

Growth, Turmoil & Transformation in the MENA region

Keynote Address @ SuperReturn Middle East

**Dr. Nasser Saidi
20 October 2014**

NASSER SAIDI

— & ASSOCIATES —

Agenda

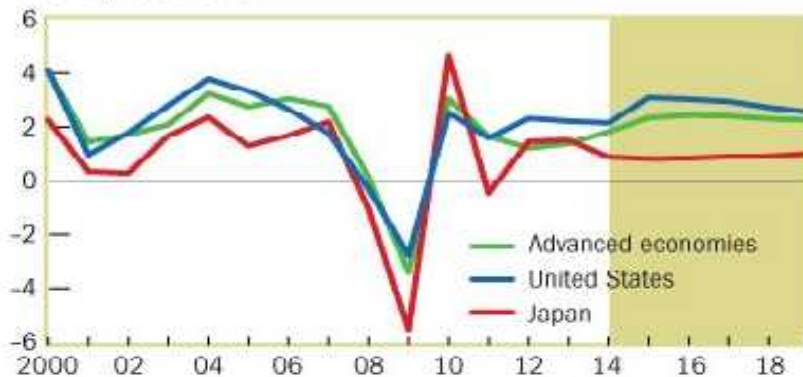
- ✓ **Global Economic Developments & New Economic Geography; MENA Implications**
- ✓ **Regional Economic Outlook**
 - **Developments & Challenges**
 - **Transformational Factors**
 - **Policy & Structural Reforms**

Global Recovery Fragile & Uneven; Secular Stagnation in Advanced Economies? Slowing growth in EMEs

(Real GDP, percent change)

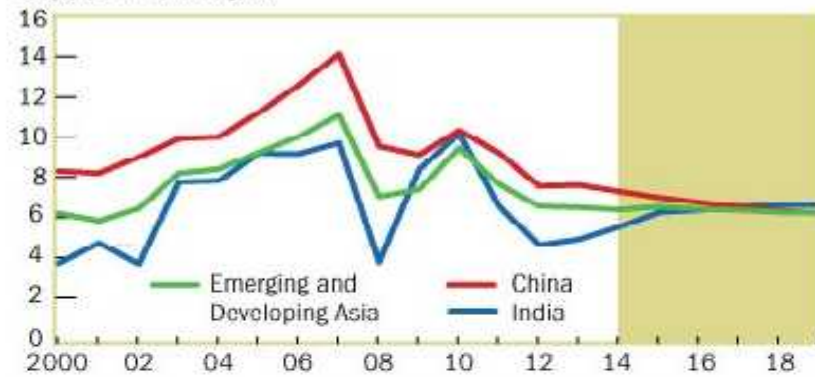
United States and Japan

Growth in the U.S. has rebounded with jobs picking up; Japan's recovery has slowed



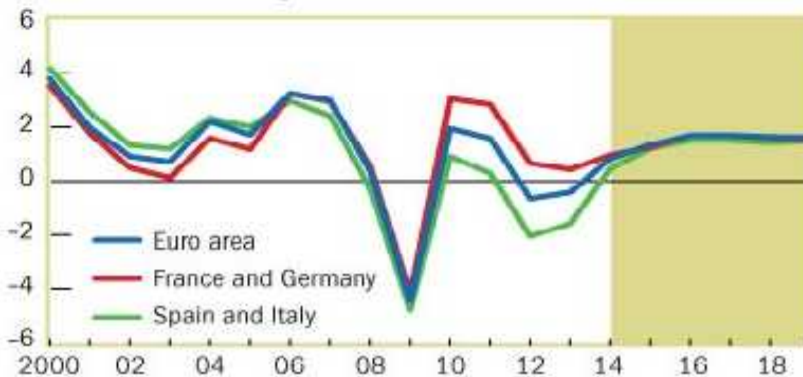
Emerging and Developing Asia

Emerging markets are adjusting to slower growth to different degrees in the region



