

Financial Crises & New Economic Geography: Emerging Alternative Finance

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*The Annual Falcon Group Trade and Corporate
Finance Forum
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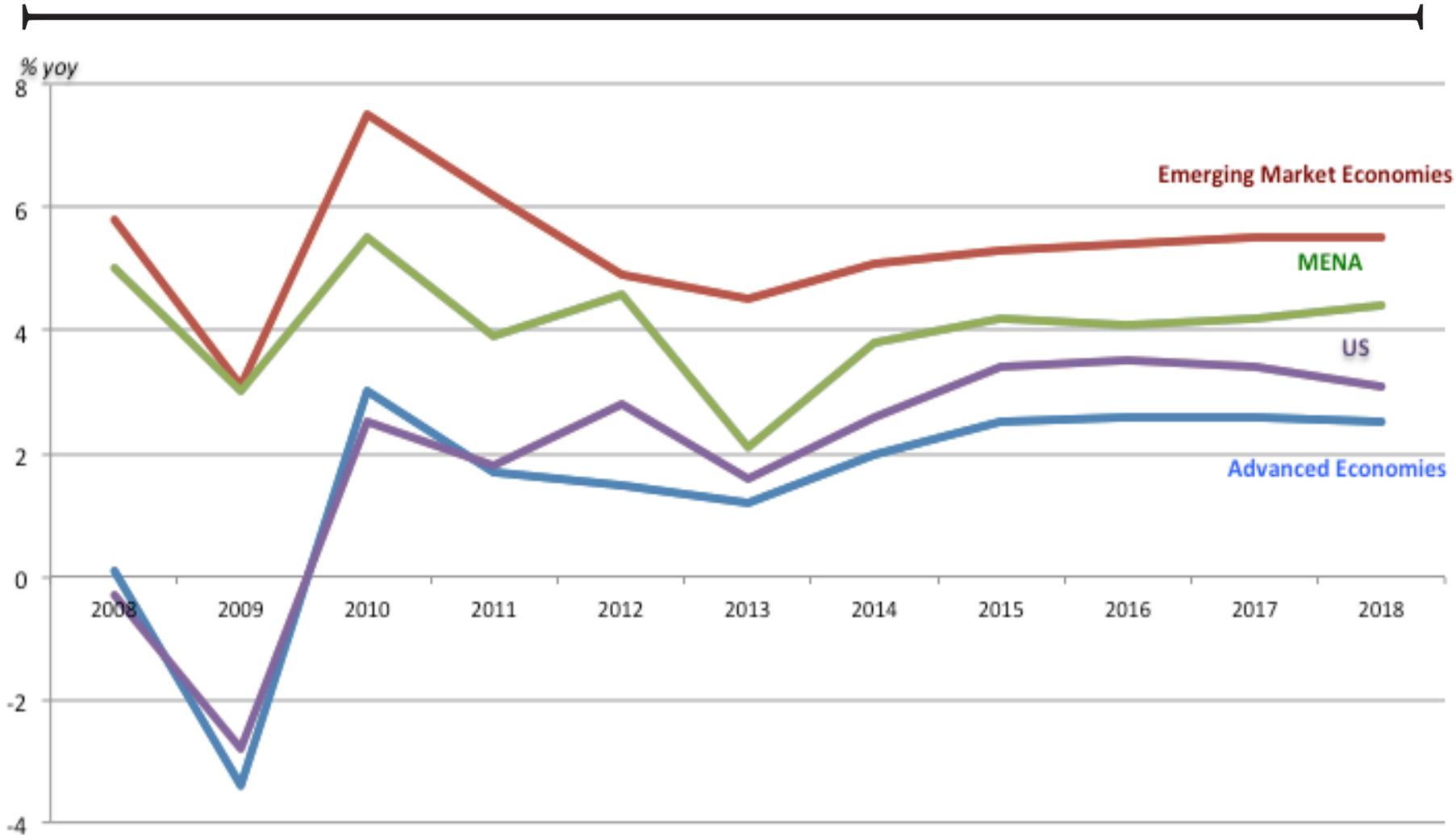
NASSER SAIDI

— & ASSOCIATES —

Agenda

- ✓ **Shifting Global Economic Geography**
- ✓ **Whither the Middle East & Arab
Firestorm?**
- ✓ **Great Financial Crisis & Aftermath**
- ✓ **Paradigm shift & Emergence of
“Alternative Finance”**

3-Speed Recovery from Great Contraction & Great Financial Crisis



Source: IMF World Economic Outlook, Jan 2014.

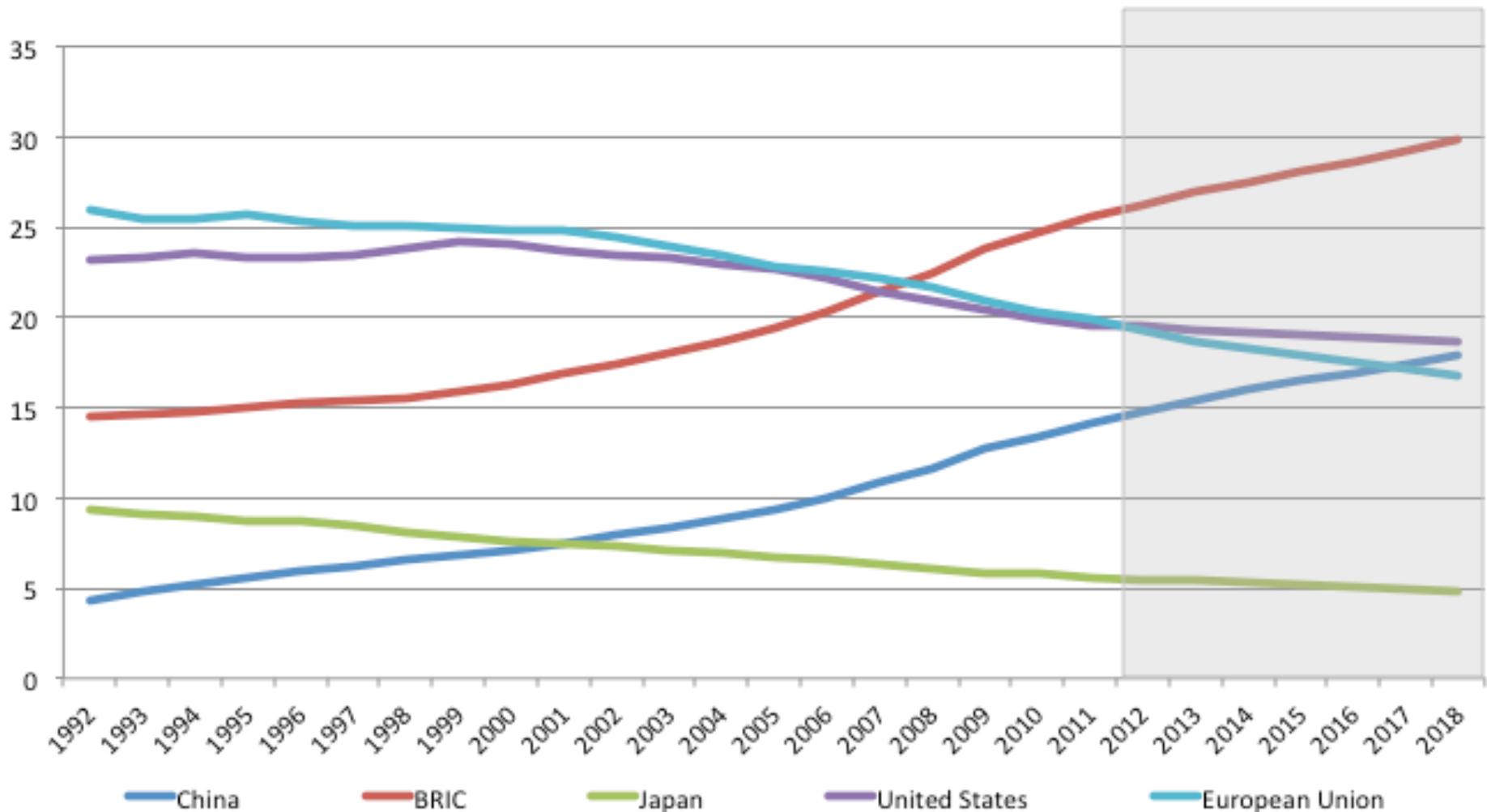
Global Economic Geography Shifting to Asia & EMEs: LT Convergence process

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP growth (%)										
World (PPP exchange rates)	-0.7	5	3.8	2.9	2.9	3.6	3.8	3.9	3.9	4
World (market exhcgnage rates)	-2.3	3.9	2.6	2.2	2.1	2.9	2.9	2.8	2.8	2.9
US	-2.8	2.5	1.8	2.8	1.9	3	2.6	2.5	2.4	2.6
Japan	-5.5	4.7	-0.4	1.4	1.7	1.7	1.6	1.1	1.2	1.3
Euro area	-4.4	1.9	1.6	-0.6	-0.4	1.1	1.4	1.4	1.4	1.6
China	9.2	10.4	9.3	7.7	7.7	7.2	7	6.9	6.4	6
Eastern Europe	-5.6	3.4	3.9	2.1	1.5	3	3.4	3.7	4.3	4.3
Asia & Australasia (excl Japan)	5.1	8.5	6.5	5.3	5.5	5.6	5.7	5.8	5.6	5.6
Latin America	-1.5	5.8	4.4	2.9	2.7	3.2	3.5	3.8	3.8	3.8
MENA	1.9	5.3	2.6	3.6	2.5	3.7	4.3	4.6	4.7	5
Sub-Saharan Africa	1.3	4.6	4.7	4	3.7	4.5	4.8	5.5	5.7	5.2
World inflation (% , avg.)	1.6	3	4.2	3.4	3.1	3.4	3.5	3.4	3.4	3.6
World trade growth (%)	-11.7	14.1	6.5	2.5	2.9	5.2	5	5.3	5.4	5.4
Commodities										
Oil (US\$/ barrel; Brent)	61.9	79.6	110.9	112	108.9	105.5	107.3	103.8	97.5	93
Exchange rates; avg										
¥:US\$	93.6	87.8	79.8	79.8	97.6	103.1	103.2	102	101	100
US\$:€	1.39	1.33	1.39	1.29	1.33	1.29	1.26	1.26	1.27	1.27

Source: EIU (updated as of Feb 10, 2014)

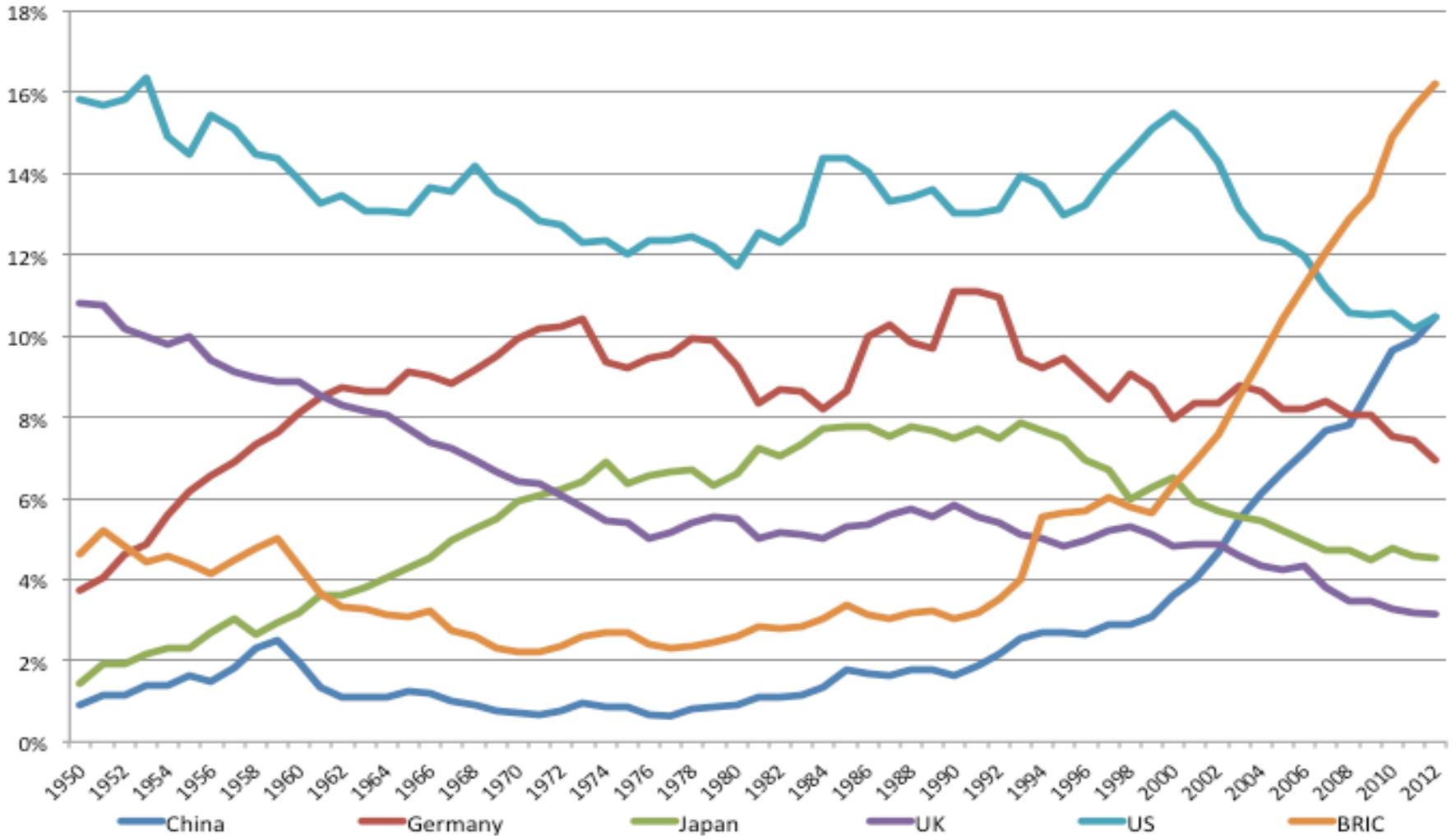
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Economic Geography Shifting to Asia & EMEs (Share of Global GDP @ PPP rates)



