DIFC | Dubai International Financial Centre

Sub-Prime Blues or De-linking? GCC's Economic Renaissance

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Sub-Prime Blues or De-linking?

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- **US Uncertainty: Sub-Prime Blues and Credit Crunch**
- **Investment, Infrastructure & Productivity**
- **Demographics, Migration & Remittances**
- **GCC: Structural Change & Drivers of Economic Growth**
- **Liquidity, Markets & Volatility**
- **Prospects & Challenge of Financial Markets**

Sub-Prime Blues, Credit Crunches & Transmission Effects

- Second longest expansion period witnessed in the post-war period (starting in November 2001) except for the exuberant 1990s (1991-March 2001): slowdown would be 'normal' business cycle phenomenon
- US experienced housing exuberance
- Policy reaction:
  - Fiscal/tax package
  - Monetary policy easing
- Uncertainty phase leading to credit and capital market volatility. SP losses and write-downs currently running at $120 billion. Likely total losses: $300 to $350 billion of the $1.2 trillion SP market

SINCE 2000

	Correlation	Return	Volatility	Sharpe
S&P/CSI	1.00	88.82%	0.73%	1.50
Bonds	-0.09	67.31%	1.44%	1.33
Commodities	0.58	155.59%	5.29%	0.48
REITs	0.22	110.33%	4.24%	1.06
Stocks	-0.11	2.65%	3.44%	0.09

Financial Crises = Recessionary Fears ?

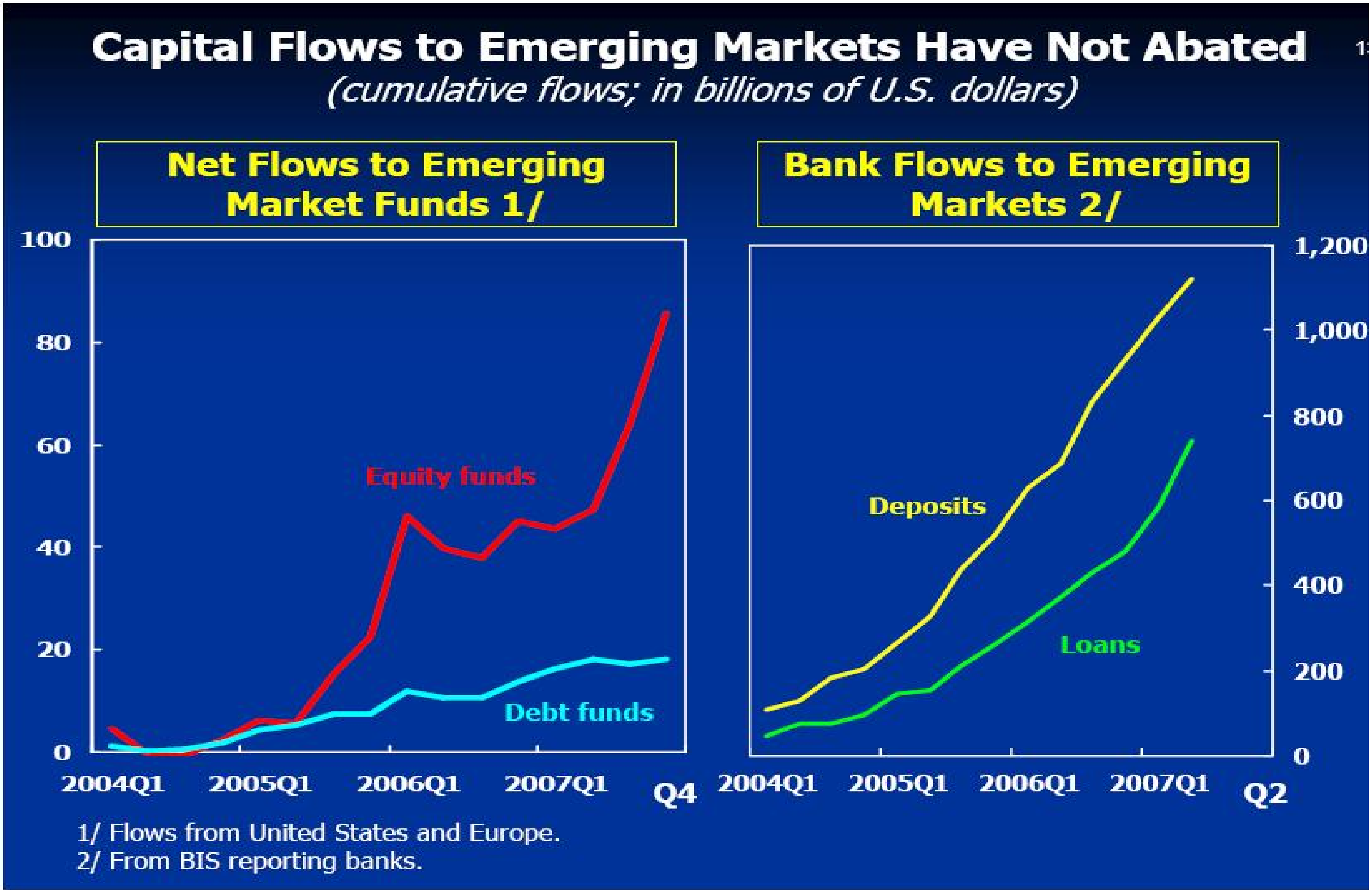
- Sub prime shock resembles LTCM induced financial crisis: possibility that a credit contraction will trigger a series of hedge fund failures in succession.
- But Sub Prime shock occurred in a period with:
  - Greater liquidity in markets
  - Consumption rates sustained and have increased in tandem with household wealth
  - Most plausible estimate is that 10% in housing prices would lower consumption ratio by about 1%
- There have been 3 'crashes' in recent history:
  - Saving & Loans Crisis (late 1980s to beginning of 1990s)
  - LTCM Crisis (1998)
  - Enron/WorldCom Crisis (2001-2002)
- Current equity market decline looks small in relation to previous declines.

Policy Effects:

- Tighter lending terms and standards in the sub prime mortgage market
- Commitment of central banks to ensuring liquidity
- Concerted policy action by central banks

Assessment: US slowdown rather than ‘recession’