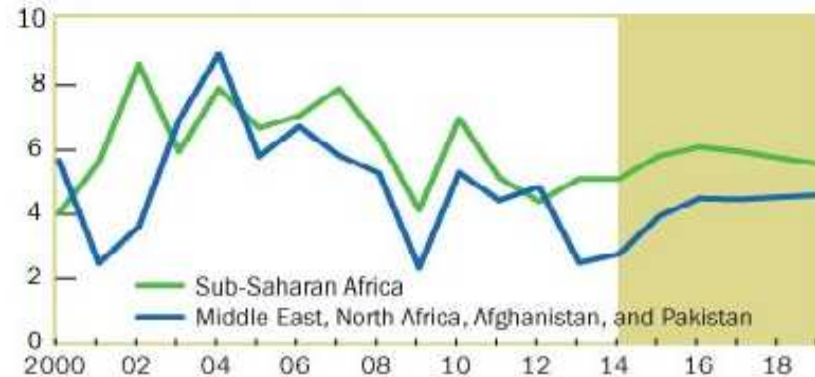
Euro Area

The euro area shows signs of a slow and fragile recovery, but still faces difficult challenges



MENAP² and Sub-Saharan Africa

Growth in the Middle East has been marked down; Africa is still doing well, although Ebola poses risks



