & Reconstruction Bank to intervene in hotspots such as Iraq, Pakistan, Palestine, Lebanon and boost infrastructure

•**GCC have to play a central role in the economic & financial integration of the wider MENASA** region through infrastructure, their role as capital exporters and linkages & spillover effects on labour exporting countries, as standard setters and policy reformers

•**Local currency money & capital markets:** it is imperative to create liquid and deep markets to finance infrastructure, mortgage market, government debt;

- ➢Public finance reform (e.g. debt management offices); monetary policy instruments (repo auctions, T-Bills); revenue diversification
- ➢Islamic Securities Market

Why Local Currency Market Development?

Developing debt markets in local currencies would allow to:

- Deal with currency mismatching & exchange rate risk
- Provide Central Banks an effective monetary policy tool: open market operations feasible => help maintain an inflation target without a peg to a major currency
- Absorb volatile capital flows and reduce financial instability
- Provide institutional investors instruments that offer safe and stable long term yields in local currency
- Develop a stable source of capital to fund public and private ventures
- As a by-product, debt market would:
  - ✓ enhance transparency in pricing and intermediation,
  - ✓ facilitate constant monitoring of macro-economic expectations,
  - ✓ ensure disclosure of information and periodic communication regarding public policies.

Local Debt Markets: Cornerstone of Development Policy

Potential drivers of MENA 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
- **Promissory Notes Market** for corporate debtors discountable at the central bank

Infrastructure and Growth

- Public investments increase the competitiveness of an economy. This in turn sets in motion a virtuous circle because higher productivity and competitiveness translate into higher tax revenues and in turn more public investment in a mutually reinforcing pattern as it has been the case of China over the past two decades.
- In the process other positive spill-overs are felt in the form of learning-by-doing effects, efficiency gains in companies, human capital improvement, research and development in construction techniques, technology transfers, process innovation.
- The recent economic history of emerging markets clearly provides examples of these positive feedbacks. It can be argued that the success stories of South East Asia, East Europe, Brazil, China and the GCC can be attributed more to public investment than to exports.
- This process is likely to continue in the foreseeable future on the wings of two powerful forces: demographics and urban middle class expansion in the emerging economies.

Debt Market: Major Role in Infrastructure Financing

- Infrastructure projects with predictable revenue stream over long term is suitable and consistent with the orientation of Islamic Finance towards real underlying assets.
- **Flexibility to offer risk - reward structures** to issuers. Financial institutions can lend - be a partner based on a pre-specified profit sharing arrangement.
- Lenders/investors **can impose restrictions on unethical and speculative** financial activities by the issuer or borrower.
- **Encourage risk management** through explicit disclosure and transparency of the roles and responsibilities of the parties to a contract. Risks are integrated in the economic activities, which must generate sufficient wealth to compensate for such risks. **Risk mitigation matrix is essential.**
- Requires the financing to be **channeled for productive purposes**, such as financing projects, rather than for speculative activities. The risk exposure is therefore to the project and not to the uncertainties or activities that have no real economic benefits.
- Under the sukuk structure, an asset-backed instrument provides **continuous security to the investors.** This approach discourages over-exposure of the financing facility beyond the value of the underlying asset, given that the issuer cannot leverage in excess of the asset value

Additional Policy Actions

•New institutional structures: new ME Development & Reconstruction Bank: Iraq, Pakistan, Palestine, Lebanon etc.

•GCC have to play a central role in the economic & financial integration of the wider MENASA region through infrastructure, their role as capital exporters and linkages & spillover effects on labour exporting countries, as standard setters and policy reformers

•GCC Monetary Union necessary to Acquire Monetary Policy independence and creation of the "Khaliji"; requires all GCC countries to participate and peg to a currency basket

•Strengthen Corporate Governance, Shareholders Rights, Transparency

•Modern framework on Insolvency, Creditor Rights, Bankruptcy Procedures

Main Global Threats: The New Debt Trap

•A meltdown of the global financial system was avoided last year by shifting massive private sector liabilities onto public institutions, i.e. central banks and Treasuries, so ultimately burdening future generations.

•Growth of public debt and deficit spending (highest in peacetime) could pave the way to a virulent inflationary episode and an crippling dollar devaluation.

•A mounting risk of a sovereign debt crisis is materializing in Greece and other Mediterranean countries, but risks triggering a domino effect to the UK and the US. In these conditions, maintaining the high levels of public spending that social democracy requires will be next to impossible.