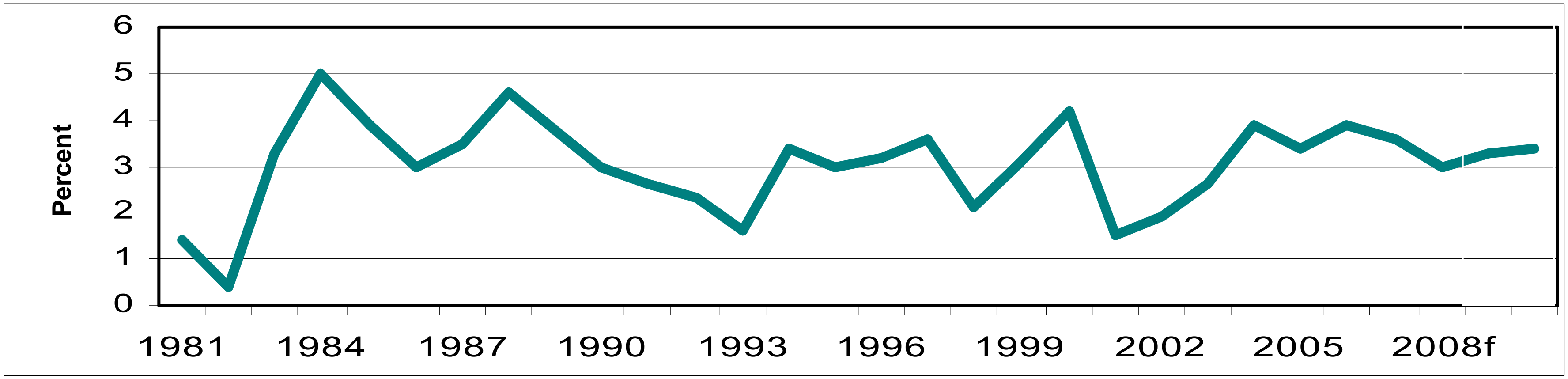
Capital Flows to Emerging Markets Remain Strong (Source: IMF)

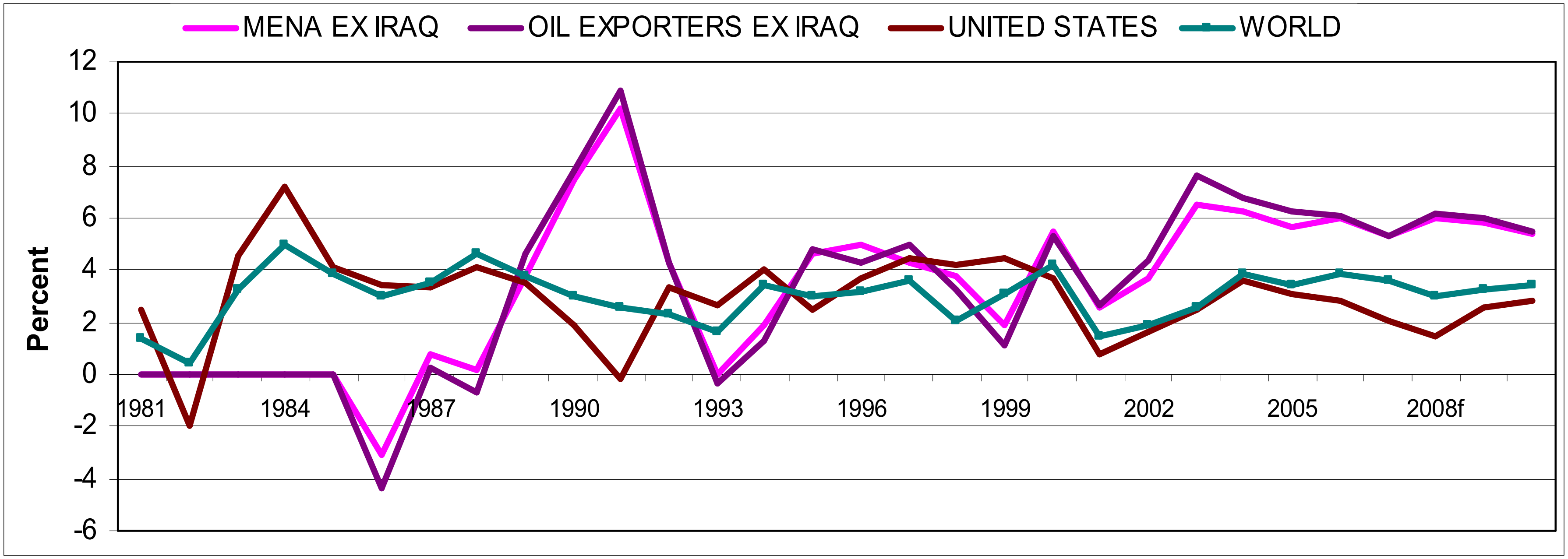


A ME/GCC Economic & Financial Renaissance

- MENA has achieved above trend economic growth rates:
  - Average real GDP growth 6.2% over 2004-2007 vs. 3.7% in 1998-2002
  - Growth resurgence has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity and ↑ in productivity growth
  - Sustained by strong global growth led by Emerging Markets
- Private sector is leading and driving regional economic integration of markets, FDI, Tourism, labor flows
- Emergence of multinationals: DP, Etisalat, Emaar, MTC…
- Infrastructure investments with an estimated value in excess of USD 1.7 trillion are currently under development or planned in the GCC alone.
- Oil export receipts reached $381bn in 2007, up 8% from 2006
- Positive demographics & migration sustaining labour & output growth

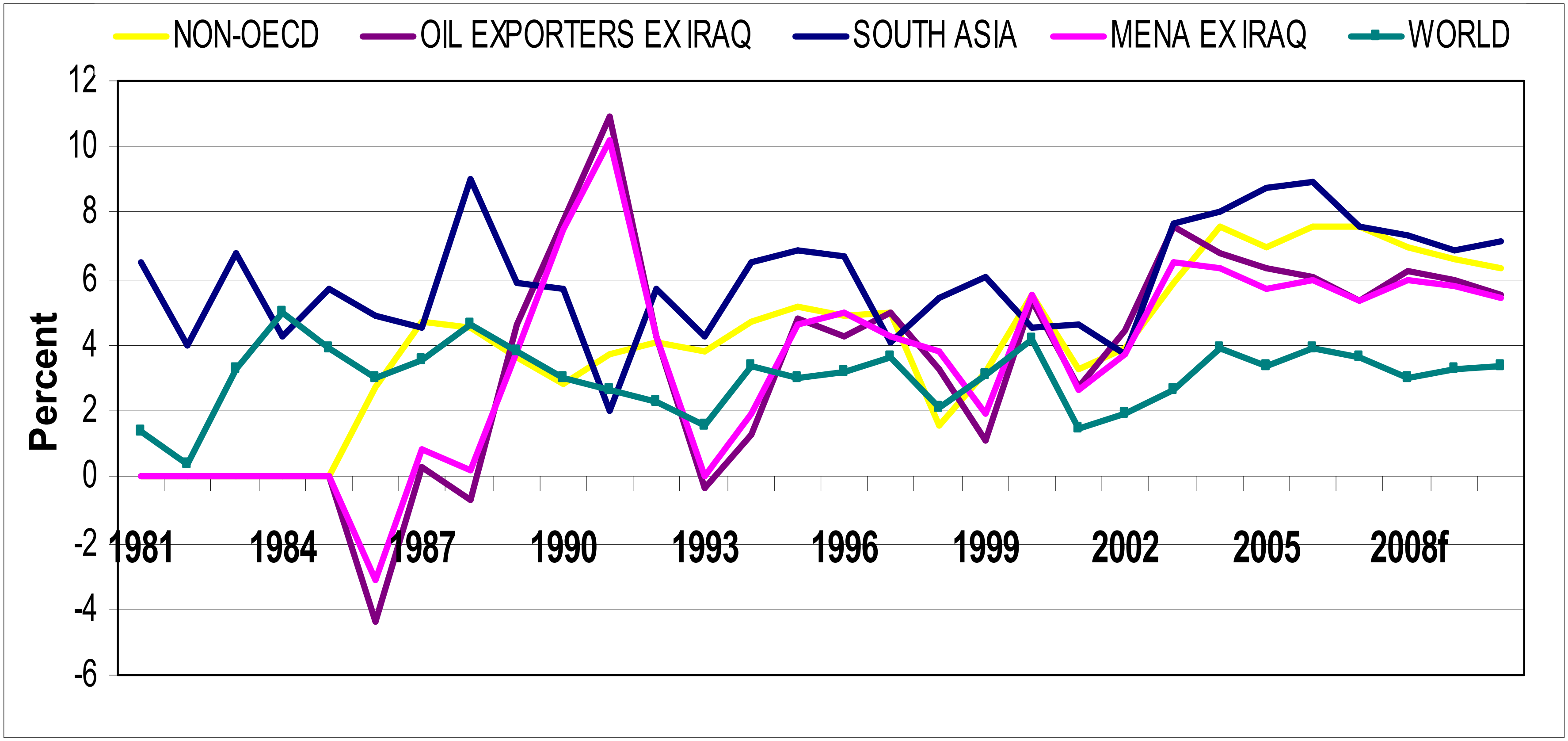
World Real GDP Growth @ 30 Year High & Less Volatile





