

# **ECONOMIC & FINANCIAL DEVELOPMENT IN MENA**

**Investment opportunities in Asian Real estate &  
Infrastructure**

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# MENA: Growth, Structural Change and Trade

## Agenda

- Drivers of Economic Growth & Structural Change
- Private Participation in Infrastructure
- MENA Infrastructure Priorities
- DIFC & MENA Infrastructure

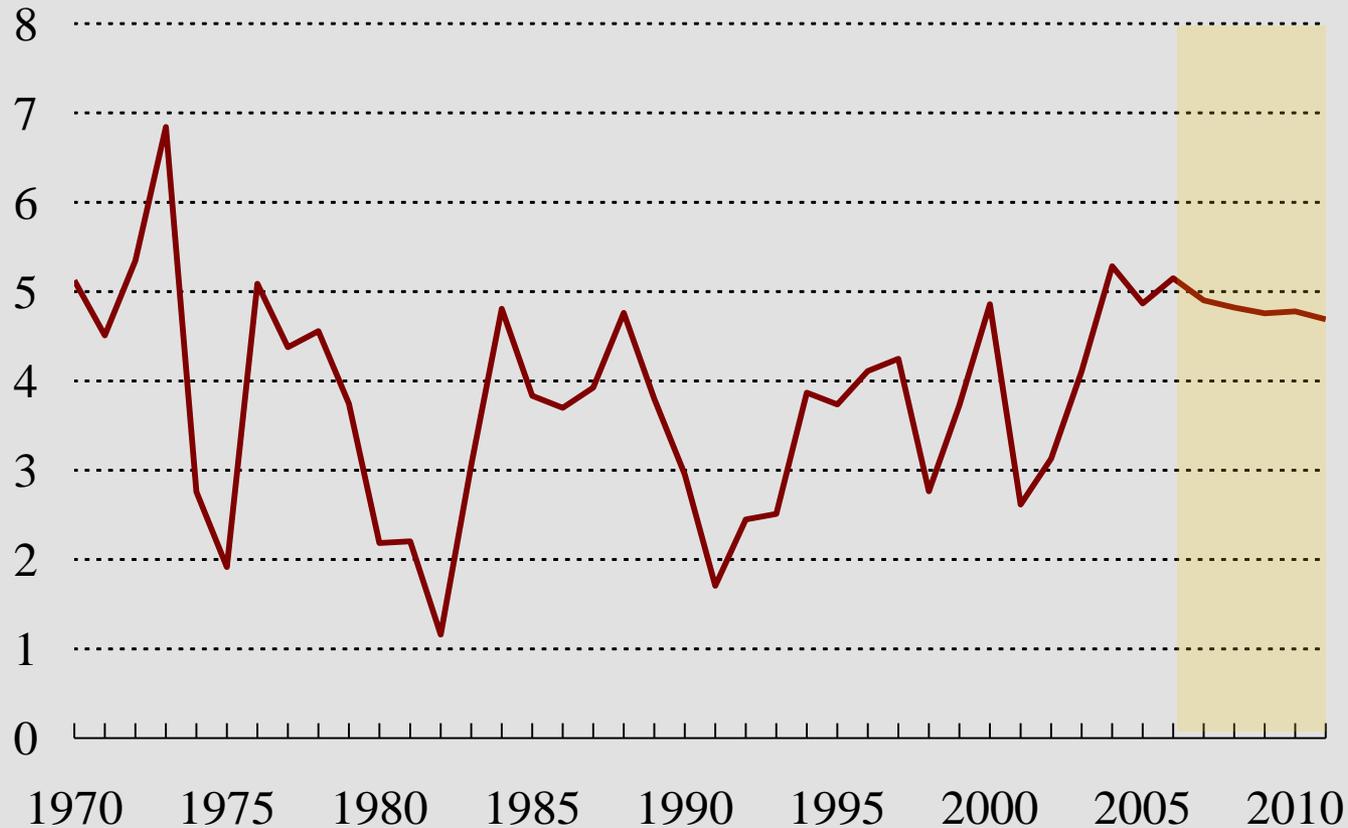


