

SAMEA ECONOMIC RENAISSANCE

Reflections on the MasterIndex of Consumer Confidence for SAMEA

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SAMEA Regional Advisory Board of Directors'
Meeting Rabat 10 April 2007



SAMEA: Liquidity, Growth & Structural Change

Agenda

- Drivers of Economic Growth & Structural Change: New Economic Geography
- Investment, Migration & Remittances
- Liquidity, Markets & Volatility
- Consumer Sentiment & the MasterIndex
- Whither the Region? Reforms matter



A MENA Economic & Financial Renaissance?

- MENA has achieved above trend economic growth rates sustained by
 - Average real GDP growth 6.2% over 2003-2005 vs. 3.7% in 1998-2002
 - Favorable global developments: high growth, low inflation and interest rates, no financial crises
 - 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: \$188.7bn (2002) to \$517.7bn (2006)
- Inflation higher, but limited pass-through of higher oil prices to consumers



Investment, Migration and Transmission Effects

- MENA's growth resurgence has been investment led with increased infrastructure investment by governments accompanied by complementary private sector investment.
- Infrastructure investments with an estimated value in excess of USD 1.4 trillion are currently under development or planned in the GCC, India & Iran.
- Private sector is leading and driving regional economic integration in the areas of trade, services, tourism, infrastructure and FDI.
- Region's companies are becoming multinationals – e.g. DP, EMAAR, Etisalat, Orascom, Mittal and MTC.
- These developments promise to break the boom-bust economic cycle driven by oil prices experienced in the past.



A MENA Growth Resurgence and Economic Renaissance?

- Positive demographics & migration sustaining labour & output growth
- 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
- Current account surpluses running at **20-25% of GDP** much of which is being recycled back into regional economies
- Surge in Shari'a compliant banking & finance



A MENA Growth Resurgence and Economic Renaissance? II

- Higher growth in the oil producers has been transmitted to the labour exporting countries of the SAMEA region (Egypt, India, Lebanon).
- Transmission effects and new linkages affecting Egypt, India, Lebanon:
 - Higher incomes of migrant populations
 - ↑ Labour flows to oil exporters → ↑ remittances to labour exporting countries
 - Portfolio investment
 - FDI

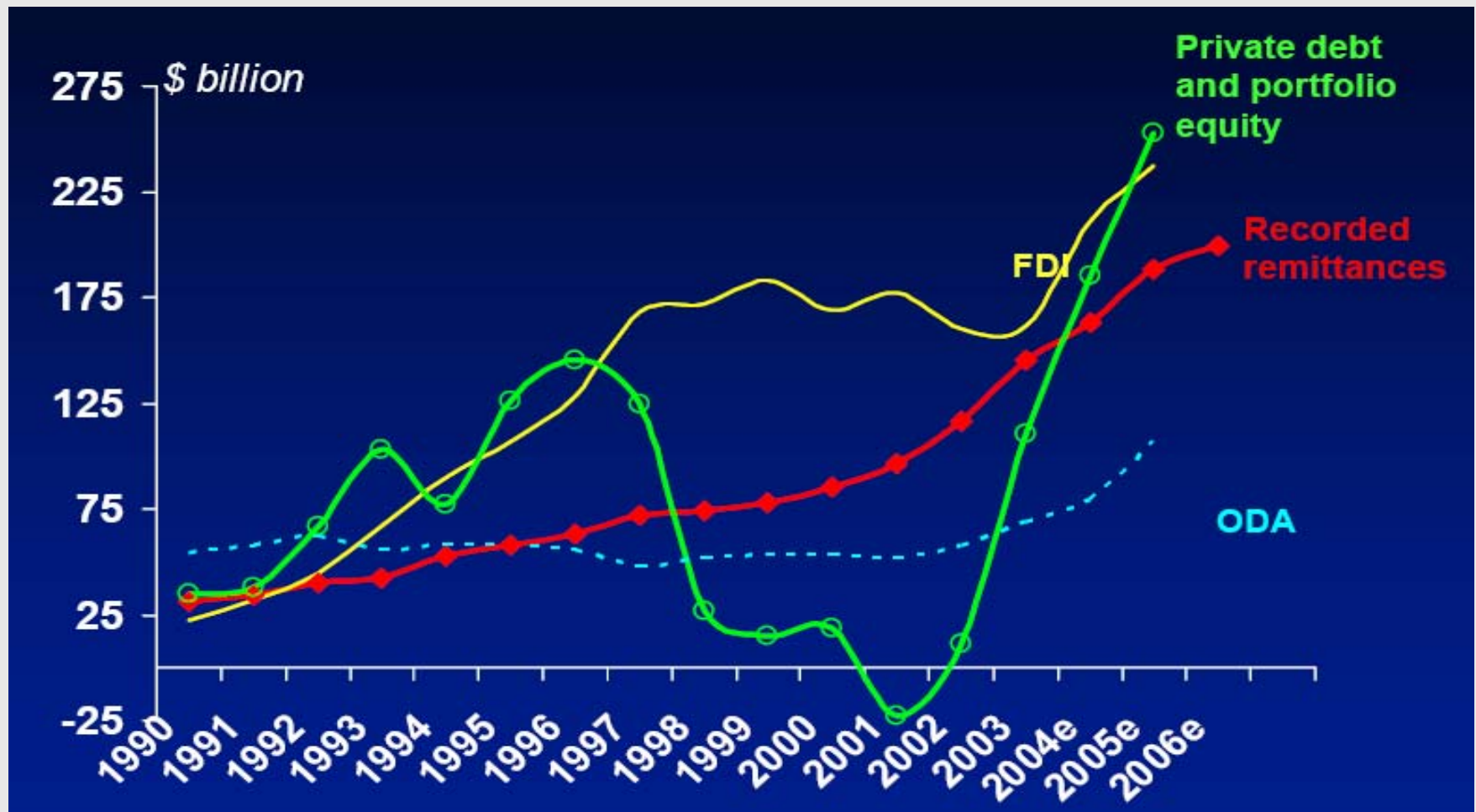


Investment, Migration and Remittances

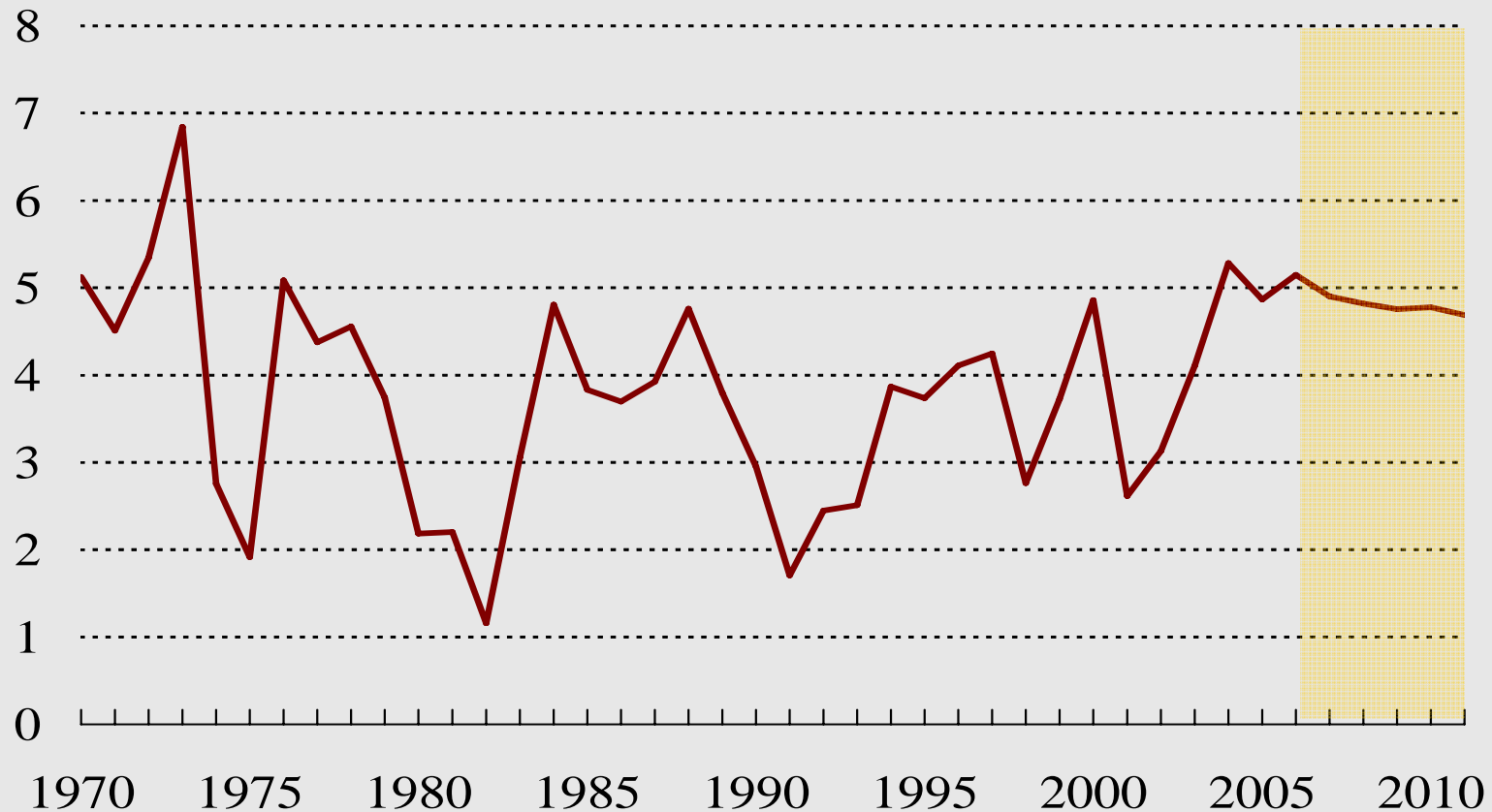
- Officially recorded remittances worldwide have risen from an estimated \$73 billion in 1999, to more than \$232 billion in 2005 (\$21.3 billion for MENA). Amount to between 12%-15% of GDP for India & Egypt to more than 22% for Lebanon
- However, official remittances are likely to represent only a fraction of total remittances
- 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.
- 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 increased retaining of migrants' saving.
- People are “voting with their feet”