Source: EIU, February 2008

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

A GCC Growth Resurgence and Economic Renaissance

- **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**
- **Fiscal Policy:**
  - Oil producers policy reaction has been fiscally conservative: 60% of higher oil revenues have been saved
  - Substantial fiscal surpluses (19% of GDP in 2007) even as spending has picked up..
- **Current account surpluses running at 25-30% of GDP much of which is being recycled back into regional economies**
- **Surge in Shari’aa compliant banking & finance**

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%

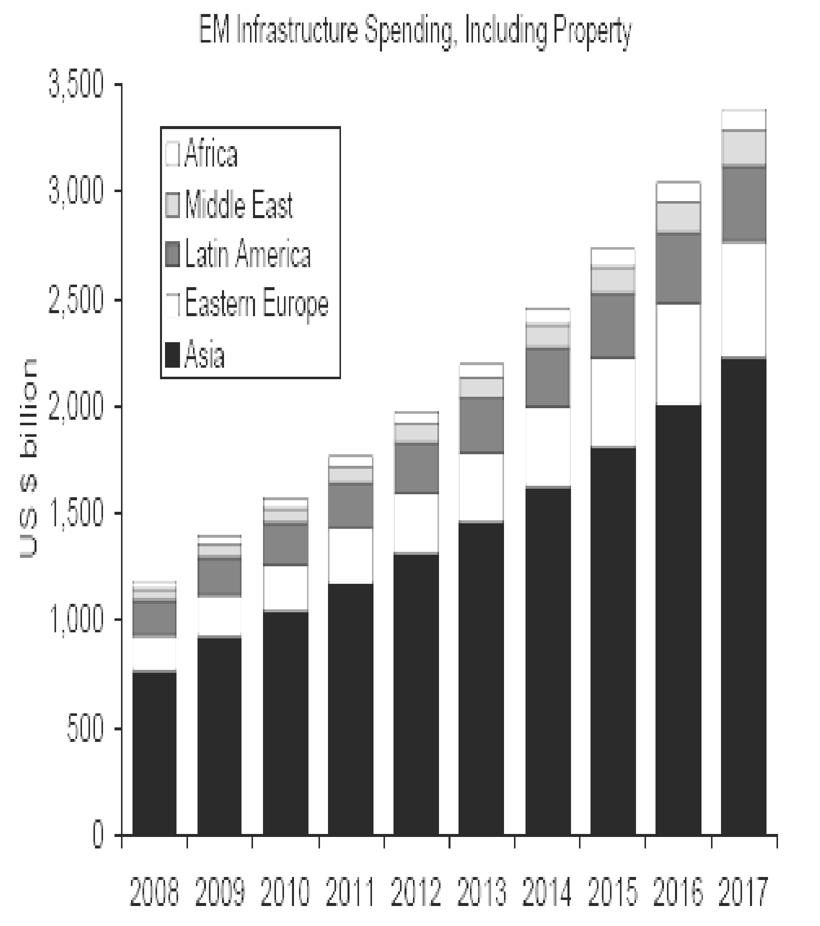
Infrastructure drivers:

- 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)

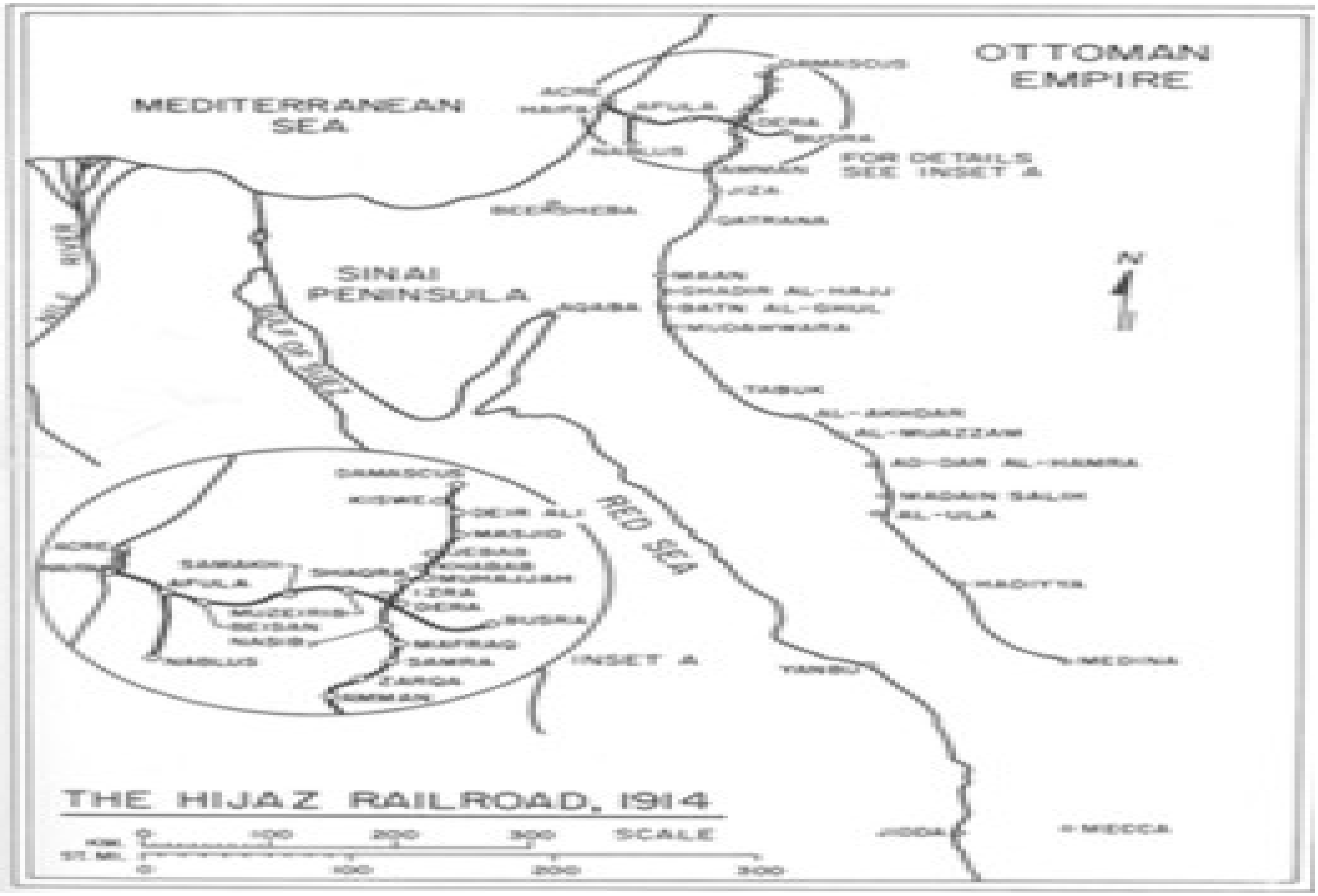
(Source: MEED)