Global Economy Is Still Struggling to Get on Track

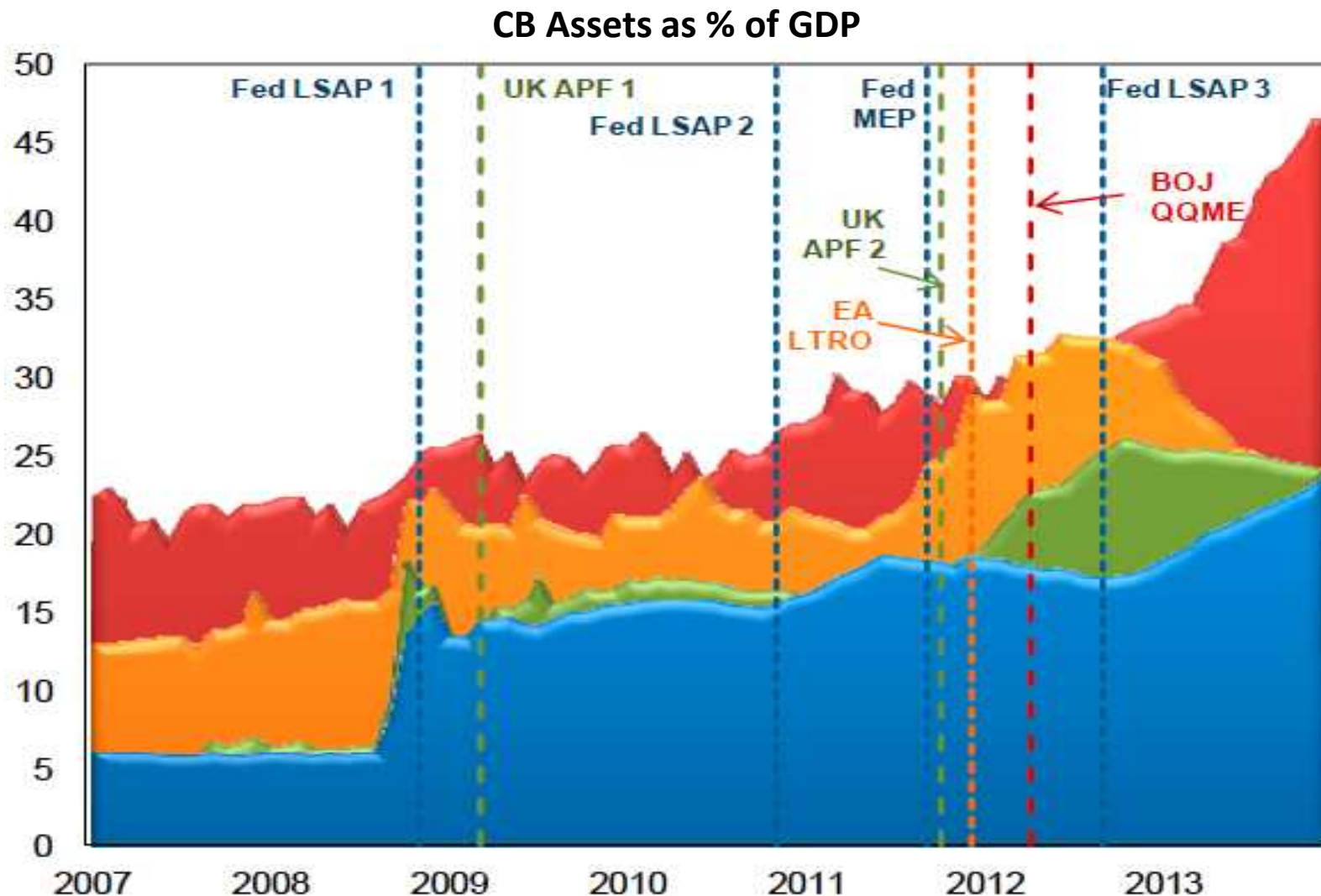
Risks have increased

- ✓ Uneven fragile growth
- ✓ Potential deflation risks
- ✓ Bubbly Asset Markets
- ✓ Simmering geopolitical tensions
- ✓ Slowing Emerging Markets
- ✓ Uncertainty over Monetary Policy normalisation

However, growth potential still remains via:

- ✓ Structural labour & product market reforms
- ✓ Infrastructure investment
- ✓ Macro-prudential regulation
- ✓ Low interest rates
- ✓ Reducing private debt