Source: IMF WEO Oct 2013

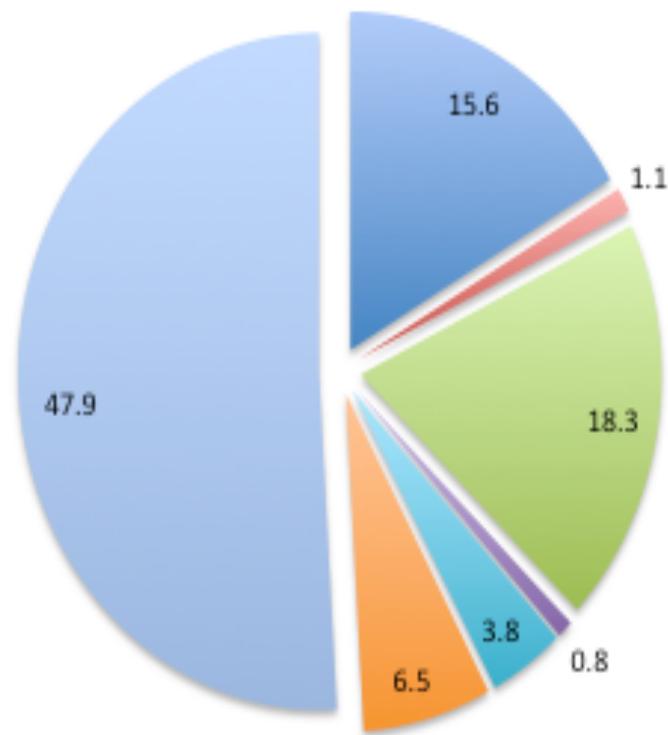
Globalisation & Liberalisation led to dominance of China & BRICS (share of world trade, %)



Source: International Trade Statistics, WTO

Middle East Trade Shifted to Asia: China replaced US, EU as main oil importer

2000



North America

South and Central America

Europe

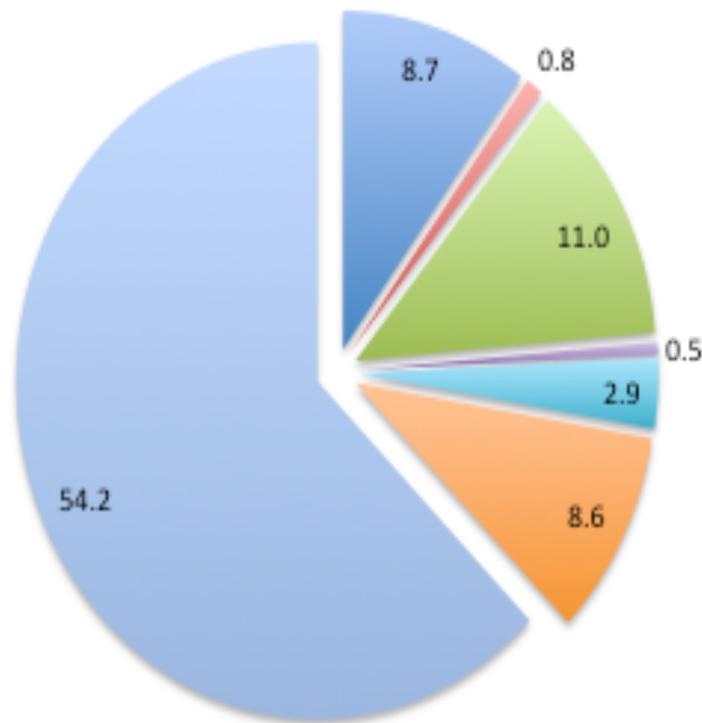
CIS

Africa

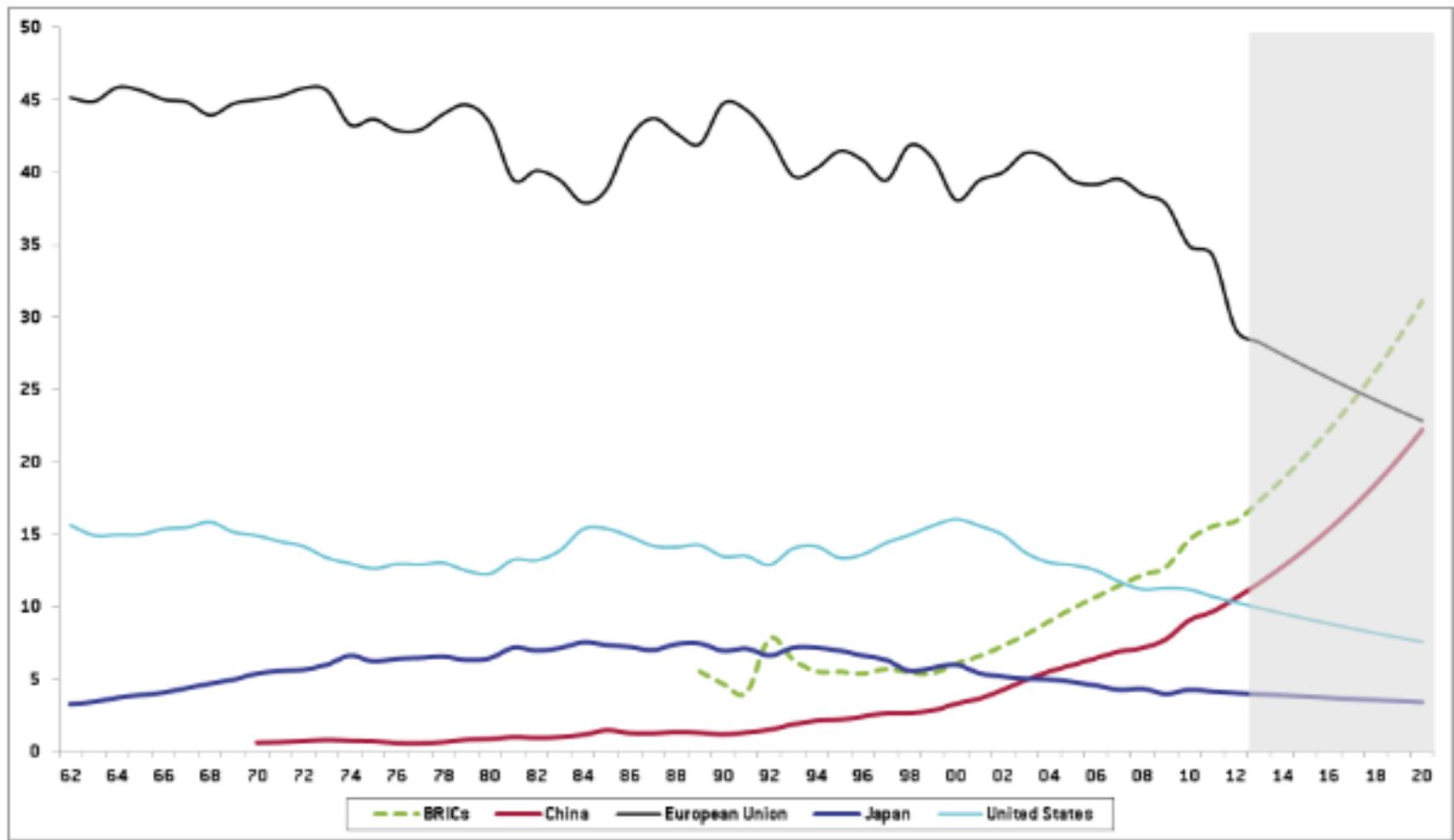
Middle East

Asia

2012



China & BRICS Will Dominate World Trade by 2020 (shares of global trade, %)



Source: Bruegel calculations based on World Bank data.

Tectonic Shift in Global Economic & Financial Geography Towards EMEs

- ✓ **GDP:** EMEs account for more than 50% of World GDP; Asia 26%
- ✓ **Trade:** Emerging markets account for 52% of world trade; Asia 34%;
- ✓ **Energy Markets:** OECD 40%; Non-OECD 60% (China dominant)
- ✓ **Tourism:** EME tourists & destinations increasingly dominant
- ✓ **Investments:** 45% of FDI flows into EMEs; 28% into Asia
- ✓ **New Wealth** being created in EMEs and will be deployed internationally;
Of top 10 SWFs by asset size, EME nations account for 42%!
- ✓ **EME Capital Markets:** 25% of World Equity by 2012 from 8% in 1999;
- ✓ ***But banking different so far:*** OECD 77% of global bank assets in 2013, 84% of insurance premiums & manage 91% of non-government funds

EME Shift: Implications for MENA/GCC

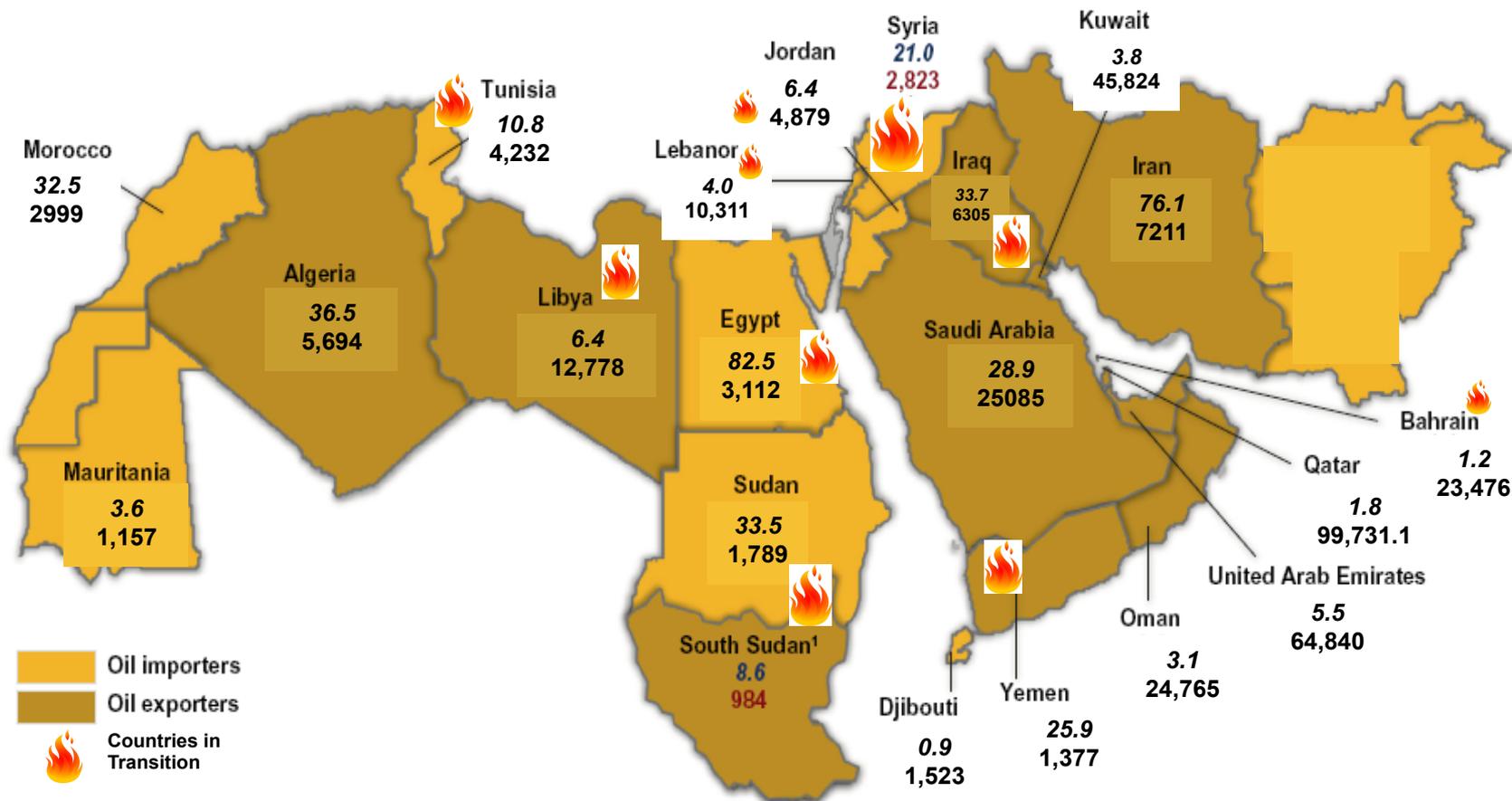
1. Shrinking share of global activity in advanced economies, expanding in EMEs/Asia: 2 growth drivers no longer 1
2. Radical change in Structure & Dynamics of Energy Market
3. Monetary Policy conflicts: GCC Peg to US\$ & US Monetary Policy vs. Business Cycle links to Asia
4. Re-orient Trade, Labour, Investment, Financial Policies & Linkages to the EMEs; Asia/Africa main economic partners
5. MENA needs to integrate its economies into ‘New Silk Road’ & new emerging supply chains

