MENA Markets, Growth, and Integration

Citi's MENA Conference

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Agenda

- MENA Economic 'Renaissance'
- Capital Markets: Liquidity, Volatility & Fundamentals
- MENA & GCC Outlook
- Challenges & Policy Issues

MENA Economic 'Renaissance'

MENA has achieved above trend average real GDP growth 6.2% over 2003-2007 vs. 3.8% in 1998-2002.

Growth 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 of markets, FDI tourism, labor flows

Region's companies are becoming multinationals: Emaar, Orascom, Etisalat, SABIC, MTC, Dubai Ports, Mittal…

Growing private sector participation in infrastructure in GCC

Infrastructural developments estimated value of projects planned or under development in the Gulf has exceeds USD 1.3 trillion.

Greater regional economic integration (GCC Monetary Union in 2010 (?), lower trade barriers Greater Arab FTA)

Economic reforms, diversification and state divestment & privatisation: non-oil growing faster than oil sector

Infrastructure Investments: Lower Costs, Increased Trade, Networks & Productivity

Projects Planned and/or Currently Underway in the Region (Millions of USD)

	UAE	Bahrain	Kuwait	Qatar	KSA	Oman	Iran	Iraq	Total Value
Oil & Gas	32,633	1,110	26,228	59,725	44,605	9,860	54,845	10,155	239,161
Construction	264,501	21,740	170,375	36,326	83,349	10,135	4,275	14,180	604,881
Industry	15,980	2,705	2,130	5,030	10,585	3,450	5,335	1,218	46,433
Power	16,970	1,305	5,632	6,303	23,115	2,610	11,613	2,680	70,228
Petrochemicals	6,350	1,000	4,270	9,720	55,002	7,250	20,240	175	104,007
Water & Waste	2,035	1,070	2,380	1,173	5,500	2,140	560	50	14,908
Total Value	338,469	28,930	211,015	118,277	222,156	35,445	96,868	28,458	1,079,618

Source: Data as of May 2006, MEED Projects

Gulf Projects ($ millions)

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

Source: MEED Projects

Conservative Fiscal Policies

Fiscal Policy:

- Governments have learnt lessons from 1970s, 1980s
- Oil producers policy reaction has been fiscally conservative: ½ of increased oil revenues have been saved.
- But expenditure rapidly rising
- Fiscal position of GCC remains in surplus for an oil price in the range of $35-$38

Monetary Policy and Asset Markets

- Accommodating monetary policies leading to high money and credit growth rates; financing real estate and financial market booms with spectacular gains and returns in equity and debt market instruments
- Real exchange rate appreciation with pegged rates: pressure increasing to change exchange rate policy
- Inflation higher, mainly in non-traded goods & services, with limited pass-through of higher oil prices to consumers; increase in 'imported' inflation
- Low or negative real interest rates & high liquidity growth resulted in an investment driven boom:

Real estate boom and asset price appreciation

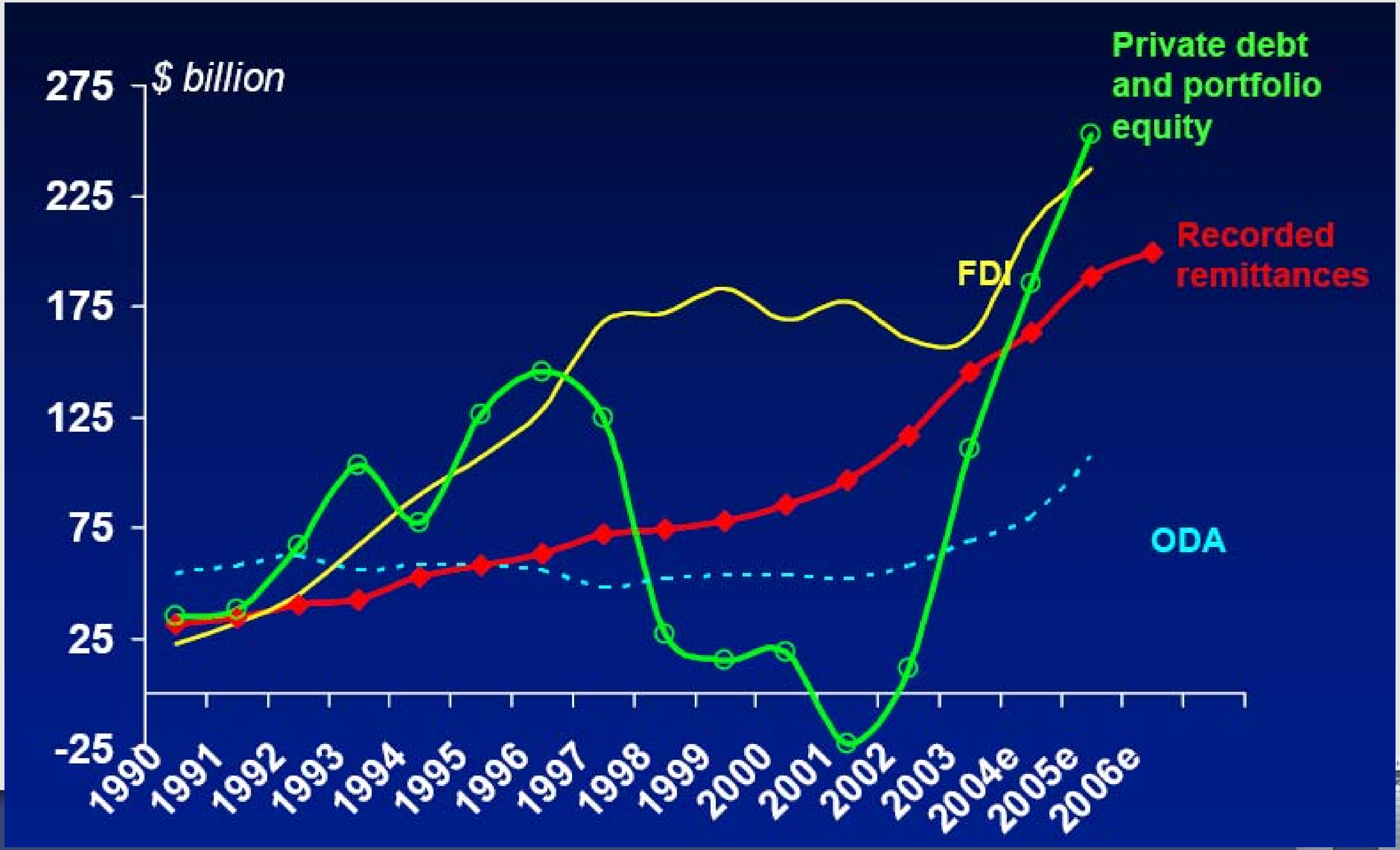
Stock market boom

Credit market boom

Demographics, Migration & Transmission Effects

- Demographics & migration sustaining low labor costs & output growth
- Transmission effects affecting labor exporters Egypt, Jordan, Lebanon, North Africa:
  - Higher incomes of migrant populations
  - ↑ remittances to labor exporting countries
  - Portfolio investment
  - FDI
- 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.
- Growth & reforms inducing ‘reverse brain drain’
- 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 people ‘voting with their feet’

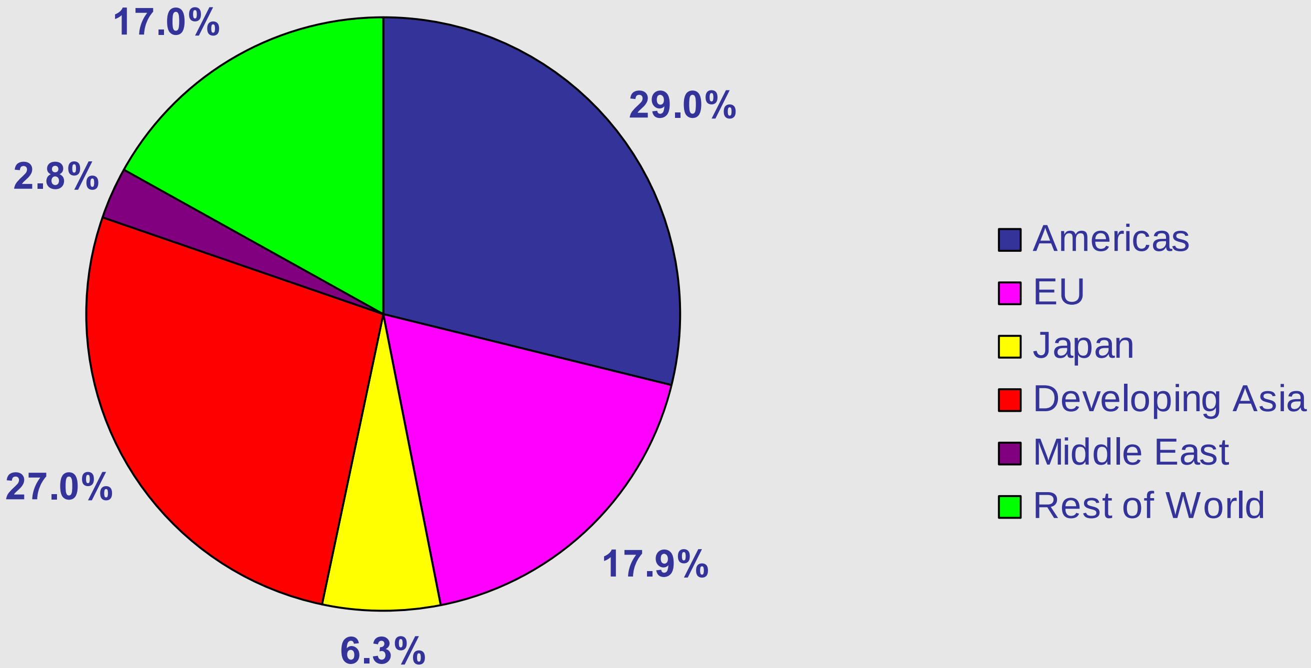
Remittances Growing & More Stable than Capital Flows, FDI or ODA



