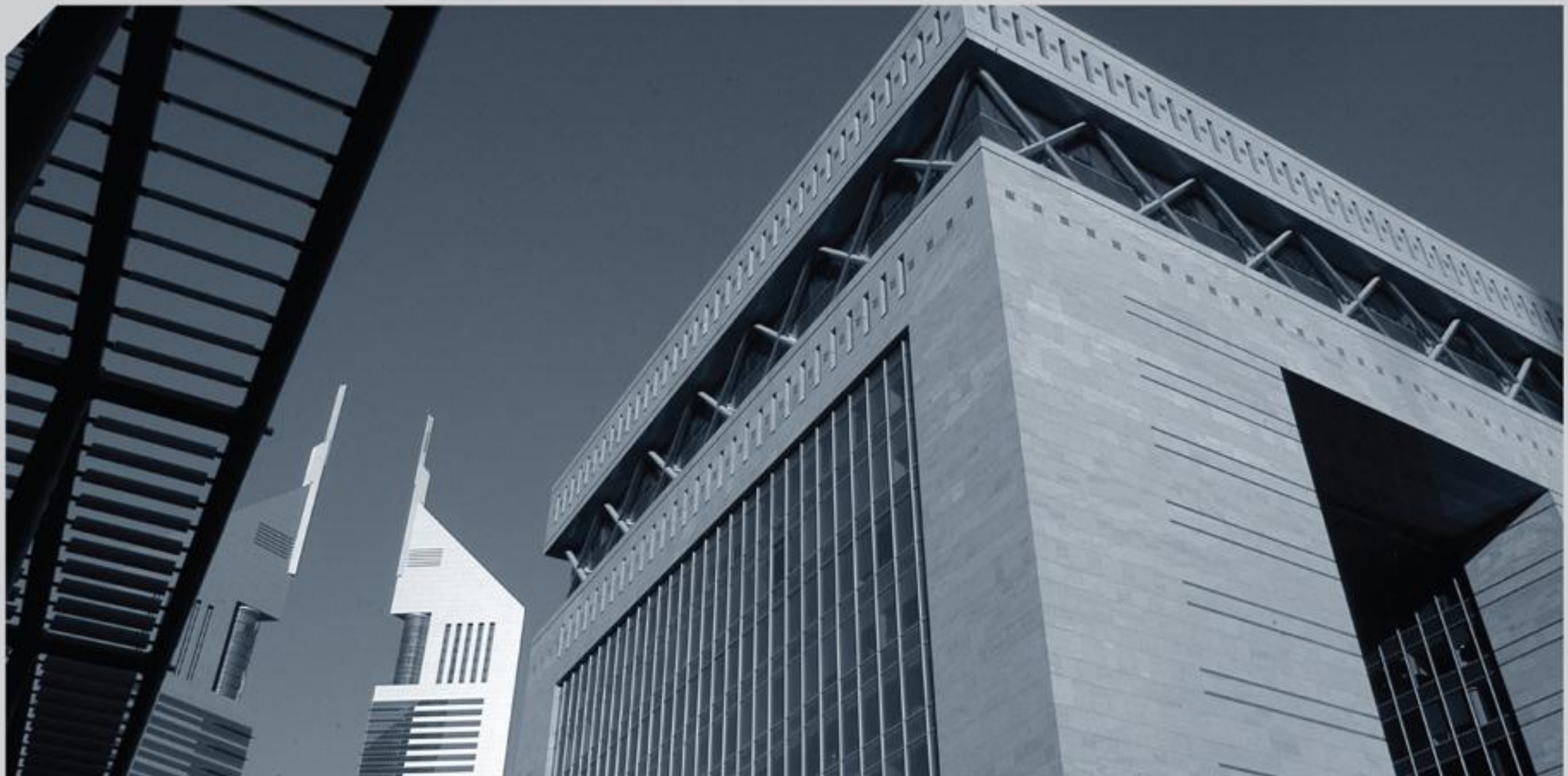


Regional Economic Outlook:Transitions,Vulnerabilities & Opportunities

Presentation at the Mubadala GE Cap Offsite Meeting

Dr. Nasser Saidi,
Chief Economist, DIFC
16th January 2012

DIFC Dubai International Financial Centre

Agenda

- Changing Economic and Financial Geography
- MENA Transitions and Transformations
- Macroeconomic Outlook of the UAE/ Dubai
- Vulnerabilities, Opportunities & Synergies

Two Speed Economic Growth Forecasts (IIF, Dec 2011)

DIFC

Global Output Growth

percent, y/y

	2010	2011f	2012f	2013f
Mature Economies	**2.8**	**1.3**	**0.9**	**1.9**
United States	3.0	1.8	2.1	2.4
Euro Area	1.8	1.5	-1.0	1.2
Japan	4.5	-0.9	1.9	1.8
Other Mature	2.7	1.8	1.1	2.0
Emerging Economies	**7.2**	**6.0**	**5.4**	**6.1**
Latin America	6.2	3.9	3.4	4.2
Argentina	9.2	6.5	3.5	3.0
Brazil	7.5	2.8	3.0	5.0
Mexico	5.4	4.0	3.3	3.5
Emerging Europe	4.5	4.6	2.7	3.6
Russia	4.0	4.0	3.7	4.0
Turkey	9.0	8.5	3.2	4.5
Asia/Pacific	9.1	7.7	7.4	7.9
China	10.4	9.3	8.6	9.0
India	8.5	7.0	6.5	7.0
Africa/Middle East	4.3	4.6	3.4	4.1
South Africa	2.8	3.1	2.9	3.7
World	**4.4**	**3.2**	**2.8**	**3.7**