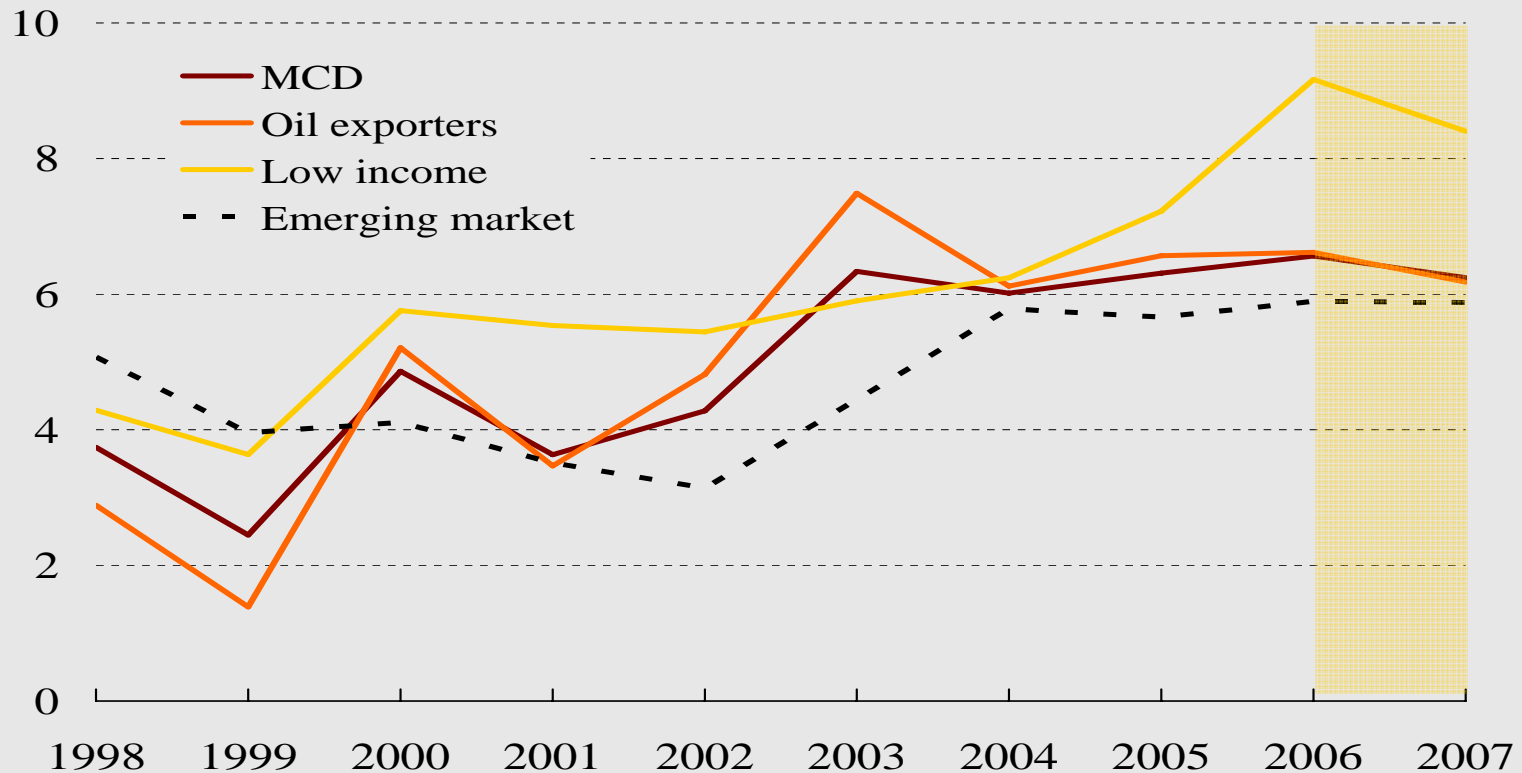
Remittances growing , more stable than capital flows, FDI or ODA



World Real GDP Growth @ 30 year high & less volatile (Source: IMF)

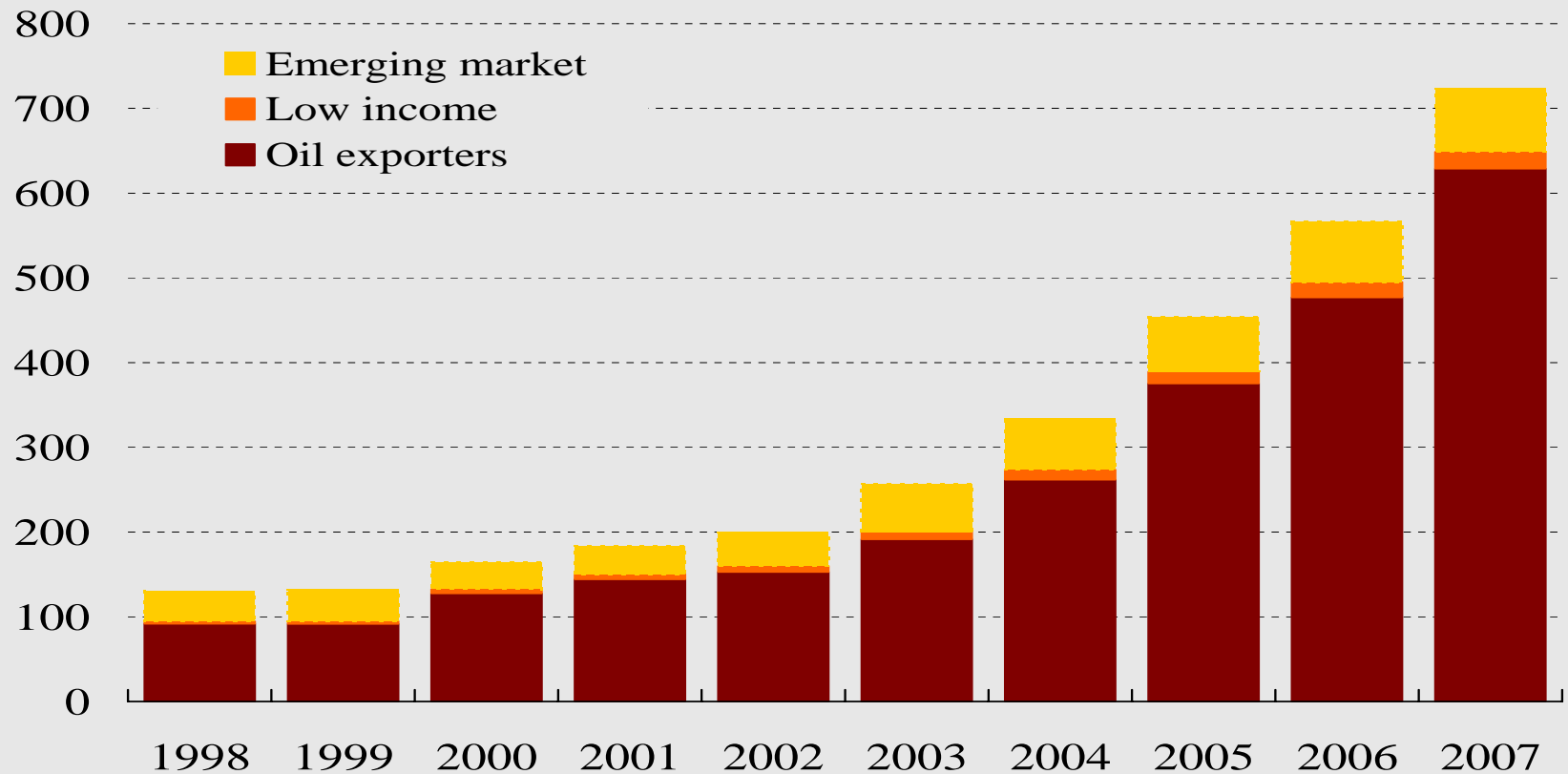


Real GDP growth: Actual & Forecast (Source: IMF)



Real GDP growth has been strong across country groupings, the Middle East and Central Asia (MCD). The forecast is for a slowdown in 2007. Source: IMF

Gross Official Reserves (Billions US\$; Source: IMF)



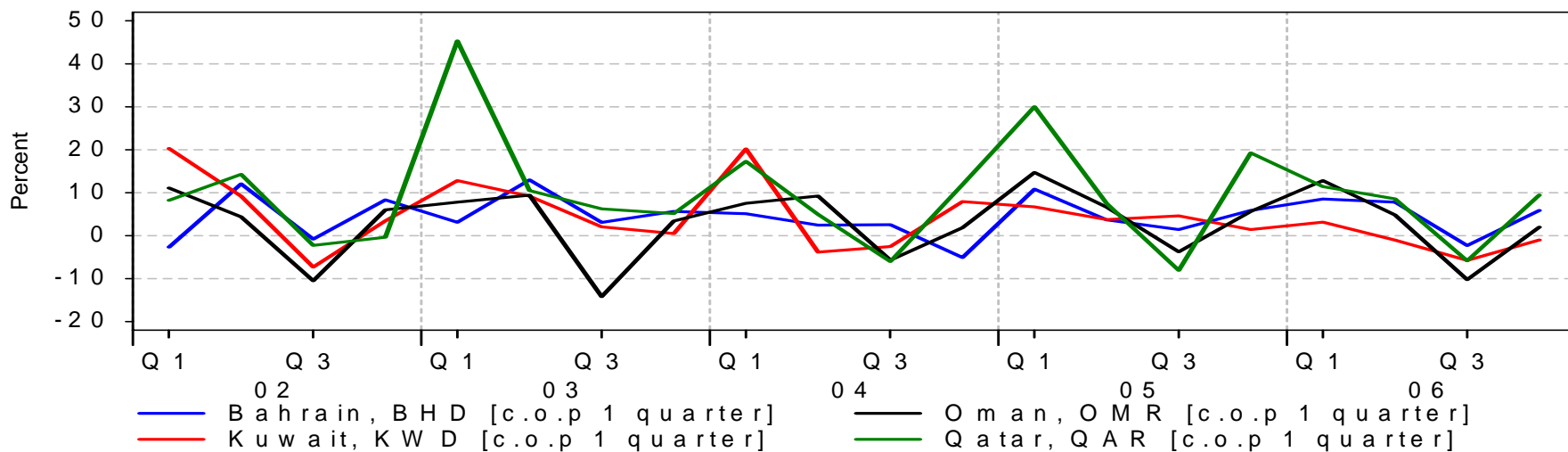
Increase in Wealth and Permanent Income

- Value of oil wealth of GCC oil exporters increased by an estimated **US\$27 trillion** between 1995 and 2006
- Permanent Income increase of some **\$510 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**