Main Global Threats: Financial Regulation Revamp

- Conflicts of interests have marred the sequence of crises in the past decade.
  - Stock analysts and investment bankers in the dot com bubble
  - Consultants and auditors in the corporate scandals (Enron, WorldCom, Parmalat)
  - Rating Agencies in the sub-prime and toxic assets debacle

- General lessons:
  - 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

Basel III

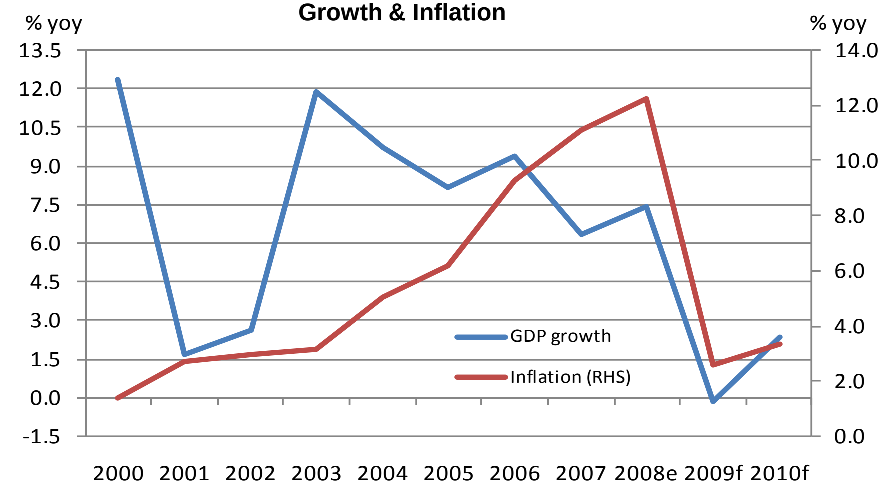
•**Basel III will emerge**, but not clear that it will be any more successful. New Financial & Regulatory architecture and end of hub-spoke model.

•IIF Regulatory Update Jan 2010: The IIF released “Reform in the Financial Services Industry: Strengthening Practices for a More Stable System” which assessed the extent to which firms have implemented recommended reforms in critical areas first identified in the July 2008 Committee on Market Best Practices (CMBP) Final Report. The report examines the findings of a high-level survey by Ernst and Young of 48 banks in 20 countries, including:

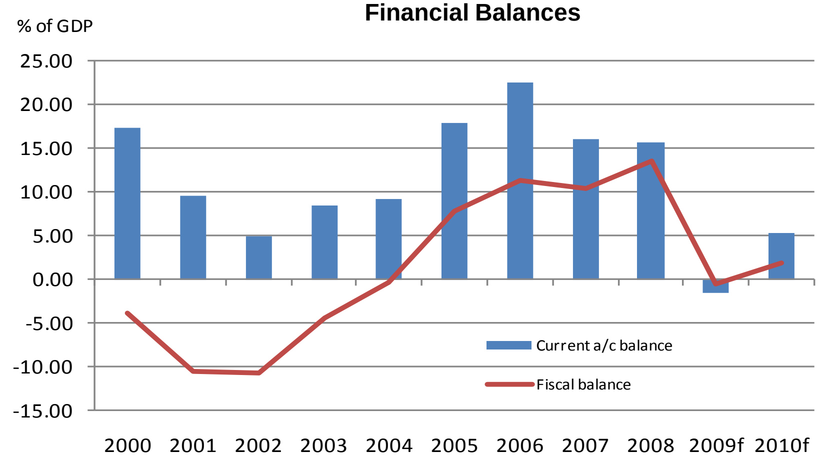
- •Financial institutions have invested considerable resources in necessary improvements; significant changes are currently underway.
- •Strengthening risk management is a top priority - this includes the governance and management of risk as well as the use of improved risk management techniques.
- •There is evidence of a change in culture in many firms with a shift in orientation from “sales-driven” to more “risk-focused.”
- •Firms are also making structural improvements – eg. to strengthen the roles of Chief Risk Officers
- •There has also been considerable progress in aligning compensation with risk.