Monetary Policy Risks: Interest rates & CB deleveraging

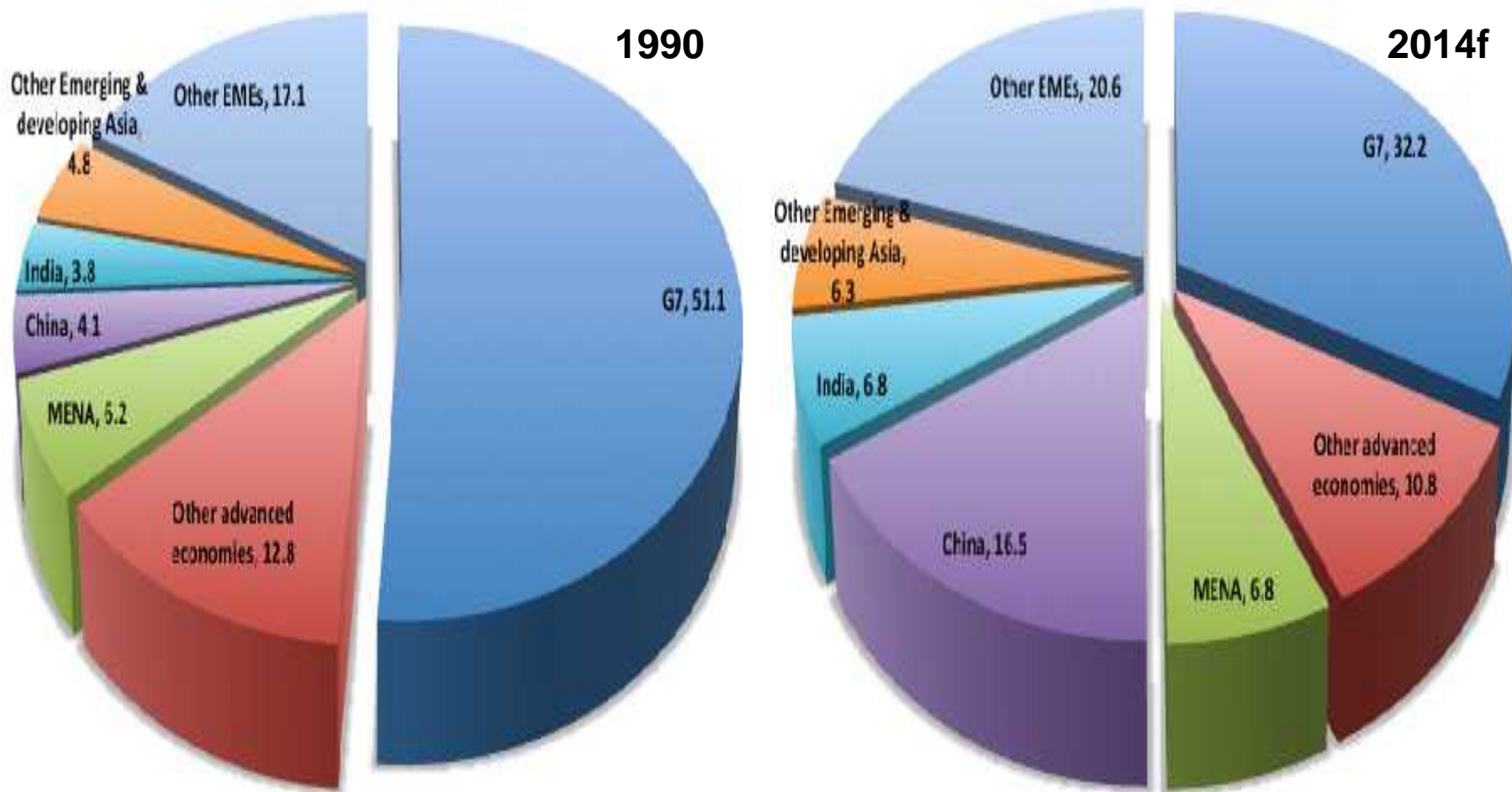


Source: Emerging Market Volatility: Lessons from the Taper Tantrum, IMF Staff Discussion note, Sep 2014.

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Tectonic Shift in Global Economic Geography Toward EMEs & Asia: Output, Trade & Investment

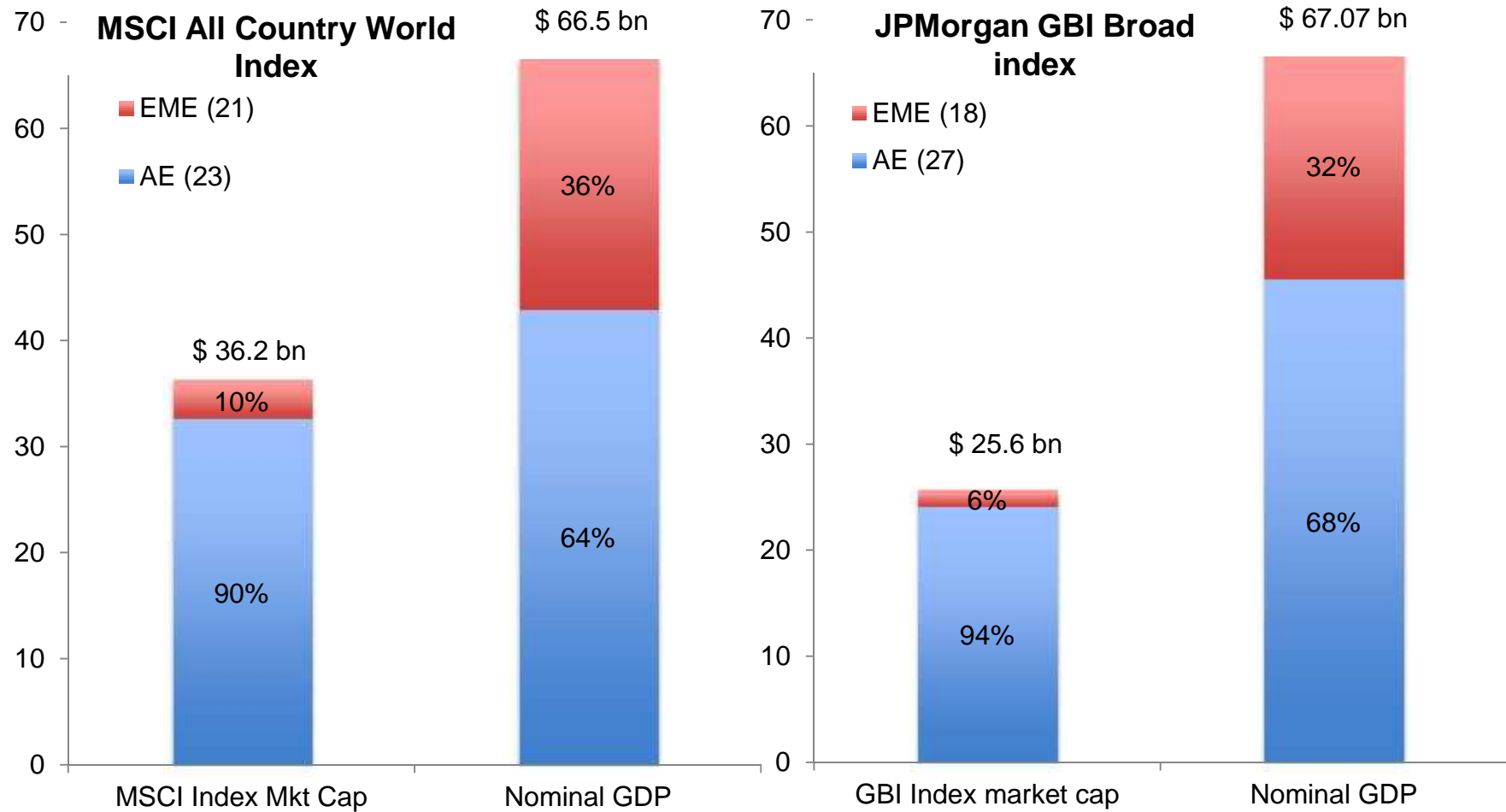
GDP based on purchasing-power-parity (PPP), shares of world total