MENA/GCC Well Located to Benefit from New Global Economic Geography

WEO Groups Share in Aggregate GDP-Based on PPP

Source: IMF WEO October 2007

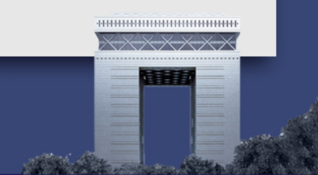


* includes US, Canada, Western Hemisphere

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, diversification & 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



Increase in Wealth and Liquidity

- Value of oil wealth of Middle East oil exporters increased by an estimated $30 trillion between 1995 and 2007.

- **Massive Wealth Creation:**
  - 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. [G. Sachs]

- Permanent Income increase of some **$550** billion at a real rate of 3%

Increase in Wealth and Liquidity

- Accumulation of Net Foreign Assets with cumulative Current Surpluses (2003-2007) of oil producers $934 billion (GCC $702 billion) & international reserves
- MENA international reserves have tripled between 2003 and 2007: $242.9bn (2003) to $776.6bn (2007)
- **GCC have become 'asset based' economies:** income from assets (including foreign assets) more important than income from natural resources

Stylized Facts: GCC Markets Recent Performance, 2002-2007

- **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.**

- **High average returns were also highly volatile: risk-adjusted returns lower than in emerging markets, developed markets or un-hedged investment in oil!**

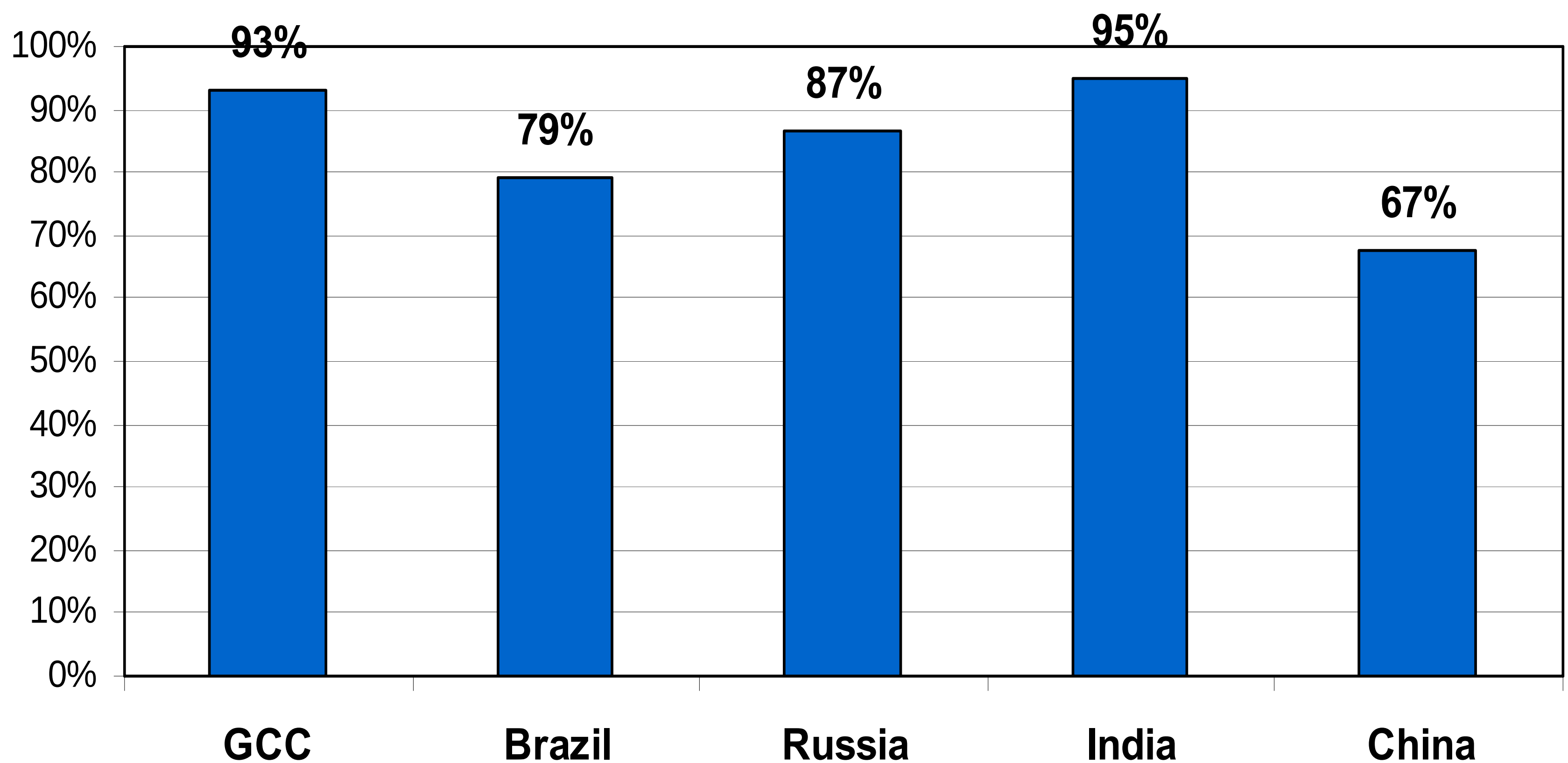
- **Growth of Shari'a compliant finance**