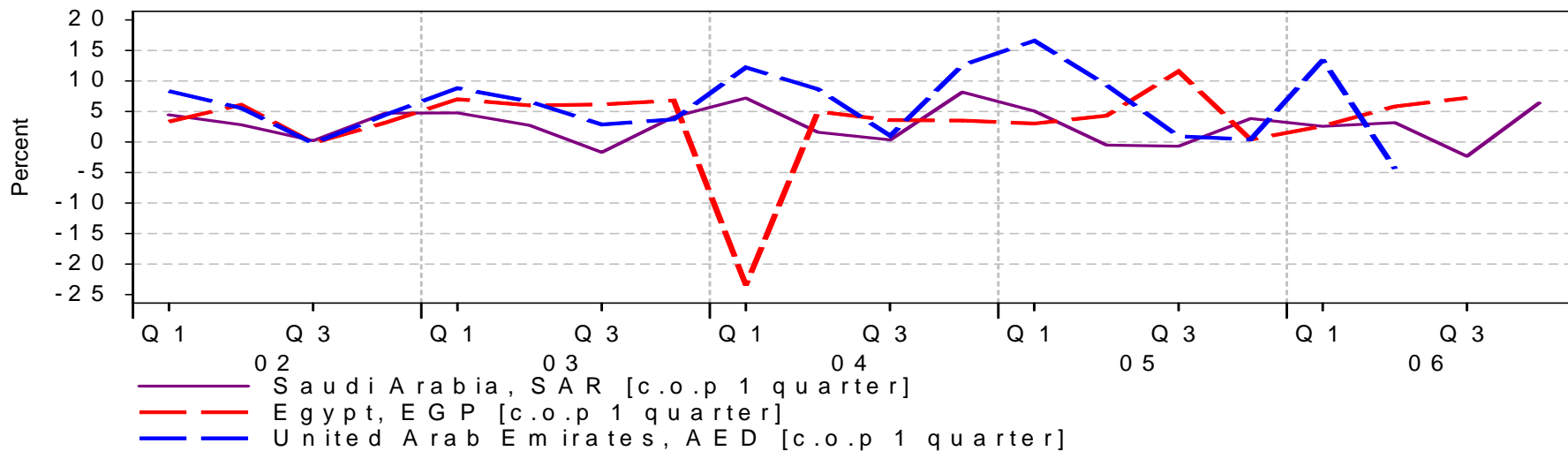
Money Growth in the GCC & Egypt

MONEY Growth



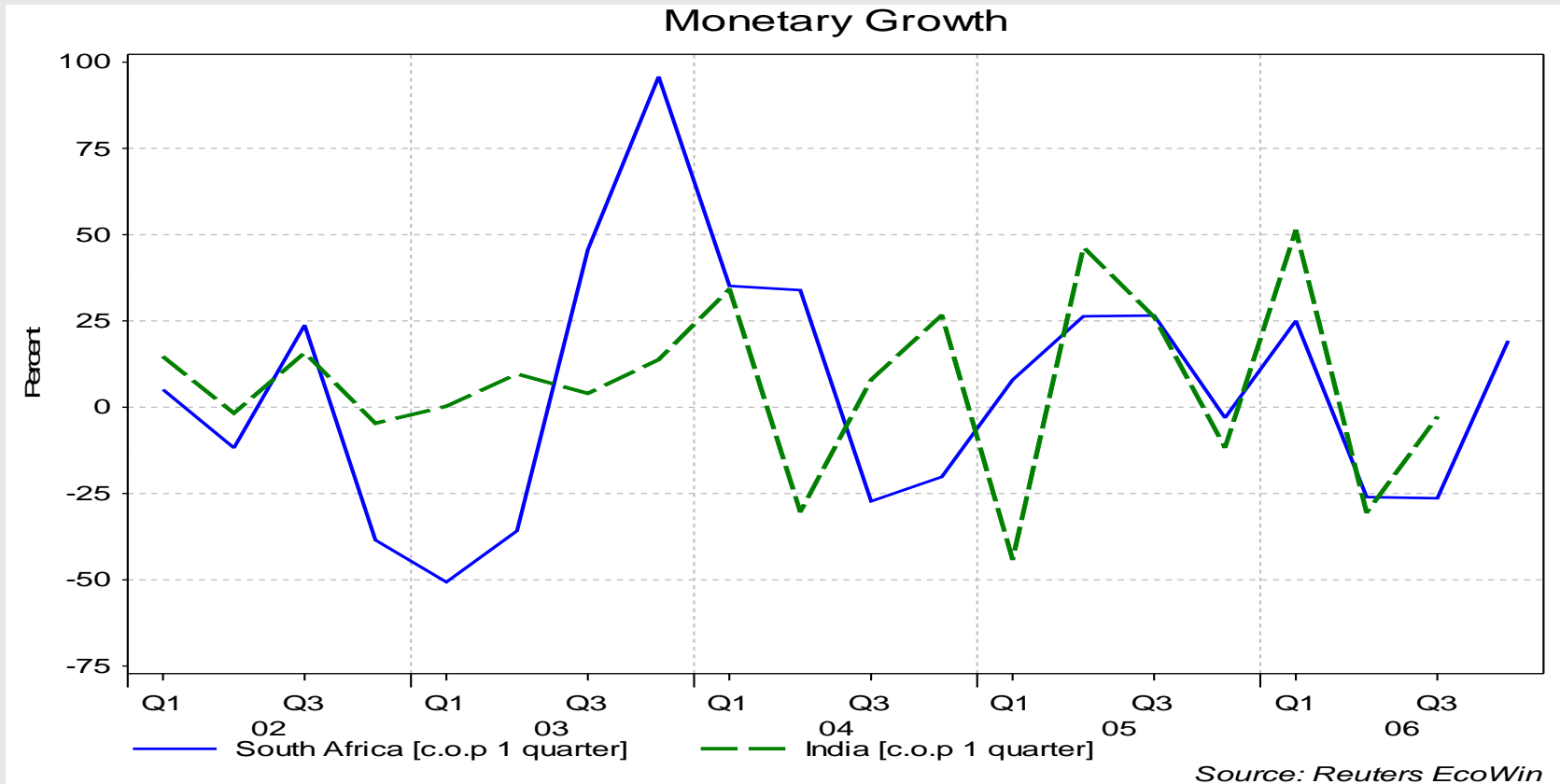
Source: Reuters EcoWin

MONEY Growth



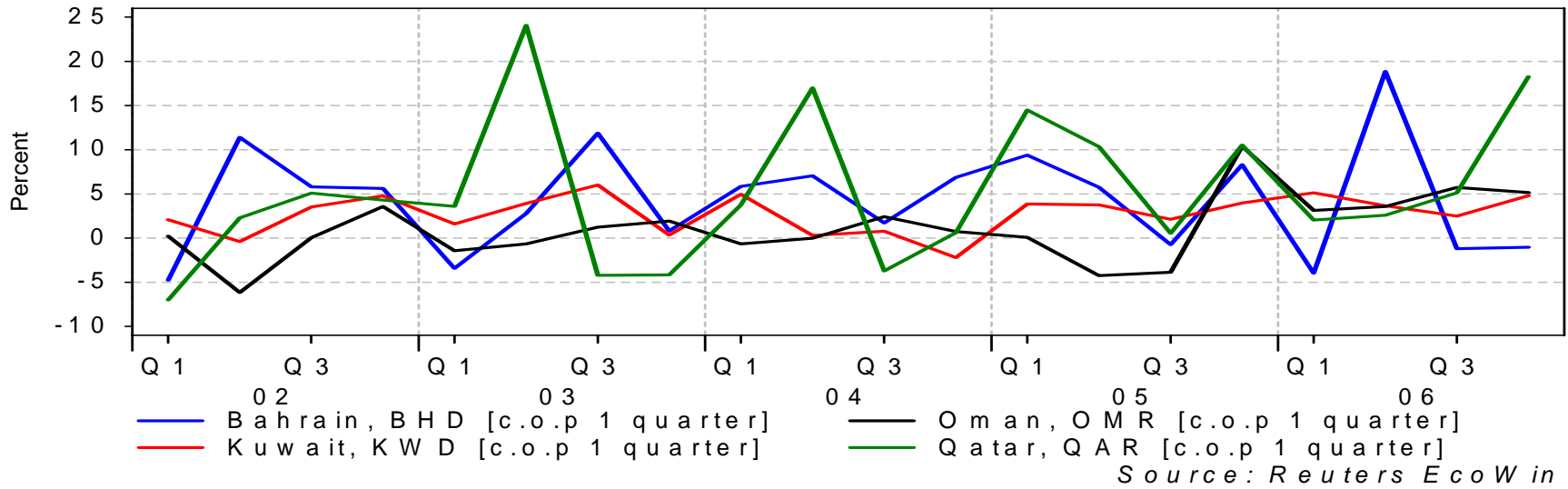
Source: Reuters EcoWin

Money Growth in India & South Africa

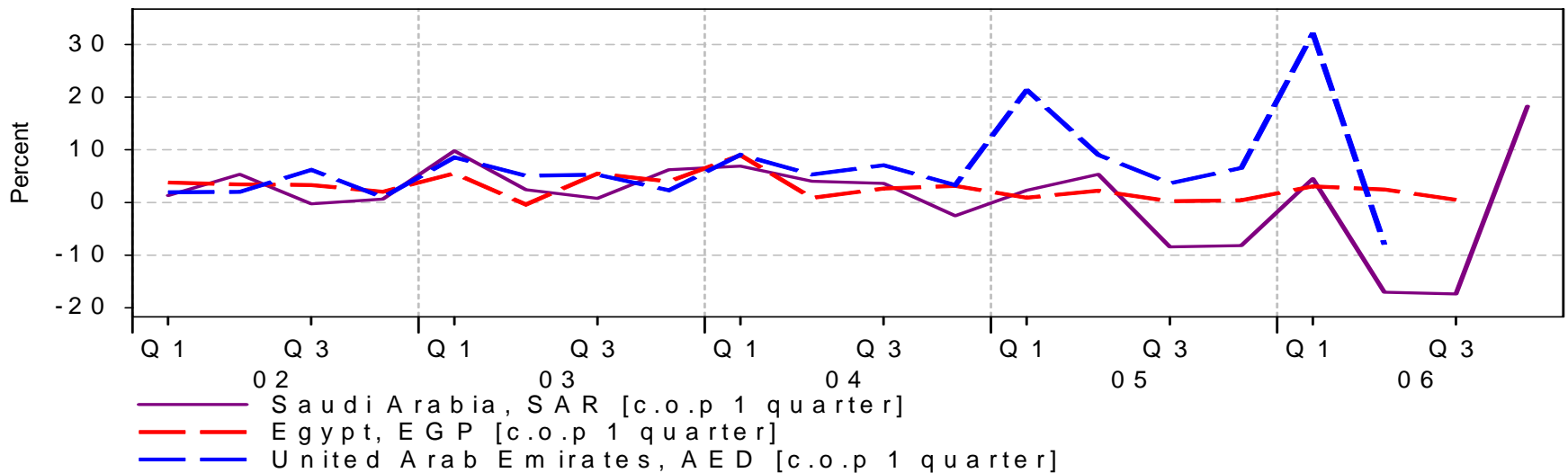


Domestic Credit Growth in the GCC & Egypt

DOMESTIC CREDIT Growth

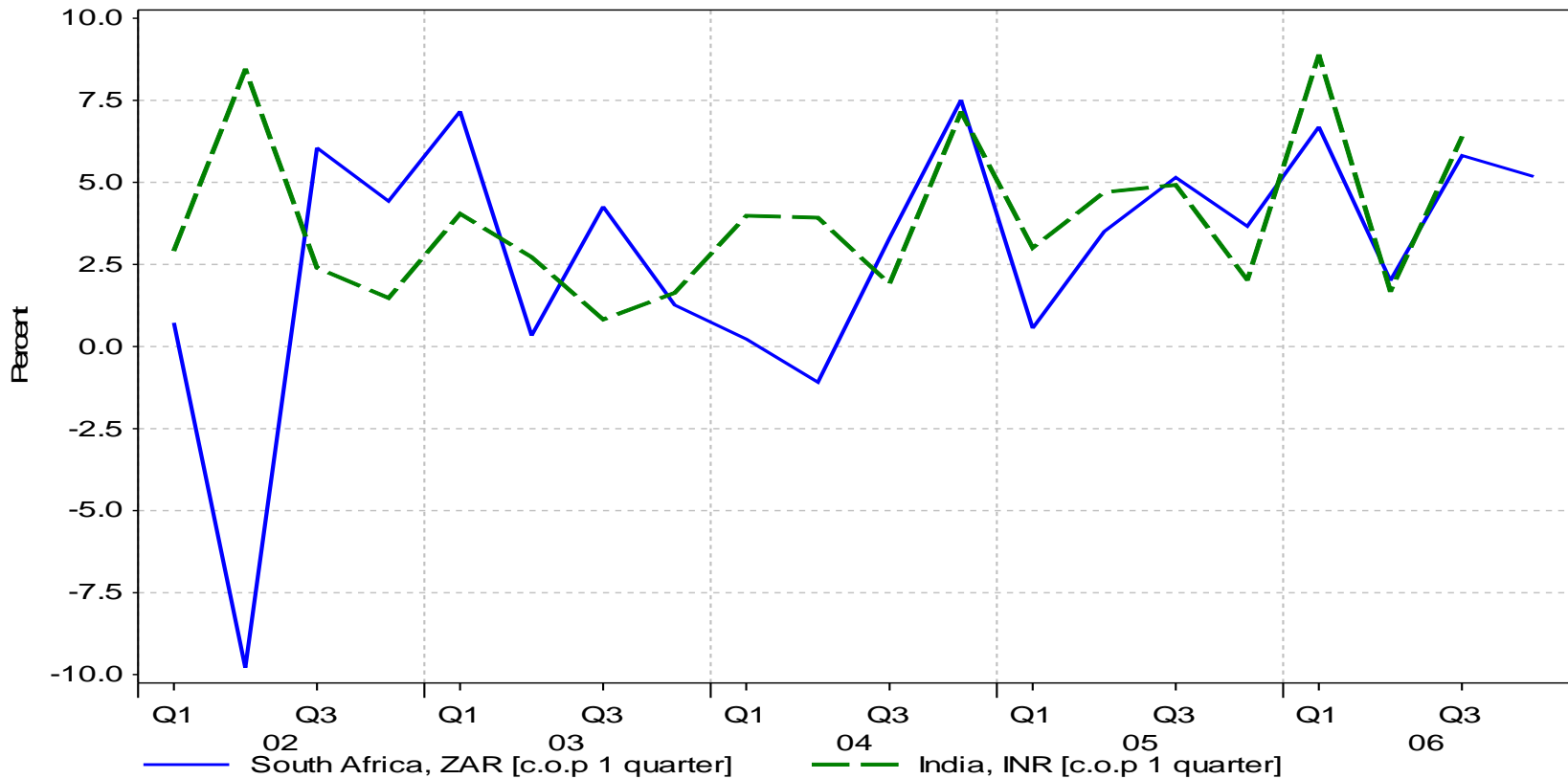


DOMESTIC CREDIT growth