Based on market exchange rates

Global Imbalances Persist

DIFC

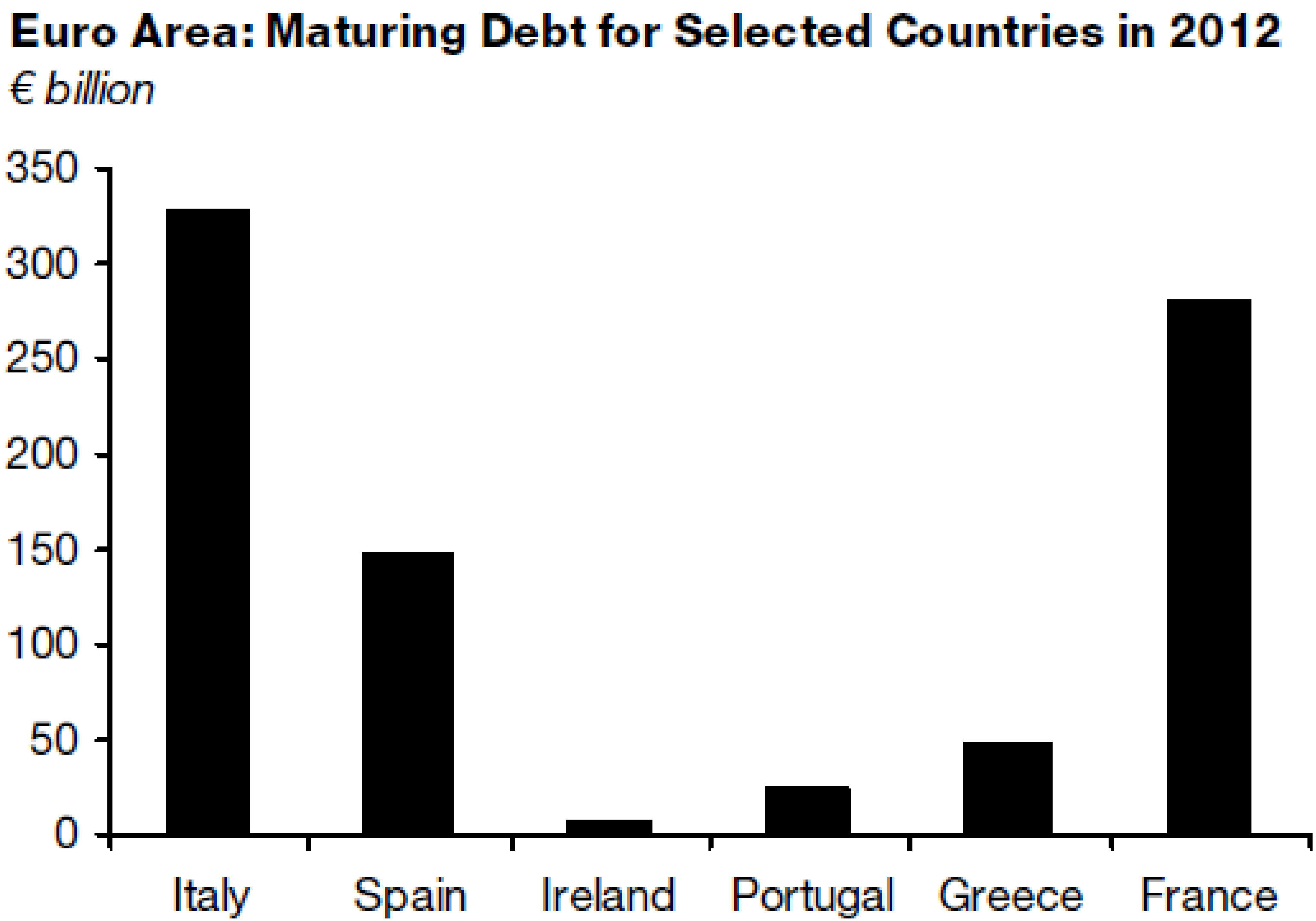
Global Current Account Balance

$ billion

	2010	2011f	2012f	2013f
United States	-471	-463	-405	-397
Euro Area	-61	-57	4	37
Japan	196	104	113	131
Other Mature Economies	-21	-40	-37	-35
Emerging Economies (IIF 30)	365	324	162	-9
Africa / Middle East	65	174	114	82
Latin America	-45	-45	-90	-113
Emerging Europe	0	-26	-65	-77
o/w Russia	71	83	22	12
Emerging Asia	345	222	203	99
o/w China	305	205	183	95
Other Countries*	-8	132	163	273

* Includes global discrepancy

Euro Zone Worries



Global Transitions Are On the Horizon

2012 will be a year of transition – political (elections across the globe), economic and social.

The IIF projects a **decline in growth** for both advanced economies' and emerging economies **during 2012, before showing a pickup in 2013**. Global growth is expected at **2.8% in 2012 & 3.7% in 2013**.

- Real GDP growth in the **advanced economies** – including US, euro area, & Japan- is forecast to **decline slightly, from 1.3% in 2011 to about 0.9% in 2012**.
- **Activity will be more robust** in some advanced economies, especially **in those with close ties to emerging Asia**.
- In **emerging economies**, capacity constraints, policy tightening, and slowing foreign demand are expected to dampen growth to varying extents across countries. As a result, growth in these economies will **drop from about 6.0% in 2011 to about 5.4% in 2012**. Growth is forecast at **6.1% in 2013.**

Emerging Markets: Changing Economic Geography

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

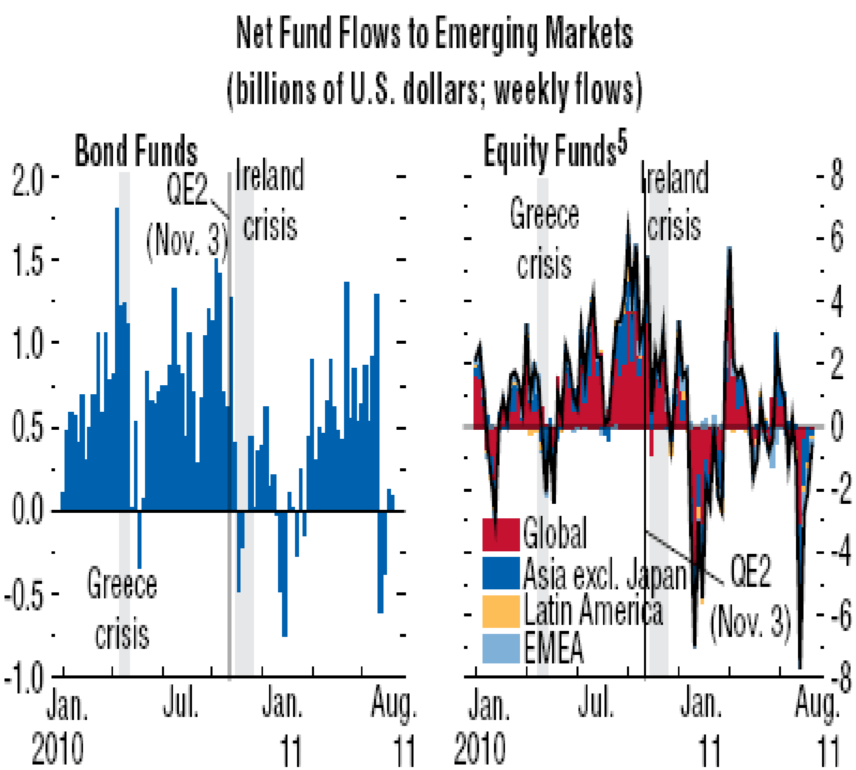
- The world's economic centre of gravity in 1976 was a point West of London, somewhere towards the middle of the Atlantic Ocean.
- But in the 30 years since then, that centre of gravity has drilled 1800 km - one third of the planet's radius - deeper into the Earth's crust, away from the US & towards the East.
- 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%.

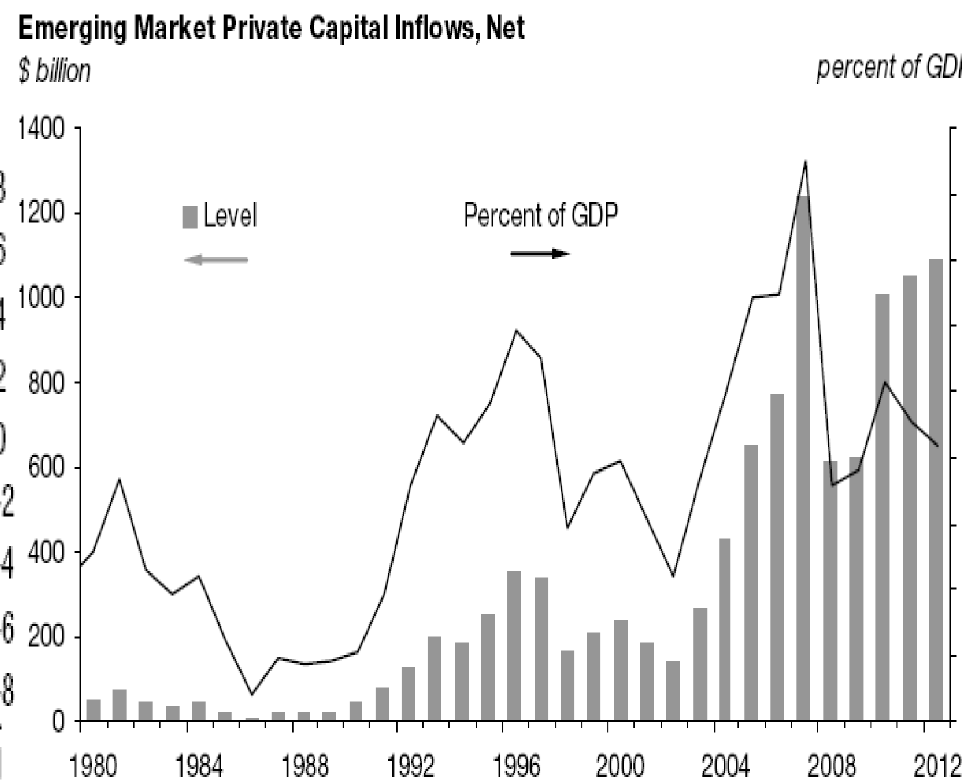
Source: Quah, D (2011): "The Shifting Distribution of Economic Activity", London School of Economics, Jan 2011.

Emerging Markets - Resilient, but Slowing

DIFC

- **Emerging economies** real GDP growth is expected to slow from around 6.0% in 2011 from 7.2% in 2010 on capacity constraints and anti-inflationary tightening of monetary policies.
- Additionally, with global downside risks rising, emerging markets could also face a sharp reduction in demand, a reversal in capital flows and a rise in funding costs that could impact the financial soundness of domestic banks.