## A MENA Economic & Financial Renaissance?

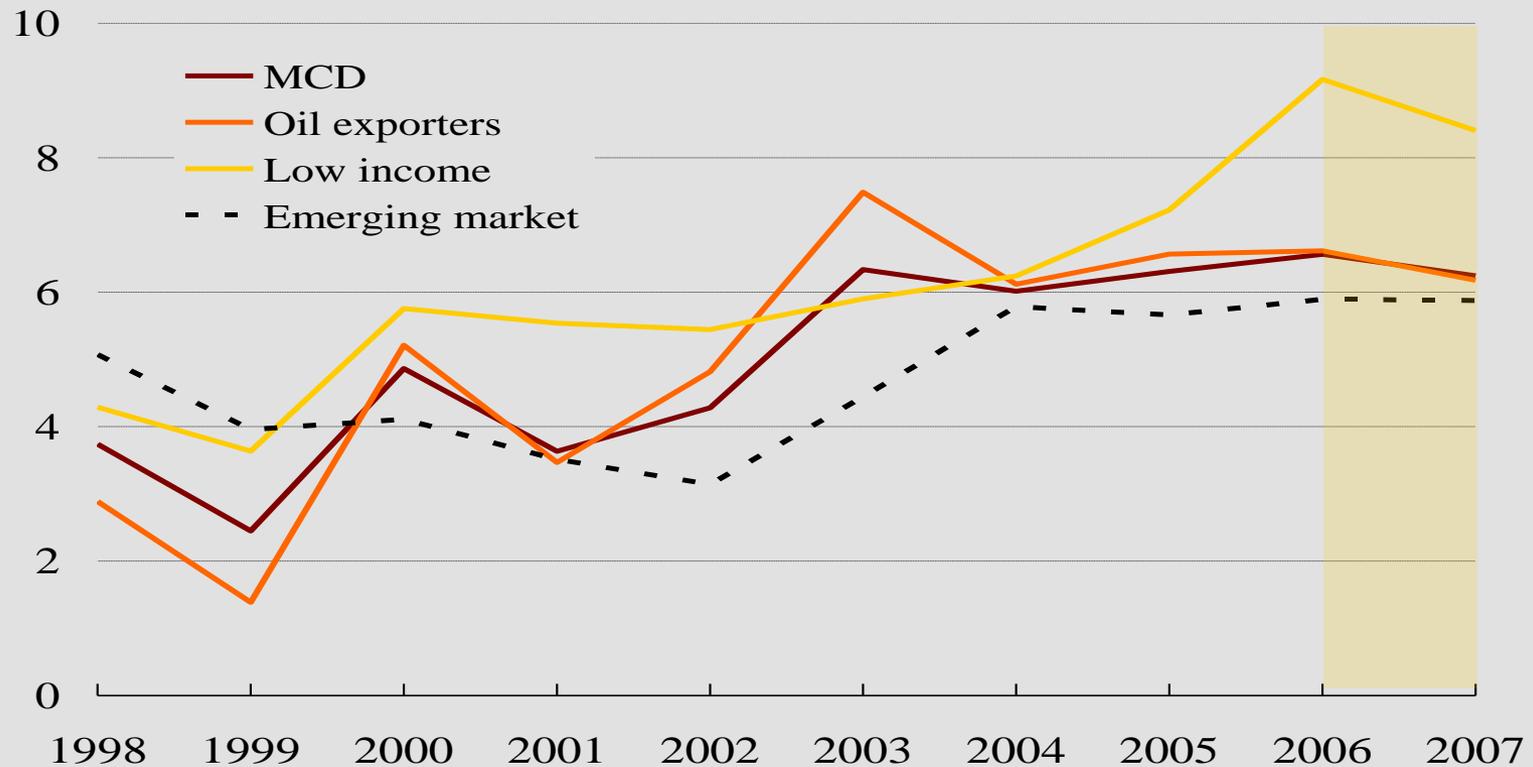
- MENA has achieved above average growth rates sustained by
  - Average real GDP growth 6.2% over 2003-2005 vs. 3.7% in 1998-2002
  - Favorable global developments: high growth, low inflation and interest rates, no financial crises
  - Growth boom has been investment led with increased infrastructure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