Domestic Credit Growth in India & South Africa

Domestic credit growth

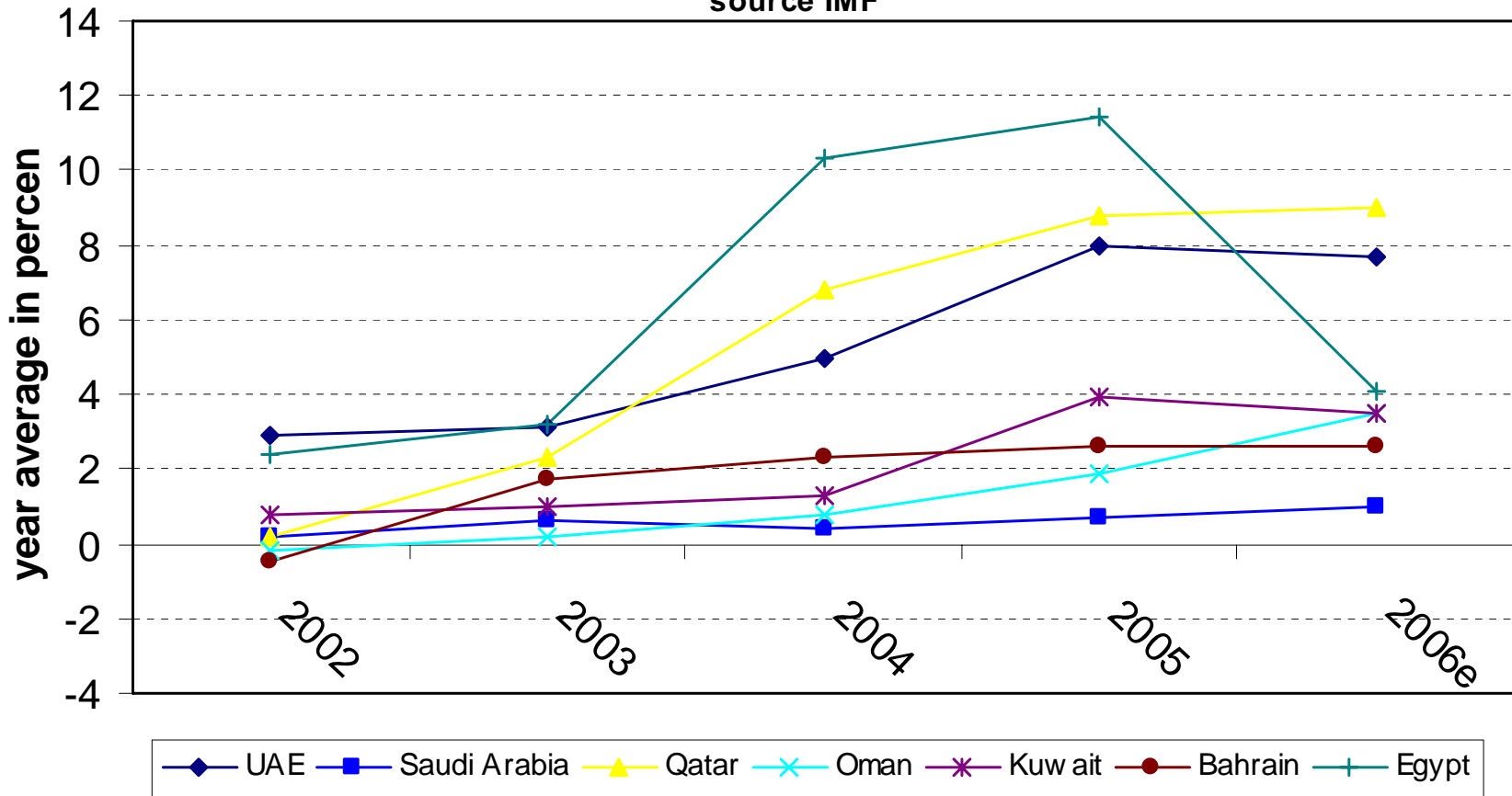


Source: Reuters EcoWin

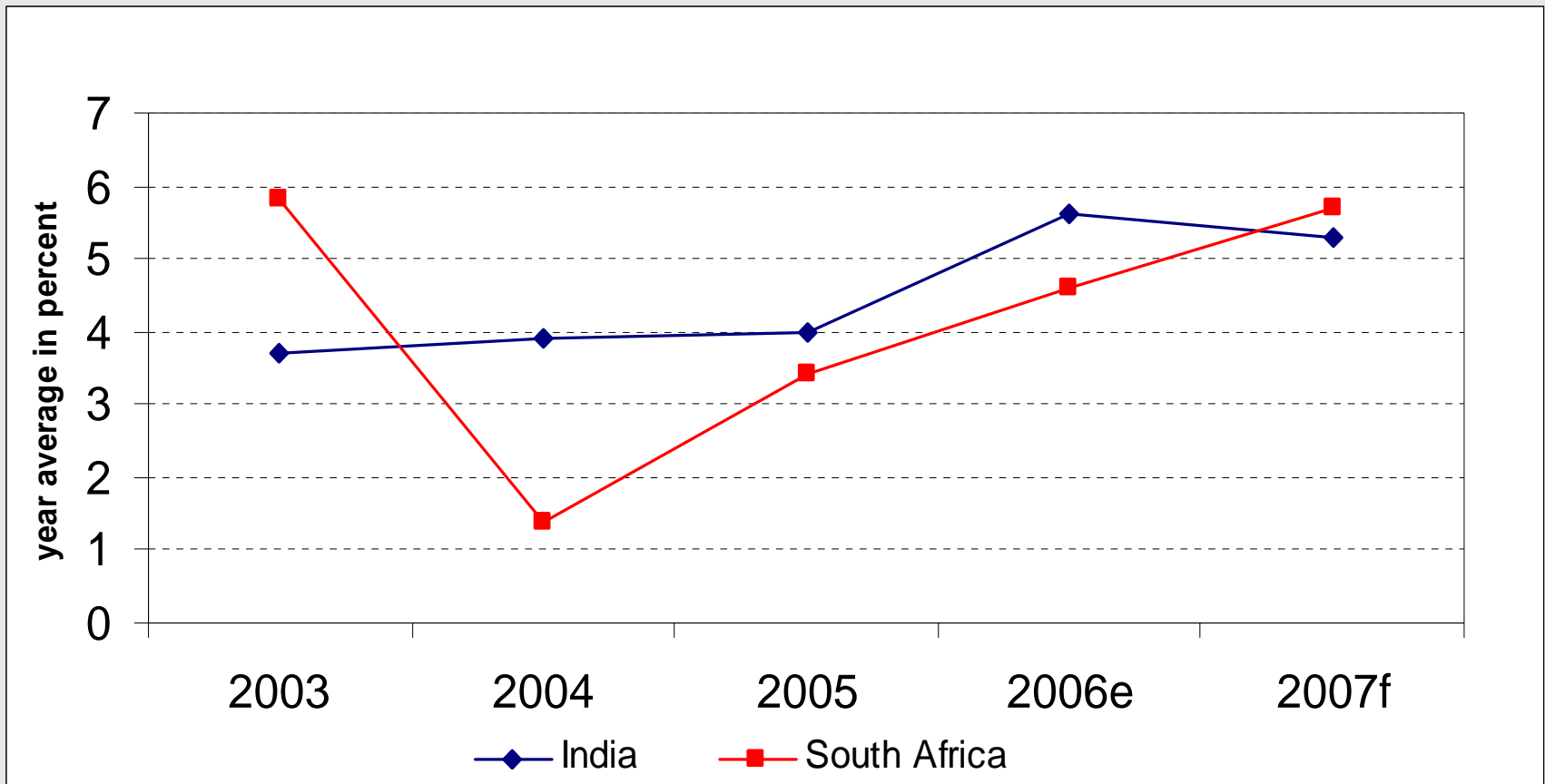
Inflation in the GCC & Egypt

CPI annual change

source IMF

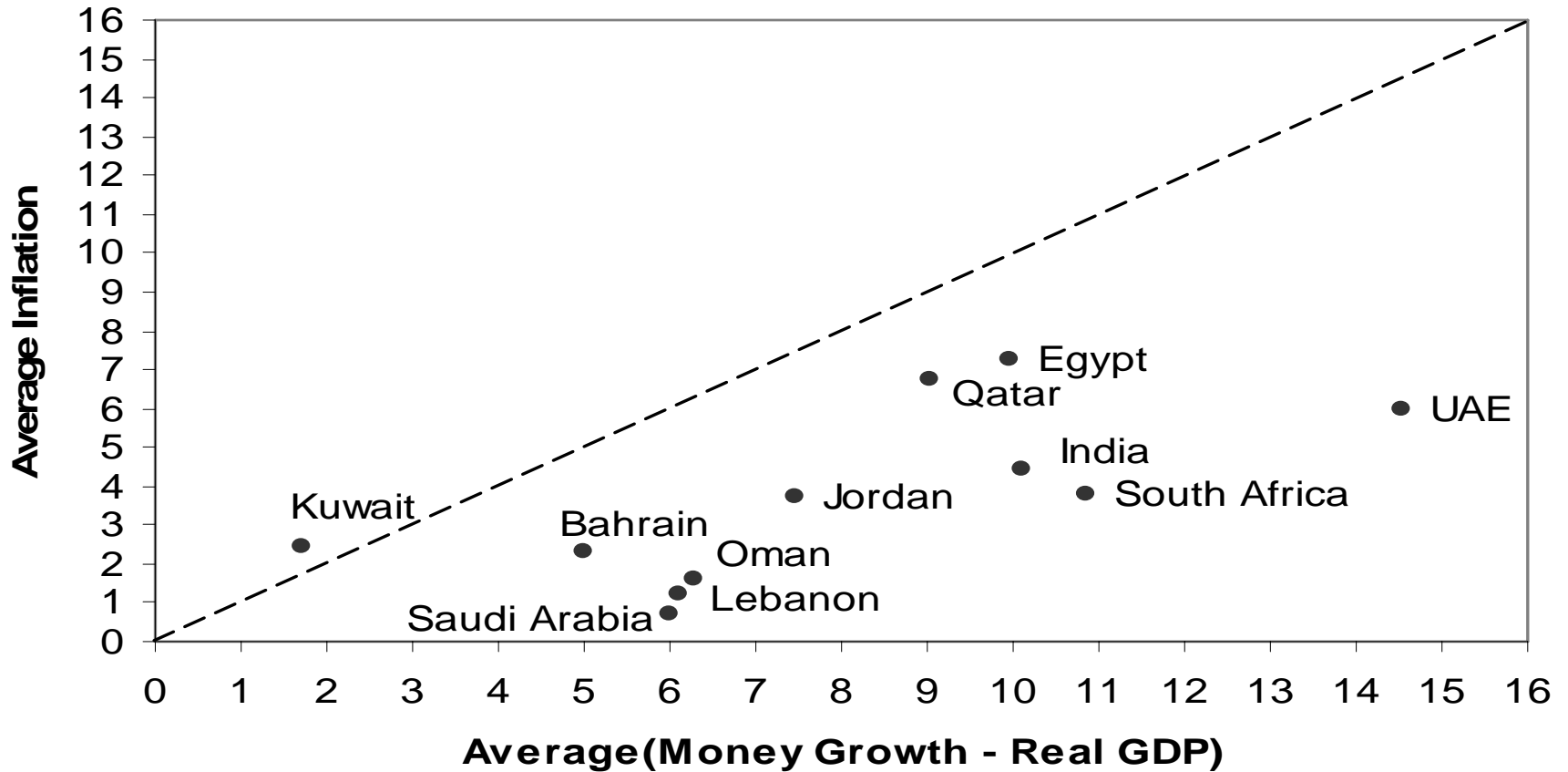


Inflation in India & South Africa



Money Growth and Inflationary Pressures

Averages 2003-2006



Consumer Sentiment & the MasterIndex

- SAMEA region lacks quality information and data on real economic activity: need to invest in improving statistical capacity
- Consumer sentiment surveys are a useful tool to gauge direction of change and potential turning points in business cycles and in consumer spending
- Need to multiply and extend use of scientific consumer and business sentiment surveys in the SAMEA region
- Recent period has not given us a full business cycle in order to judge ability of consumer sentiment survey to forecast turning points