Source: IMF WEO, Sep 2011; IIF Capital Flows to EMEs, Sep 2011

Structural Change in Financial Geography

DIFC

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011(E)
World Market Cap	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
United States	46.0%	46.9%	49.8%	47.2%	44.7%	42.7%	39.3%	36.3%	30.8%	33.6%	31.8%	31.4%	32.4%
Rest of Developed	45.7%	45.0%	41.2%	42.1%	43.8%	44.2%	44.3%	44.0%	40.9%	42.4%	39.0%	40.6%	41.0%
Emerging Markets	8.3%	8.1%	9.3%	10.6%	11.9%	12.8%	16.4%	19.7%	28.3%	24.0%	29.2%	27.9%	26.7%
BRIC	2.2%	3.1%	3.2%	3.4%	4.4%	4.2%	5.5%	9.4%	16.9%	12.7%	17.3%	16.4%	15.6%
Rest of Emerging	6.1%	5.0%	6.1%	6.8%	7.2%	8.6%	11.1%	10.1%	11.3%	11.3%	11.9%	11.6%	11.0%
of which MENA	0.5%	0.5%	0.6%	0.8%	1.2%	1.8%	3.0%	1.7%	2.2%	2.3%	1.9%	1.9%	1.7%

Source: Standard & Poor's (Data as of June 2011)

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- Changing Economic and Financial Geography
- **MENA Transitions and Transformations**
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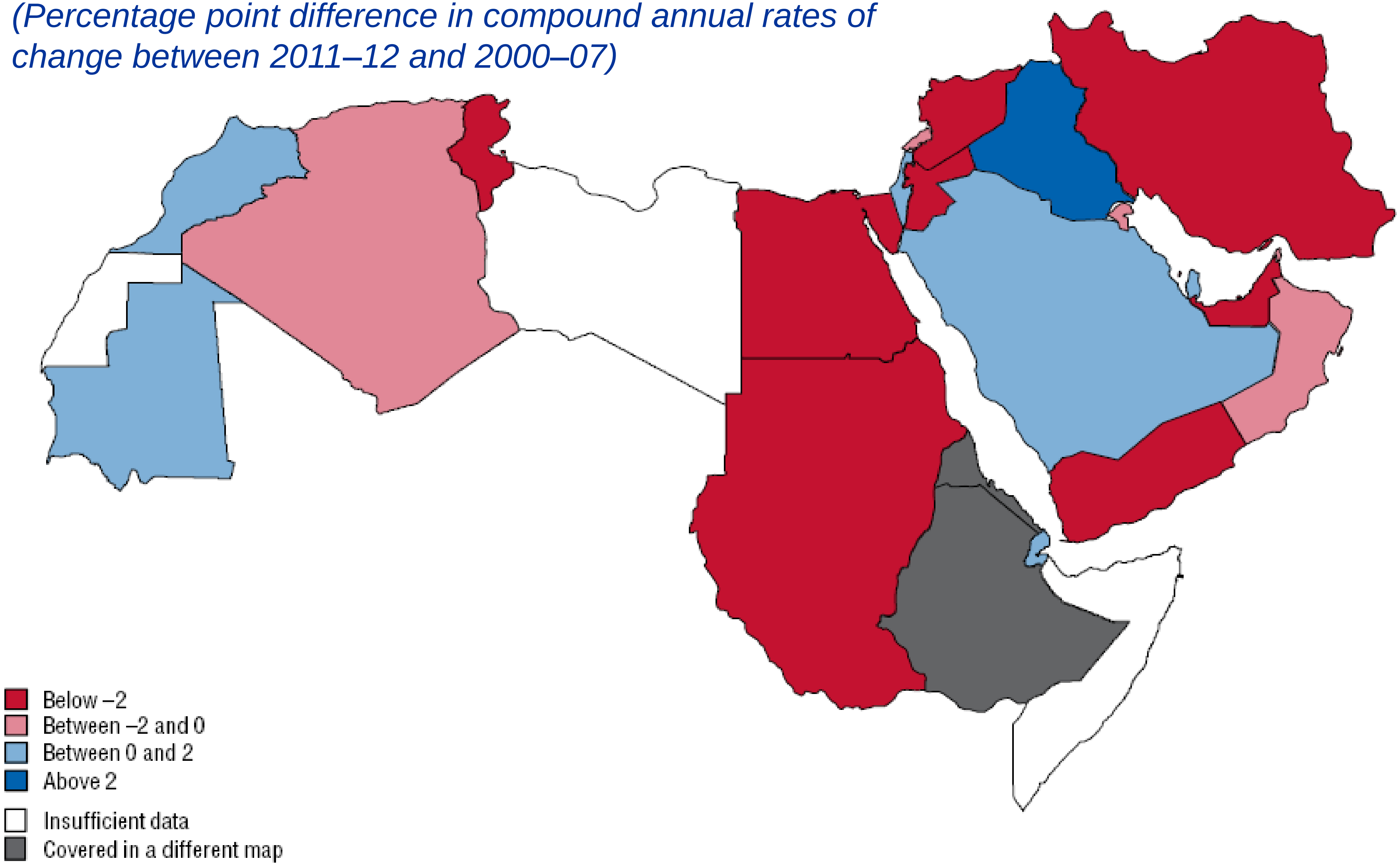
MENA: Current Growth versus Pre-crisis Average

(Percentage point difference in compound annual rates of change between 2011–12 and 2000–07)



Source: IMF World Economic Outlook, Sep 2011

Arab World Outlook: Main Macroeconomic Indicators

	GDP ($ billion)	Real GDP Growth (% change)			Fiscal Balance (% GDP)			Current Account Balance ($ billion)		
	2011f	2010	2011f	2012f	2010	2011f	2012f	2010e	2011f	2012f
Arab World	**2180**	**4.7**	**4.9**	**3.6**	**0.9**	**4.5**	**-0.3**	**148.1**	**296.5**	**201.7**
Oil Exporters	**1677**	**4.7**	**6.5**	**4.0**	**3.2**	**8.1**	**2.1**	**170.1**	**321.8**	**225.0**
Bahrain	26	4.5	2.2	3.3	-6.6	0.2	-3.1	0.8	2.6	2.5
Kuwait	168	2.9	4.4	3.1	19.8	20.8	10.1	36.9	59.9	43.4
Oman	73	4.1	4.4	4.5	3.2	9.4	3.4	6.6	13.6	7.4
Qatar	174	18.3	18.0	5.3	2.9	3.2	0.4	14.8	35.2	26.9
Saudi Arabia	571	3.8	5.8	3.7	5.6	10.4	3.2	67.1	132.1	89.7
UAE	368	3.2	4.4	3.1	-1.4	5.8	2.3	24.3	49.2	42.6
Algeria	189	3.2	4.0	3.9	3.8	0.3	-3.2	10.0	22.4	11.5
Iraq	108	0.8	8.2	8.4	-11.1	7.6	-3.1	-6.7	7.0	0.9
Oil Importers	**503**	**4.5**	**-0.4**	**2.3**	**-5.9**	**-7.7**	**-8.0**	**-22.0**	**-25.3**	**-23.3**
Egypt*	232	4.8	-1.4	2.0	-8.1	-9.6	-10.2	-4.3	-3.7	-3.5
Jordan	28	2.3	2.5	3.2	-5.6	-5.7	-4.7	-1.3	-2.4	-2.0
Lebanon	41	7.0	1.8	3.8	-5.5	-8.3	-9.6	-8.0	-7.0	-7.0
Morocco	100	3.8	4.3	3.9	-4.5	-5.5	-5.1	-4.2	-5.6	-4.3
Syria	57	4.5	-6.0	-3.0	-3.8	-6.7	-8.2	-2.1	-3.6	-3.9
Tunisia	45	3.7	-1.7	4.0	-1.4	-4.5	-3.1	-2.1	-3.0	-2.5
Memoranda:										
GCC	1380	5.2	6.7	3.7	4.8	9.3	3.3	150.5	292.5	212.5
Libya	34.0	4.3	-56.0	55.0	13.1	-34.3	-15.6	16.4	-8.0	-2.1

e = estimate; f = IIF forecast
*Egypt growth rates have been adjusted to a calendar year basis to make them consistent with other countries, while figures for inflation and the fiscal and current accounts are on a fiscal year basis.