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MENA: Wide Differences in Wealth, Resources & Incomes

Population, millions (2012)
GDP per capita, USD (2012)



Source: IMF WEO database

Regional macroeconomic developments: growth, inflation & foreign assets accumulation in oil exporters; stressed economies in oil importers/transition countries

	2000-07 avg	2008	2009	2010	2011	2012	2013f	2014f
<i>Oil Exporters</i>								
Real GDP growth	6.1	4.7	2.3	5.9	4.6	5.4	1.9	4.0
Nominal GDP (USD bn)	910.6	1948.7	1653.3	1961.8	2389.2	2664.9	2542.1	2665.0
CPI	7.5	13.4	5.3	6.1	9.8	12.1	15.1	11.3
Non-oil fiscal balance as % of non-oil GDP	-30.2	-42.9	-40.4	-42.8	-45.0	-44.3	-42.0	-40.5
Current account balance (% of GDP)	13.4	18.4	4.3	10.1	18.6	17.4	13.9	12.4
Gross International Reserves	297.5	886.1	863.5	942.3	1086.2	1260.1	1386.2	1475.4
<i>GCC</i>								
Real GDP growth	5.9	7.8	0.9	6.4	7.7	5.2	3.7	4.1
Nominal GDP (USD bn)	568.5	1180.8	955.2	1139.6	1446.1	1577.2	1604.7	1661.8
CPI	2.2	8.4	2.8	2.6	3.1	2.4	3.2	3.4
Non-oil fiscal balance as % of non-oil GDP	-33.9	-40.3	-47.7	-52.3	-57.0	-52.3	-49.8	-46.8
Current account balance (% of GDP)	15.3	21.1	6.6	12.4	23.7	24.4	21.3	19.8
Gross International Reserves	166.2	514.0	485.8	543.7	631.9	774.9	885.8	983.0
<i>Oil Importers</i>								
Real GDP growth	5.1	5.7	3.8	3.9	2.4	3.0	3.1	2.9
Nominal GDP (USD bn)	366.9	641.2	675.3	741.1	753.0	782.5	808.1	835.2
CPI	4.9	12.9	10.4	8.6	9.9	9.4	8.3	8.7
Fiscal balance as % of GDP	-4.6	-5.5	-5.1	-5.9	-7.0	-8.4	-9.7	-8.0
Current account balance (% of GDP)	-0.8	-4.0	-4.6	-3.0	-3.5	-5.8	-4.8	-3.5
Gross International Reserves	64.7	125.4	137.8	149.1	121.8	99.1	99.3	110.5

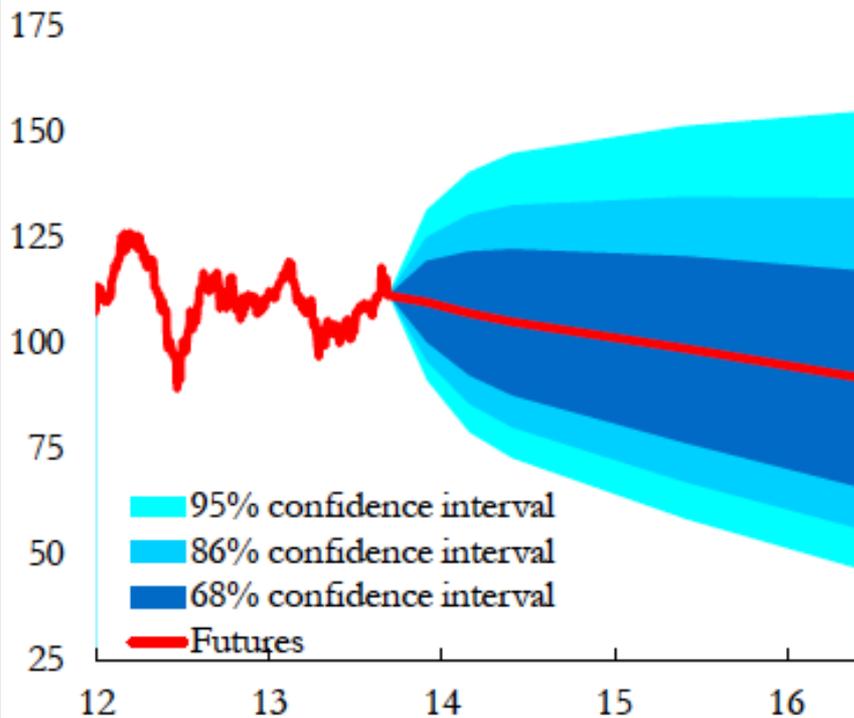
Source: IMF Regional Economic Outlook, Nov 2013

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Lower growth in Asia/China, shale oil/gas, available capacity & higher energy efficiency leading to downward prospects for oil prices

Oil price uncertainty¹

(U.S. dollars per barrel)

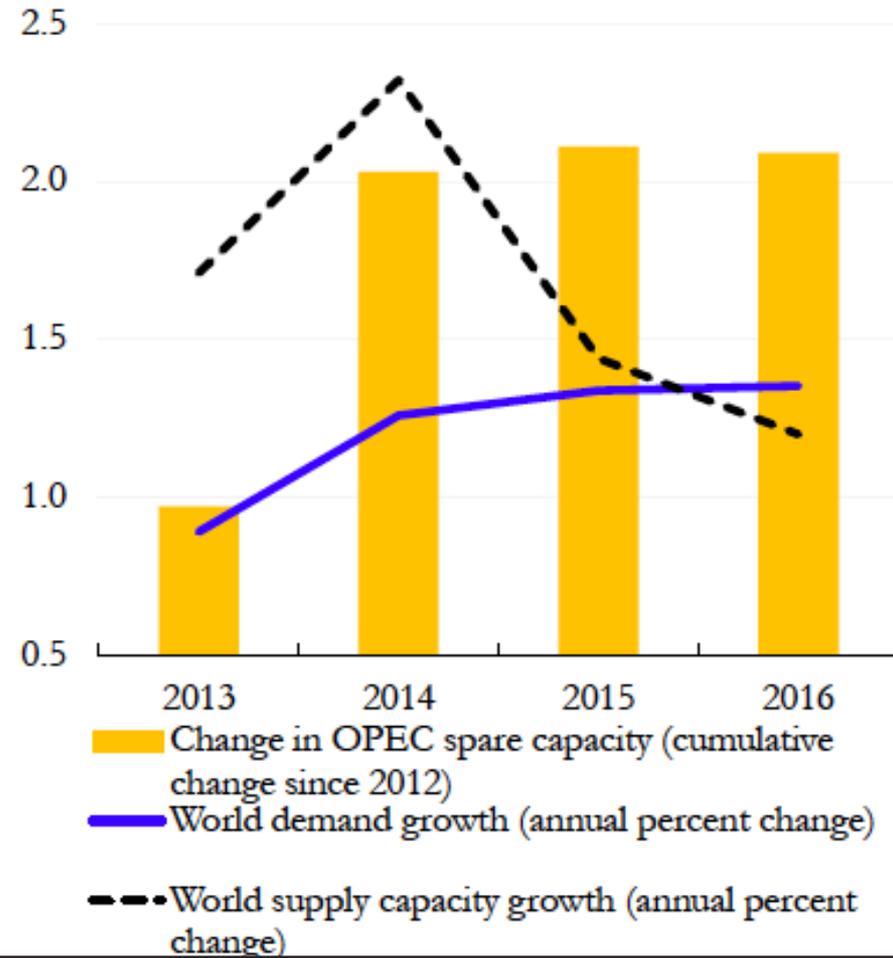


Sources: IEA Medium Term Oil Market Report (2013); IMF, Primary Commodity Price System; and IMF staff calculations.

¹Derived from prices of futures and options on Sep. 12, 2013.

Ample medium-term capacity

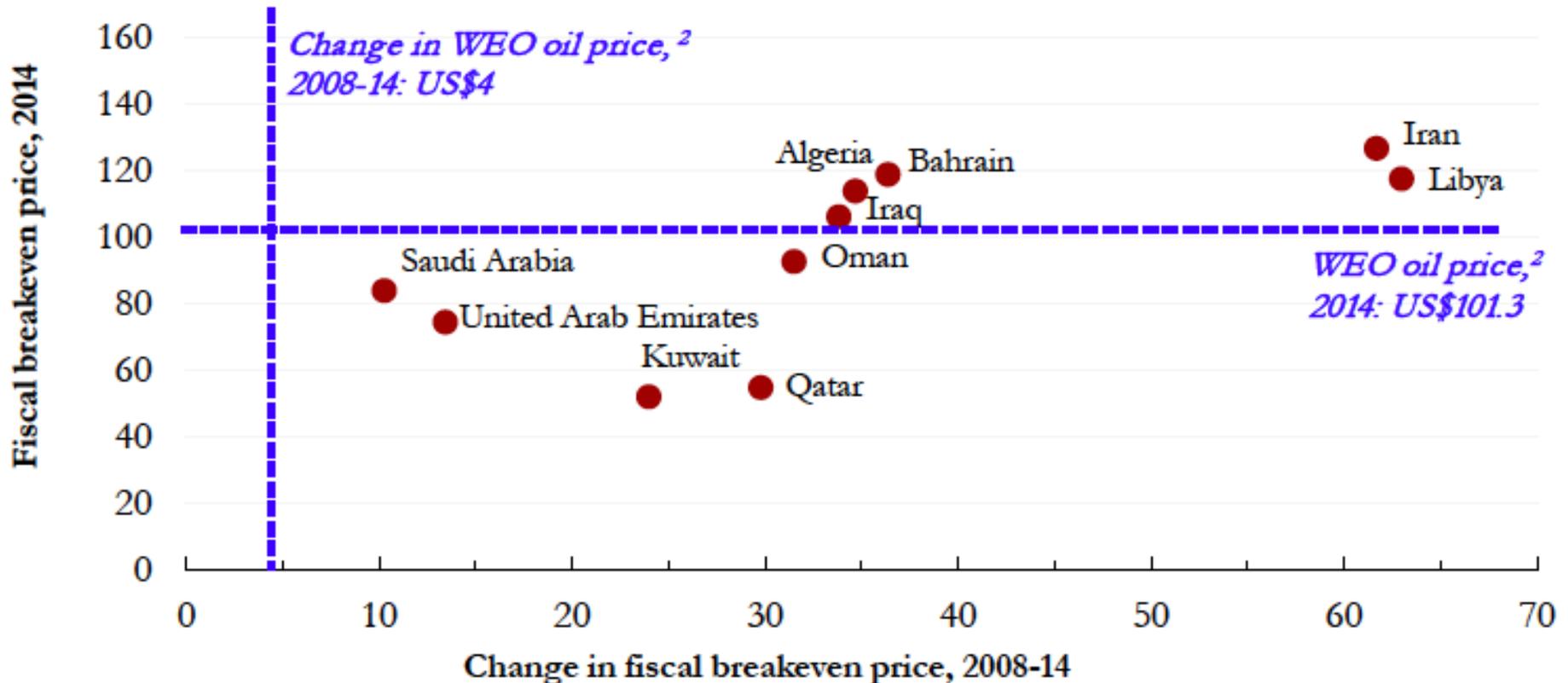
(Millions of barrels per day, 2013–16)



High growth of government spending in oil exporters implies higher fiscal breakeven oil prices & threatens fiscal sustainability