Stylized Facts: GCC Markets Recent Performance, 2002-2007

Strong macroeconomic fundamentals imply <u>low macro risks</u>:

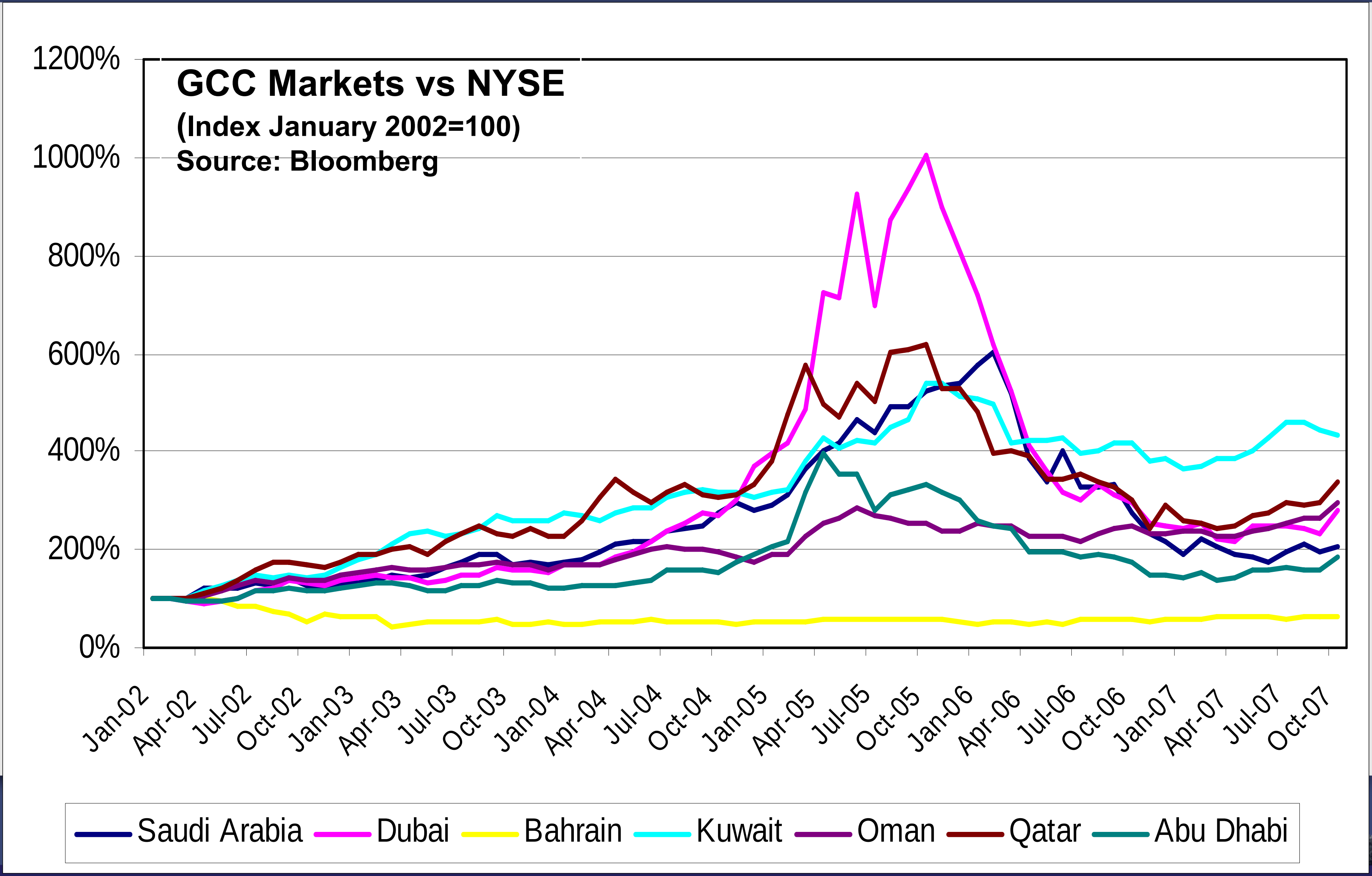
- High growth rates driven by higher oil prices, diversification and economic liberalization policies imply high expected corporate profits and investment returns
- Investment-led growth with large infrastructure component →increased productivity growth & ↑private sector investment
- Expectations of 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.