Source: IMF WEO Oct 2014

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EMEs share in Global Equity & Bond indices underrepresents their share of Global GDP



Source: BIS Quarterly Review, Sep 2014.

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EME Shift: Implications for MENA/GCC

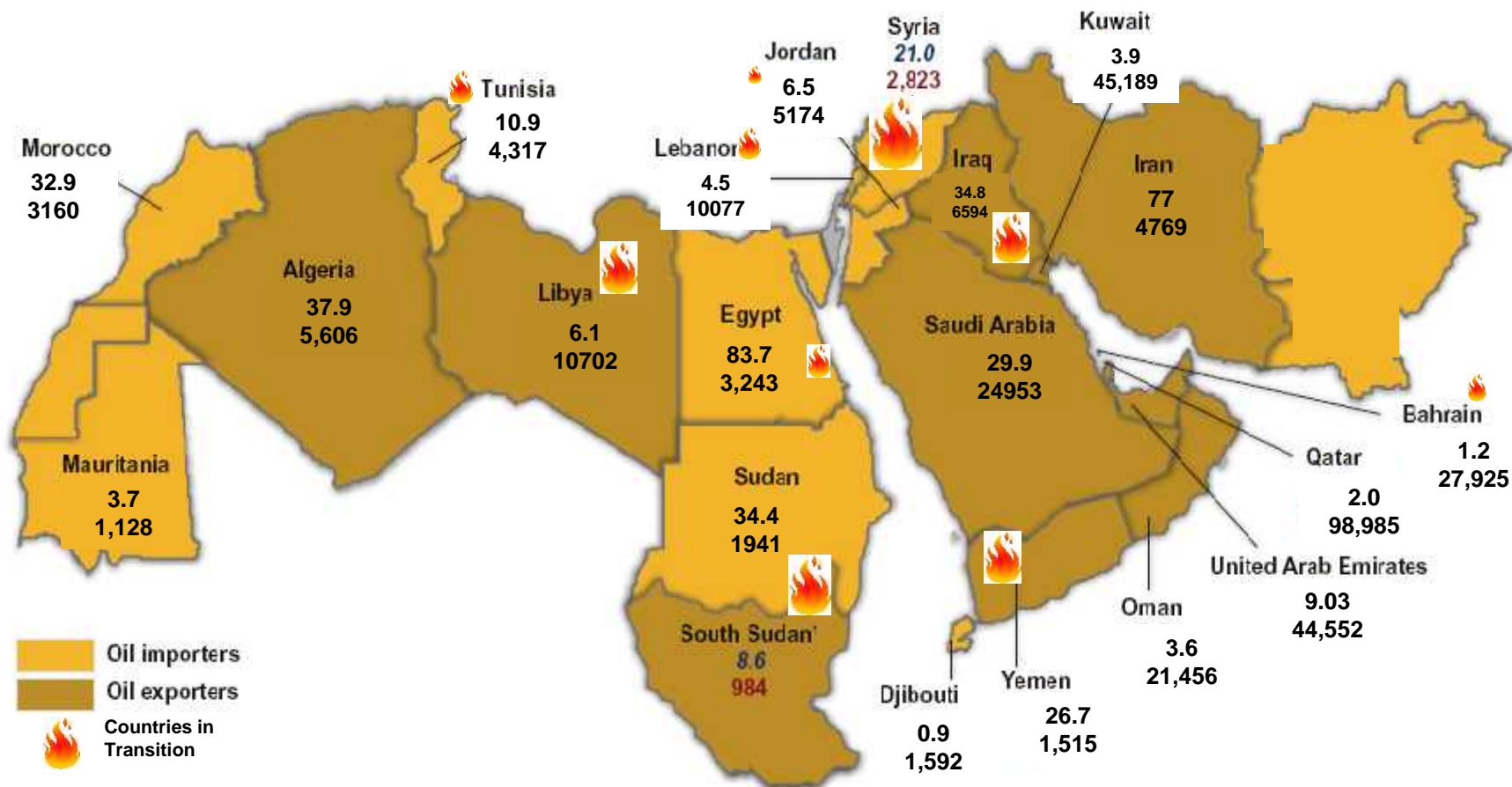
1. Shrinking share of global activity in advanced economies, expanding in EMEs/Asia: 2 growth drivers no longer 1
2. Energy Market: Structural shift to EMEs & New Tech
3. Monetary Policy conflicts: GCC Peg to US\$ & US Monetary Policy vs. Domestic Policy matters & Asia business cycle
4. Re-orient Trade, 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