	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

Berlin to Baghdad Railroad, 1913

FIG. 5.

Hijaz Railroad, 1914



Hejaz Railway Damascus –Medina

Integrated Infrastructure basis for Economic & Financial Integration

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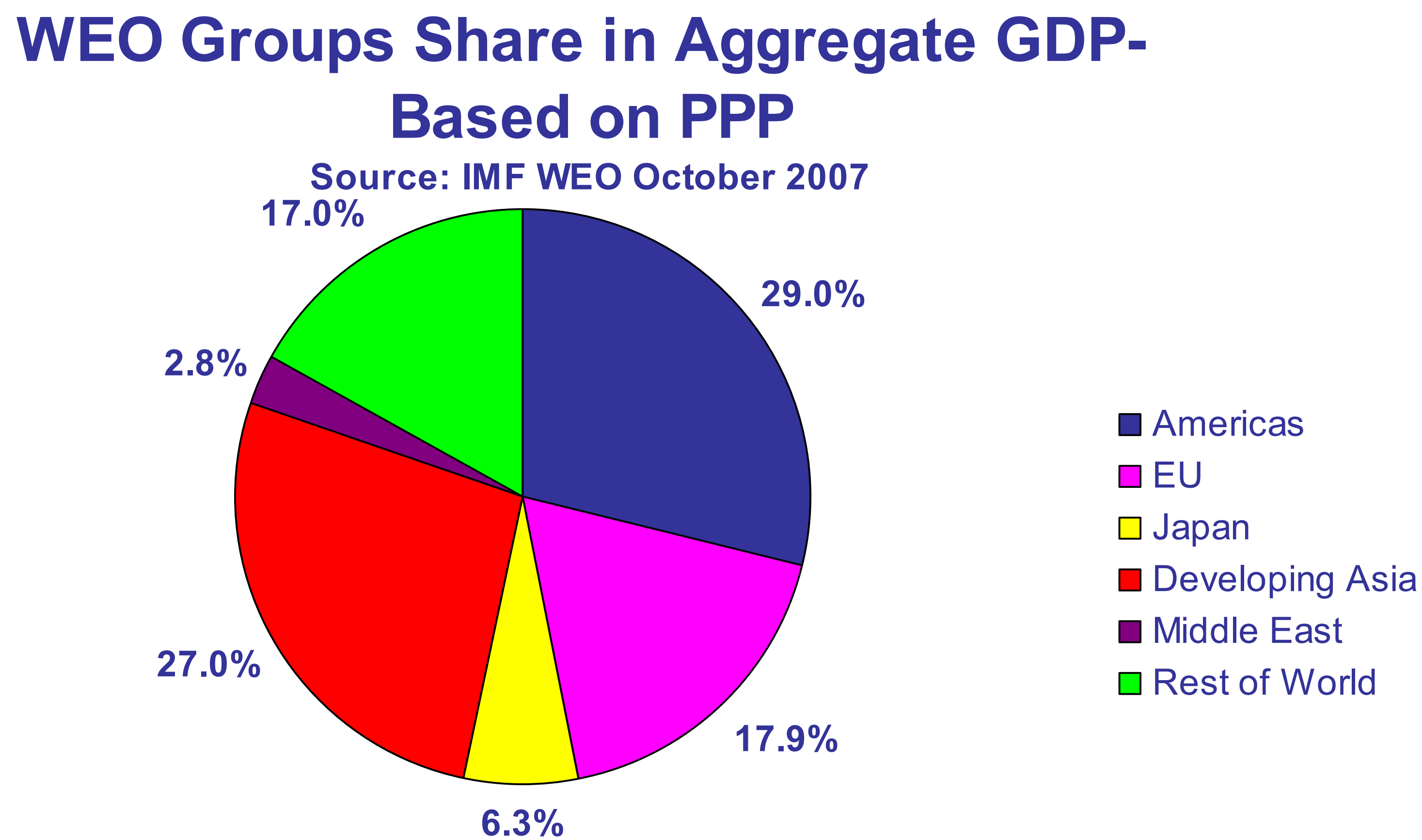
- Geography & proximity, density & intensity of traffic suggest high returns to integrated infrastructure investments: standards, policies, pricing; integrated network
- Transport: rail, road, air
- Energy: oil & gas, electricity
- Telecommunications & Infostructure (broadband+)
- Payment Networks: facilitate payments & settlements
- Financial Market Infrastructure: integrated capital markets



* includes US, Canada, Western Hemisphere

GCC: Power of Regionalism & Networks

- **Location & New Geography:**
  - GCC 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
  - Increased de-linking from the US business cycle
- GCC Common Market good start, but lack of GCC Financial Sector development is now a Barrier to sustained growth and competitiveness