Market Cap/GDP Estimates (%) 2007

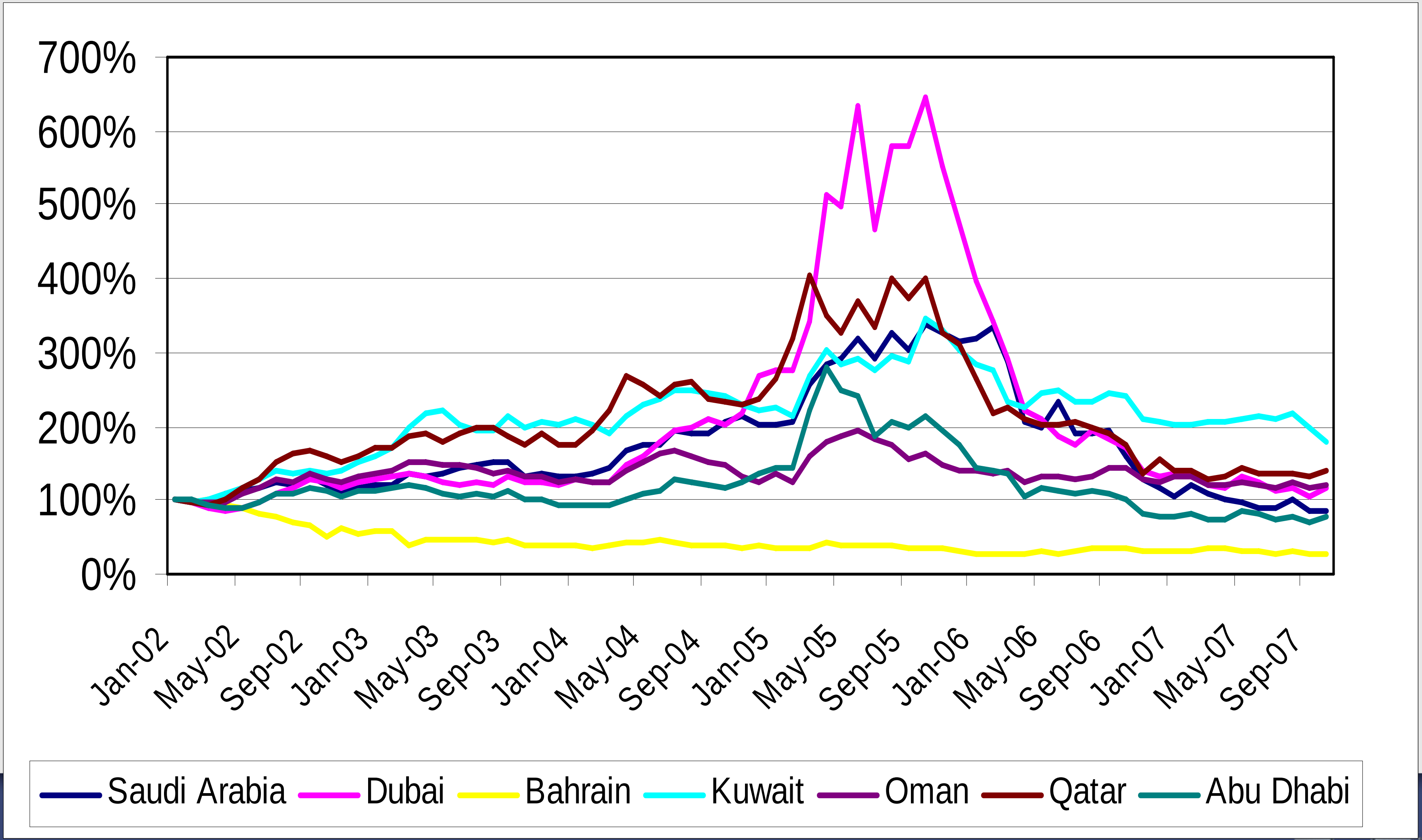


Source: SHUAA Capital (August 2007); EIU.