Recent Arab MENA Region Developments

- MENA Growth is expected at 3.6% in 2012 compared to 4.9% in 2011 but with wide disparity in prospects between oil exporters & oil importers.
- Recent developments in the region highlight the need to ensure that economic growth is both ***inclusive*** and has a ***trickle-down*** impact.
- There is a need to **reduce chronically high unemployment and wide income inequality** within countries and across countries of the region.
- While reinforcing the government sector has been the initial step, one should ensure it does not lead to a 'crowding out' of the private sector.
- Populist measures + hand outs = low productivity; begs the question: **what when support is phased out?**
- With the ongoing Eurozone sovereign crisis, MENA countries dependent on Europe face additional problems (*Nearly 50% of cross border loan syndications in the region comes from European banks and massive deleveraging in Europe could mean these institutions will be virtually absent in the market*).
- Need to focus on: **structural reforms and developmental policies** (incl. infrastructure) that encourage private sector participation, tackle job creation, lower income inequality, greater inclusiveness, lift economies to higher growth trajectories over the LT **through institutional reform & improved governance**

MENA Regional Turmoil => Increased Divergence

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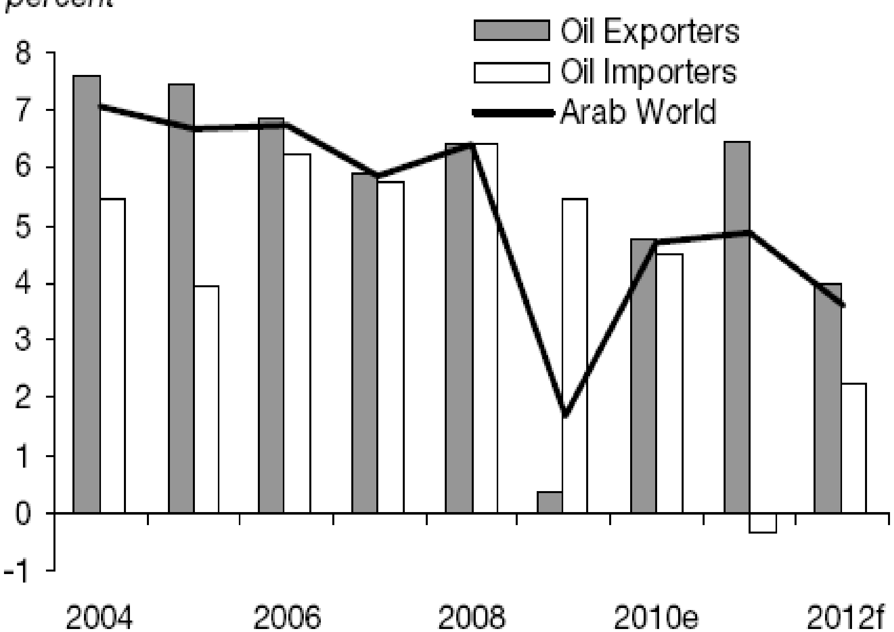
Divergence b/n oil exporters, oil importers & labor exporters

- GCC growth - boosted by high oil output & prices; Bahrain's protests will impact growth in 2011 while in KSA, growth will be boosted by the populist fiscal measures.
- With investment continuing to lag, government-supported consumption will remain the primary growth driver across the region.
- Downside risk remains that private sector activity will be subdued/crowded out.
- GCC announced that it has welcomed the bids of Jordan & Morocco to join the Union.

Arab World: Real GDP Growth

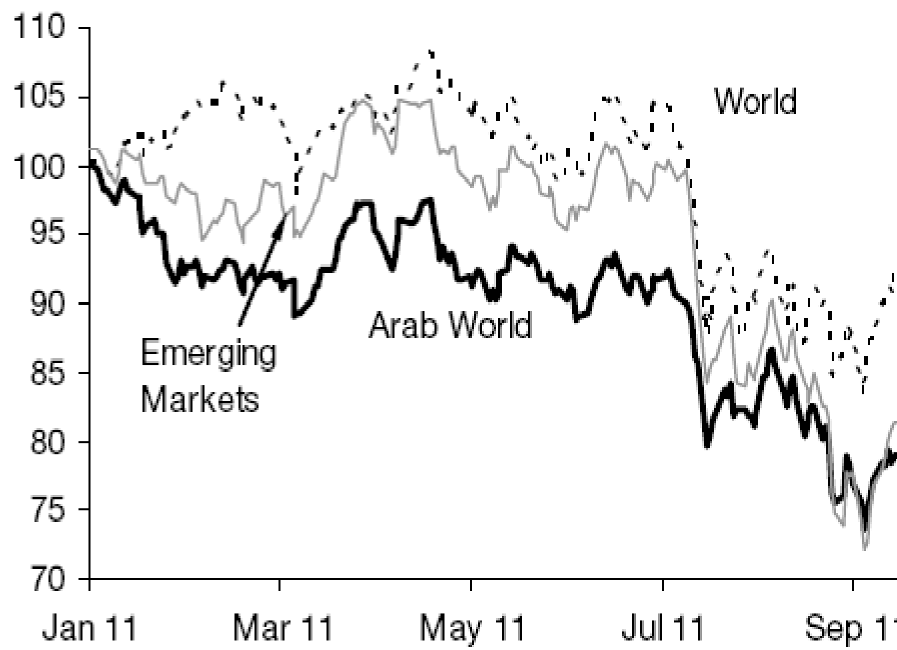
percent



e = estimate; f = IIF forecast

Arab World: Stock Market Performance

Dow Jones indices, rebased end-2010=100



Source: IIF Regional Overview, Oct 2011

Policy Responses to Turmoil: Costs

DIFC

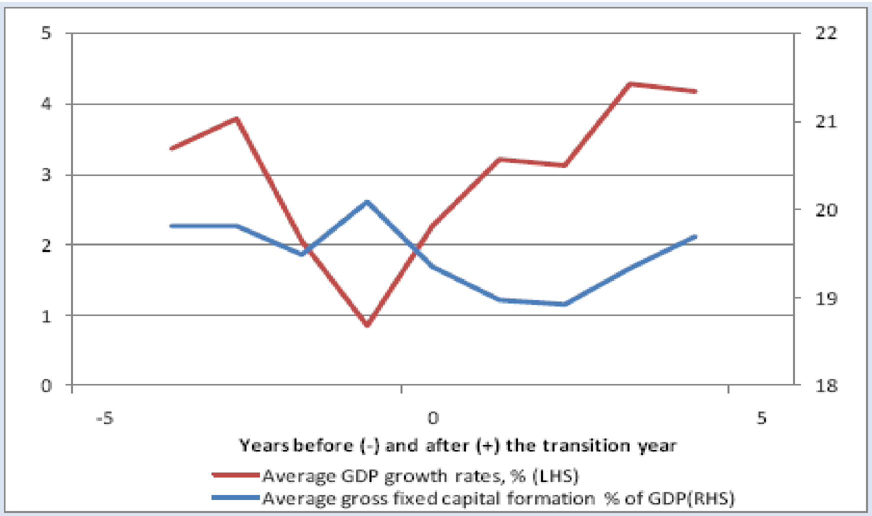
	Measures	Size (% of GDP)	Type of spending
Bahrain	BHD2,660 handouts, 25% cut in housing loans	> 1.5	Current
Kuwait	KWD1,000 handouts, free food rations until end-March 2012	>2.5	Current
Oman	43% rise in minimum wages, unemployment benefit of USD390, employment for 50,000 Omanis	>1.5	Current & Capital
Qatar	Boost in basic salaries and social benefits for state civilian employees by 60%; Military staff of officer rank will receive a 120% increase in basic salaries and benefits, with other ranks getting a 50% rise; a one time payment of 10 billion riyals toward its pension fund and another 10 billion for retirees' subscriptions.	>5	Current
S. Arabia	Increased minimum wage, bonus/ unemployment payments, more funding for housing loans, construction of 500,000, housing units, new public jobs, extended social security, etc	>23	Current & Capital
UAE	Infrastructure program for northern emirates, 70% increase in military personnel pension, food subsidies	>1.0	Current & Capital