Demographics, 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).**

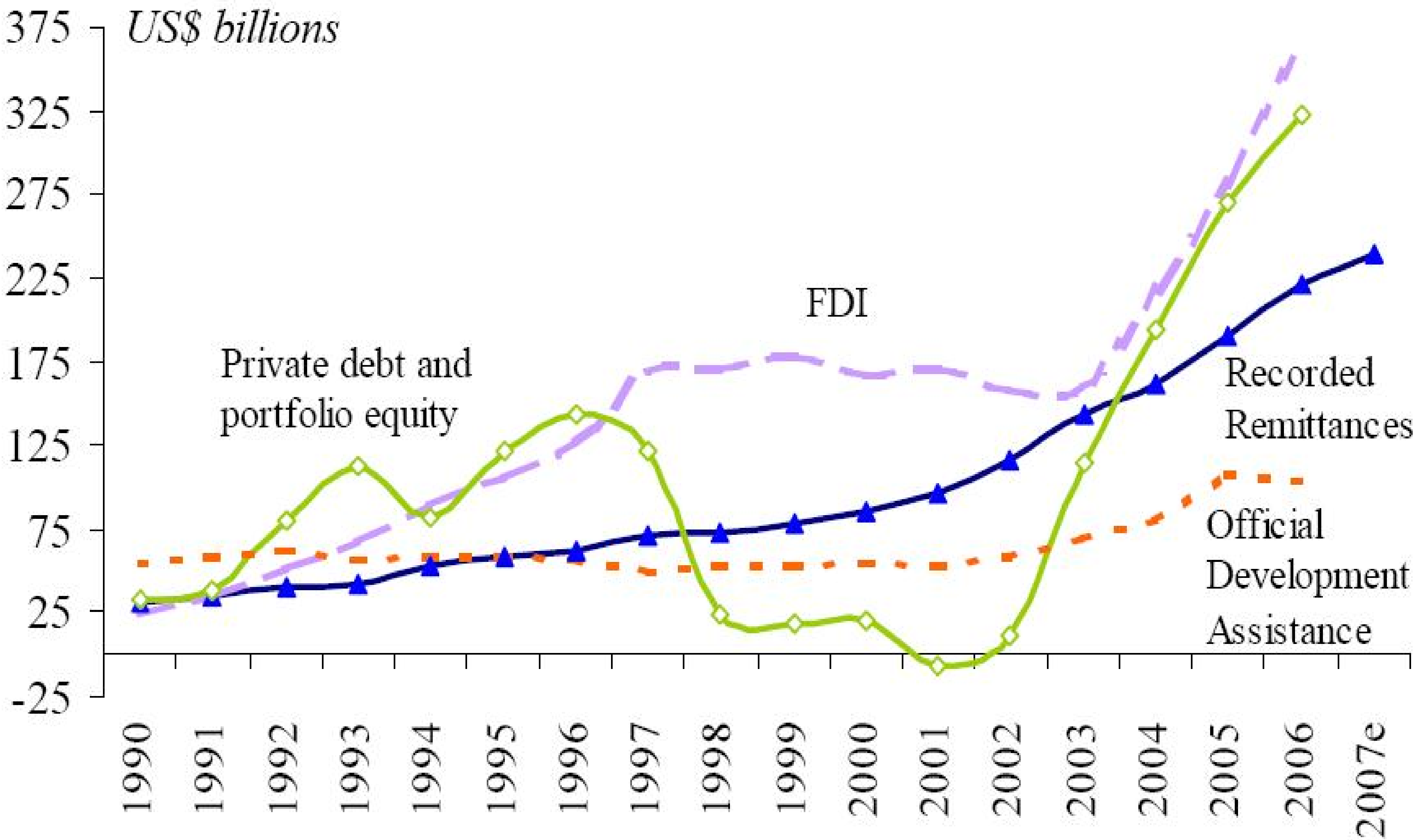
- **Inward remittance flows between 12%-15% of GDP for Egypt, around 5%, for India, and more than 22% for Lebanon.**
  - **India** world's top remittance recipient with $27.0 bn in 2007, or 5.7% of GDP.
  - **Saudi Arabia**: world's top 2nd remittance sender with $15.6bn in 2006 or 5.0% of GDP
  - **Lebanon**: world's top 8th recipient of remittances in 2006 (22.8%)
  - **India-UAE** is top migration corridor for high-income non-OECD countries. **India-Saudi Arabia**, comes in 2nd place.

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

Transmission and new Regionalism

- Official remittances are likely to represent only a fraction of total remittances
- Remittances growing , more stable than capital flows, FDI or ODA
- Transmission effects and new linkages affecting labour exporters:
  - Higher incomes of migrant populations
  - ↑ Labour flows to oil exporters
  - ↑ remittances to labour exporting countries
  - FDI
  - Portfolio investment
- *Remittances leading to greater Economic & Financial Integration*

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



Sources: *Global Economic Prospects 2006: Economic Implications of Remittances and Migration* (World Bank), *World Development Indicators 2007*, and *Global Development Finance 2007*.

Increase in Wealth and Liquidity

Massive Wealth Creation.

- GCC $585bn current account surplus has outgrown those of China and Japan.
- 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.[1]

- 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
- US$ Peg Exchange Rate policies

Money Growth and Inflationary Pressures

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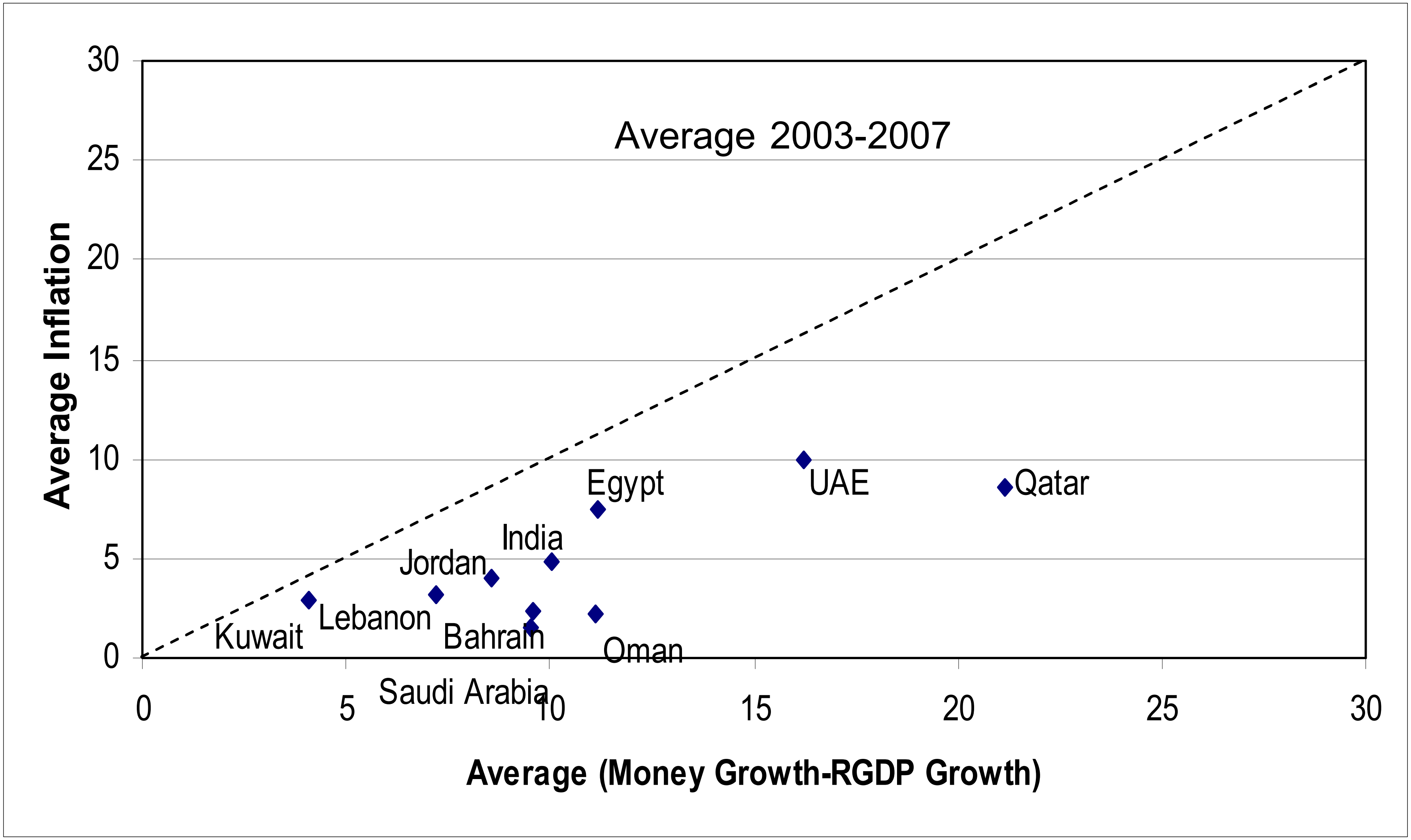