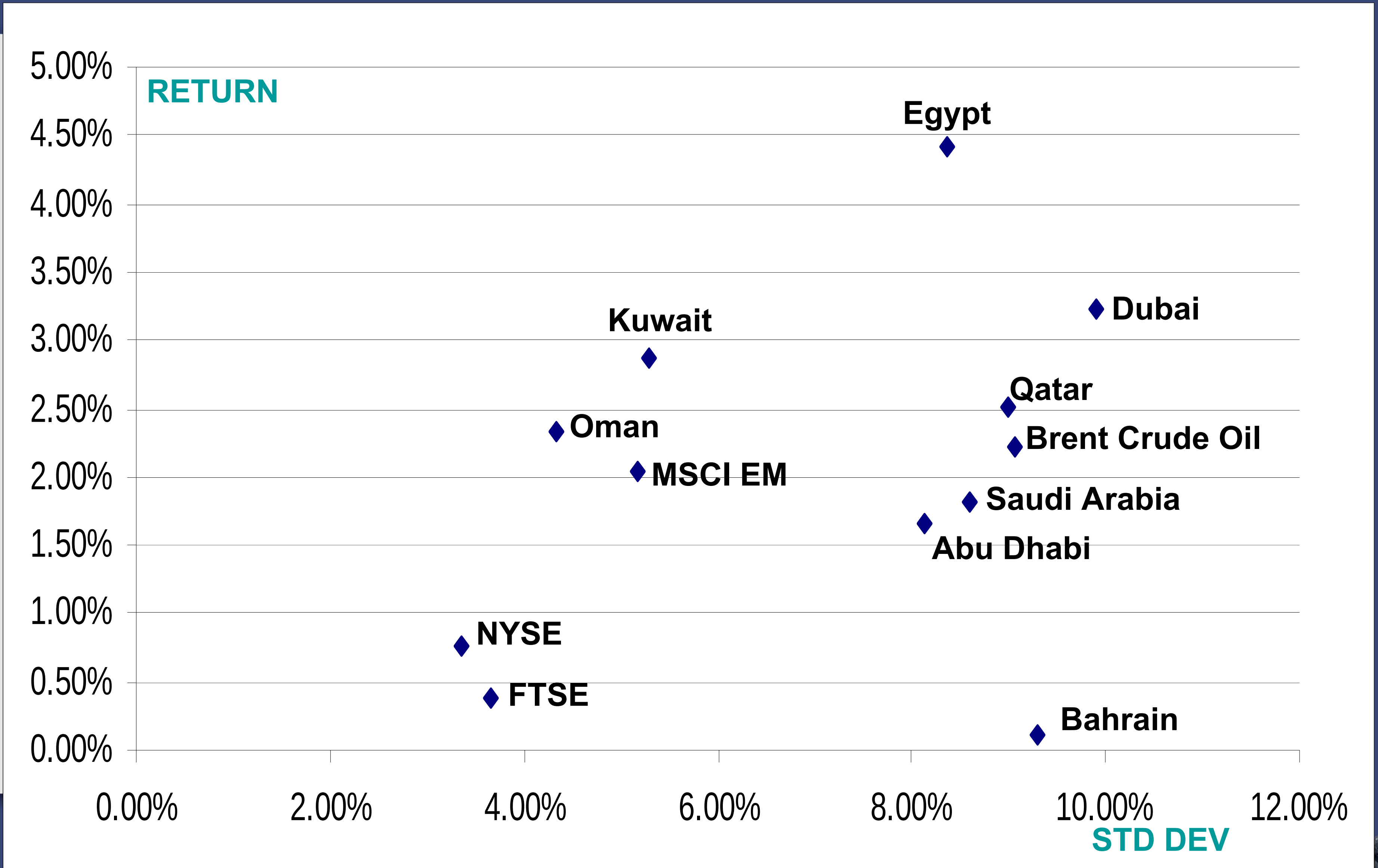
GCC markets out-performed developed markets (NYSE, FTSE 100, etc.).