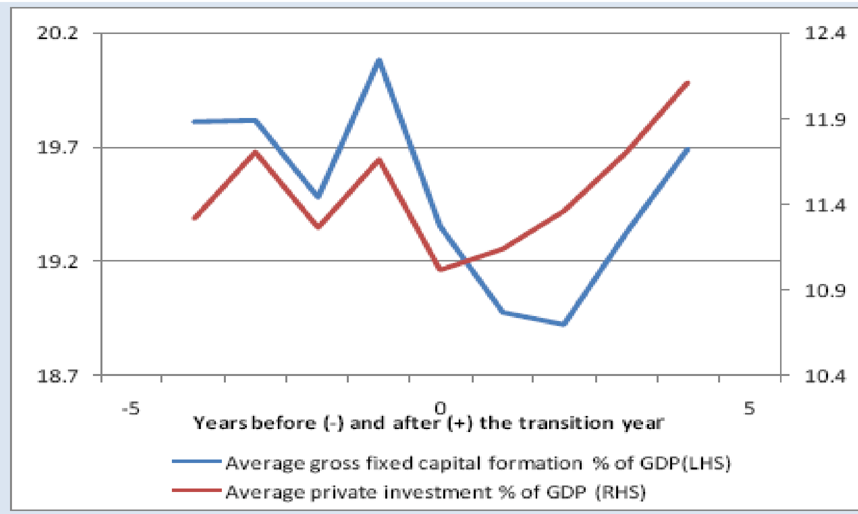
Source: DB Research, June 2011, DIFC Economics

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.
- The 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 and leads the recovery.

Average growth & investment performance during a successful transition





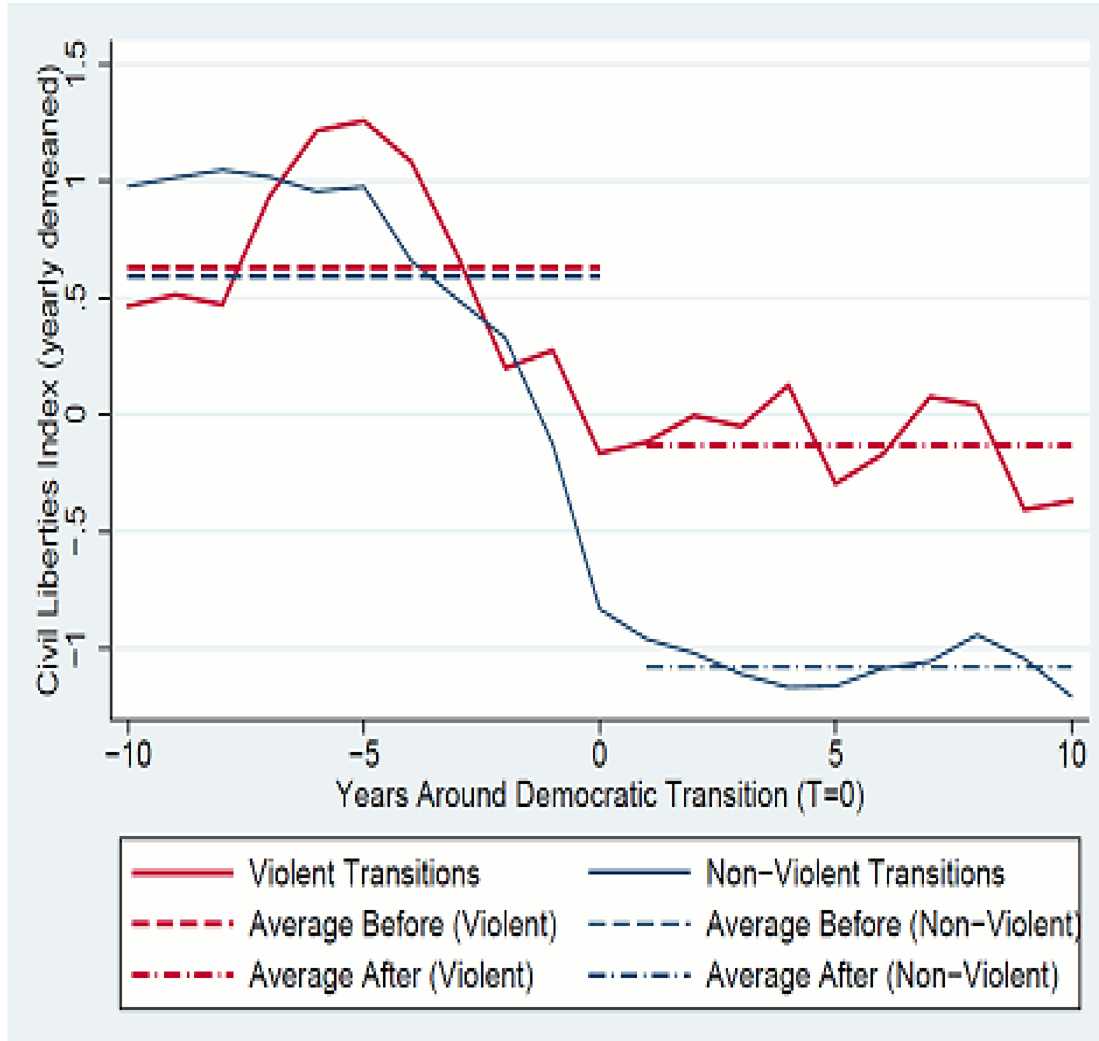
Source: Freund and Mottaghi (2011). *Note: Mean growth performance during more than 40 successful transitions based on information in the database of the Polity IV Project, which includes an index of regime characteristics, scaled from 0 (authoritarian) to 10 (democracy). Successful transitions are those 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

Transition Management

- Regime transitions have taken different paths in different countries.
- In some cases mass movements have succeeded in opening up the possibility for a rapid and peaceful regime change;
- In others, the path towards democracy is faced with stronger resistance by parts of the ruling elites - appears longer and more uncertain
- Results indicate **peaceful transitions to democracy lead to democracies with better average protection of property rights and civil liberties compared to democracies that emerge after violent conflicts**.

Violent and peaceful transitions to 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.

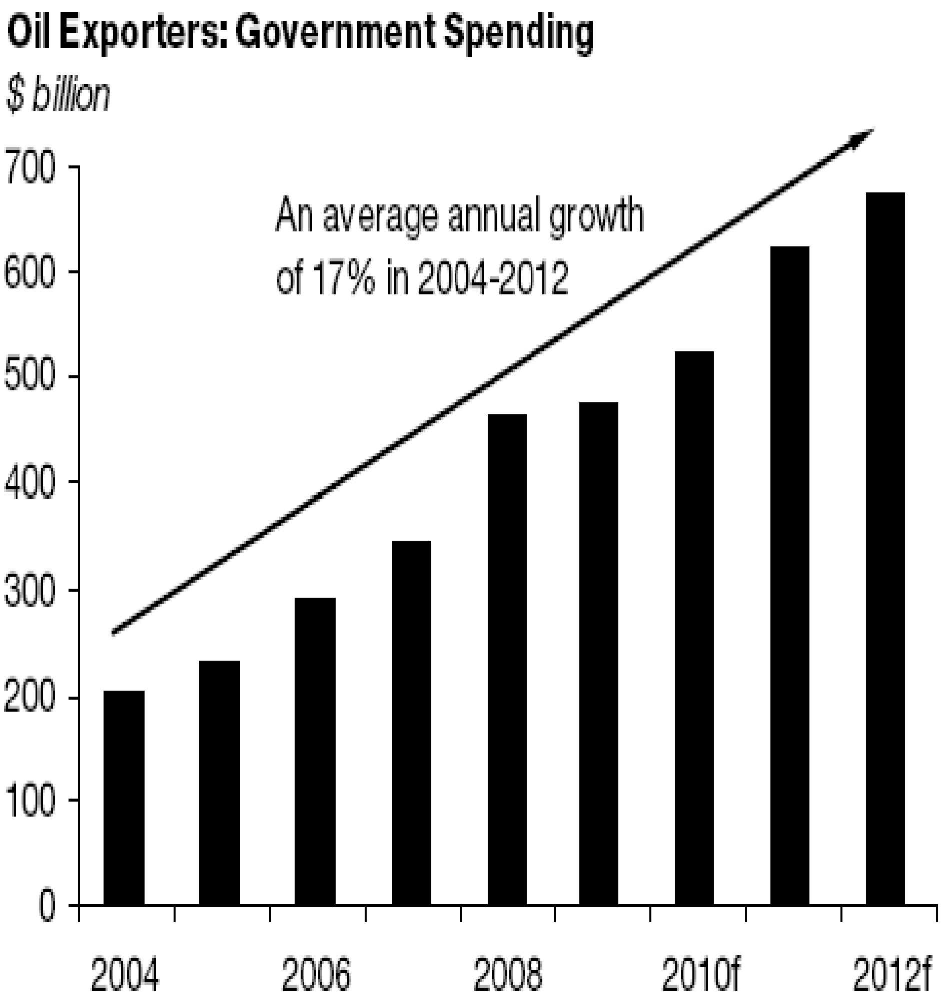
Democratisation: Lessons from Transition countries