Author's Calculation of EIU Data, 2008

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.

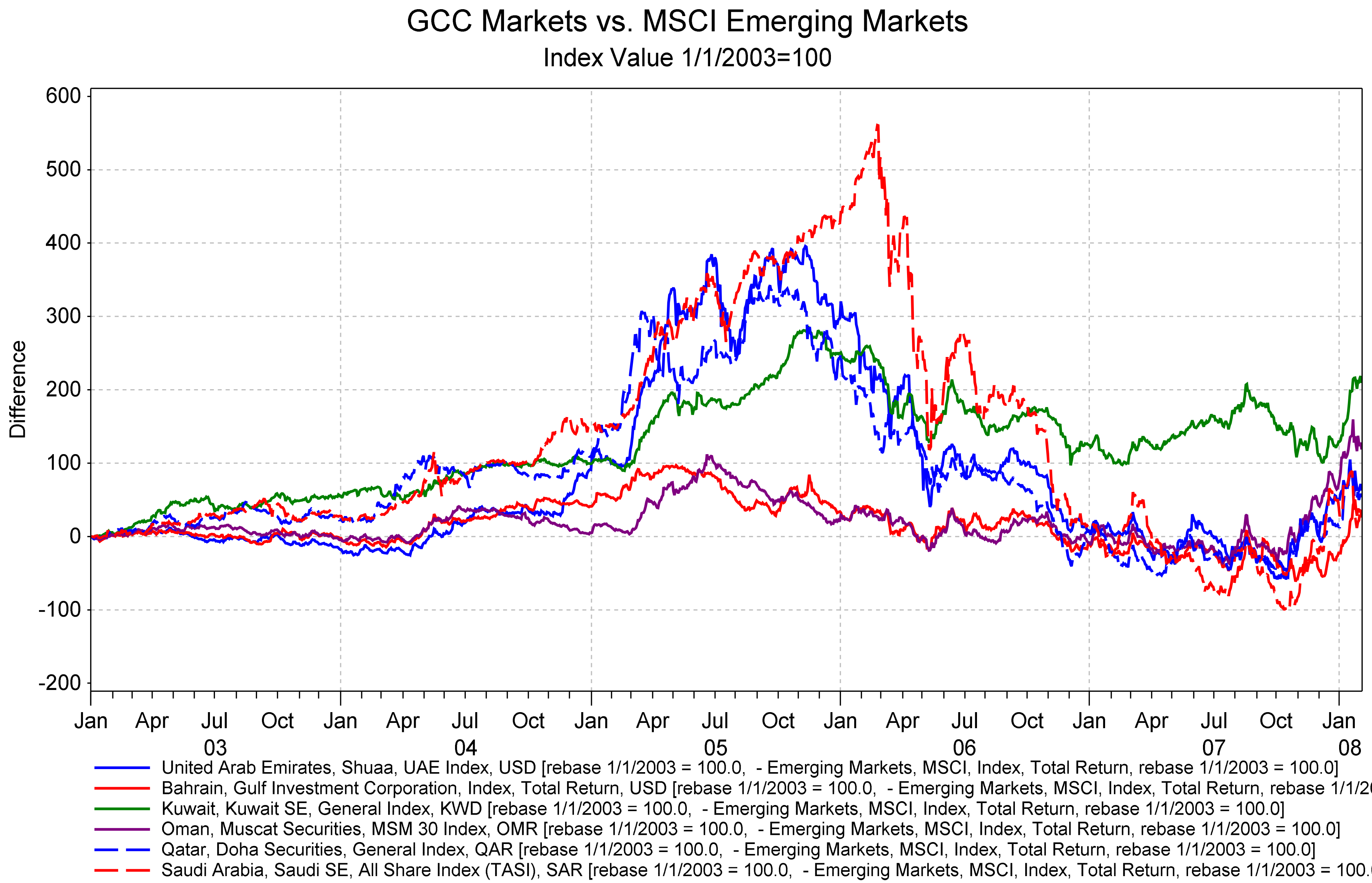
- For the GCC, market capitalization grew from less than $200 billion in 2002 to about $1,039 billion by January 2008. GCC markets out-performed emerging and developed markets.

- 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.

- 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.