GCC Markets Outperformed Emerging markets
(Index January 2002=100; Bloomberg)



Market Return/Risk: Monthly, 2002-2007



Correlation matrix, 2002-07: 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

Risks and Trends

- 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.
- The economic and financial prospects for the region are promising, characterized by increased market capitalization and portfolio diversification benefits. However, security issues and geo-political instability are a source of risk.
- High levels of liquidity available imply lower sensitivity of local asset markets to movements (including higher) global interest rates or recent financial & credit market turmoil.
- 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.

DIFC MENA Real GDP Growth Outlook, 1998-2008

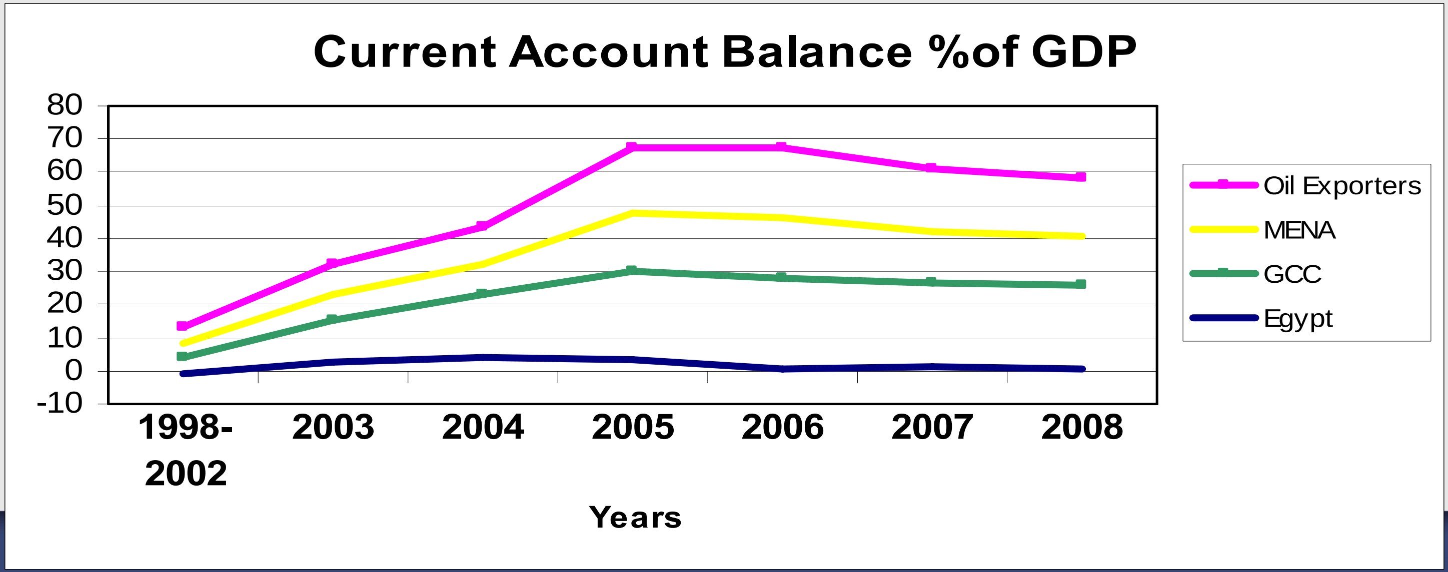
	1998-2002	2003	2004	2005	2006	2007	Proj. 2008
MENA	3.8	6.5	5.5	5.2	5.8	6	6.2
Oil Exporters	3.8	7.6	6.2	6.3	6.2	7	6.8
GCC	3	8.8	7.1	7	5.9	5.9	5.8
Algeria	3.6	6.9	5.2	5.1	3.6	5.1	5.3
Azerbaijan	7.7	10.5	10.4	24.3	31	30.2	28.2
Bahrain	4.8	7.2	5.6	7.8	7.6	7.2	6.8
Iran	4.2	7.2	5.1	4.4	4.9	6	5.5
Iraq			46.5	-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