Fiscal Breakeven Prices

(U.S. dollars per barrel)¹

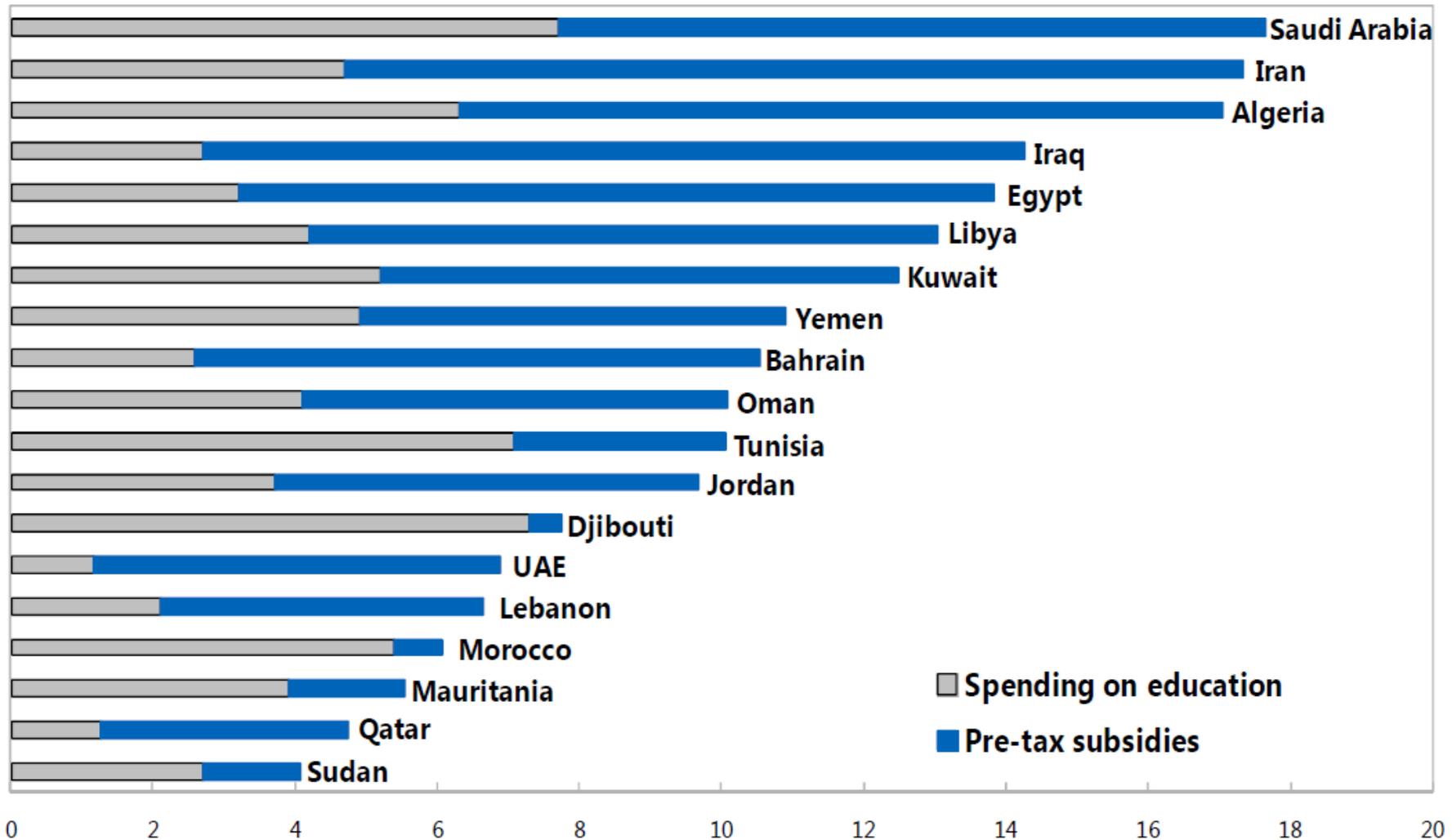


Source: IMF Regional Economic Outlook, Nov 2013

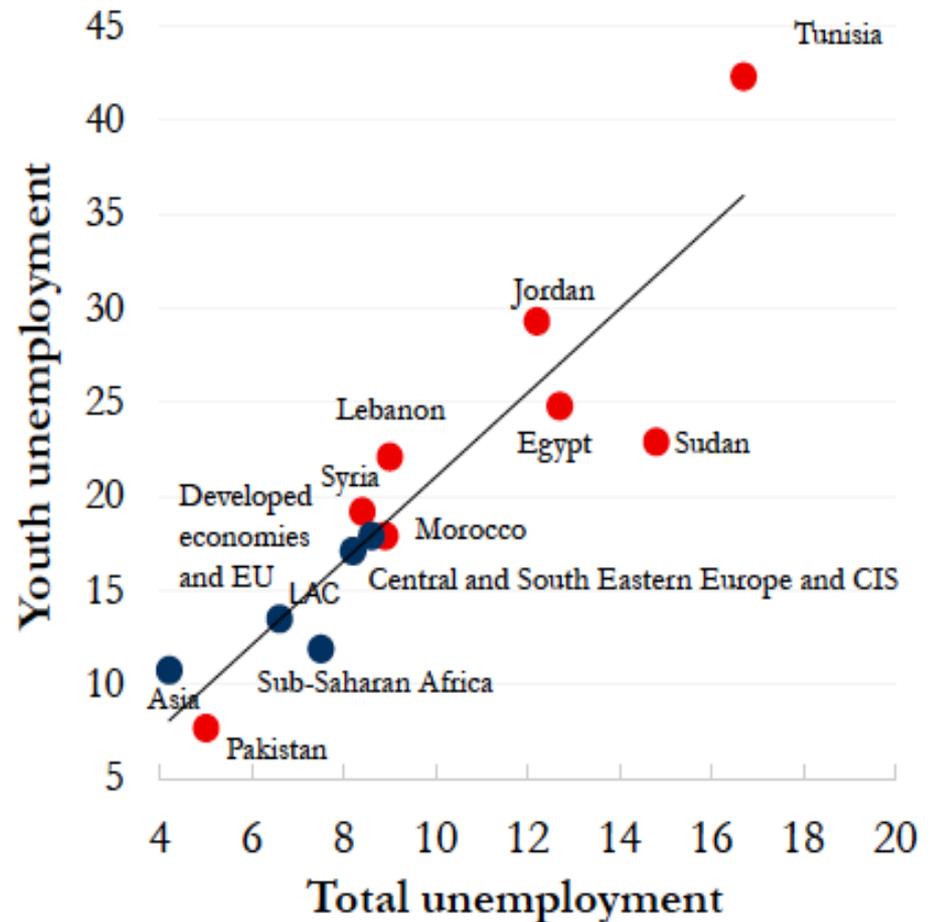
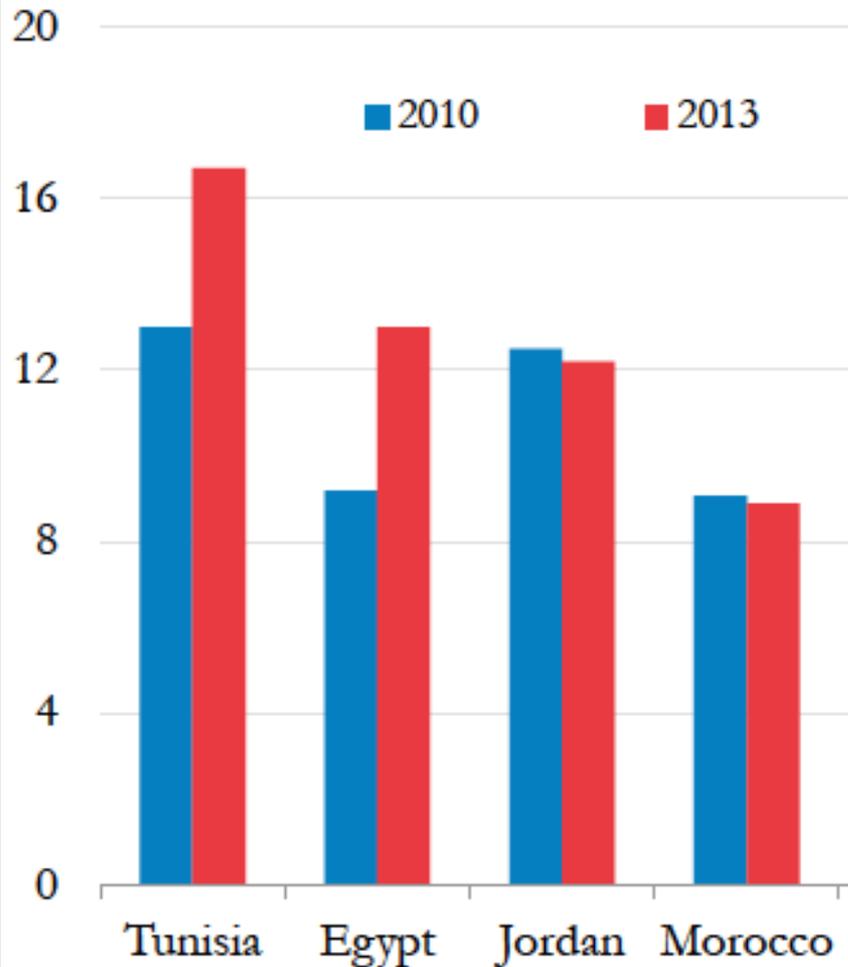
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MENA Energy Subsidies cost \$240bn: 8.5% of regional GDP, or 22% of government revenue. Despite young populations, more spent on subsidies than education!

In % of GDP

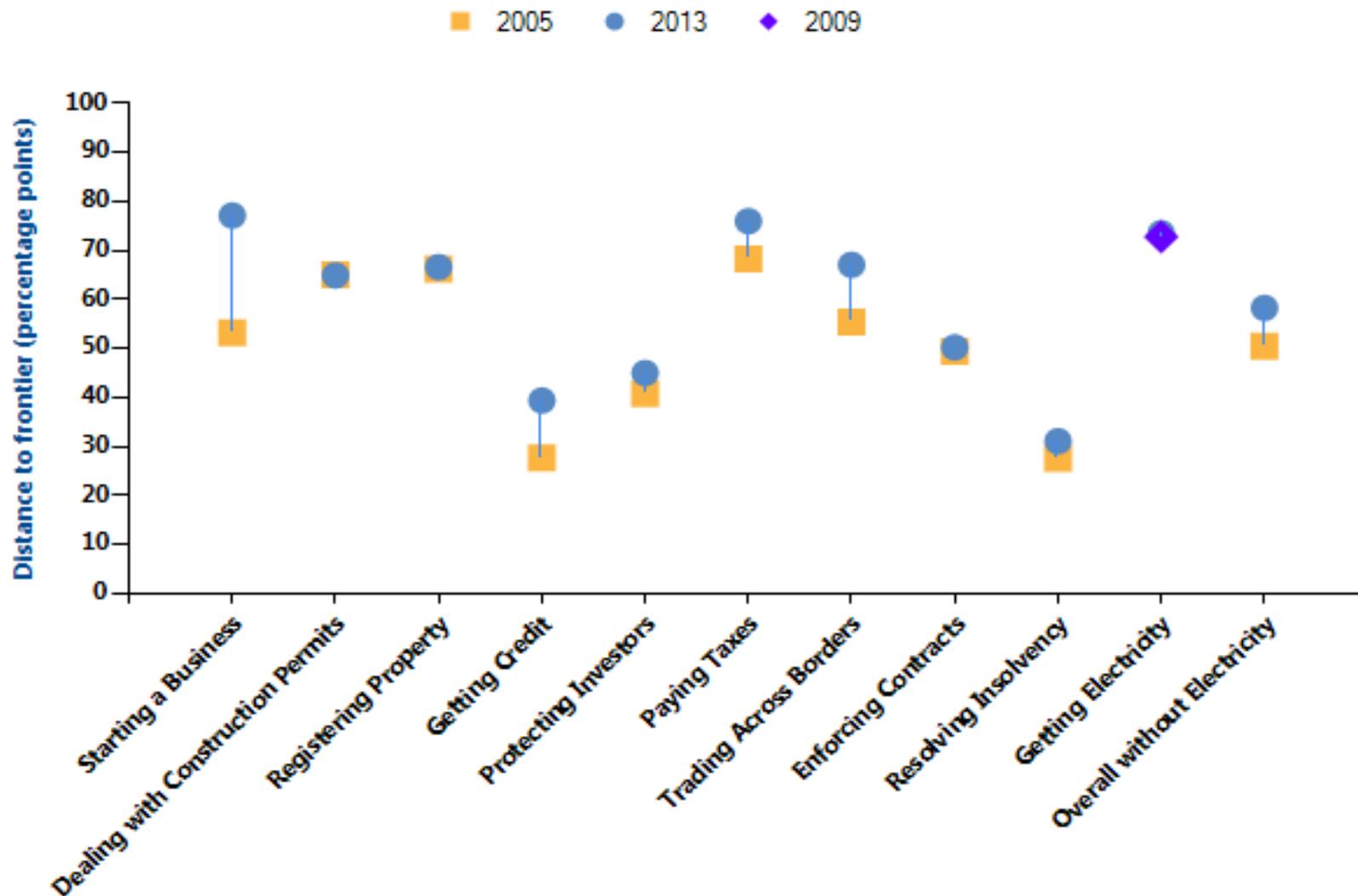


Job Creation & High Unemployment Rates: Main Economic Policy Concern in MENA



Source: IMF Regional Economic Outlook, Nov 2013

Much Room For Improvement in Doing Business



Economic Policy Challenges in MENA

GCC

1. Economic Diversification
2. Fiscal Sustainability
3. Over-dependence on Energy Subsidies
4. Job Creation & Private Sector Participation