# World Real GDP Growth (annual % change): 30 year high (Source: IMF)



# Real GDP growth: Actual & Forecast



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

# A MENA Growth Resurgence and Economic Renaissance?

- Positive demographics & migration sustaining labour & output growth
- Transmission effects affecting labour exporters Egypt, Jordan, Lebanon, North Africa:
  - Higher incomes of migrant populations
  - ↑ Labour flows to oil exporters → ↑ remittances to labour exporting countries
  - Portfolio investment
  - FDI
- Trade & Current account surpluses running at **20-25% of GDP** much of which is being recycled back into regional economies



## A MENA Growth Resurgence and Economic Renaissance? (Cont'd)

- 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
- Surge in Shari'a compliant banking & finance



## Investment, Migration and Transmission Effects

- Higher growth in the oil producers has been transmitted to the labour exporting countries
- 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).
- However, official remittances are likely to represent only a fraction of total remittances, which amount to between 12%-15% of GDP for India & Egypt to more than 22% for Lebanon.
- 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.



## Investment and Integration

- 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 1.3 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 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.



## Increase in Wealth and Permanent Income

- Value of oil wealth of oil exporters increased by an estimated **\$44 trillion** between 1995 and 2006
- Permanent Income increase of some \$850 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**

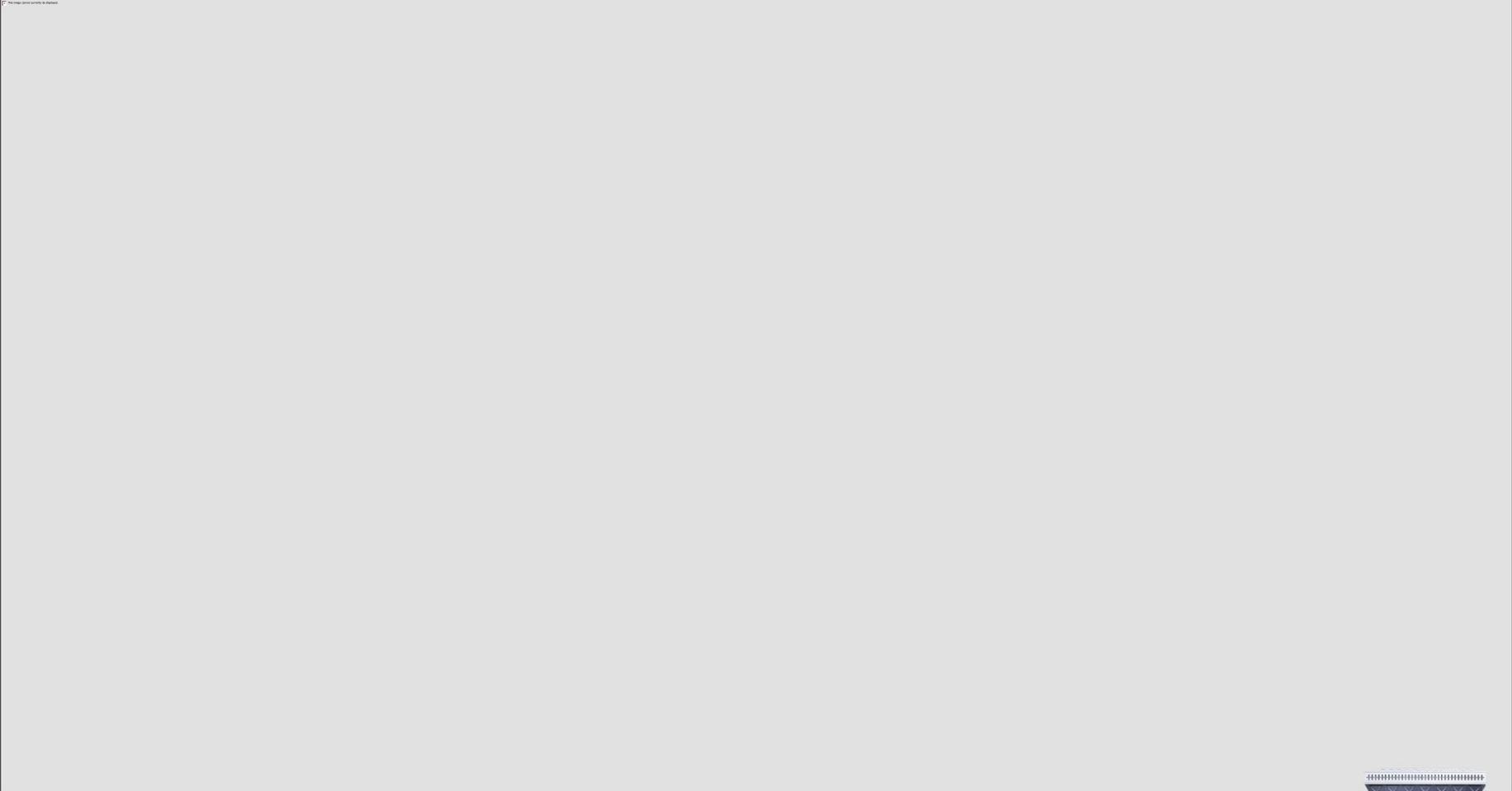


## Liquidity & the Stock Markets

- Growth and abundant liquidity have fuelled a spectacular resurgence of the credit and equity markets in 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 remain fragmented, displaying high volatility of returns and lack of 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.