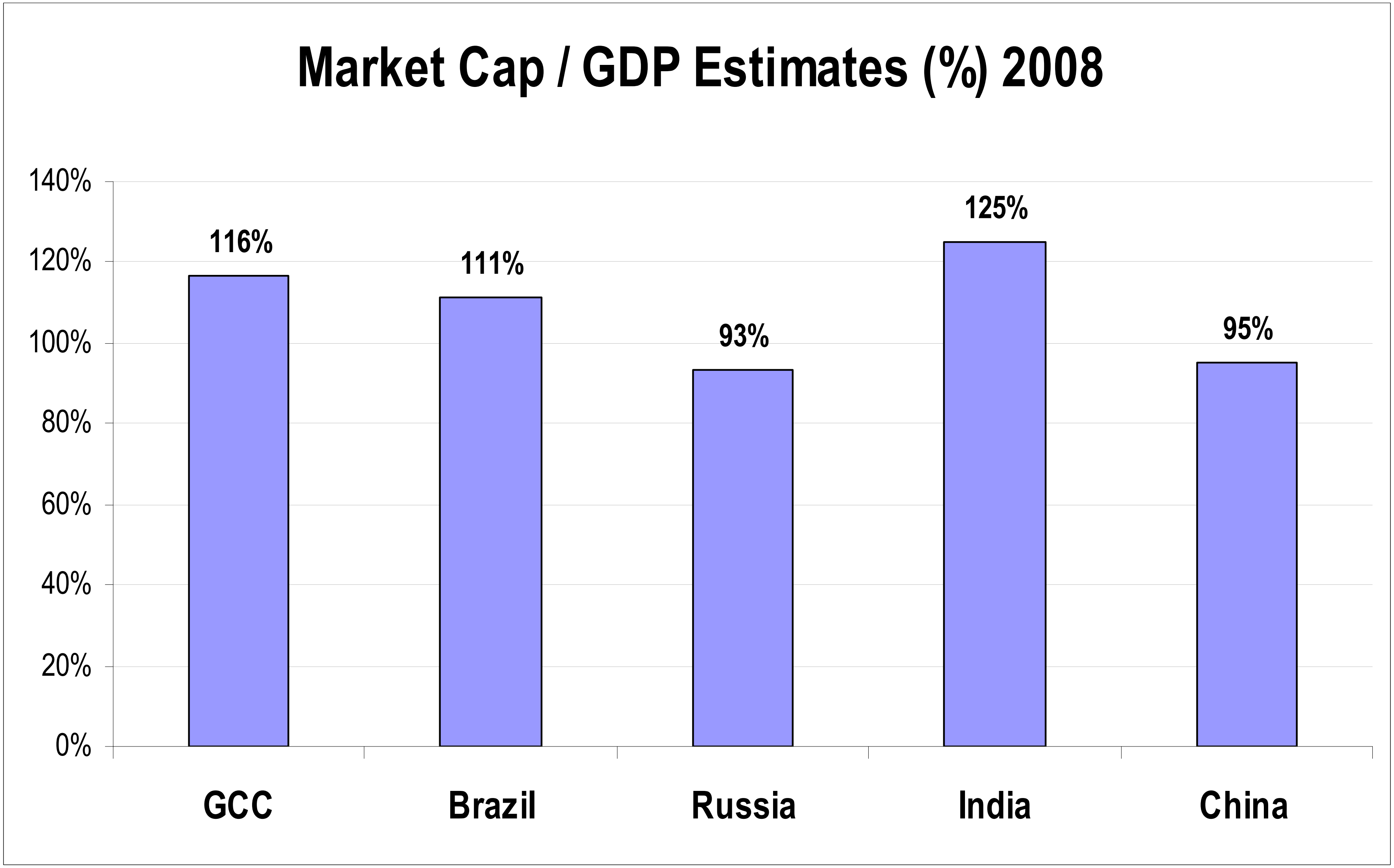
- Despite the growth in the number of companies, IPOs and higher valuations, markets remain fragmented, displaying high volatility of returns and lack of breadth, depth and liquidity.

GCC's Stock Market Performance, 2003-2008



Source: Reuters EcoWin

GCC Market Cap has doubled since 2002

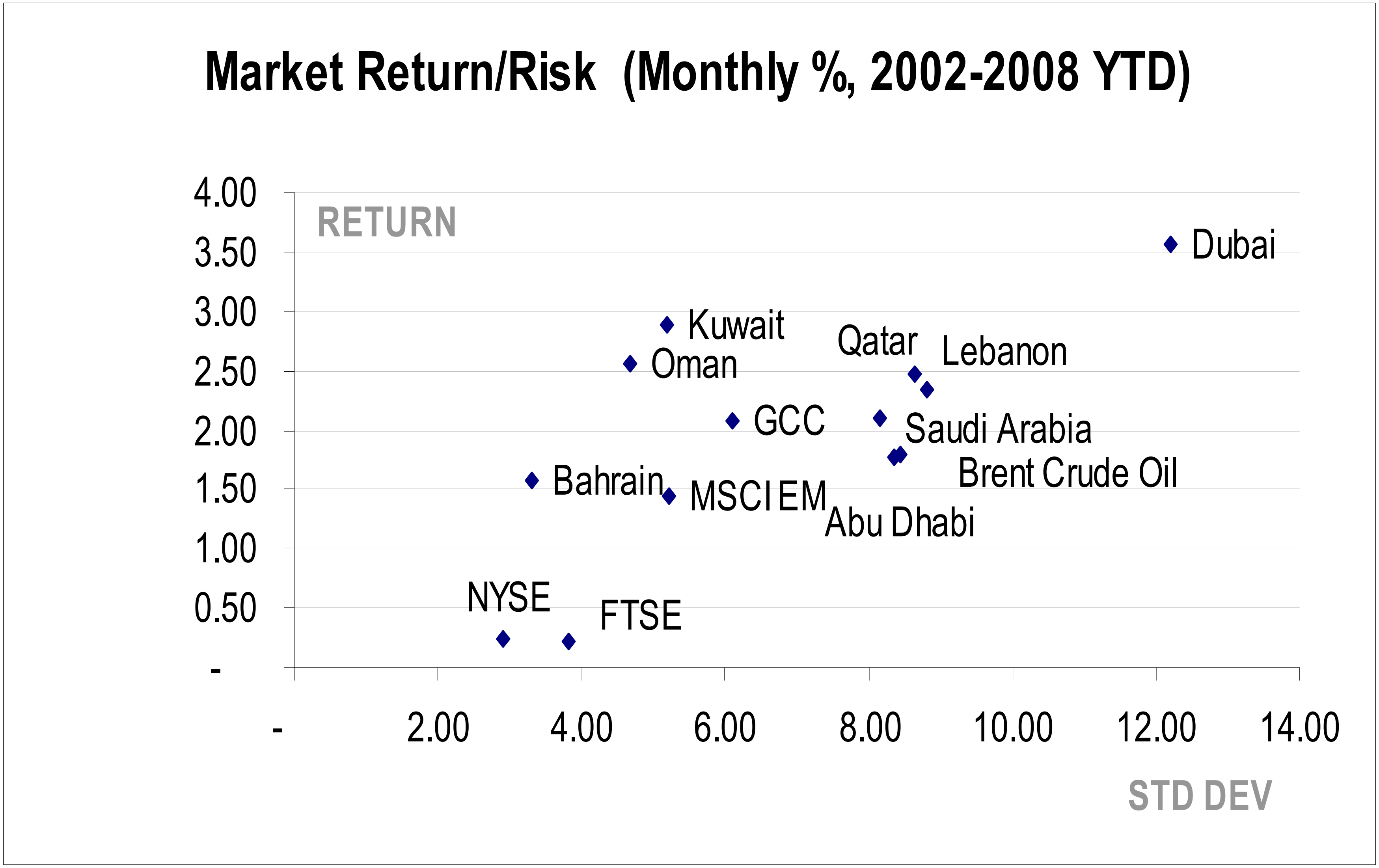


GCC Markets - Returns Descriptive Statistics (Jan 2002 - Feb 2008)

	Abu Dhabi	*Dubai*	*Doha*	*Kuwait*	*Saudi Arabia*
Mean	1.77	3.56	2.48	2.89	2.10
Standard Deviation	8.35	12.20	8.64	5.19	8.15
Range	60.93	56.50	46.18	32.84	40.75
Mean/Standard Deviation	0.21	0.29	0.29	0.56	0.26
Mean/Range	0.03	0.06	0.05	0.09	0.05

	MSCI EM	*FTSE*	*NYSE*	*Brent Crude Oil*
Mean	1.45	0.22	0.23	1.80
Standard Deviation	5.23	3.82	2.91	8.43
Range	23.48	19.13	13.54	33.72
Mean/Standard Deviation	0.28	0.06	0.08	0.21
Mean/Range	0.06	0.01	0.02	0.05