Arab Firestorm Nations

1. Macroeconomic stability
2. Job creation & “Pull-Up”/”Trickle Down”
3. Reduce subsidies & Increase Capital Expenditures
4. Cost of Doing Business & Investment Barriers

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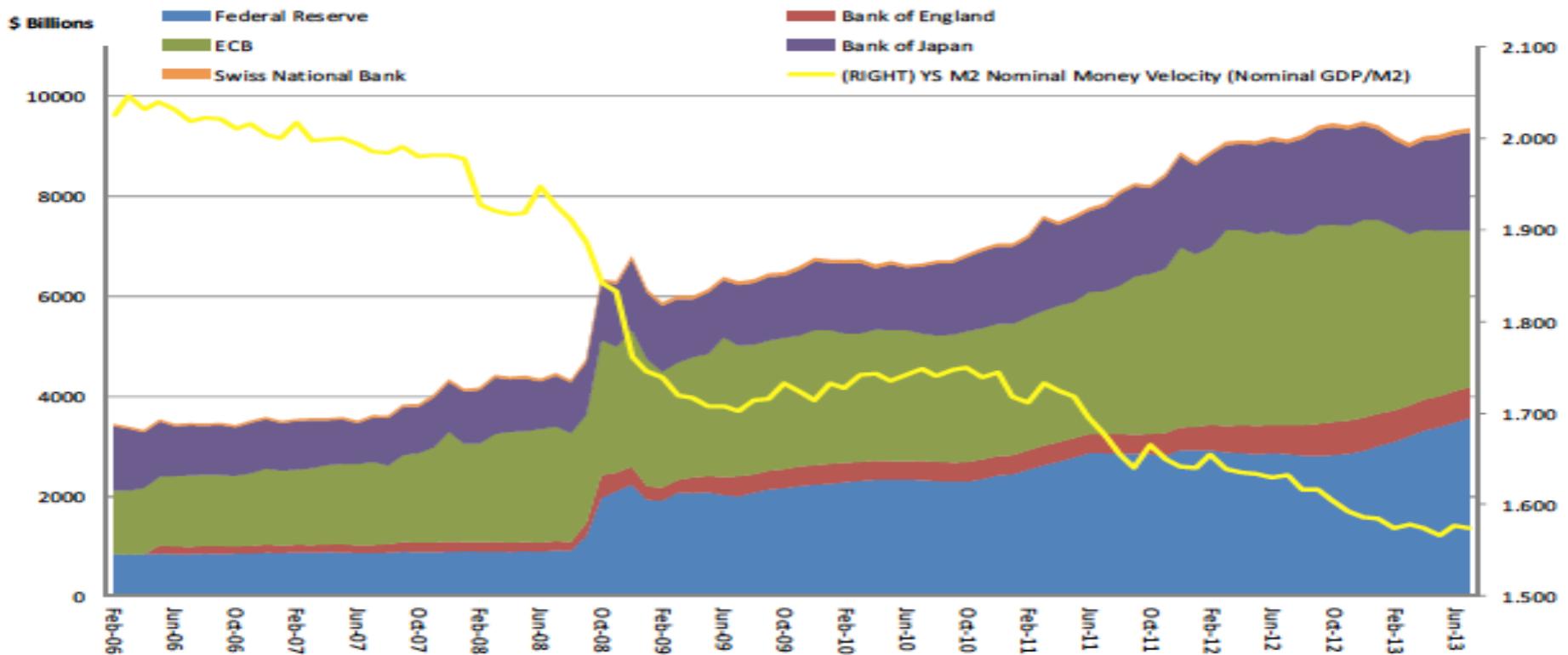
GFC Aftermath: “Unconventional Monetary Policy” & Growing Regulation

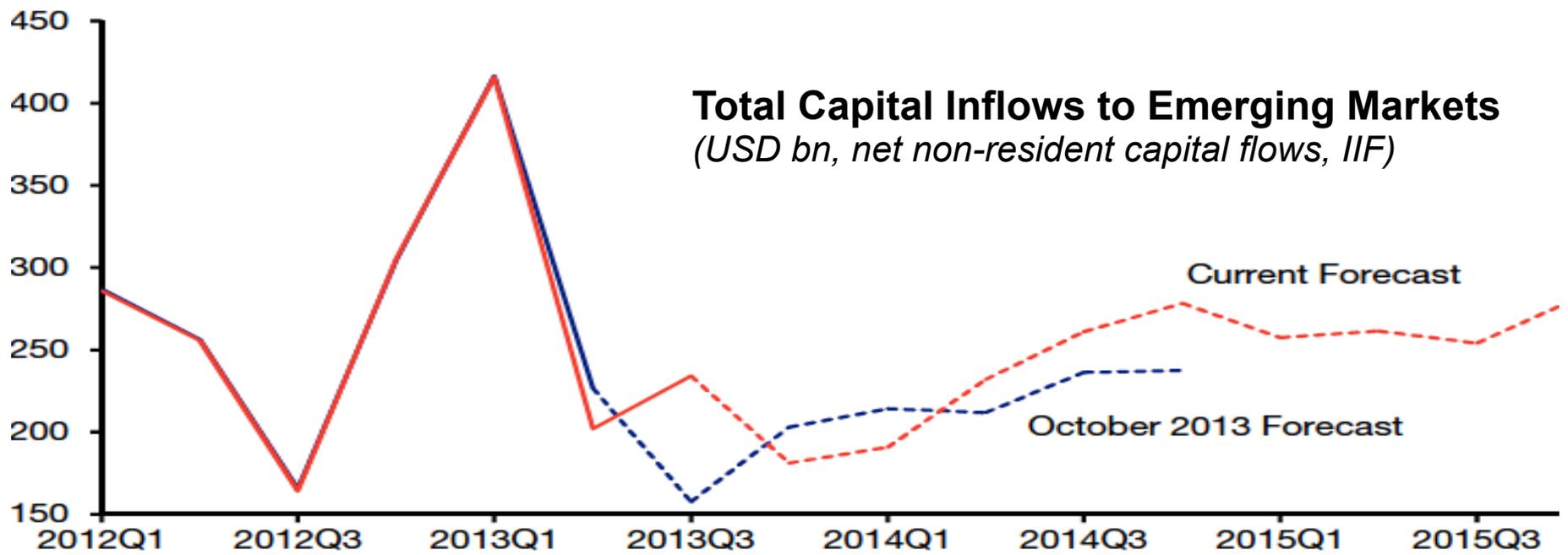
- Monetary Policy in Advanced Economies:
 - Ultra-Low Interest Rates
 - Liquidity Facilities
 - Credit Facilities
 - Large-Scale Asset Purchases or “QE”:
 - “Forward Guidance” or expectations management
- Lower rates saved US & European governments some \$1.8 tn and non-financial corporations saved \$740bn over 2007-2013Q2 and encouraged borrowing. Rising rates will lead to large fiscal cost.
- Emerging economies also benefited from access to cheap capital
- Volatile capital flows to EMEs with vulnerable macro conditions

Source: “QE and ultra-low interest rates: Distributional effects and risks”, McKinsey Nov 2013 & “When Easy Money Ends”, Project Syndicate Jan 2014.

Bloated CB Balance Sheets Grew \$4.9tn since 2007: Deleveraging Source of Next Financial Crisis

- Unprecedented money & credit splurge led to ‘bubbly’ asset prices but has not resulted in economic recovery/ job creation despite ultra-low interest rates;
- As interest rates edge higher, government & household debt service costs will rise while asset & bond prices fall threatening financial stability



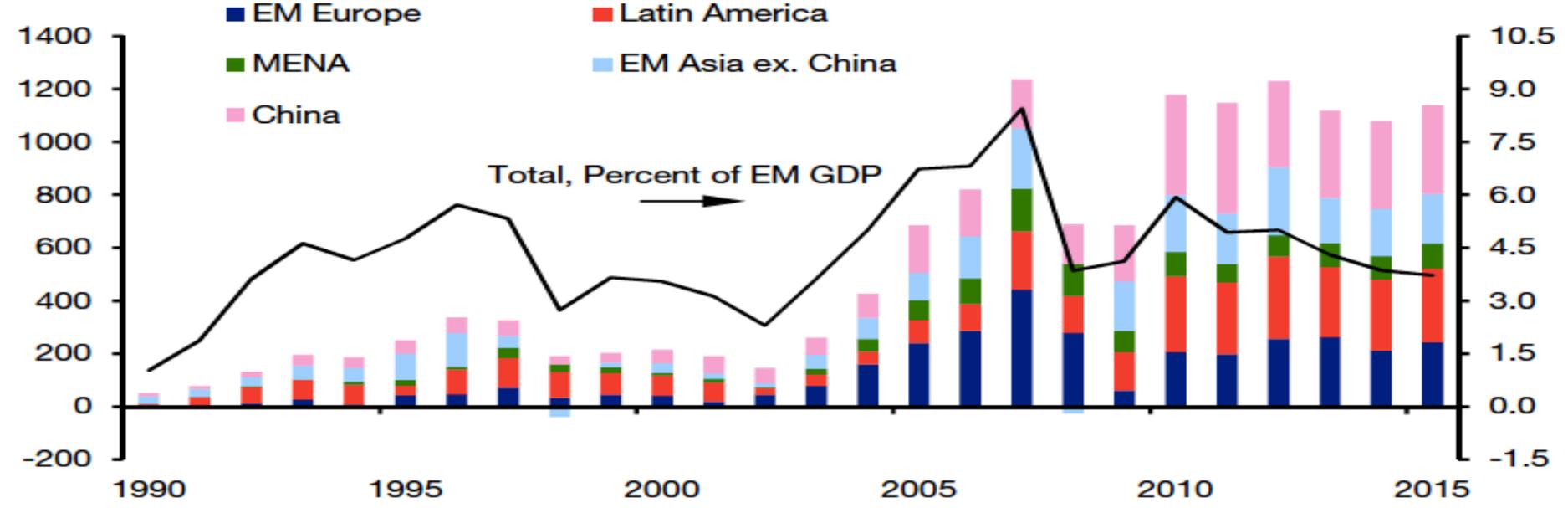


Emerging Market Private Capital Inflows, Net

Source: Capital Flows to EMEs, IIF, Jan 2014.

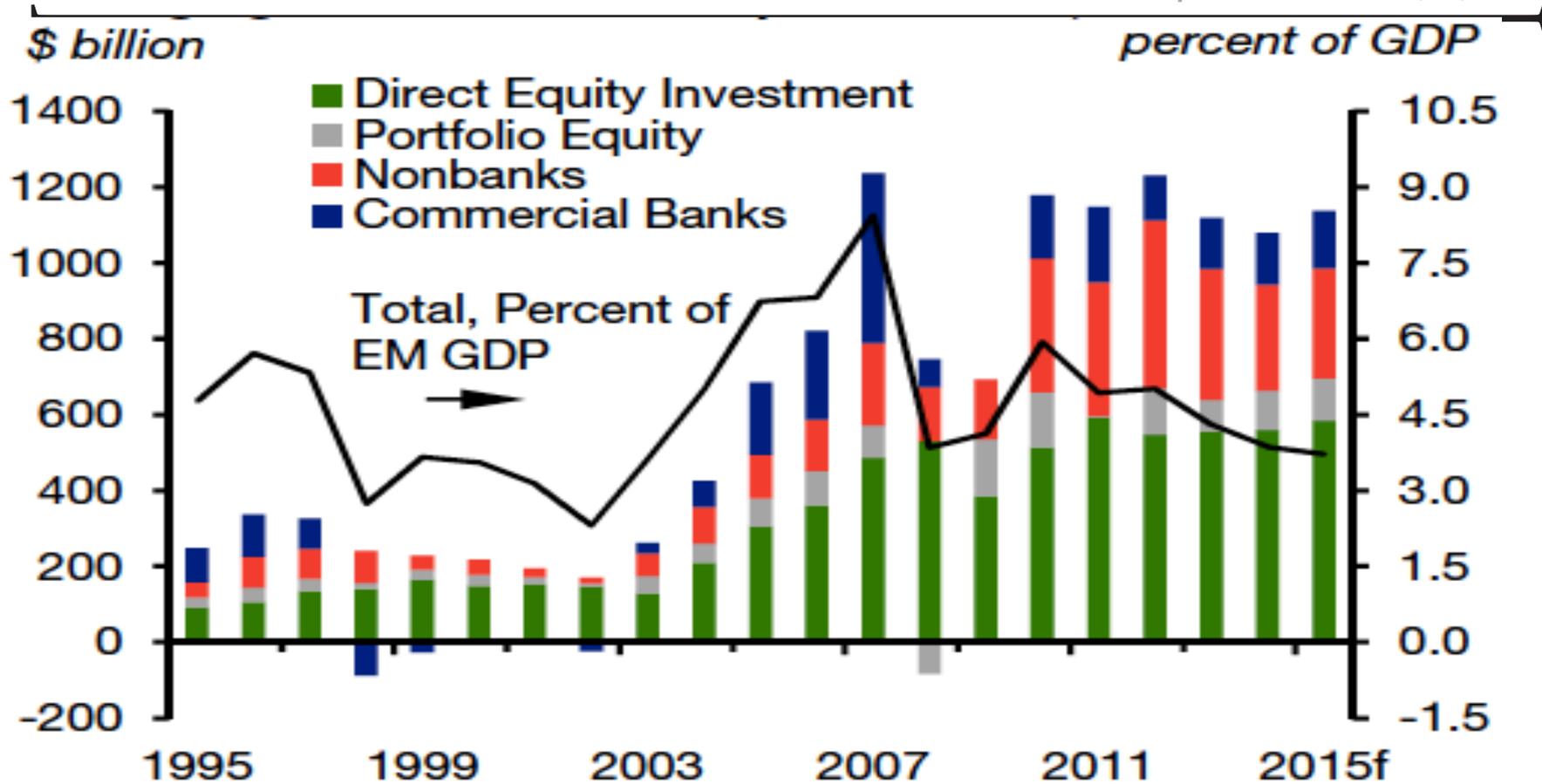
\$ billion

percent of EM GDP



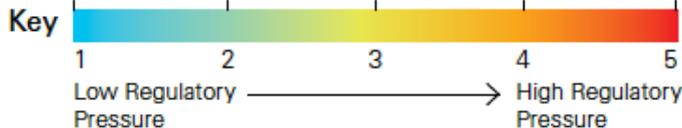
EME Private Capital Inflows: Growing Role of Non-Banks

Source: Capital Flows to EMEs, IIF, Jan 2014.