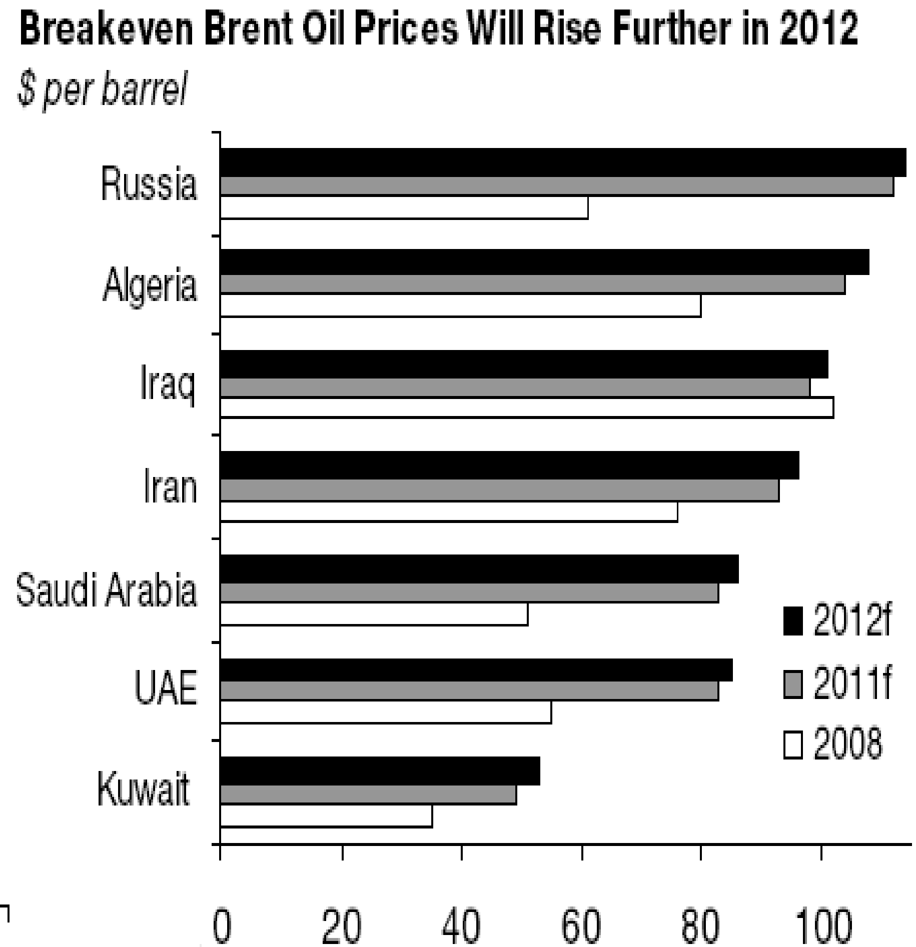
- Determinants of democratisation scenario: evidence suggests that **higher inequality before the transition is associated with a significantly larger likelihood of violent civil conflicts** during the regime change.
- Evidence documents **significant interactions between inequality and political freedom 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 nonviolent 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, 2011

Government Spending & Fiscal Sustainability

Policy response has largely been populist spending encouraging consumption => Growing threat to fiscal sustainability & external balance





f = IIF forecast

Source: IIF Regional Overview, Oct 2011

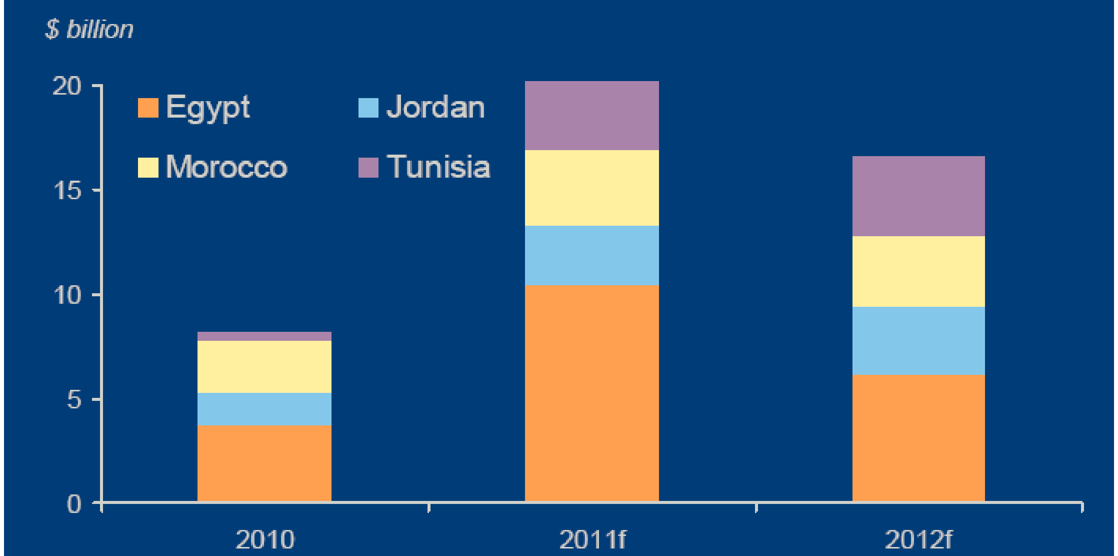
Oil Importers/Labour Exporters: The Realities

	Tourism		FDI	
$ billion	2010e	2011f	2010e	2011f
Total	**30.9**	**22.3**	**18.5**	**8.6**
Egypt	11.6	8.0	6.5	1.5
Jordan	3.4	2.9	1.7	1.4
Lebanon	3.0	2.3	5.5	3.4
Morocco	6.7	6.8	1.7	1.4
Syria	3.5	0.6	1.8	0.4
Tunisia	2.7	1.6	1.3	0.5

- *The short-term outlook is still subject to unusually large uncertainties: political & security situation + growing uncertainty about external demand.*
- *Remittances, tourism, FDI will decline, as will output (given high unemployment rates, budget deficits)*

- *Need for fiscal consolidation greatest among oil-importing economies*
- *Pro-cyclical fiscal expansion could further crowd out needed private investment, perpetuating the problems with job creation in the private sector.*