MasterIndex Economy Variable

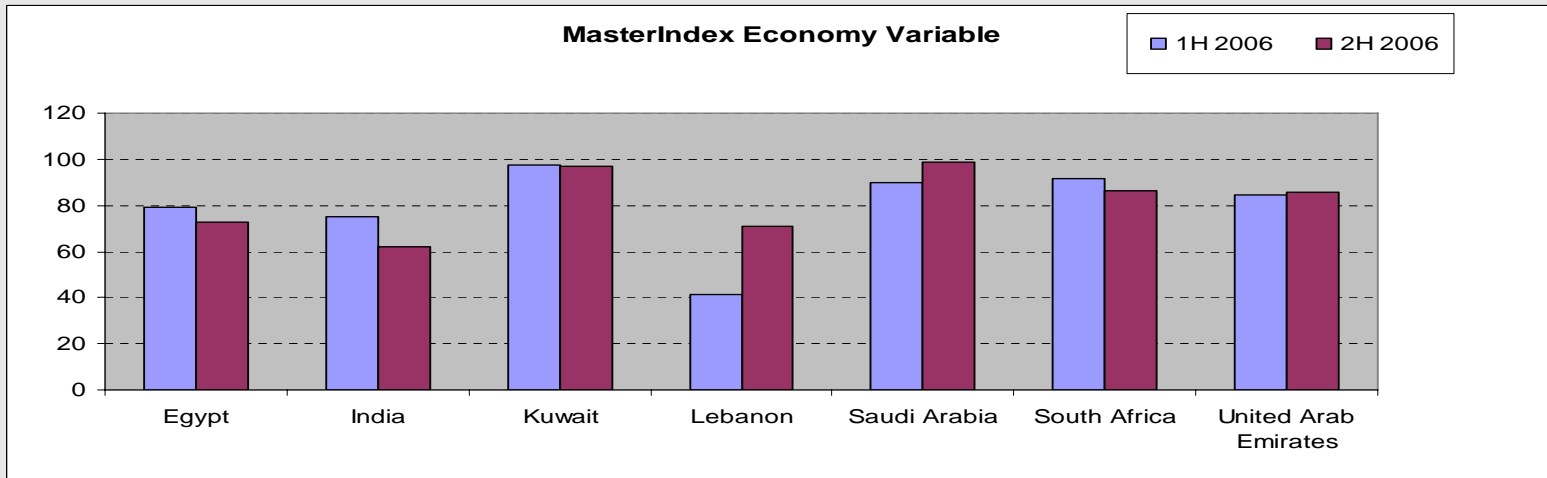


Figure 1 - MasterIndex Economy Consumer Sentiment variable

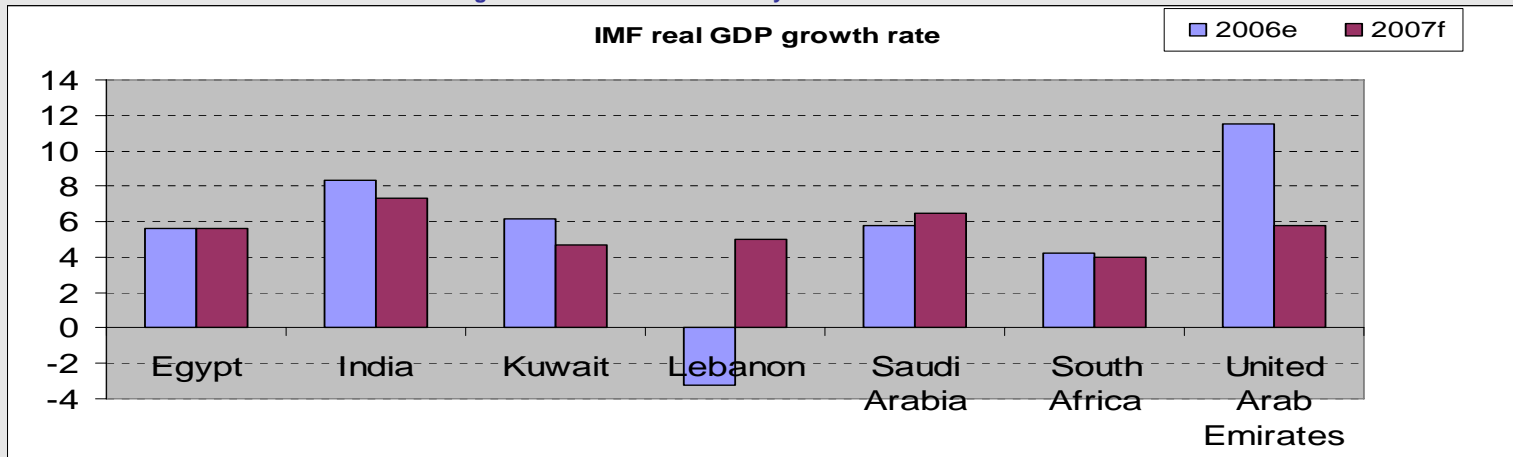


Figure 2 - IMF Real GDP growth rates (actual & forecast)



MasterIndex Economy Variable

- Consumer confidence responses appear to be consistent with the overall growth rate.
- Comparing the consumer economy confidence variable of the MasterIndex with the IMF's recent current and forecasted real GDP growth rates for the economies of the region, we can see that both the consumer sentiment about the economy and the change in the forecasted grow rate tend to move together
- Similar comments apply to consumer survey responses on employment and regular income: highly correlated with state of economy



Egypt, India and South Africa

- Egypt growing above trend:

- Economic & Structural reforms in the financial sector and privatization have stimulated domestic demand growth. Privatization receipts have increase from 1% of GDP in 2005 to 2.4% of GDP in 2006.

- Lower inflation

- New gas production facilities: expansion by some 50%

- Non-hydrocarbon FDI Inflows increased form 1.5% of GDP in 2005 to 4% of GDP in 2006

- Important to:

- Sustain reforms
- Ensure ‘trickle down’

- India showing signs of overheating: High growth, inflation, credit expansion, production above potential capacity, widening current-account deficit, supply shortages, rising share prices.

- South Africa growth is relying on private sector and consumer consumption, however credit risk is rising as a result of the build-up of private sector and household debt.

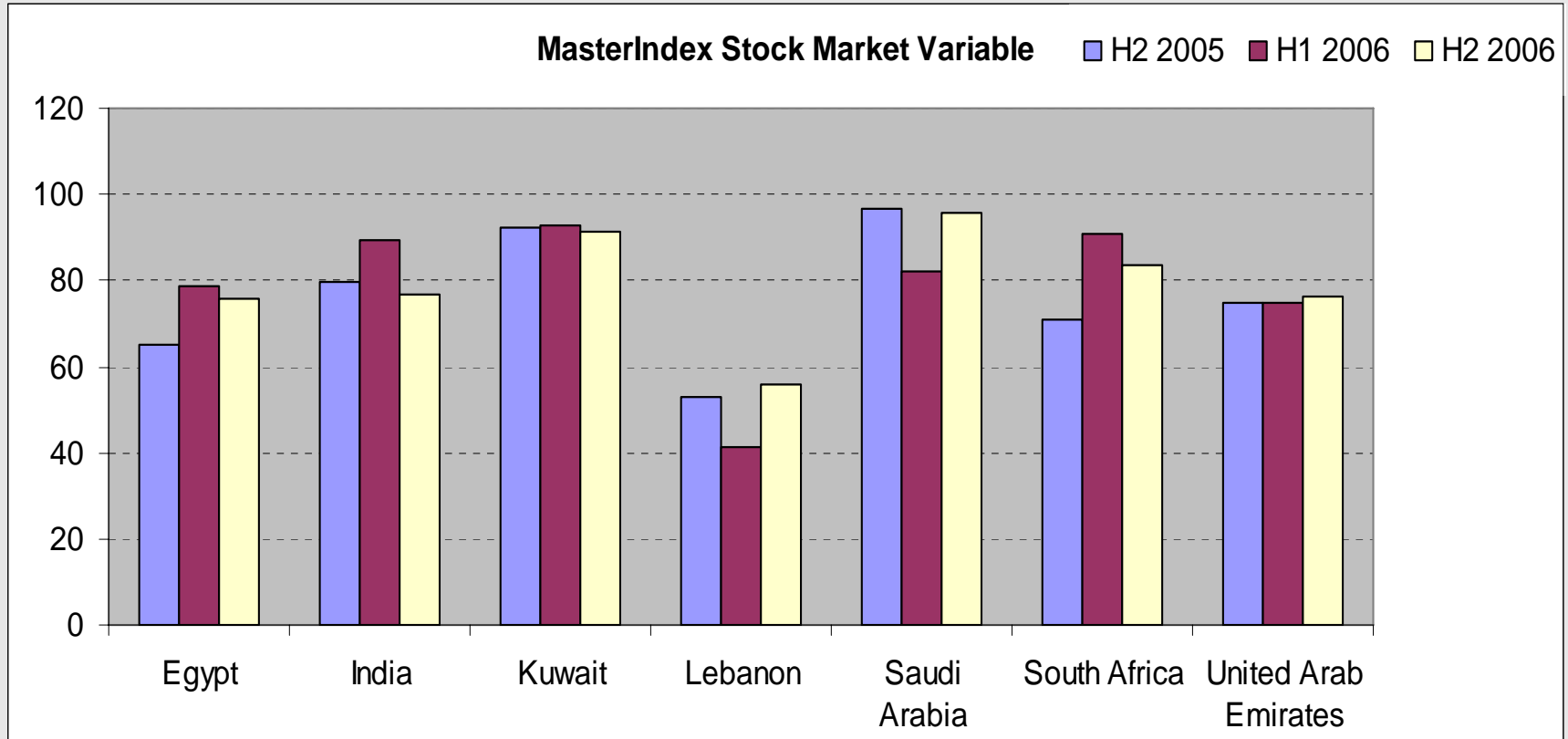
- South Africa balance of payment vulnerable: reliant on potentially volatile portfolio flows



- Strong macroeconomic fundamentals imply low macro risks:
 - 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
 - Conservative fiscal policies: more than 2/3 oil revenue increases have been saved, while debt has been reduced
 - Large current account surpluses: 20-25% GDP
- Demographics: young, fast growing native populations; liberal labour migration policies
- 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 neighbouring countries
- Expectations of GCC Regional Economic & Financial Integration: lower the cost of equity capital and lead to convergence of asset prices