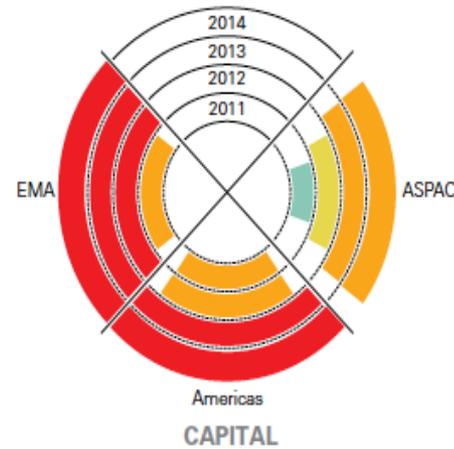
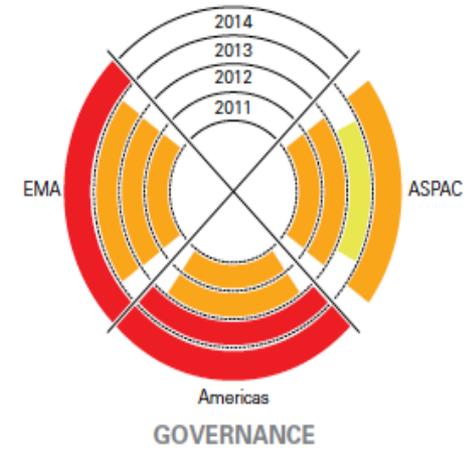
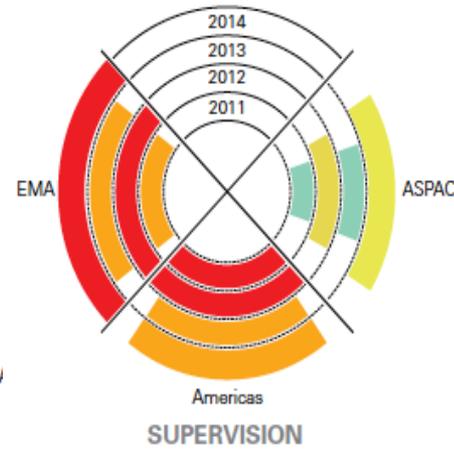
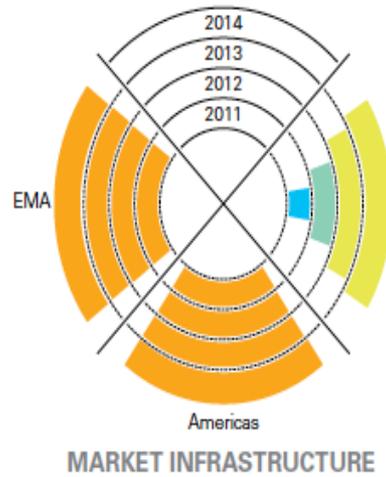
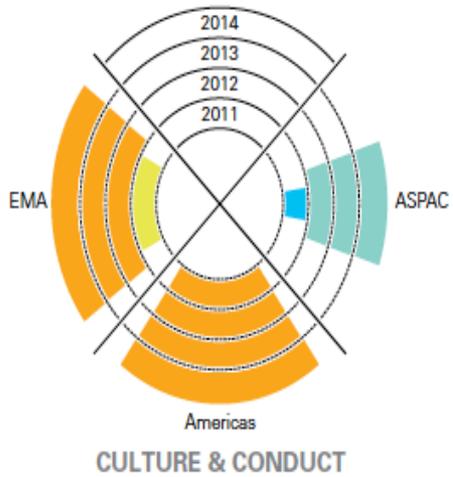
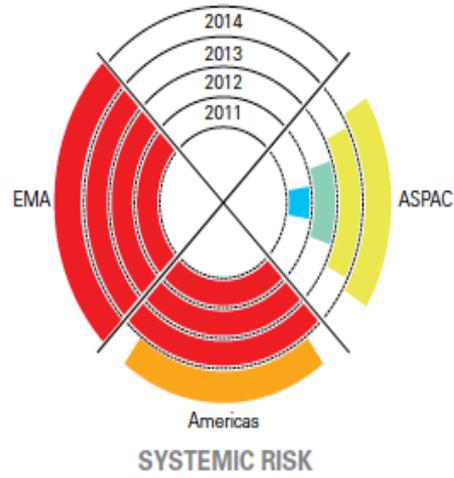
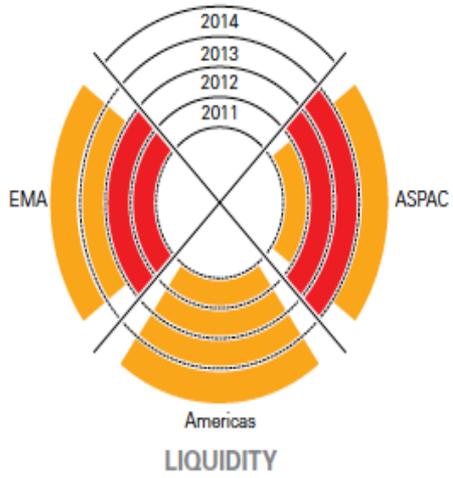
Equity inflows over 2014-15 period are projected to be around 3.75% higher than 2012-13, equally driven by higher FDI & portfolio equity inflows

REGULATORY CHANGE – REGIONAL DIVERGENCES



Source: "Evolving Banking Regulation 2014 - Europe, Middle East and Africa Edition", KPMG, Feb 2014

Areas of Regulatory Pressure



Source: "Evolving Banking Regulation 2014 - Europe, Middle East and Africa Edition", KPMG, Feb 2014

Cross-border Lending Activity in Frontier Markets

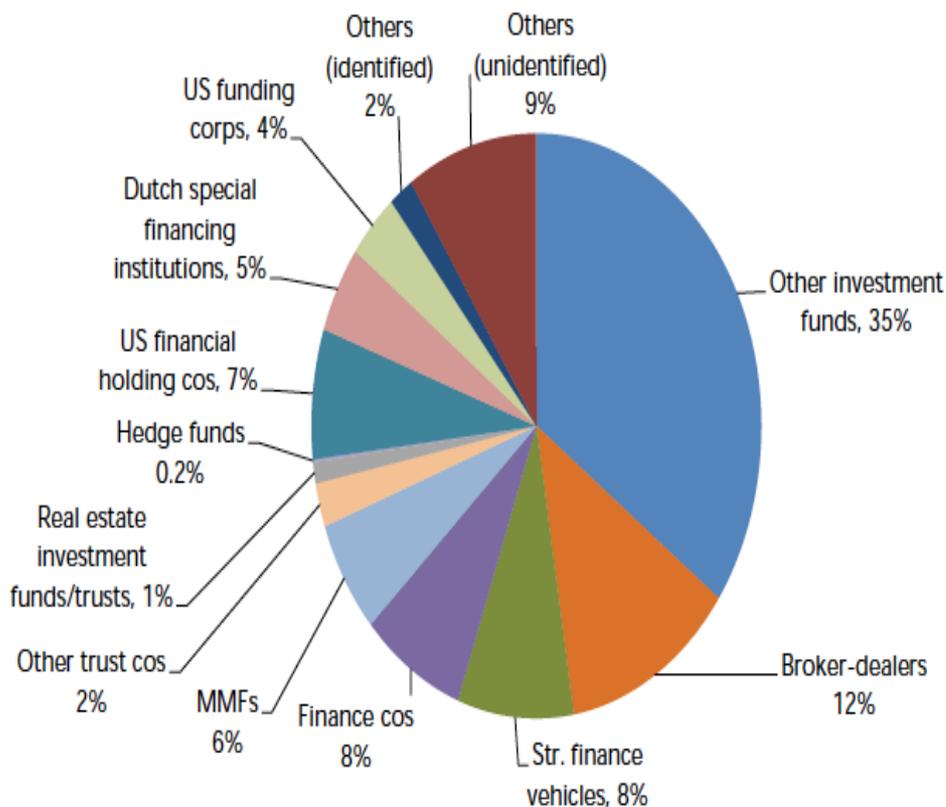
- Advanced economy banks facing 4 Rs: Regulation, Re-capitalisation, Retrenchment & Restructuring
- Banks in developed countries adjusting to new regulatory frameworks in part by cutting back cross-border lending activities: frontier markets recorded \$90bn of net banking outflows between 2009 and 2012—more than 2% of their GDP.
- Magnitude of these outflows has been largest for those countries with close ties to Euro Area banks: Frontier markets in MENA (-\$54bn in total since 2008) and Eastern Europe (-\$39bn) have been significantly affected by reversals of banking flows.
- Cross-border banking flows to Asian frontier markets recovered over time as regional emerging market and Japanese banks stepped in. Similar process in MENA, but delayed by political turmoil & unrest

Agenda

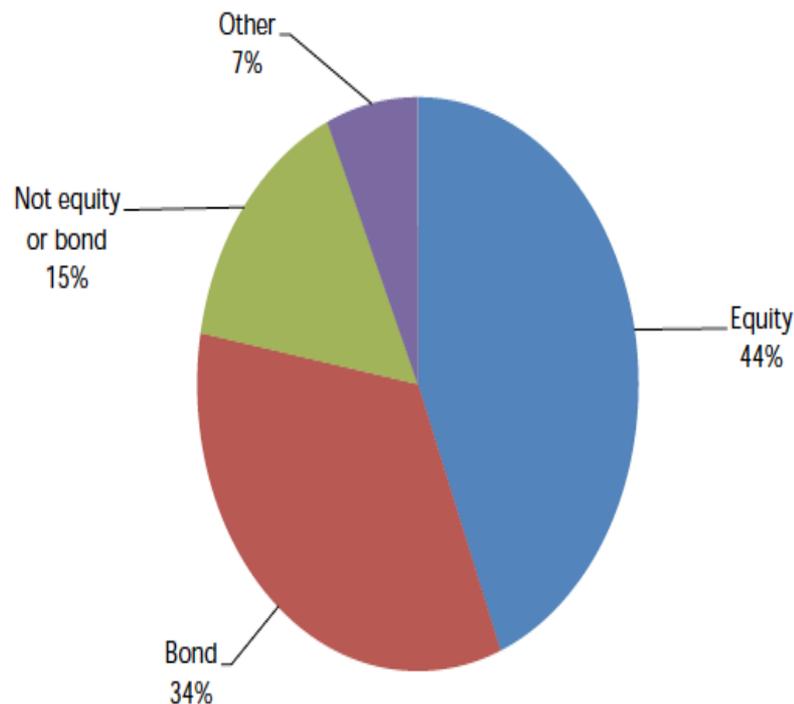
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Composition of Non-Bank Financial Intermediaries