UAE: Economic Snapshot

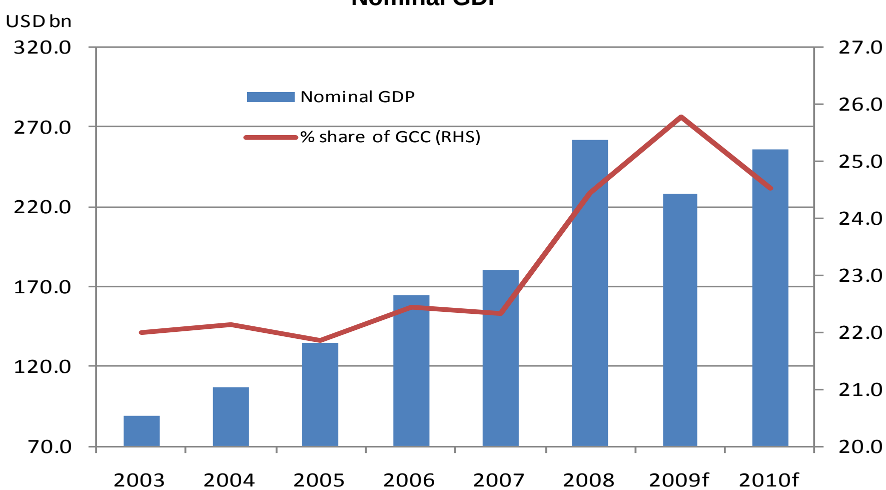
Growth & Inflation



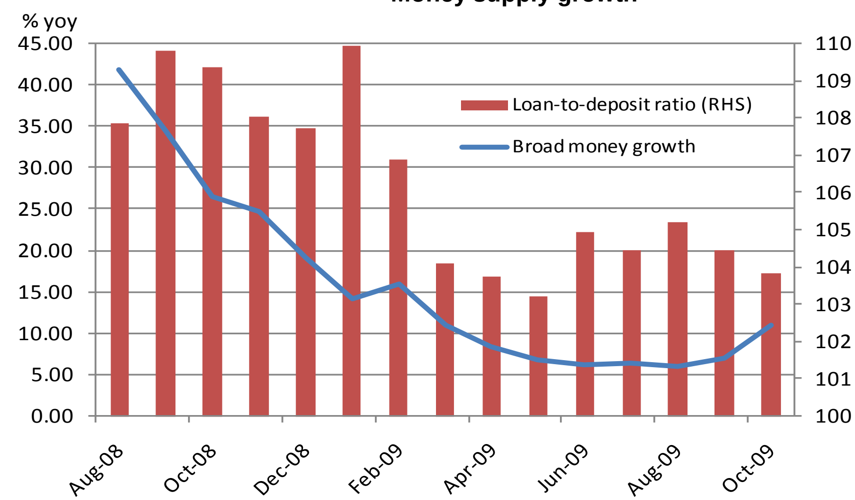
Financial Balances



Nominal GDP



Money supply growth



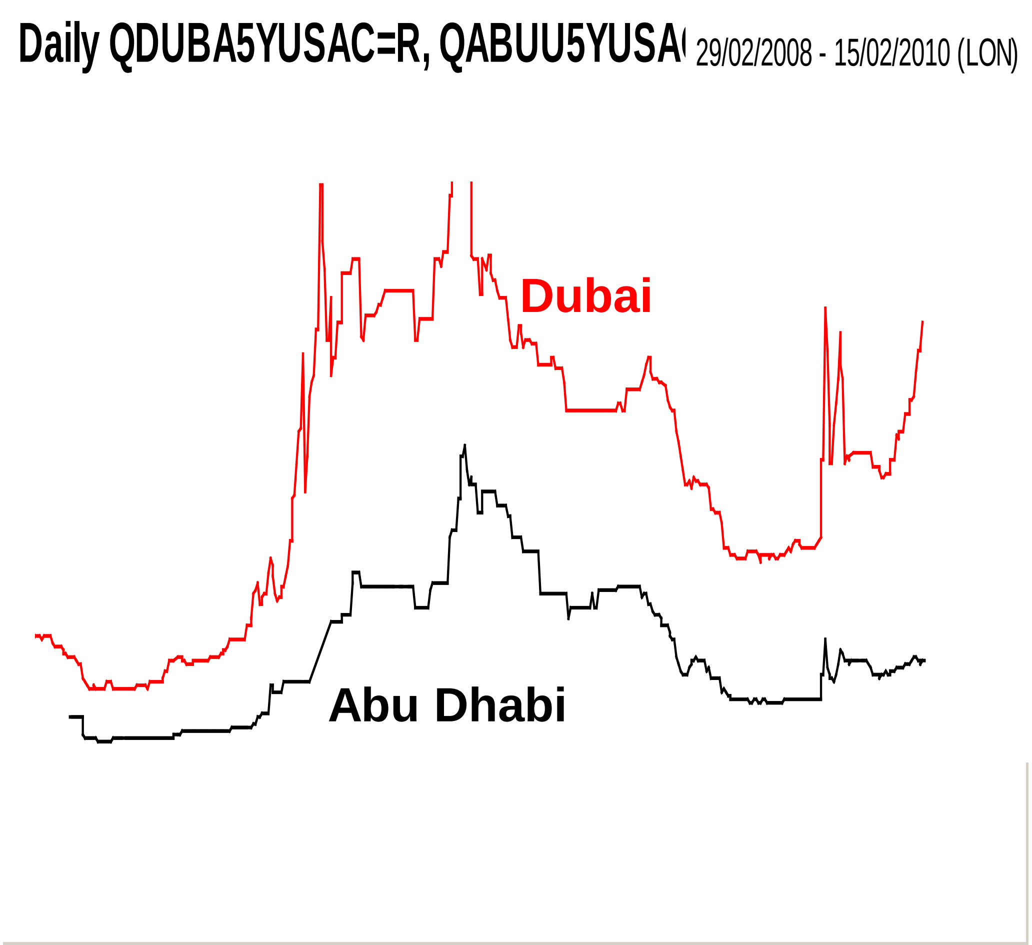
Source: IMF. Global Insight, DIFC Economics