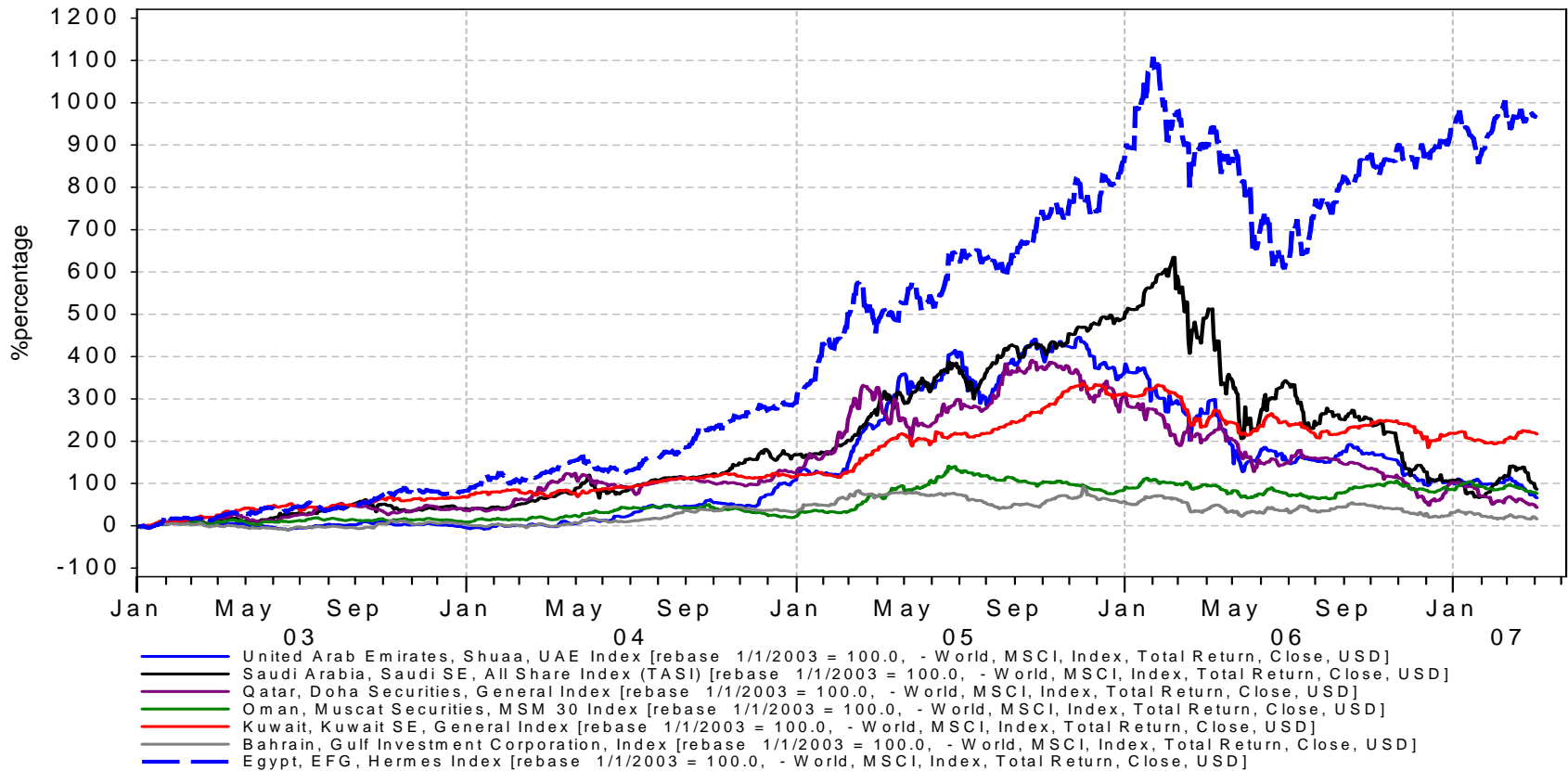


MasterIndex Stock Market



GCC & Egypt Stock Markets performance

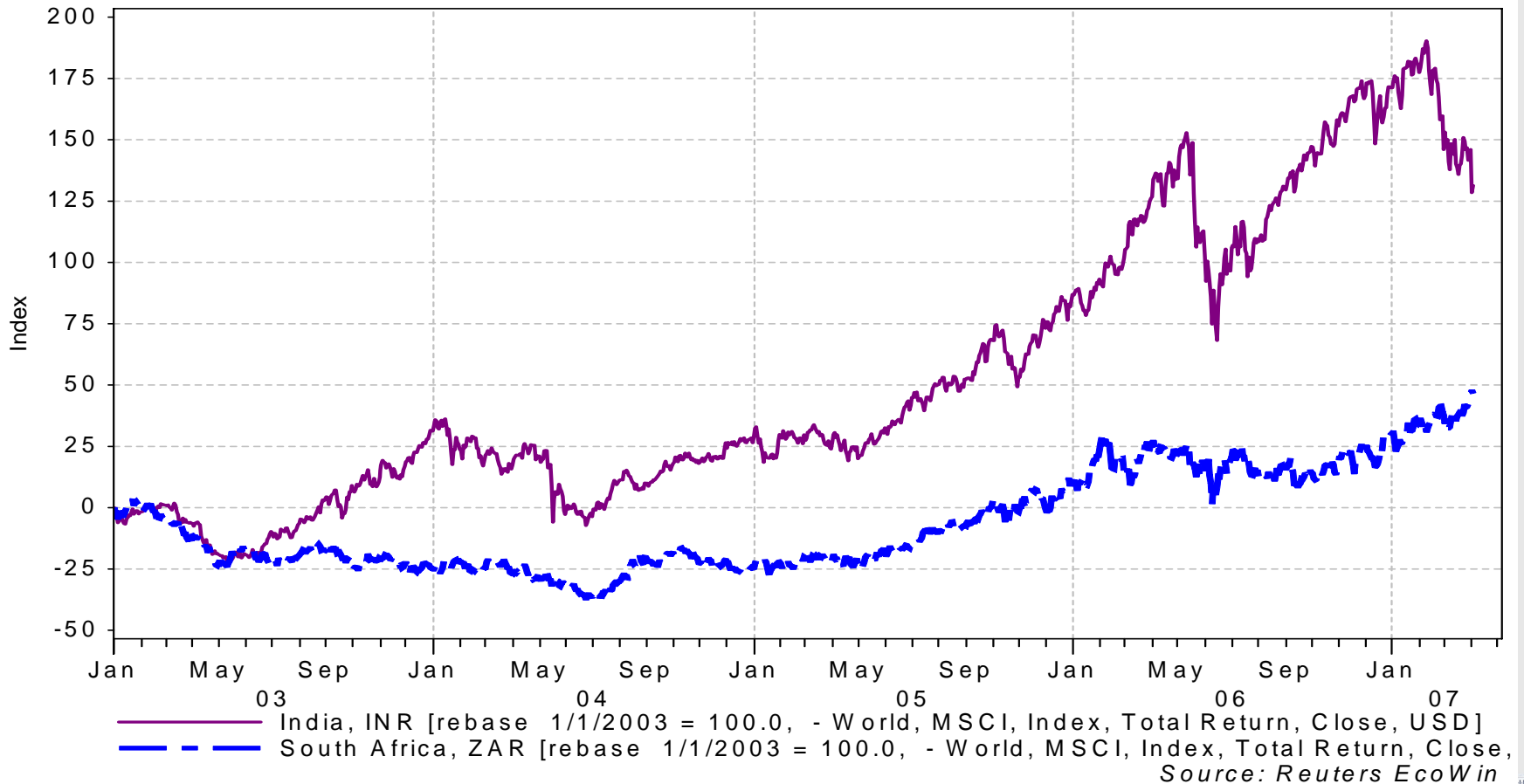
GCC & Egypt Markets vs. MSCI Emerging Markets
index value 1/1/2003 = 100



Source: Reuters EcoWin

India & South Africa Stock Markets performance

India & South Africa vs. MSCI World
index value 1/1/2003 = 100



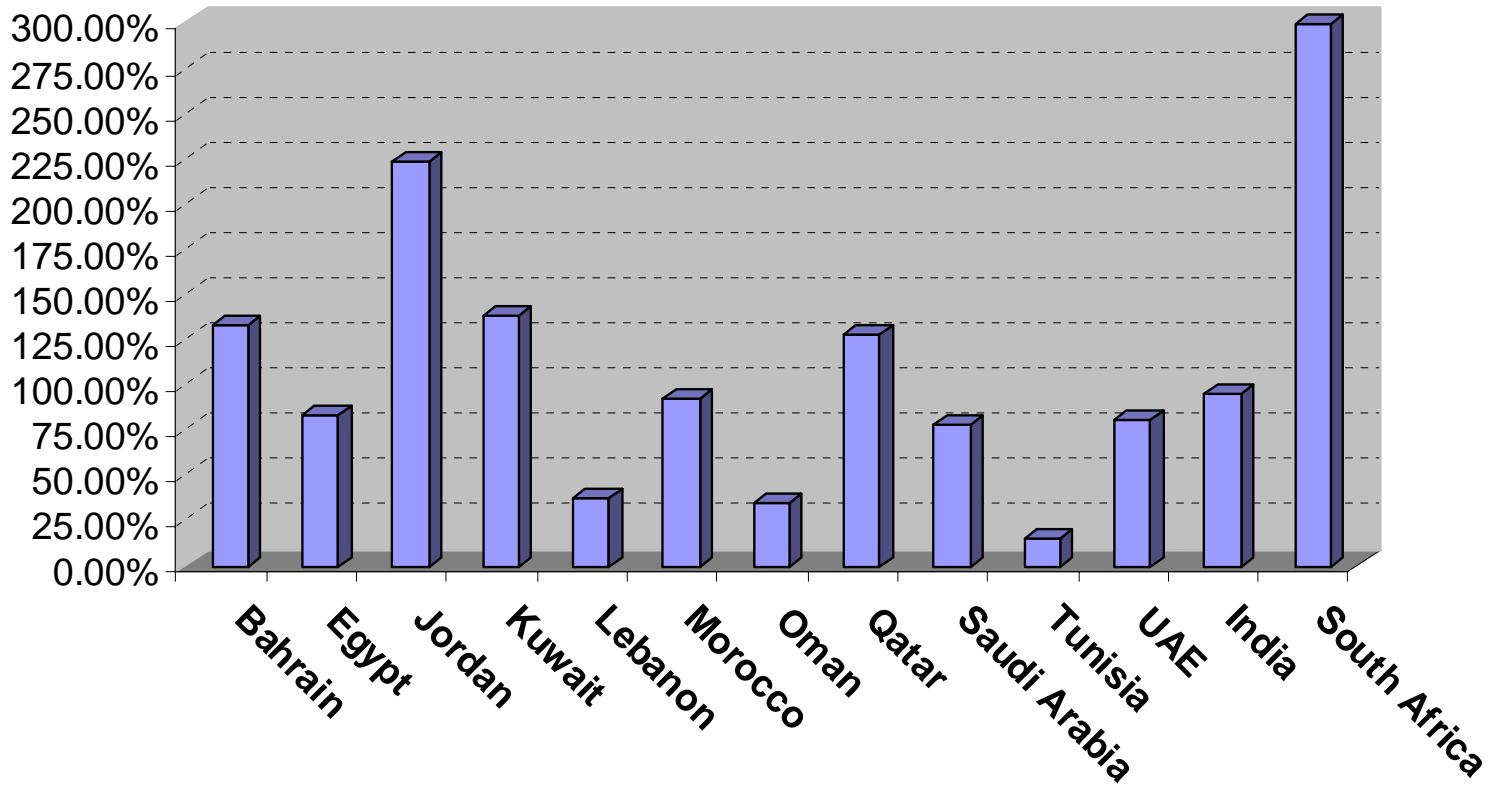
Liquidity & the Stock Markets

- 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 trillion by 2006. 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 145% of GDP between 2002 and 2005.
- Despite the growth in the number of companies, IPOs and higher valuations, markets remain fragmented, displaying high volatility of returns and lack the breadth, depth and liquidity.
- 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.