Decomposition by sub-sector¹

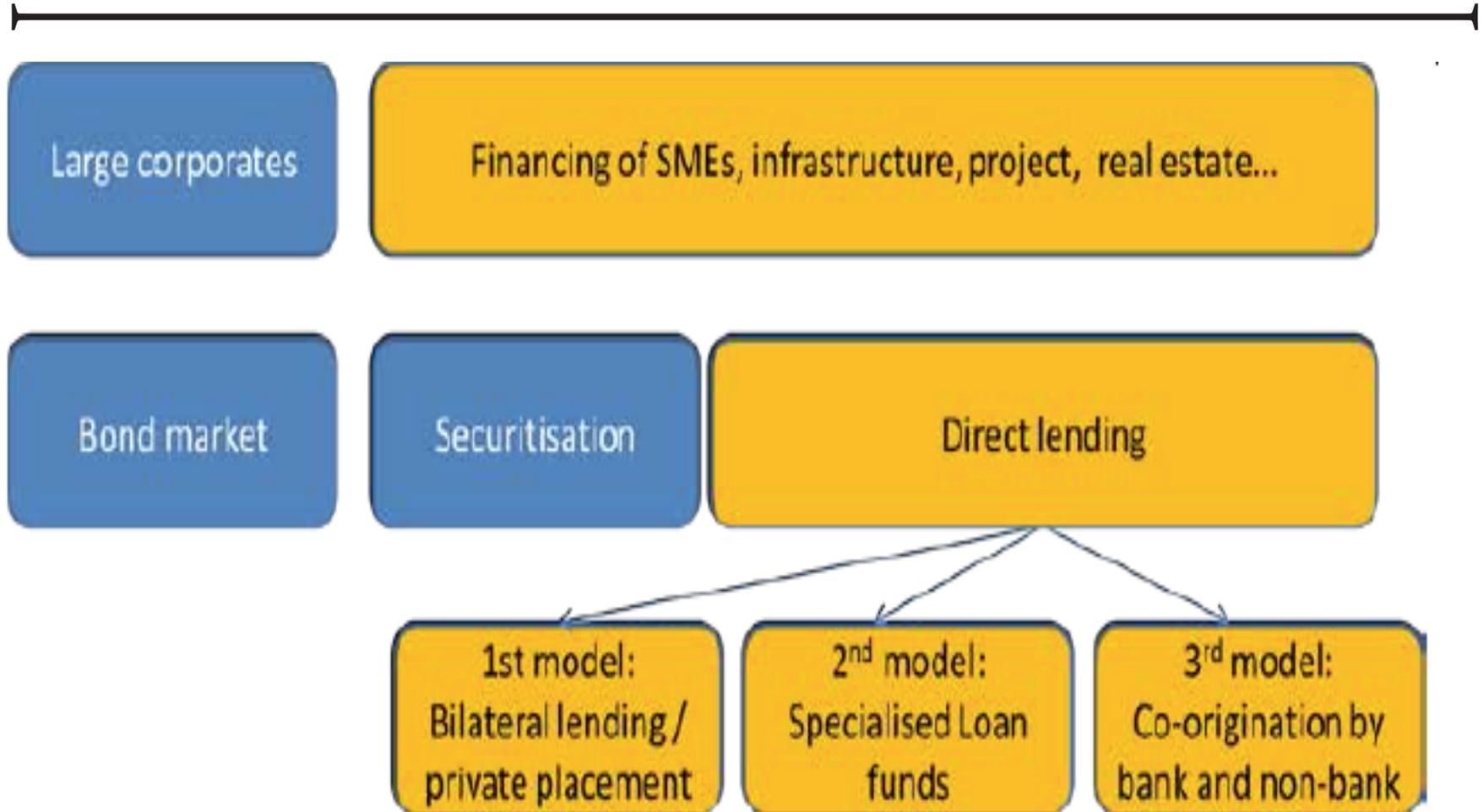


Other investment funds by type

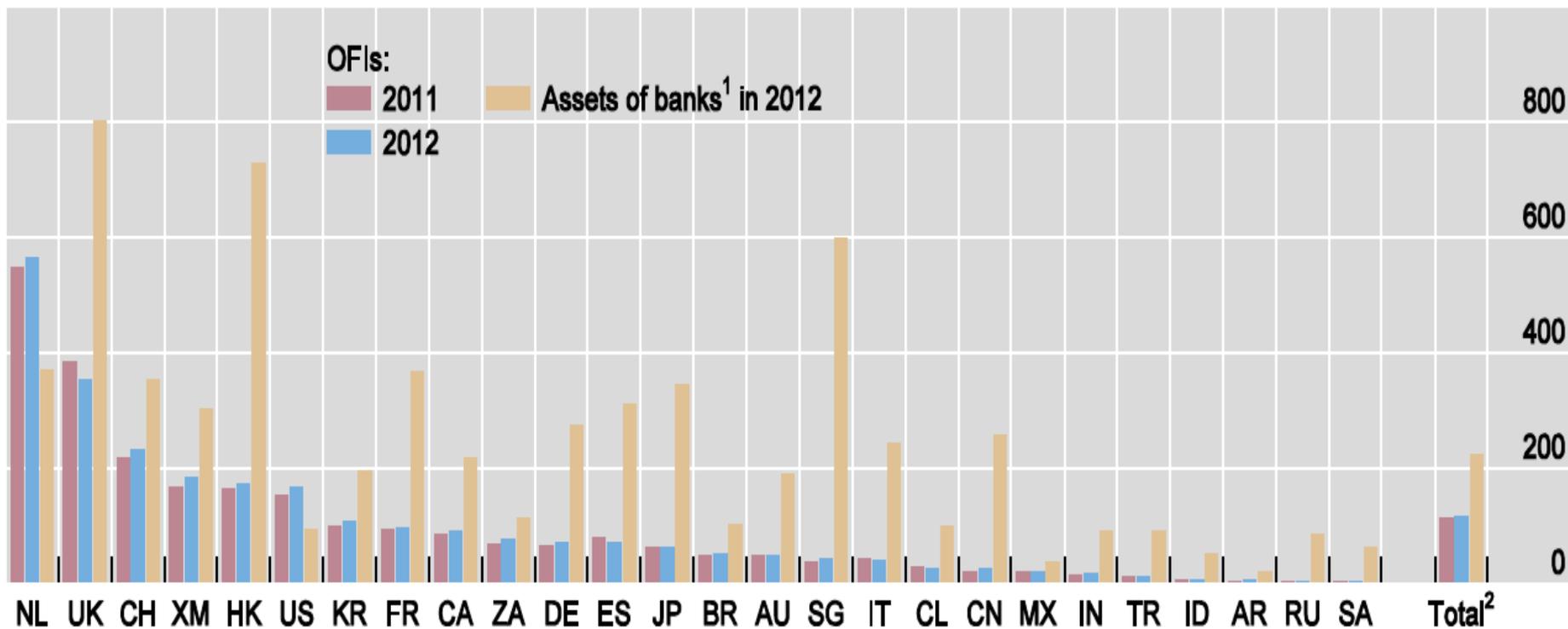


Source: Financial Stability Board, Nov 2013.

Market structures for direct lending by non-banks



Regulatory Net will Extend if NBFIs become source of Systemic Risk *(as % of GDP)*



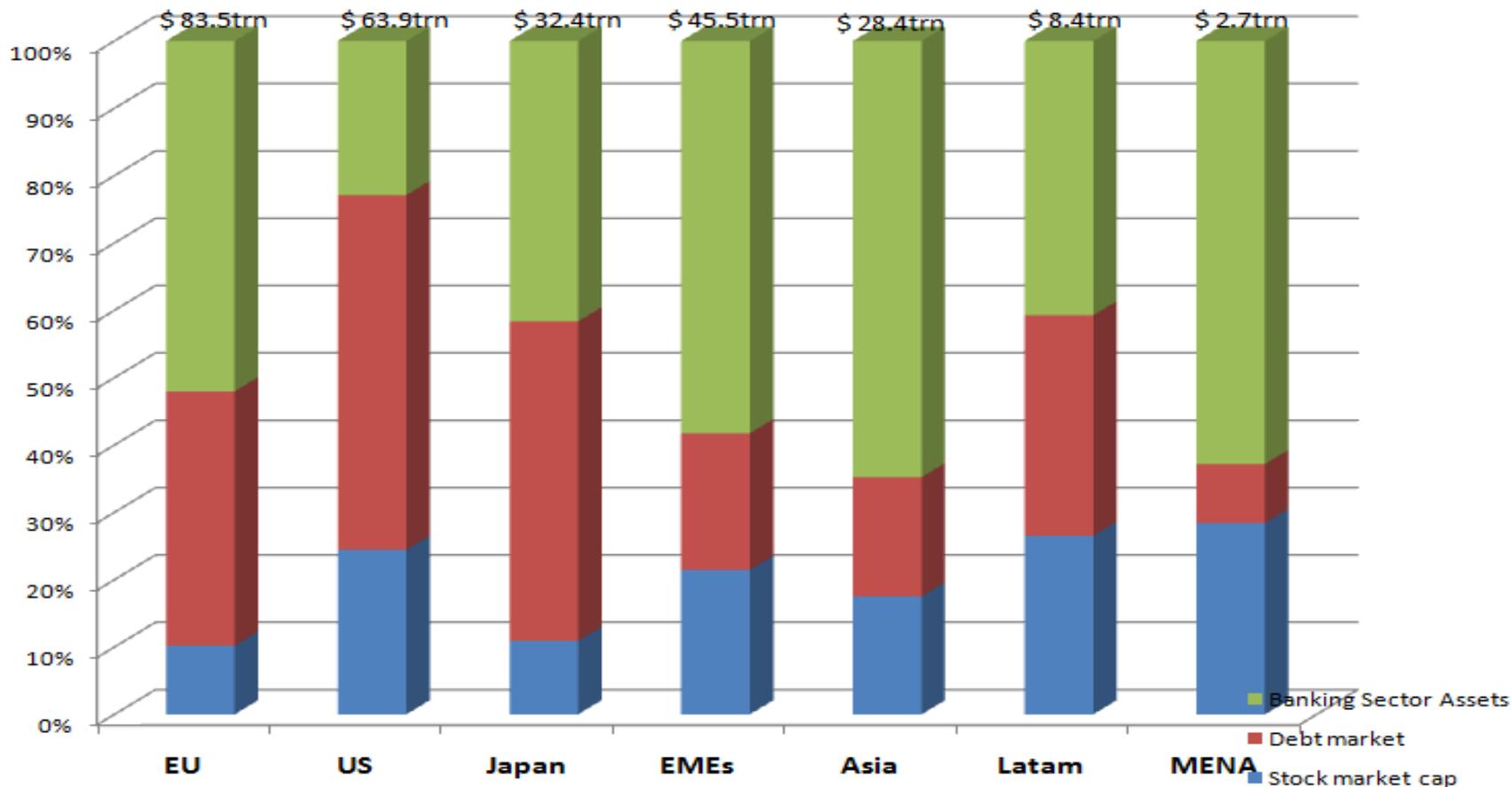
AR = Argentina; AU = Australia; BR = Brazil; CA = Canada; CH = Switzerland; CN = China; CL = Chile; DE = Germany; ES = Spain; FR = France; HK = Hong Kong; ID = Indonesia; IN = India; IT = Italy; JP = Japan; KR = Korea; MX = Mexico; NL = Netherlands; RU = Russia; SA = Saudi Arabia; SG = Singapore; TR = Turkey; UK = United Kingdom; US = United States; XM = Euro area; ZA = South Africa.

¹ Note that 'banks' refer to the broader category of 'deposit-taking institutions'. ² 20 jurisdictions and euro area.

Highly Diverse Structure of Regional Financial Markets

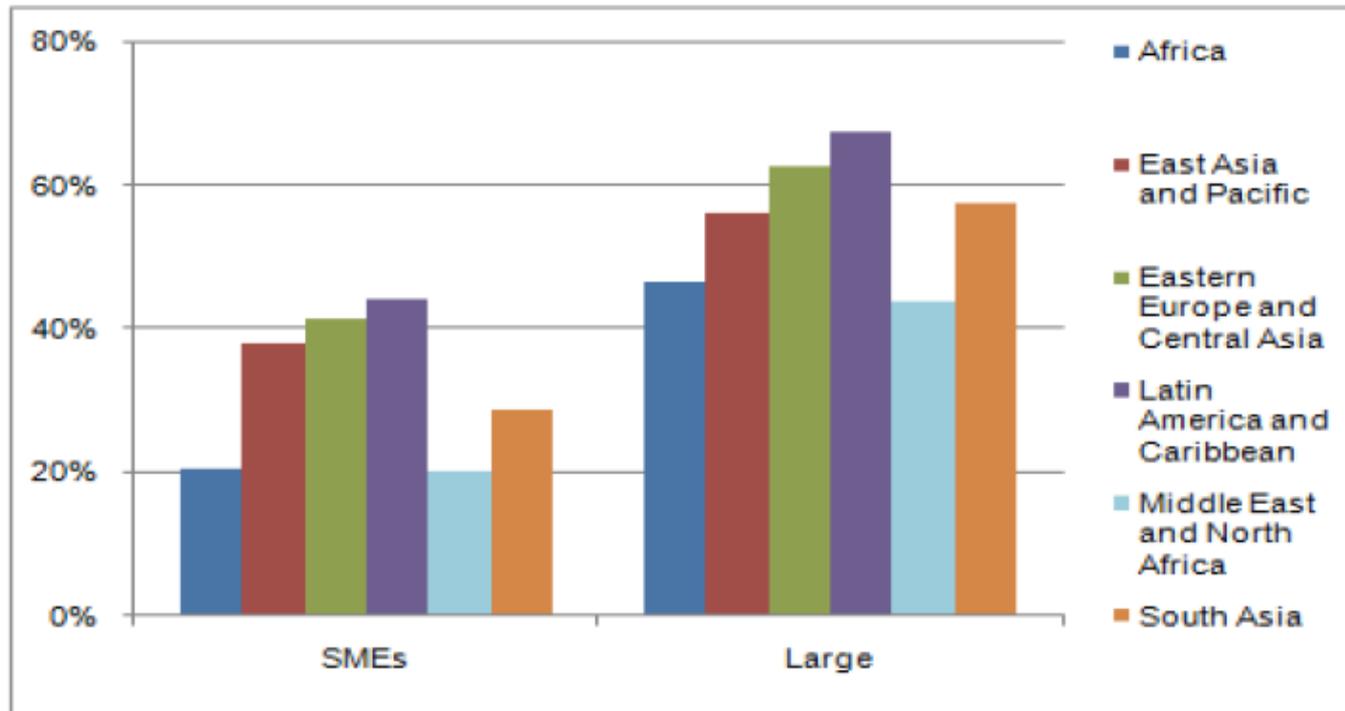
Banks continue to dominate the financial structure in the MENA region:

Banks: 62.8%; Equity market: 28.43%; Debt markets: 8.76%

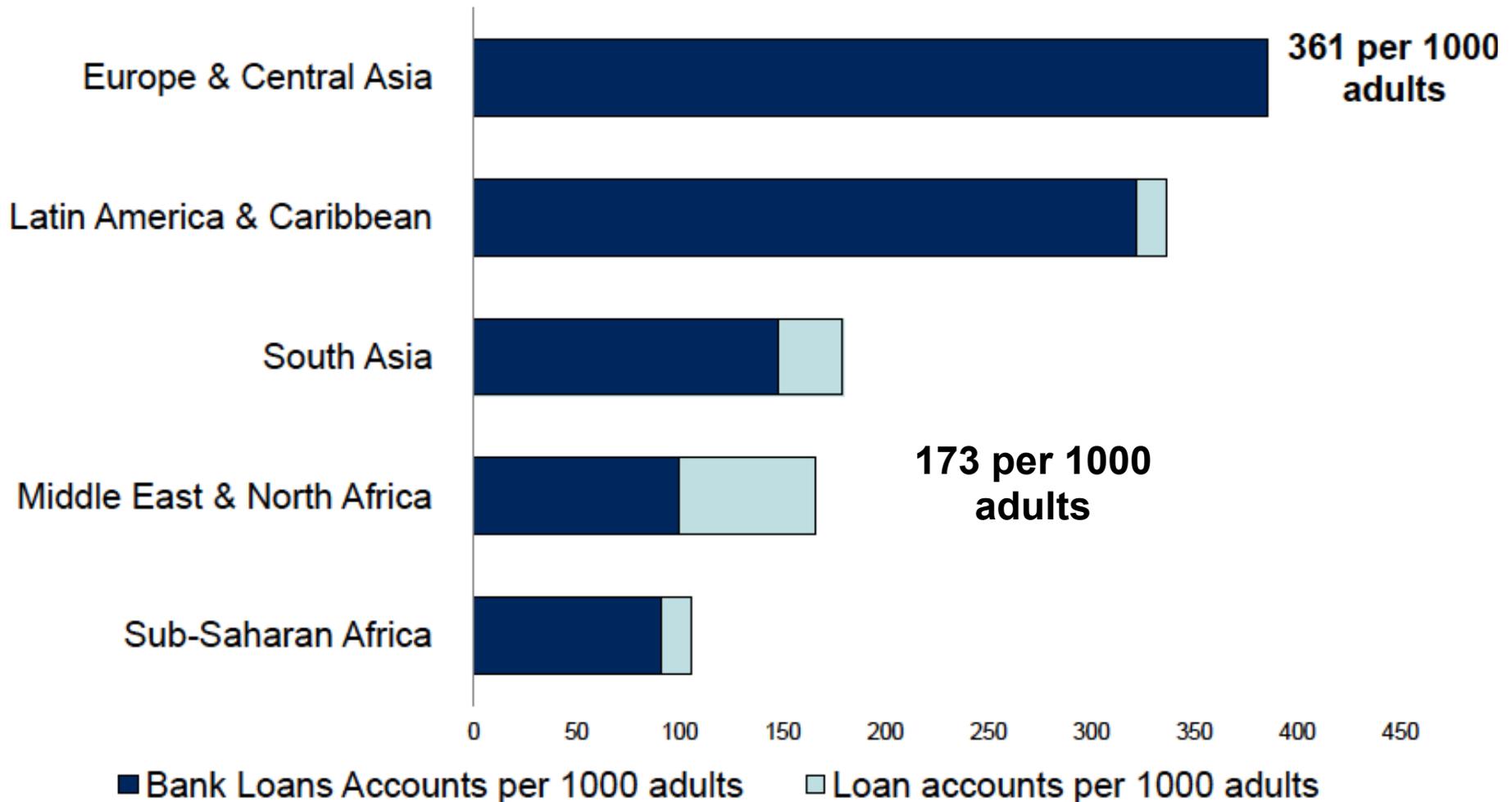


MENA Financial Wealth & Liquidity Does Not Translate Into Corporate Finance

% of Firms with a Loan/Line of Credit from Financial Institution, MENA and other Regions



Access to Loan Accounts in MENA



Need to Develop Local Currency Money & Debt Capital Markets in MENA region

- Deeper bond/Sukuk markets in local currencies allow:
 - Open economies to **better absorb volatile capital flows**;
 - **Provide institutional investors with instruments** that satisfy their demand for safe and stable long-term yields;
 - **Reduce financial instability associated with asset price bubbles**;
 - **Finance reconstruction** (\$1.2 tn) & **infrastructure** (\$2.8 tn) over 10 yrs
- **Creates a yield curve**: price financial assets transparently + provides monetary policy tools + enables development of risk management techniques
- Banks facing regulatory pressure cannot provide **long-term finance for development & infrastructure projects**
- Oil-rich GCC nations should finance infrastructure by issuing securities backed by future cash flows from the infrastructure services

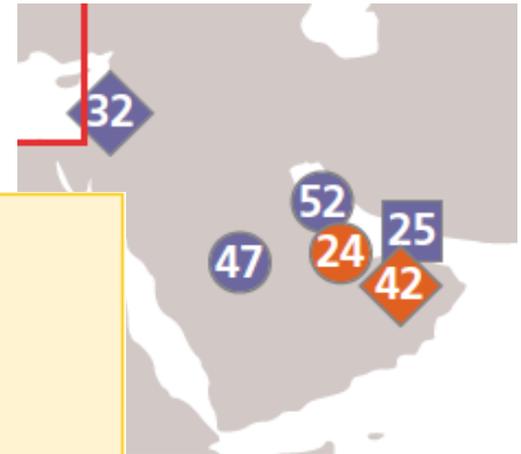
EIU Survey Findings on Financial Services

Survey questions	Agree	Neither agree nor disagree	Disagree
Five years after the financial crisis, banks in my market are less likely to fail because of stricter capital rules, ring-fencing and other reforms	70.4%	14.5%	15.1%
Investors worldwide will continue to flock to low-cost options such as index funds and exchange-traded funds	66.0%	23.3%	10.7%
Key financial centres like New York and London will lose ground to China/Hong Kong, Singapore and developing countries	58.6%	17.1%	24.4%
Banks in my market ought to be closing branches and shifting to alternative such as online and mobile banking	51.0%	21.9%	27.2%
The global market for initial public offerings will come roaring back in 2014 and regain the high levels of activity last seen in the middle-2000s	41.1%	27.8%	31.1%
Big European and North American financial groups will pull back from developing/emerging markets in the coming years	40.1%	15.8%	44.1%

Source: Industries in 2014, EIU report.

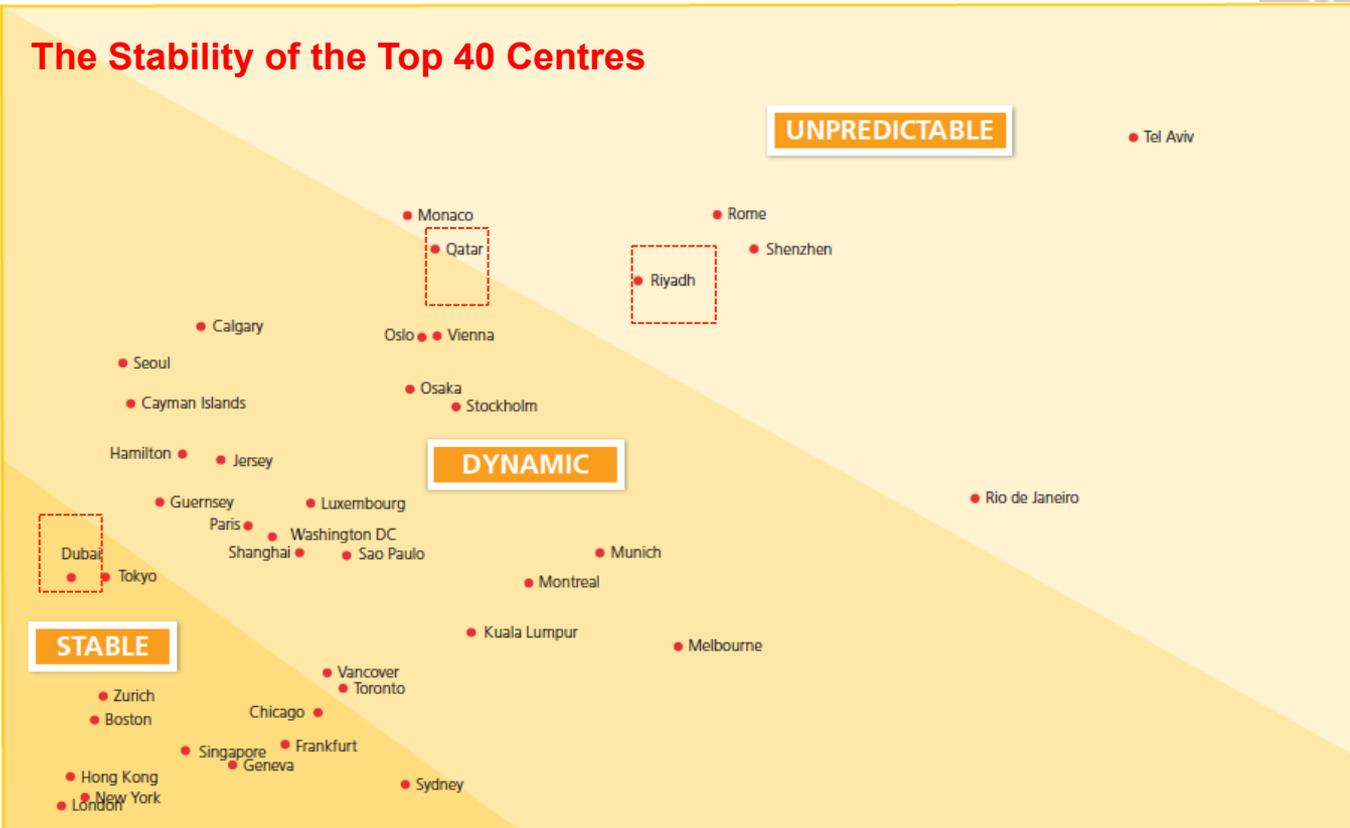
Regional Financial Centres

GFCI 2014 report shows that **Qatar** and **Dubai** are only one point apart as the most competitive centres in the region. **Abu Dhabi** is likely to be present next time.



The Stability of the Top 40 Centres

Increasing variance of assessments



- Relatively deep
- Global specialists
- Transnational specialists
- ◆ Local nodes
- Emerging
- Global contenders
- Transnational contenders
- ◆ Evolving centres

Source: Global Financial Centres Index 2014.

Non-bank financial sector development in MENA

- ✓ In most of the region, the wider nonbank financial sector - comprising the stock market, corporate bond market, insurance companies, pension funds, and mutual funds is under-developed.
- ✓ Specialised banks, insurance companies, mutual funds and pension funds are better developed in Morocco, and to a lesser extent in Tunisia. In Morocco, the insurance sector represents 11% of the total assets.
- ✓ Relatively, non-banking financial companies are rare in the GCC. The largest ones are in the UAE, where the two biggest companies were restructured and have a market share of only 3% in the total of loans granted, including in the banking sector
- ✓ Investment funds have grown rapidly in several Gulf countries, although they tend to remain largely focused on domestic capital and real estate. Investment companies in Kuwait have experienced a checkered history
- ✓ Derivatives markets have yet to develop in the GCC

GFC & New Economic Geography require a paradigm shift & 'Alternative Finance'

- Shift in Economic Geography Requires Shift in Financial Intermediation towards EMEs, Asia
- New International Financial Architecture with Regional Financial Centres
- Change in International Governance
- New International Monetary Architecture with Yuan as 3rd global currency
- Need to develop Local Currency Financial Markets & Non-Bank Financial Intermediation

But wise men perceive approaching things

Men know what is happening now.
The gods know the things of the future,
the full and sole possessors of all lights.
Of the future things, wise men perceive
approaching things. Their hearing
is sometimes, during serious studies,
disturbed. The mystical clamor
of approaching events reaches them.
And they heed it with reverence. While outside
on the street, the peoples hear nothing at all.

Constantine P. Cavafy (1915)

Thank you

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