Agenda

- ✓ Global Economic Developments & New Economic Geography; MENA Implications
- ✓ **Regional Economic Outlook**
 - **Developments & Challenges**
 - **Transformational Factors**
 - **Policy & Structural Reforms**

MENA: 48.1% of World's proven Oil reserves and 38.4% of proven Natural Gas resources but Wide Inequality in Wealth, Resources & Incomes. Many countries in turmoil

Population, millions (2013)
GDP per capita, USD (2013)



Source: IMF WEO database

MENA Macro: Growth, Inflation & Foreign Assets accumulation in Oil Exporters; Stressed economies in Oil Importers/Transition countries

	Real GDP			Consumer Prices ¹			Current Account Balance ²			Unemployment ³		
	2013	Projections		2013	Projections		2013	Projections		2013	Projections	
		2014	2015		2014	2015		2014	2015		2014	2015
Middle East and North Africa	2.3	2.6	3.8	9.2	7.5	8.0	10.9	8.6	6.8	...	...	...
Oil Exporters⁴	2.2	2.5	3.9	9.5	6.8	7.3	14.8	11.6	9.8	...	...	...
Saudi Arabia	4.0	4.6	4.5	3.5	2.9	3.2	17.7	15.1	12.4	5.5	...	...
Iran	-1.9	1.5	2.2	34.7	19.8	20.0	7.5	4.2	1.7	10.4	11.6	12.2
United Arab Emirates	5.2	4.3	4.5	1.1	2.2	2.5	16.1	11.1	11.8	...	...	...
Algeria	2.8	3.8	4.0	3.3	3.2	4.0	0.4	-3.0	-2.9	9.8	10.8	11.3
Iraq	4.2	-2.7	1.5	1.9	4.7	6.2	-0.3	3.0	2.4	...	...	...
Qatar	6.5	6.5	7.7	3.1	3.4	3.5	30.9	27.1	23.2	...	...	...
Kuwait	-0.4	1.4	1.8	2.7	3.0	3.5	40.5	40.8	38.6	2.1	2.1	2.1
Oil Importers⁵	2.6	2.6	3.7	8.3	10.0	10.6	-6.2	-4.7	-5.9	...	...	...
Egypt	2.1	2.2	3.5	6.9	10.1	13.5	-2.7	-0.4	-4.0	13.0	13.4	13.9
Morocco	4.4	3.5	4.7	1.9	1.1	2.0	-7.6	-6.8	-5.8	9.2	9.1	9.0
Sudan	3.3	3.0	3.7	36.5	38.0	20.6	-8.6	-6.3	-6.3	14.8	13.6	13.3
Tunisia	2.3	2.8	3.7	6.1	5.7	5.0	-8.4	-7.7	-6.6	15.3	15.3	15.0
Jordan	2.9	3.5	4.0	5.6	3.0	2.6	-9.3	-10.0	-6.9	12.2	12.2	12.2
Lebanon	1.5	1.8	2.5	3.2	3.5	4.0	-12.9	-12.7	-12.3	...	...	...
<i>Memorandum</i>												
Middle East, North Africa, Afghanistan, and Pakistan	2.5	2.7	3.9	9.0	7.6	8.0	10.0	7.8	6.2	...	...	...
Pakistan	3.7	4.1	4.3	7.4	8.6	8.0	-1.1	-1.2	-1.3	6.2	6.7	6.5
Afghanistan	3.6	3.2	4.5	7.4	6.1	5.5	4.3	4.8	0.1	...	...	...
Israel ⁶	3.2	2.5	2.8	1.5	0.8	1.8	2.0	1.9	2.0	6.3	6.0	6.0
Maghreb ⁷	1.1	1.3	5.4	3.2	3.1	3.9	-0.3	-7.4	-6.8	...	...	...
Mashreq ⁸	2.1	2.3	3.5	6.5	9.1	12.0	-4.7	-3.0	-5.3