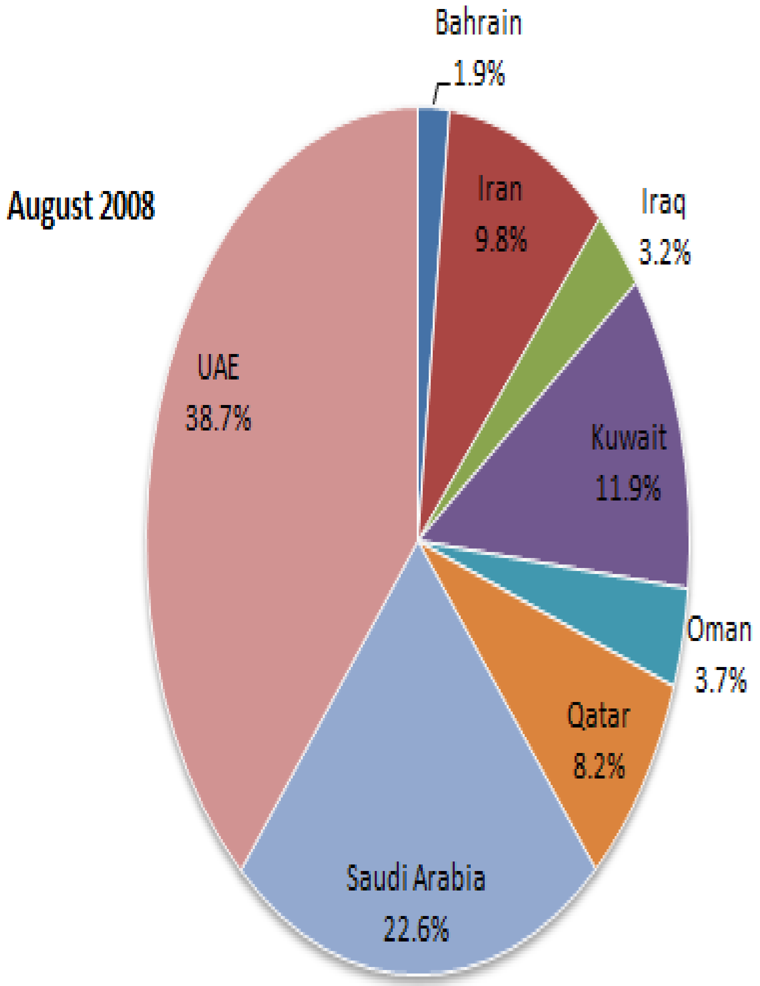
Oil Importers: External Financing Needs*

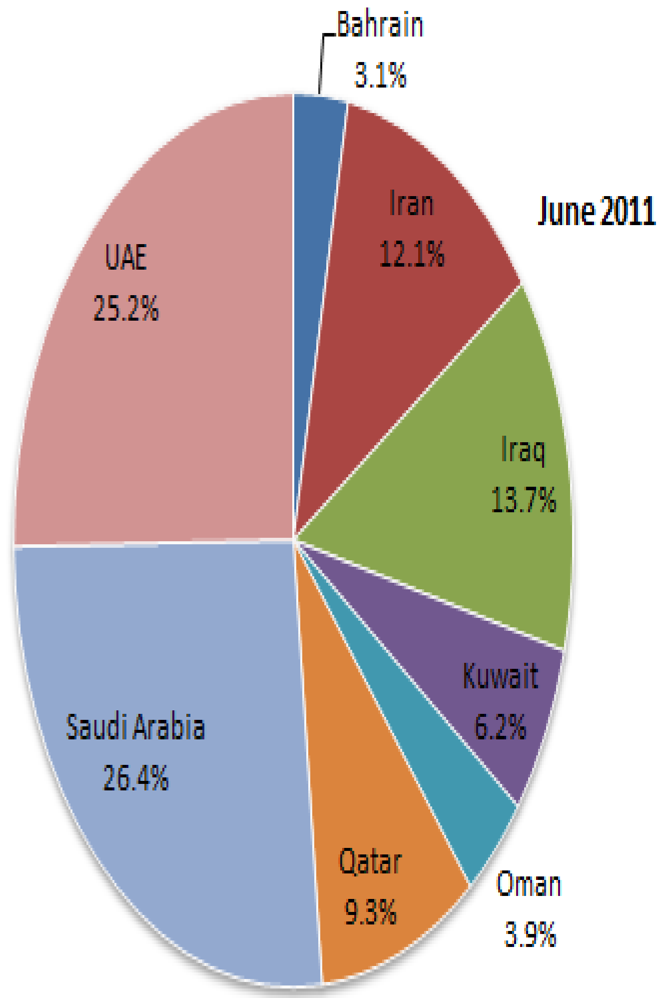


*Includes grants and net external borrowing. Actual figures for 2010. Forecasts for 2011 and 2012 assume official reserves in months of import cover remain the same as in 2010.

Strong Infrastructure Spending

Projects worth more than $1.8 trillion are planned or underway across the GCC according to MEED.





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Key Macroeconomic Indicators: UAE

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- UAE/ Dubai benefitted from: Higher oil prices/ production; Increased trade with EMEs; Arab regional turmoil highlighting UAE/ Dubai as a safe haven leading to inflow of tourists/ capital; Stronger domestic demand/ retail sales
- Real Estate remains Weak; lower prices & rents are leading to new equilibrium. Large real estate supply overhang + continued retrenchment in the construction and real estate sectors => the share of construction and the real estate sector in Dubai's GDP declined from 30% in 2007 to 23% in 2010.

UAE: Selected Macroeconomic Indicators

	2008	2009	2010e	2011f	2012f
Nominal GDP, $ billion	315	270	303	367	369
Real GDP, % change	4.8	-3.5	3.2	4.4	3.1
Hydrocarbon	1.8	-8.5	4.6	7.0	3.0
Nonhydrocarbon	6.3	-1.0	2.5	3.2	3.1
Abu Dhabi	7.0	2.6	3.5	3.6	3.7
Dubai	5.7	-4.5	1.7	3.1	2.8
CPI Inflation Rate, avg., %	12.3	1.8	0.6	1.2	1.8
Bank Lending, % change	45.0	2.4	1.3	2.0	3.5
Fiscal Balance, % GDP	16.4	-12.6	-1.4	5.6	2.1
Current Account, % GDP	7.4	3.1	8.0	13.1	11.3

e = estimate; f = IIF forecast

UAE: Financial Sector Soundness Indicators

percent

	2007	2008	2009	2010	August 2011e
Capital to Risk-Weighted Assets (Tier I + Tier II)	14.0	13.3	19.2	20.8	21.0
o/w: Tier I	12.4	12.3	15.4	16.1	16.4
NPLs/Total Loans	2.9	2.5	4.8	6.3	7.5
Provisions to NPLs	100	101	85	87	81
Return on Assets	2.0	1.8	1.3	1.4	...
Return on Equity	19.3	15.6	7.9	8.4	...
Loans to Deposits	97.5	107.7	103.6	98.0	98.3