UAE/Dubai: Resilient in face of global turmoil

- GCC/UAE/Dubai have weathered the global economic and financial crisis
- Policy mix is sound: monetary easing, increased liquidity and fiscal stimulus
- Higher oil prices easing pressure on budget and current account
- UAE/Dubai benefit from strong trade links with Asia
- Expected lower growth in 2009, 1%-1.5% and lower inflation 1.5%
- Infrastructure, investment and positive demographics will remain key
- Institutional & Structural reforms required to sustain growth
- Reforms in public finance management and transparency in the use of resources are necessary to efficiently tap the financial markets

UAE still remains a large net creditor

Sovereign CDS spreads



External Debt Service

$ billion

	2008	2009
Dubai	**19.3**	**10.1**
o/w Syndicates	12.4	7.3
o/w Bonds	6.9	2.8
Abu Dhabi	**8.1**	**9.3**
o/w Syndicates	7.8	6.0
o/w Bonds	0.3	3.2
Other Emirates	0.3	1.4
TOTAL UAE	**27.7**	**20.7**

Source: Deutsche Bank

UAE Foreign Debt to BIS Reporting Banks

$ billion, end-June 2009

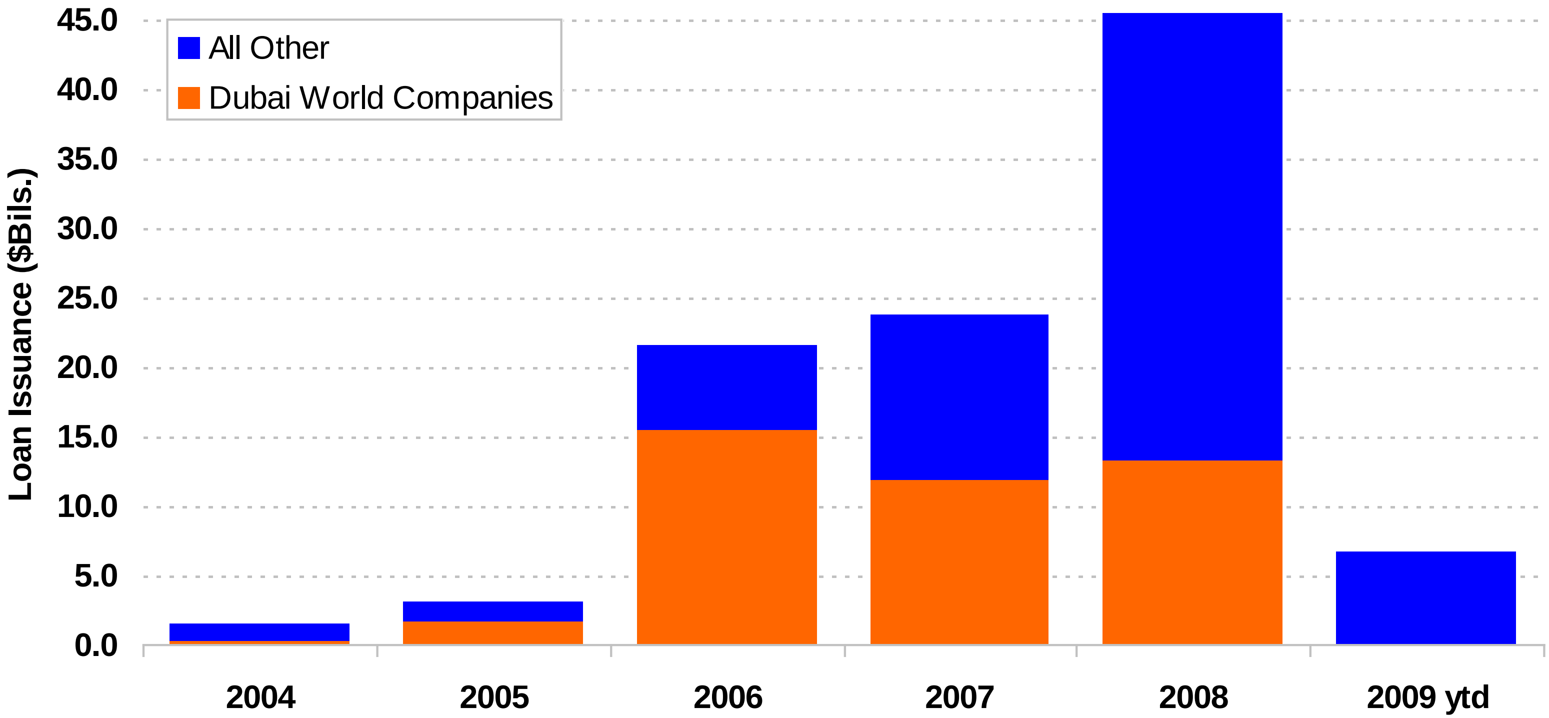
Total foreign claims	123.1
o/w: Short-term debt	39.1
By creditors	
United Kingdom	49.5
France	11.3
Germany	10.2
USA	9.9
Japan	8.6
Switzerland	4.6
Netherlands	4.5
Others	24.5

Source: Bank of International Settlements (BIS).

Source: Reuters 3000Xtra

Volume: Dubai loans including Dubai World companies

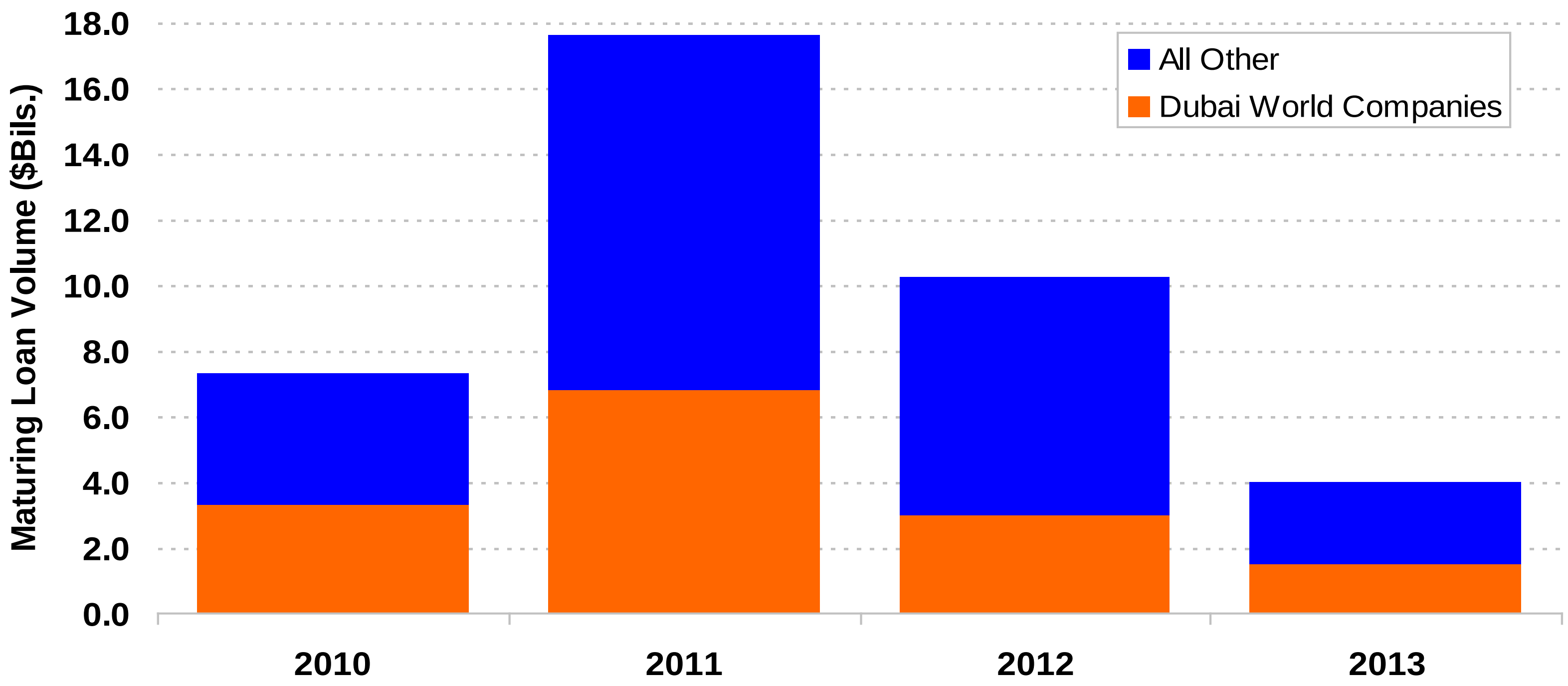
- Lending to Dubai peaked in 2008 when the Middle East was seen to be immune to the credit crunch
- In the last 6 years, lending to Dubai World companies totalled $42.6 bn
- This made up 71.6% of all lending to Dubai in that time