GCC Comparative Market Return and Risk



GCC markets show low or negative correlation with emerging and developed markets, offering potential risk diversification benefits

	Abu Dhabi	Dubai	Doha	Kuwait	Saudi Arabia	Egypt	MSCIEM	FTSE 100	NYSE	Oil
Abu Dhabi	1									
Dubai	0.773	1.000								
Doha	0.456	0.367	1.000							
Kuwait	0.384	0.363	0.205	1.000						
Saudi Arabia	0.416	0.400	0.317	0.351	1.000					
Egypt	0.113	0.319	0.295	0.185	0.171	1.000				
MSCI EM	(0.088)	0.021	0.166	0.071	0.014	0.363	1.000			
FTSE 100	0.006	0.068	0.162	0.139	0.006	0.170	0.693	1.000		
NYSE	(0.028)	0.049	0.090	0.165	(0.069)	0.212	0.818	0.846	1.000	
Brent Crude Oil	(0.112)	(0.108)	0.152	(0.213)	0.062	0.153	0.069	(0.077)	(0.164)	1.000

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.

DIFC MENA Real GDP Growth Outlook, 1998-2008

	1998-2002	2003	2004	2005	2006	2007	Proj. 2008
MENA	3.8	6.5	5.5	5.2	5.8	6	6.2
Oil Exporters	3.8	7.6	6.2	6.3	6.2	7	6.8
GCC	3	8.8	7.1	7	5.9	5.9	5.8
Algeria	3.6	6.9	5.2	5.1	3.6	5.1	5.3
Azerbaijan	7.7	10.5	10.4	24.3	31	30.2	28.2
Bahrain	4.8	7.2	5.6	7.8	7.6	7.2	6.8
Iran	4.2	7.2	5.1	4.4	4.9	6	5.5
Iraq			46.5	-0.7	6.2	6.3	5.3
Kazakhstan	6.8	9.3	9.6	9.7	10.7	9.2	8.4
Kuwait	8.2	16.5	10.5	10	5	4.2	4.8
Libya	2.2	5.9	5	6.3	5.6	9.7	8.2
Oman	3.6	2	5.4	5.8	5.9	6.2	6.4
Saudi Arabia	1.5	7.7	5.3	6.1	4.3	4.5	4.6
UAE	4	11.9	9.7	8.2	9.4	8.4	7.8
Turkmenistan	15.6	17.1	14.7	9	9	11	10.5
Syria	2.9	1.1	2.8	3.3	4.4	4.1	3.9
Qatar	7	6.3	17.7	9.2	10.3	14.5	14.3
Egypt	5.1	3.2	4.1	4.5	6.8	7.3	7.5

DIFC MENA Inflation Outlook, 2002-2008

	1998-2002	2003	2004	2005	2006	2007e	2008f
MENA	4.9	6	6.9	5.8	6.8	8.8	7.7
GCC	0.1	1.2	1.7	2.6	4.2	4.5	3.9
Oil Exporters	5.6	6.8	6.6	6.6	7.1	9.9	8.1
Algeria	2.7	2.6	3.6	1.6	2.5	4.6	4.4
Azerbaijan	-0.6	2.2	6.7	9.7	8.4	16.6	17
Bahrain	-0.8	1.7	2.3	2.6	2.9	3	2.8
Iran	15.1	16.5	14.8	13.4	11.9	17.5	16.7
Iraq	12.7	35.1	7.8	38.5	64.8	30	12
Kazakhstan	8.7	6.4	6.9	7.6	8.6	8.8	7.8
Kuwait	1.5	1	1.3	4.1	2.8	2.7	2.6
Libya	-3.1	-2.1	-2.2	2	3.4	15.8	8.2
Oman	-0.3	0.2	0.7	1.9	3.2	3.8	3.5
Saudi Arabia	-0.7	0.6	0.4	0.7	2.2	3.2	2.9
UAE	2.2	3.2	5	6.2	9.3	7.8	6.2
Turkmenistan	13.7	5.6	5.9	10.7	8.2	6.5	9
Syria	-1.1	5.8	4.4	7.2	10	7.2	7
Qatar	1.7	2.3	6.8	8.8	11.8	12	9.8
Egypt	3.1	4.5	11.3	4.9	7.6	8.5	8.1

ME/GCC Economic Outlook

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- 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.

Sub-Prime Blues or De-linking?

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- **Forget the Sub-Prime Blues**
- **Paradigm shift in thinking and doing is required**
- **Not a Business Cycle view but a Structural Change and Economic Development view**
- **Trade patterns and business cycle models for Emerging Markets used in the past need substantial revision**
- **Emerging markets have been driving global growth. Sustained robust growth in emerging markets should provide support to withstand the slowdown in US economy**

CHALLENGES & POLICY ISSUES

- **Inflation & Exchange Rate Policy**
- **Sovereign Wealth Funds**
- **Capital Market Development**

CHALLENGE OF INFLATION

- **Two sources of inflation:**
  - Non-Traded Goods & Services: housing, services
  - Imported: international commodity prices, weak US$

- **Inflation & GCC exchange rate peg:**
  - Real rate appreciation from high inflation
  - Misalignment of monetary policy
  - Pressure to move to currency basket
  - Adopt inflation targeting

But:
  - Have to build central banks' monetary & exchange rate management capacity; build money, debt markets
  - Requires GCC policy coordination

Sovereign Wealth Funds

- Total value of SWFs estimated by IMF at between $1.9 trillion and $2.9 trillion, growing to about $12 trillion by 2012
- Distinguish between Stabilization Funds & Intergenerational Funds
- Surplus countries need to diversify against commodity price volatility and revenue risks; earn higher returns than on central bank portfolios
- SWFs allow countries to separate the management of their revenues from natural resources from their fiscal and monetary policies.
- Increased investment & financial protectionism
- Need cooperative solution to resolve global imbalances

Financial Sector Development: 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
- Financing Infrastructure & Regional Economic Integration
- Enable & support economic and financial reforms:
  - Enable separation of oil revenue management from fiscal policy & investment
  - Privatisation and Private sector Participation in Infrastructure
- DIFC will play a central role in MENA's Renaissance

DIFC: MENA Financial Sector Development

- GCC have become 'asset-based economies' with income on assets more important than oil & gas revenue
- GCC Common Currency can emerge as a global currency alongside US$, Euro and Remimbi; need to develop payment System Infrastructure
- Invest, Manage and Control region's financial wealth of $2+ trillion and growing as a result of high energy prices:
  - Financial sector to be an engine of growth
  - Strategic issue: security and safety of assets
- Develop new markets and instruments
  - Shari'a compliant financial sector & market
  - Bond market
  - Securitisation and structured finance
  - Housing Finance & Mortgage markets

GCC RENAISSANCE
A Time for Vision
A Time for Action
A Time for Architects and Designers
A Time for Builders & Investors

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