e = estimate

Source: IIF Regional Overview Report, Oct 2011

Agenda

DIFC

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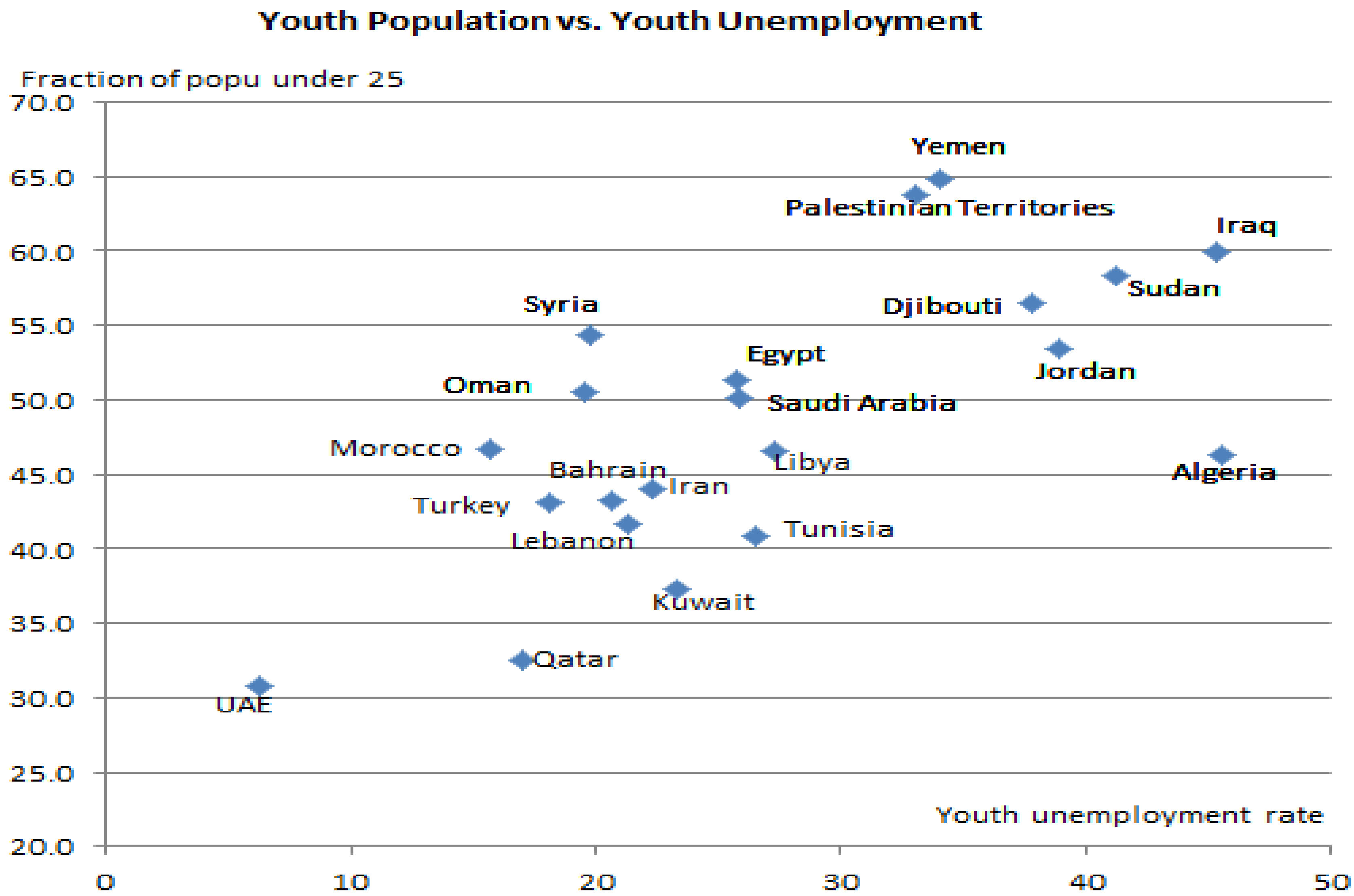
MENA Vulnerabilities: Demographic, Political & Economic

DEMOGRAPHIC FACTORS	POLITICAL FACTORS	ECONOMIC FACTORS
Fraction of population under 25	Voice & Accountability	Food Price Inflation
Youth Unemployment rate	Political rights	GDP per capita
Age Dependency ratio	Corruption	Military Spending as a percentage of GDP
Infant Mortality Rate	Civil Liberties	
	Press Freedom	

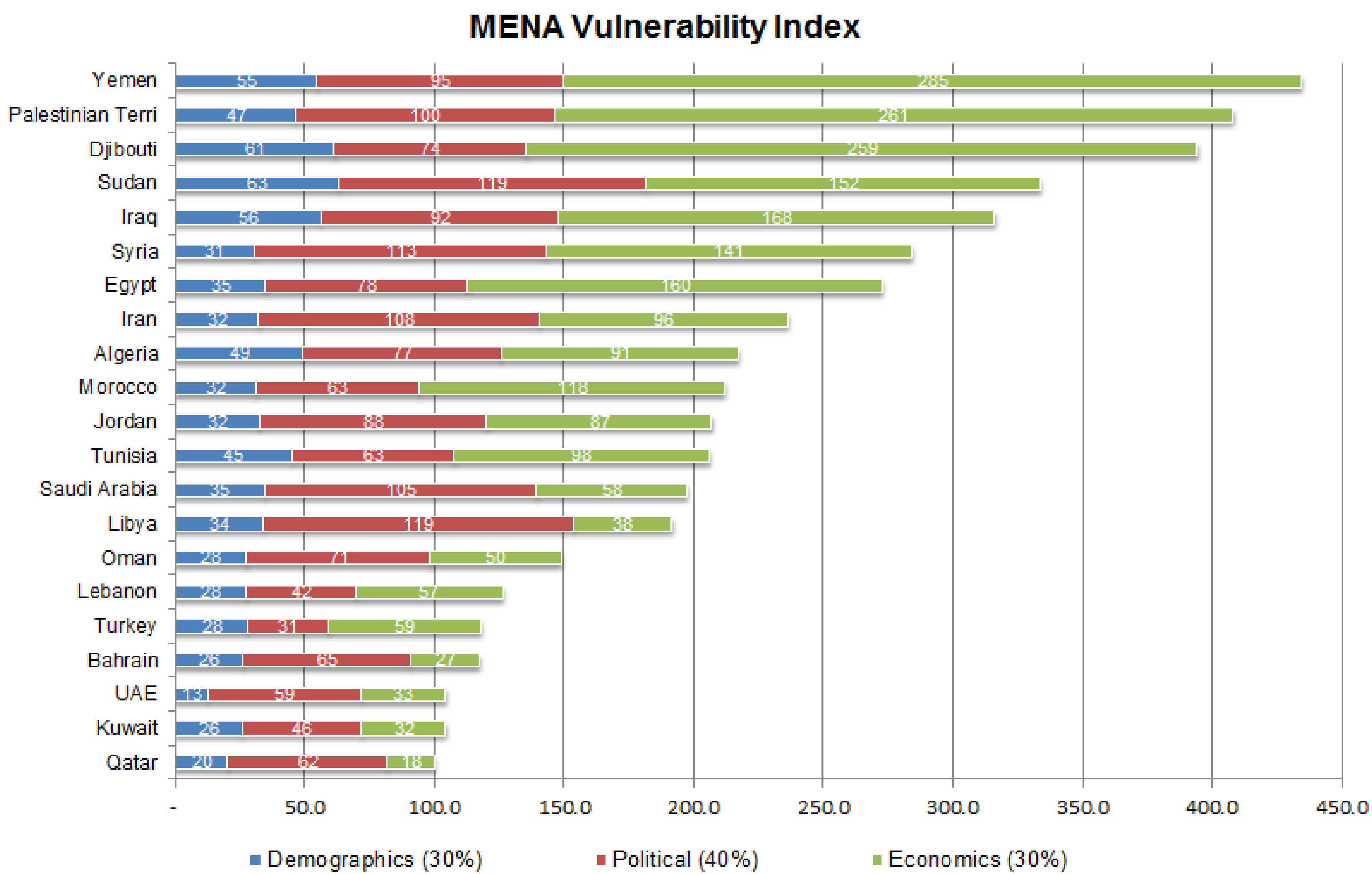
Source: DIFC Economics

Explosive Mix: Young & Unemployed Populations



Source: UN Population Division, DIFCA Economics

MENA Vulnerability Index (2010)



Source: DIFC Economics

Policy Agendas for Transformation & Stabilization

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DOMESTIC

- Political Transformation
- Governance
- Social Safety Nets
- Educational Transformation
- Women Empowerment
- Fiscal Transformation
- Economic Diversification
- Job Creation

REGIONAL

- MENA Bank for Development & Reconstruction
- GCC Common Market & Common Currency
- Regional Economic Integration
- Develop Local Currency Financial Markets
- Shift Economic Policy Toward Asia & EMEs

INTERNATIONAL

- Resolve Israel-Palestine Cancer
- Aid
- Trade
- Investment
- Economic Focus not Military Engagement

Transformational agenda for MENA is about Structural Change

MENA region/ GCC countries need to achieve their own transformation - need an Arab Renaissance and a new Development paradigm:

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

Market Development Initiatives & Synergies

- **Second Tier Equity Market** for Small & Medium Enterprises & Family-owned businesses
- **Warehouse Receipts Financing** at the DIFC/ Collateralised Securities Lending
- Role of a regional financing & capacity building institution: **MENA Bank for Reconstruction and Development/ Emirates Development Bank**
- Renewable Energy & the development of a **Clean Energy Cluster at the DIFC**
- **Partnerships with SWFs** are important: involvement in reconstruction and development in the region through infrastructure projects (increasingly important given the problems in Europe, lack of access to finance from traditional means/ partners)

Thank You!

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