Source: Thomson Reuters PLC.

Maturities: Dubai's loans incl. Dubai World co's.

- Dubai has $7.3 bn of maturing loans in 2010, $3.3 bn of which are Dubai World firms
- This peaks in 2011 at $17.6bn, when Dubai World faces its heaviest maturities: $6.8bn
- Dubai's maturing loans fall to $10.3 bn in 2012 and $4 bn in 2013



Dubai Debt in Perspective

Total external debt stock of UAE increased from $94 bn in 2006 to $162 bn at end-2008 (**equivalent to 70% of UAE's GDP**), split equally between commercial banks and nonbanks.

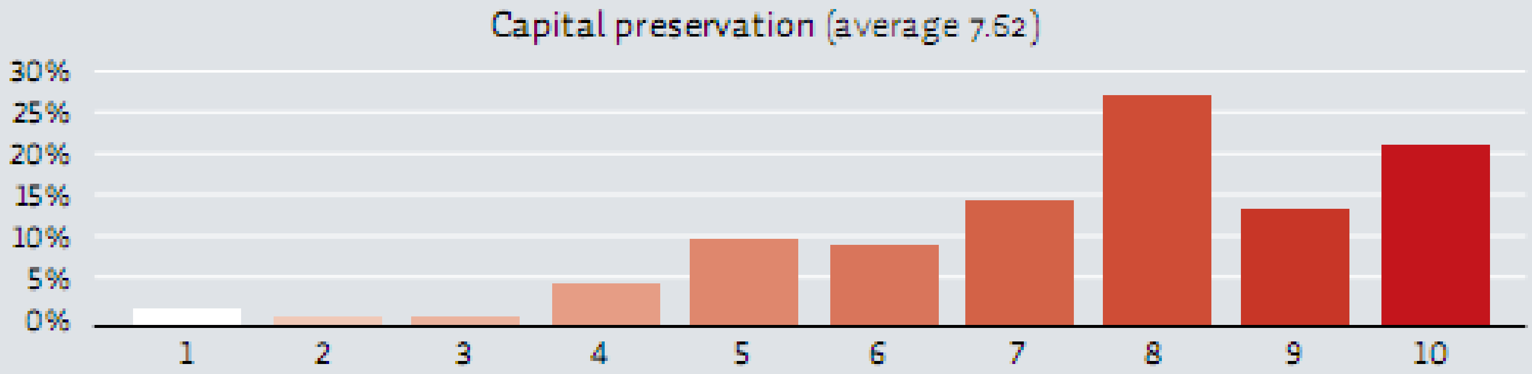
Total debt of the Emirate of Dubai, including QSEs, banks, and the public sector, accounts for **slightly more than half of the external debt of the UAE.**