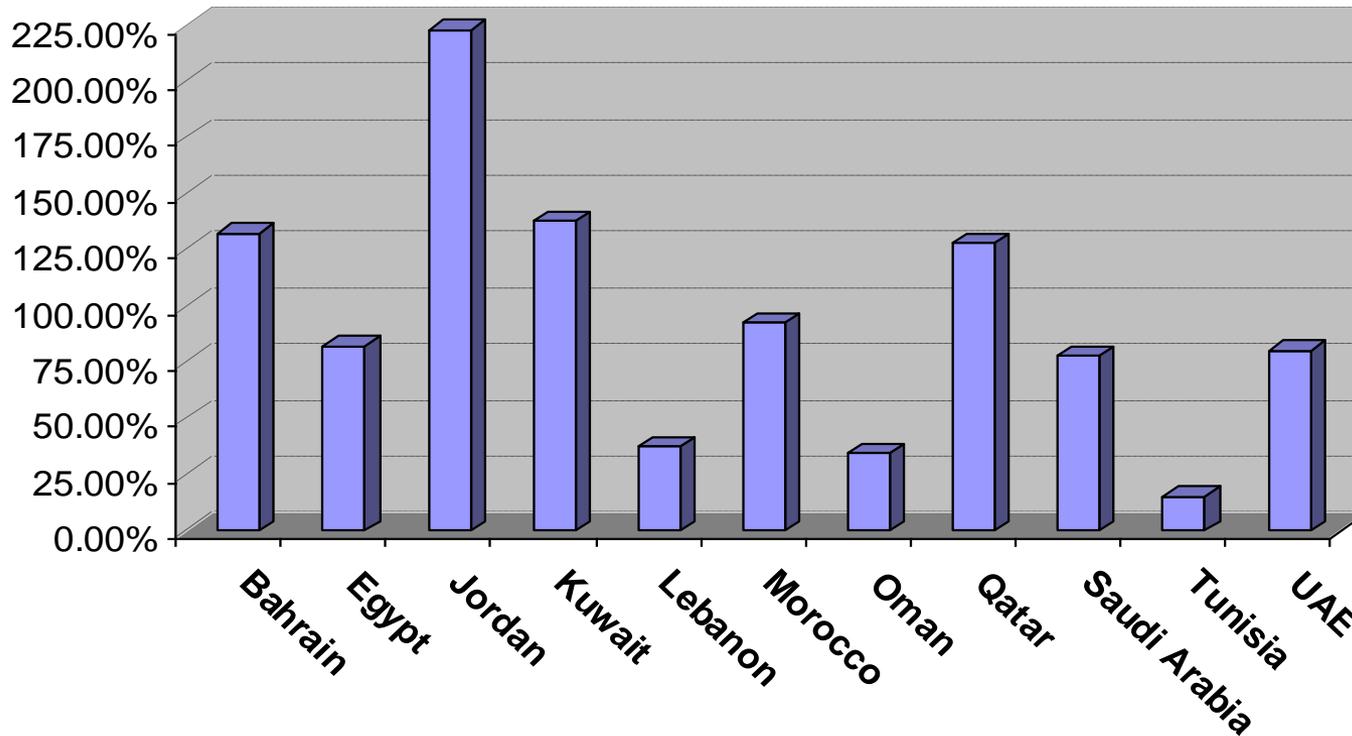


# GCC & Egypt Stock Markets performance

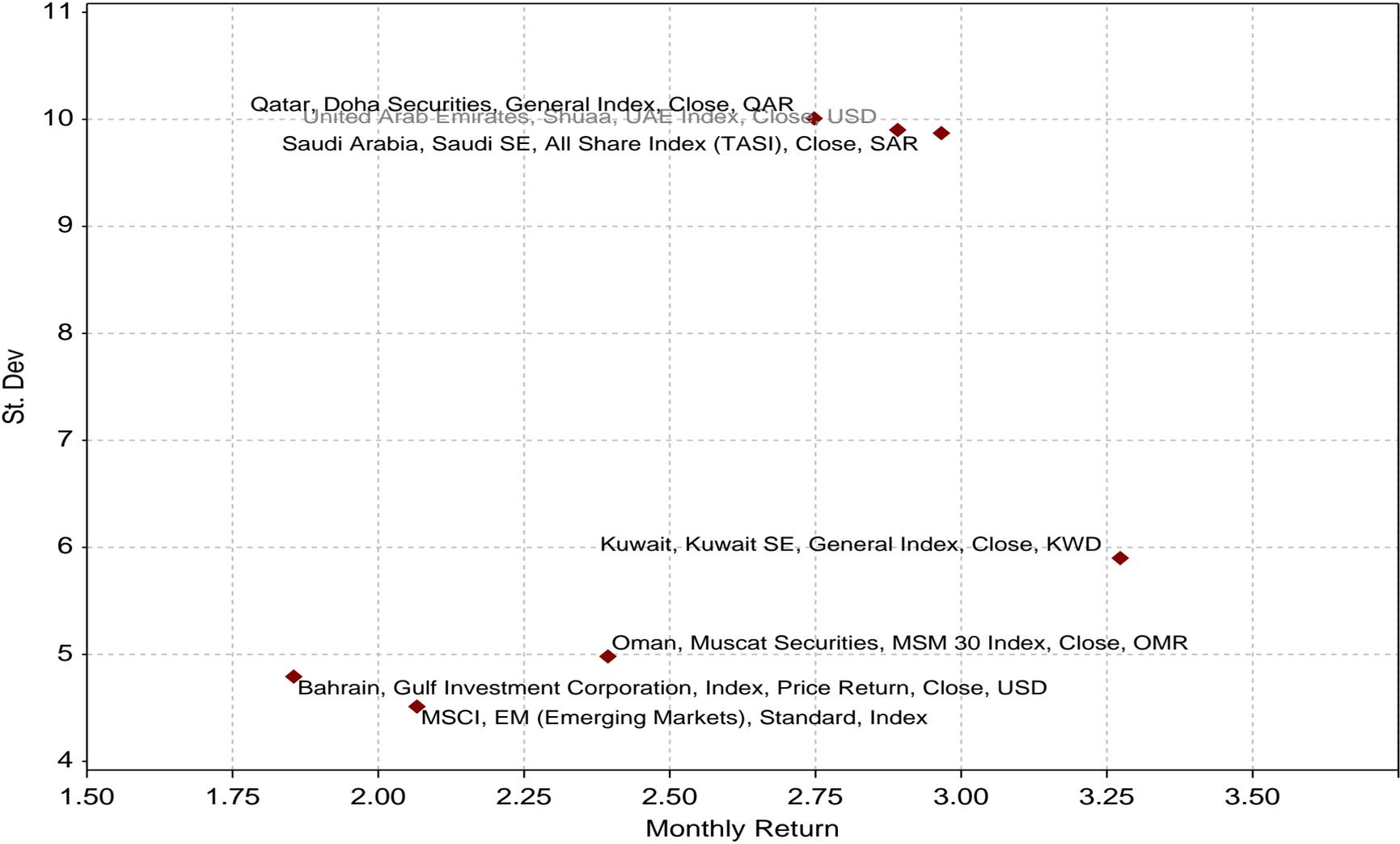


# Stock Market Capitalization

Market Cap/Nominal GDP  
Jan 30th 2007



# Markets Risk/Return



Source: Reuters EcoWin

## Stylized Facts: GCC Markets Recent Performance, 2002-2006

- Spectacular growth since 2003: in size relative to GDP, listed companies and equity valuations
- GCC markets out performed emerging and developed markets and oil
- High average returns were also highly volatile: risk-adjusted returns lower than in emerging markets, developed markets or un-hedged investment in oil!
- GCC markets show low or negative correlation with emerging and developed markets: offer potential risk diversification benefits
- GCC markets are becoming increasingly integrated (cross-correlated)



## GCC Strong Economic Fundamentals driving markets

- 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 Integration: lower the cost of equity capital and lead to convergence of asset prices



## MENA: Power of Regionalism & Networks

- **Location & New Geography:**
  - Increased de-linking from the US business cycle