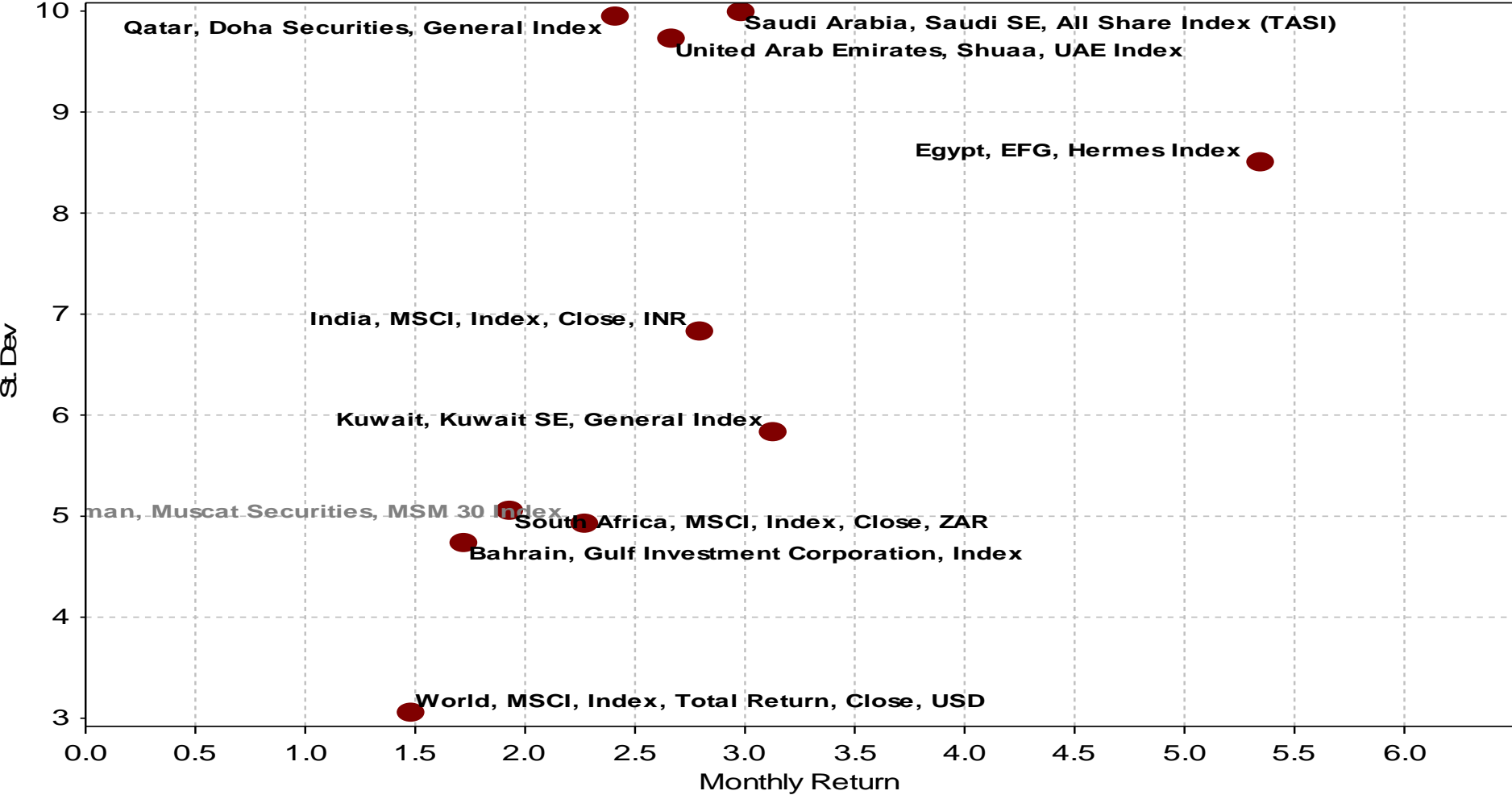


SAMEA Stock Market Capitalization

Market Cap/Nominal GDP
Jan 30th 2007



Markets Risk/Return



Source: Reuters EcoWin

Hawkamah-IIF GCC CG Survey

- Hawkamah Institute for Corporate Governance partnered with the Institute for International Finance to assess the corporate governance environment of the GCC countries, from an investors perspective.
- GCC Task Force met with close to 100 regulators, Central Bank officials, accountants, auditors, investment firms in all 6 GCC countries.
- Analysis of the corporate governance environment focused on:
 - > Minority shareholder rights
 - > Structure and responsibilities of Board of Directors
 - > Accounting and auditing
 - > Transparency of ownership and control
 - > Regulatory environment



Table 5: Comparison of Corporate Governance Frameworks in the GCC with IIF Guidelines
(on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Minority Shareholder Protection	2.0	4.0	3.0	2.5	3.5	2.5
<i>Voting Rights</i>	1.5	3.5	3.5	2.5	2.0	3.5
<i>Firm/Capital Structure</i>	1.5	4.5	1.0	2.0	5.0	2.0
<i>Shareholder Meetings/Other Rights</i>	3.0	3.5	3.5	3.0	3.0	2.5
Structure and Responsibilities of the Board of Directors	2.0	1.5	3.5	1.5	2.0	1.5
<i>Board Structure</i>	1.0	1.5	3.5	1.5	1.0	1.0
<i>Disclosure</i>	4.0	3.5	5.0	1.5	4.0	3.5
<i>Others</i>	1.0	0.5	2.5	0.5	2.5	0.0

the GCC countries with IIG Guidelines

(on scale of 1-5 with 5 being fully)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Accounting and Auditing	2.0	2.5	4.0	2.0	2.5	2.0
<i>Standards</i>	3.0	3.5	3.5	3.0	3.5	2.5
<i>Audit Committee</i>	0.5	0.0	5.0	0.0	0.0	0.0
Transparency of Ownership and Control	2.5	3.5	3.5	1.0	4.5	2.5
Regulatory Environment	2.0	2.0	4.5	2.5	2.5	2.0
OVERALL ASSESSMENT	2.0	3.0	3.5	2.0	3.0	2.0

Takeaway of IIF-Hawkamah Survey

- Excess Liquidity in the GCC Region
 - Too much money chasing too few stocks
 - High valuations due to lack of sophisticated investor and poor equity culture
 - This creates high volatility in stock markets
- Easy access to capital provides little incentive for change at company level
- Efforts being made by authorities to improve overall corporate governance frameworks but some initiatives lack strategic focus and political will
- Banking sector in general has better corporate governance due to Basel II compliance



CG Reforms Required to Strengthen GCC Equity Markets I

STRUCTURAL REFORMS

- Judicial and legal reforms
 - Establish specialized financial courts to deal with cases pertaining to securities related offences
 - Revise corporate and securities law to strengthen minority shareholder rights
- Privatize stock markets
- Establish rating agencies to help investors assess degree of risk and value of securities.
- Regulate fund managers to tackle problems of:
 - Front running
 - Insider trading
- Introduce market pricing mechanism for the IPO market such as book building and rating of IPO securities



CG Reforms Required to Strengthen GCC Equity Markets II

REGULATORY REFORMS

- Introduce corporate governance codes on a mandatory compliance basis for all listed companies
- Strengthen surveillance and enforcement functions at the regulatory level by increasing/strengthening prosecution of errant individuals and companies
- Make securities regulatory fully independent like DFSA

TRANSPARENCY

- Improve quality of financial disclosure by requiring companies to provide information on a consistent basis including a management analysis of strategy and risks
- Require public disclosure of board of directors and details of frequency of board meeting, pay etc
- Require disclosure of
 - Related-party transactions
 - Material information
 - Ownership structure and shareholdings



Risks and Trends

- The economic and financial prospects for the region are promising, consistent with the sentiments expressed by respondents of the MasterIndex survey. However, 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 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 imply lower sensitivity of local asset markets to movements (including higher) global interest rates.
- Resilience of economies should not lead us to become complacent: the countries of the region need to undertake policy reforms, notably in the banking and financial sector, as well as modernize laws and regulations relating to market access to reflect the greater openness of the economies.



Some Payment Implications of Emerging Trends

- New Economic Geography: invest and build new payment infrastructure
- Space capabilities and systems are becoming integral elements of modern economies and their supporting payments infrastructure. Investment is required in satellite infrastructure systems to ensure redundancy, business continuity, and importantly, the safety and security of data and its processing
- Migration & Remittances: GSMA and MasterCard pilot remittances transfer programme can address needs of 200 million + migrants, remitting some US\$ 250 billion and provide access to finance.
- More investment in remittance payment systems would encourage the use of formal channels, increase efficiency of remittance transfers & reduce transaction costs, and facilitate international labour mobility and ultimately increase remittance flows, raise growth rates and serve to lower poverty in labour exporting countries
- DIFC will support emergence of a Single Gulf Financial Area (SGFA), with a sound & efficient multi-currency payment system linking and integrating the financial markets of the region to support and provide payment infrastructure for greater economic and financial integration



SAMEA ECONOMIC RENAISSANCE

A TIME TO BUILD, INVEST & TRADE

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