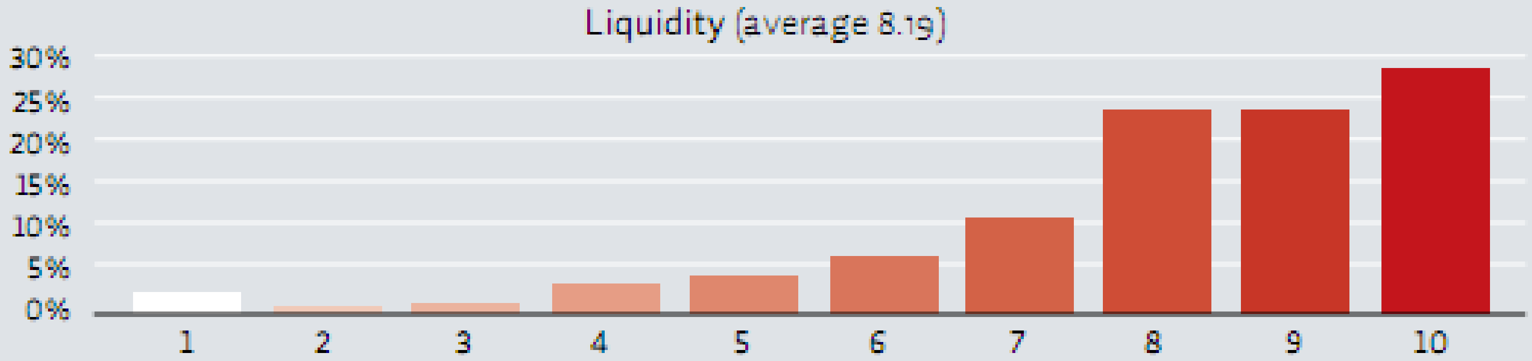
Overall, the **UAE is in a large net creditor position** of around $300 billion, equivalent to **140 percent of the projected GDP in 2009**. (incl. ADIA assets)

The **oil reserves of the UAE** are in the range of 4 trillion USD (DIFC Economic Note No.6 "Wealth Effects in the GCC form Energy Commodity Prices)