  - MENA 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
- But lack of MENA Financial Sector development is now a Barrier to sustained growth and competitiveness
- **Financial sector can and should be an engine of growth**
  - ‘Bank the Demographic Dividend’: allow populations to have access to finance
  - Finance Infrastructure: physical, human, social



# Integrated Infrastructure basis for Economic & Financial Integration

- **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: increased use of Euro; facilitate payments & settlements in capital markets**
- **Financial Market Infrastructure: integrated capital markets**



# Infrastructure in the MENA Region

- Existing infrastructure is old and or even obsolete: need for upgrading & modernization.
- Due to the severe fiscal constraints by in non-oil producers, the MENA region has a low infrastructure investment per capita.
- High demographic growth is increasing the pressure
- Countries like Iraq, Lebanon, Palestine, require major investment in reconstructing the damaged infrastructure network.
- Deteriorating infrastructure is obstructing or slowing economic development by increasing the cost of doing business.
- Direct infrastructure investments & networks to prepare for regional integration and improve logistics

*source will appear at the bottom*



# Private Sector Participation in Infrastructure Projects in MENA

- The population of the MENA region is one of the fastest growing in the world. According to World Bank, MENA region has a population of more than 415 million today, and is expected to grow to at least 833 million by 2050.
- Rising demand for infrastructure services as a result of growing populations and changing demographics.
- Private sector participation is an engine of growth and can play an important part in meeting infrastructural demands of countries.
- Investment flows to infrastructure projects with private participation in developing countries overall grew by 12 percent to US\$64 billion in 2004.
- Telecommunications investments drove the growth, rising by 35 percent, while investment flows to other infrastructure sectors fell by 20 percent.
- Private sector participation in infrastructure projects in MENA ranked low compared to other regions.