MENA: Inflation, CPI Annual Change, %

	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

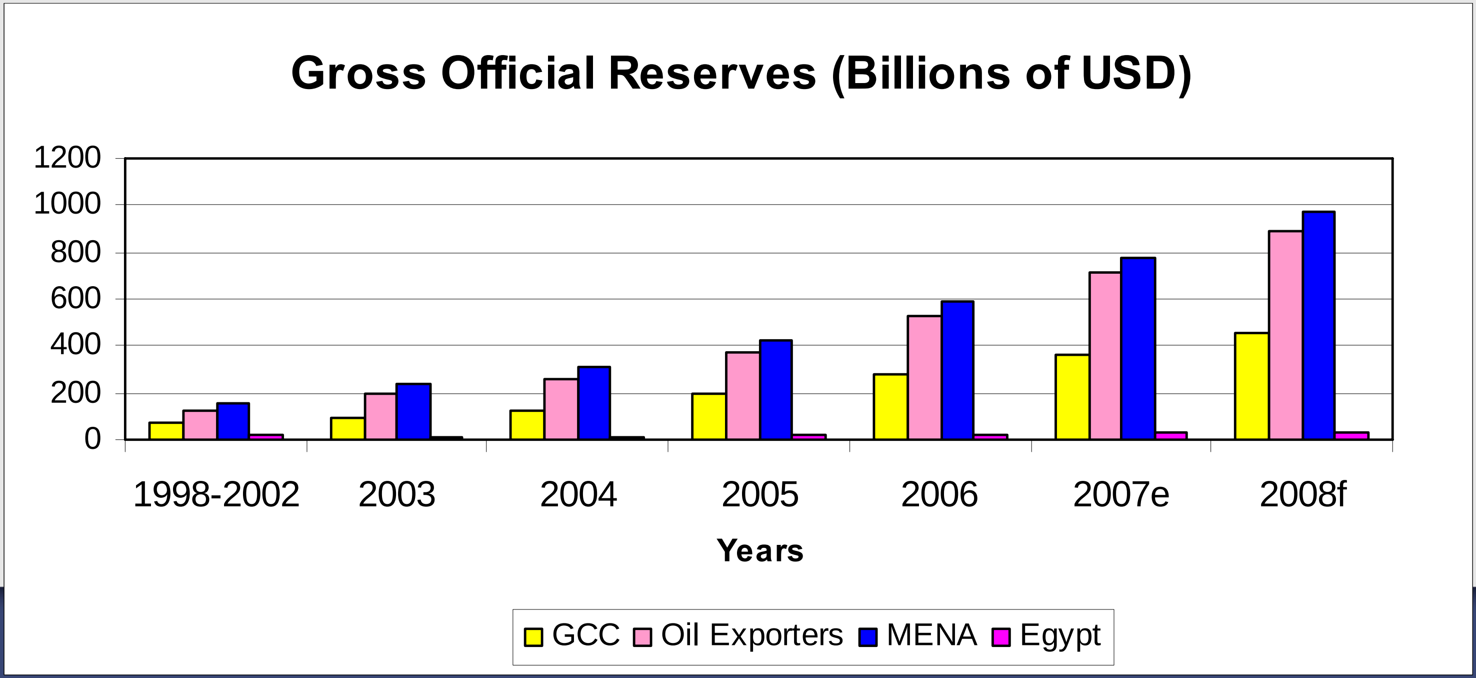
MENA: Current Account Balance % of GDP

	1998-2002	2003	2004	2005	2006	2007	2008
Egypt	-1.1	2.4	4.3	3.2	0.8	1.4	0.8
GCC	5.5	12.8	18.4	26.9	27.2	25.4	24.8
MENA	3.6	7.7	9.5	17.4	18.4	15.4	14.8
Oil Exporters	5.4	9.2	10.9	20.1	21.1	18.5	17.8



Gross Official Reserves
(Billions of USD)

Gross Official Reserves(Billions of USD)							
	1998-2002	2003	2004	2005	2006	2007e	2008f
GCC	70.1	90.5	123.4	194.3	275.5	365	455
Oil Exporters	122.3	196.9	261.8	374.6	531	711.2	886



DIFC MENA-Regional Economic Outlook

- MENA/GCC and Central Asia are living an ‘economic renaissance’ with above trend growth of 6.2% over 2003-2007. Continued high growth is forecast in 2008: MENA 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

DIFC MENA-Regional Economic Outlook

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.

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.

Capital markets are driven by strong fundamentals, liquidity and sound macroeconomic conditions with limited or no fallout from US sub-prime and credit market turmoil and uncertainty in developed financial markets; prospects are for markets to act as engines of growth for region

CHALLENGES & POLICY ISSUES

- Inflation & Exchange Rate Policy
- Sovereign Wealth Funds
- De-linking natural resource revenue management from fiscal & investment policy
- Capital Market Development

CHALLENGES & POLICY ISSUES

- 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 capacity and money, debt markets

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.
- Facing Increased investment & financial protectionism
- Need cooperative solution to resolve global imbalances

DIFC: Focus on Financial Sector Development

- Invest, Manage and Control region's financial wealth of $2+ trillion and growing as a result of high energy prices:
  - Financial sector can be an engine of growth
  - Strategic issue: security and safety of assets
- Financing Infrastructure & Regional Economic Integration
- Develop new markets and instruments
- 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

MENA Markets, Growth & Integration:

A Time for Vision
A Time for Action
A Time for Architects and Builders

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