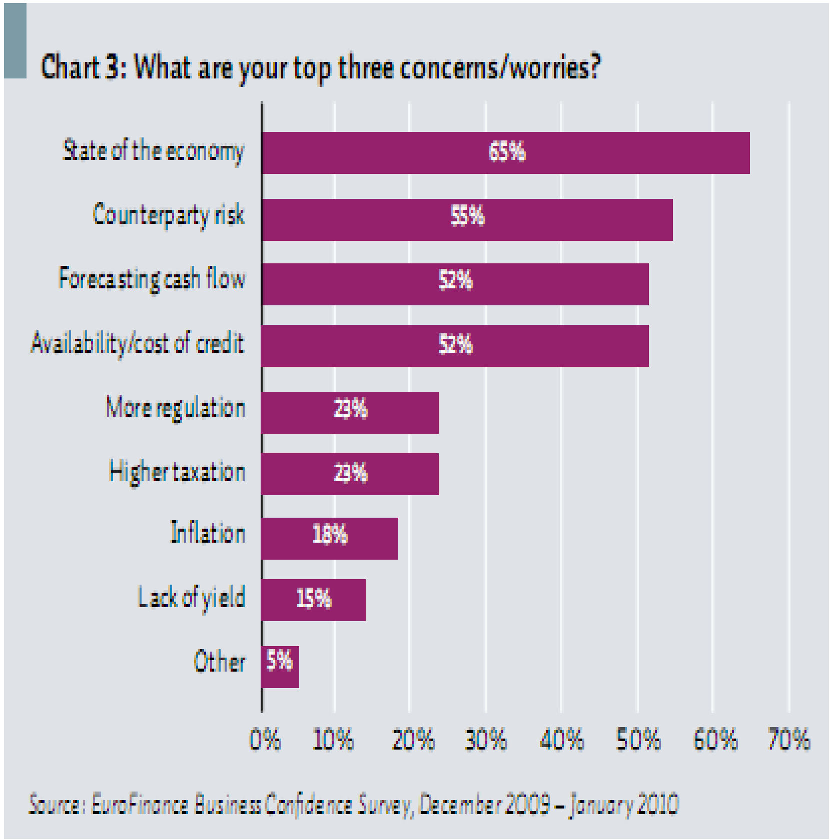
Treasurers' Strategic Priorities

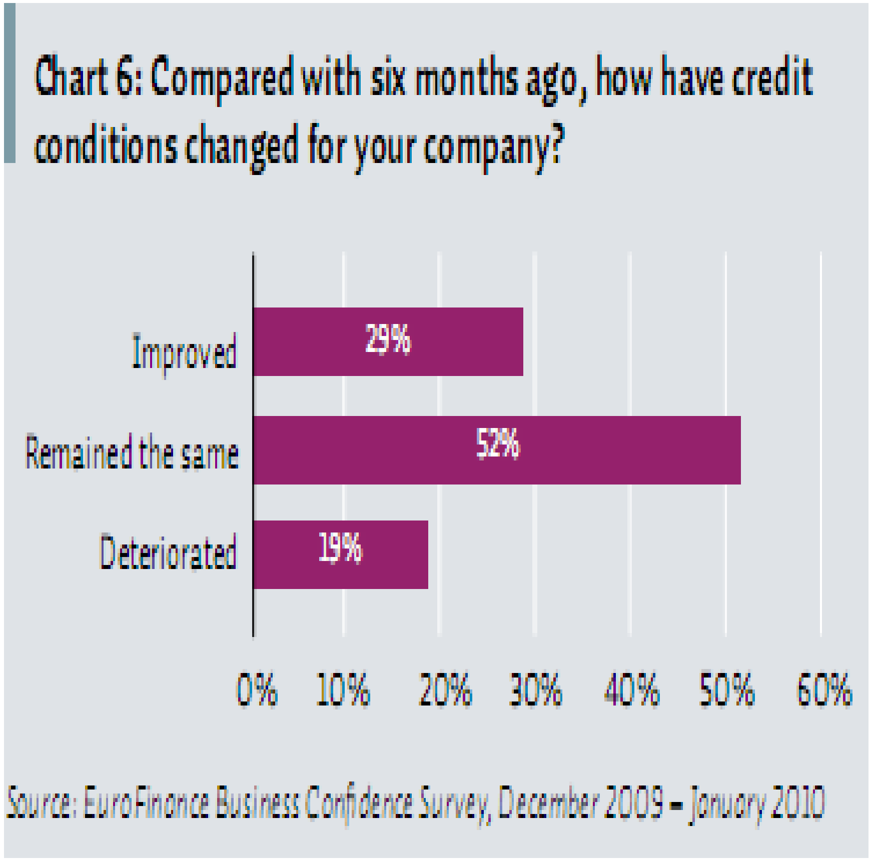
Chart 4: On a scale of 1 (not important) to 10 (critical), how would you rate the following strategic priorities for your treasury?





Top Concerns of Treasurers





Source: MEED Project Tracker

Transformational Role of the DIFC

- DIFC has set in place a sophisticated framework of laws, regulations and 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, privatisation, project finance, securitisation
  - ✓ Lower access barriers to financial services
  - ✓ Lead integration of financial markets: DFM + Nasdaq-Dubai
  - ✓ Develop Regional Debt Market
  - ✓ Build payment system infrastructure for $ and Euro payments
  - ✓ Greater harmonization of laws & regulations across UAE and wider GCC

Dubai's status as a leading Global Financial Centre

The DIFC-KPMG "International Financial Centres Competitive Assessment Report" highlighted the status of DIFC as a leading financial centre. Overall, **DIFC ranks 7th** and Dubai/UAE ranks 10th amongst the selected 15 international and regional financial centres.

Financial Centre (Country)	Overall Competitive Assessment Ranking	Ranking under Individual Pillars		
		Industry Opinion Pillar	Industry Performance Pillar	Capability Measurement Pillar
Singapore	1	4	3	1
London (United Kingdom)	2	1	1	13
New York (United States)	3	2	2	9
Hong Kong	4	3	4	5
Zurich (Switzerland)	5	5	5	2
Tokyo (Japan)	6	6	6	15
DIFC (United Arab Emirates)	7	10	11	3
Frankfurt (Germany)	8	7	8	10
Luxembourg	9	8	10	7
Dubai (United Arab Emirates)	10	10	11	6
Paris (France)	11	9	7	14
Dublin (Ireland)	12	12	9	11
Doha (Qatar)	13	13	15	4
Manama (Bahrain)	14	13	14	8
Riyadh (Saudi Arabia)	15	15	13	12

Source: "International Financial Centres Competitive Assessment Report", DIFC, Dec 09

Men know what is happening now.
The gods know the things of the future,
the full and sole possessors of all lights.
Of the future things, wise men perceive
approaching things. Their hearing

is sometimes, during serious studies,
disturbed. The mystical clamour
of approaching events reaches them.
And they heed it with reverence. While outside
on the street, the peoples hear nothing at all.

Constantine P. Cavafy (1915).

Thank You