# Regions Ranked by Number of Projects 1990-2005

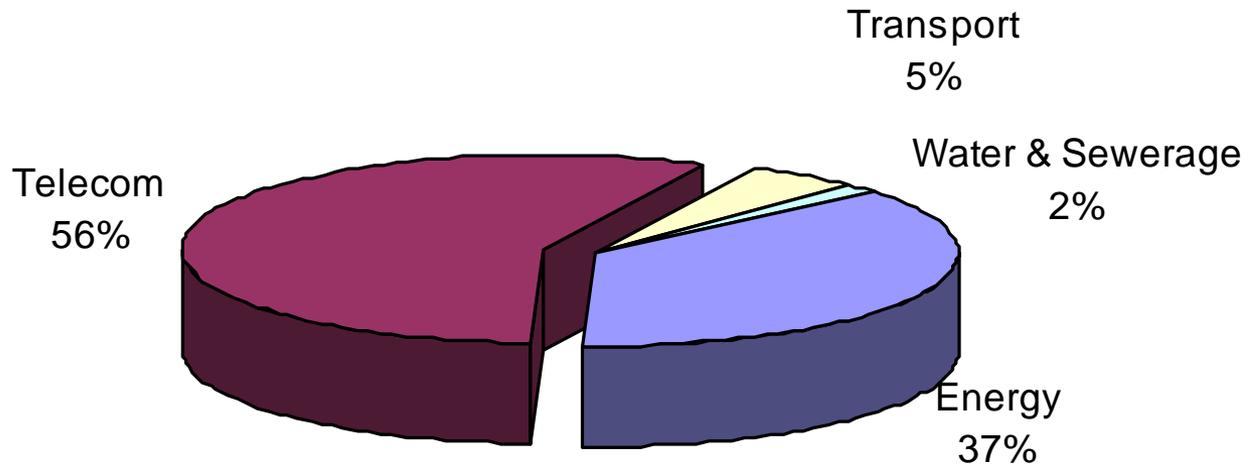


## Total Projects by Primary Sector and Subsector (US\$ million) 1990 - 2005

Primary Sector	Sub-Sector	Number of Projects	Total Investment (US\$ millions)
<b>Energy</b>	Electricity	23	11,964
	Natural Gas	4	3,177
	<b>Total Energy</b>	<b>27</b>	<b>15,141</b>
<b>Telecom</b>	Telecom	37	23,312
	<b>Total Telecom</b>	<b>37</b>	<b>23,312</b>
<b>Transport</b>	Airports	9	588
	Railroads	1	182
	Seaports	11	1,301
	<b>Total Transport</b>	<b>21</b>	<b>2,072</b>
<b>Water and sewerage</b>	Potable Water	5	679
	Potable Water and Sewerage	4	0
	Sewerage	1	0
	<b>Total Water and sewerage</b>	<b>10</b>	<b>679</b>
<b>Total</b>		<b>95</b>	<b>41,203</b>



# Total Infrastructure Projects with Private Participation by Sector in MENA (US\$ million)



**Total \$ 41.2 billion USD**

Source: World Bank, PPI Project Database

# Gulf Projects (\$ millions)

	2-Mar-07	2-Mar-06	% change on year
<b>Bahrain</b>	32,670	25,145	29.9%
<b>Kuwait</b>	233,040	80,171	190.7%
<b>Oman</b>	42,156	32,375	30.2%
<b>Qatar</b>	132,655	112,542	17.9%
<b>Saudi Arabia</b>	324,141	198,856	63.0%
<b>UAE</b>	497,962	271,547	83.4%
<b>GCC</b>	1,262,624	720,636	75.2%
<b>Iran</b>	102,870	92,128	11.7%
<b>Iraq</b>	28,460	27,498	3.5%
<b>Gulf Total</b>	1,393,954	840,262	65.9%

Source: MEED Projects



## Infrastructure: Old and New Projects

- We are re-discovering our own history!
- MENA region at the time of the Ottoman Empire had used bond finance for infrastructure projects on a regional level: e.g. Berlin-Baghdad railroad, Hejaz railroad
- EUROMED oil, gas and energy projects are currently limited to the Mediterranean: they should be extended to the Gulf region
- Regional economic integration of the GCC countries requires investment in region-wide infrastructure: oil, gas, power network, telecommunications, broadband and info-structure, transport facilities and networks



# Role of DIFC

- **Invest, Manage and Control region's financial wealth of \$2.1 trillion and growing as a result of high energy prices:**
  - **Strategic issue: security and safety of assets**
- **Financing Infrastructure & Regional Economic Integration**
- **Develop new markets and instruments:**
  - **Shari'a compliant financial sector & market**
  - **Bond market**
  - **Leasing**
  - **Securitisation**
- **Enable & support economic and financial reforms:**
  - **Enable separation of oil revenue management from economic policy**
  - **Privatisation and Private sector Participation in Infrastructure**
  - **Housing Finance & Mortgage markets**



# 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 trade and 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.



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