Source: IMF World Economic Outlook, Oct 2014

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Arab Firestorm => Growing Vulnerabilities

- ✓ MENA region going through a historic end of 'Sykes-Picot' transition period with many 'fault lines' :
 - Role of Islam in Politics; 'Mosque or Secularism'
 - Growing Sunni-Shia Schism
 - Role of Army/Security Forces in Politics
 - Change of Economic Development Model from high dependence on Government to Private sector led growth
- ✓ MENA countries share a number of common vulnerabilities and legacies: *Socio-Demographic, Political & Governance, Economic*

Arab Countries in Transition: Risks tilted to the downside

- Growth in the ACTs (excluding Libya) limited to 2.5% in 2014 and 3-4% in 2015, whereas 6-7% growth required to manage unemployment & new entrants
- Weak domestic demand + favorable commodity prices will keep inflation relatively stable + should support a narrowing of current a/c deficits.

Risks include:

- Growing Spillover Effects from region's Conflicts; massive inflows of refugees
- Limited space for economic reforms due to volatile political environment
- Disruption of trade flows or a generalized loss of confidence vis-à-vis the MENA
- Weaker-than-expected global/EU growth could affect projected recovery of tourism, exports and foreign investment especially for Maghreb
- But ACTs are less affected by a normalization of interest rates in the US, given their limited exposure to international financial markets.

Egypt, Iran, Turkey are 'Next-11 Countries'

<u>Country</u>	<u>Population</u>	<u>GDP (PPP) (2013)</u>	<u>GDP (nominal) (2013)</u>	<u>GDP per capita (PPP) (2014)</u>	<u>GDP per capita (nominal) (2013)</u>	<u>Exports (2012)</u>	<u>Imports (2012)</u>	<u>Trade (2012)</u>	<u>HDI (2012)</u>
Bangladesh	150,039,000	\$324.6 bn	\$153.6 bn	\$2,575	\$1,044	\$30.2 bn	\$29.3 bn	\$59.5 bn	0.515
Egypt	83,700,000	\$909.8 bn	\$271.4 bn	\$10869.7	\$3,242.8	\$28.4 bn	\$58.8 bn	\$87.1 bn	0.662
Indonesia	237,641,000	\$1,285 bn	\$867.5 bn	\$5,433	\$3,498	\$187.0 bn	\$178.5 bn	\$365.5 bn	0.629
Iran	76,970,000	\$1244 bn	\$367.1 bn	\$16,164.7	\$4768.9	\$67.0 bn	\$70.0 bn	\$137.1 bn	0.742
Mexico	118,337,000	\$1,845 bn	\$1,327 bn	\$16,002	\$11,224	\$370.9 bn	\$370.8 bn	\$741.7 bn	0.775
Nigeria	174,507,539	\$509.9 bn	\$292.0 bn	\$3,027	\$1,725	\$95.7 bn	\$53.4 bn	\$149.0 bn	0.471
Pakistan	182,490,721	\$574.1 bn	\$236.5 bn	\$3,623	\$1,295	\$29.7 bn	\$33.0 bn	\$62.7 bn	0.515
Philippines	99,622,900	\$454.3 bn	\$272.2 bn	\$4,771	\$2,792	\$52.0 bn	\$57.2 bn	\$109.2 bn	0.654
South Korea	50,004,441	\$1,666 bn	\$1,198 bn	\$34,155	\$23,837	\$552.6 bn	\$514.2 bn	\$1,066.8 bn	0.909
Turkey	76,484,000	\$1,443 bn	\$819.9 bn	\$18,873	\$10,721	\$163.4 bn	\$228.9 bn	\$392.3 bn	0.722
Vietnam	90,388,000	\$358.9 bn	\$170.0 bn	\$4,231	\$1,896	\$109.4 bn	\$109.6 bn	\$219.0 bn	0.617

Economic Policy Challenges

GCC

1. Job Creation in High Value Added, Export Oriented Sectors
2. Economic Diversification & Private Sector Participation
3. Remove Distortionary Energy Subsidies
4. Fiscal Sustainability

Arab Firestorm Countries

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

Falling Oil Prices & Implications for the MENA region

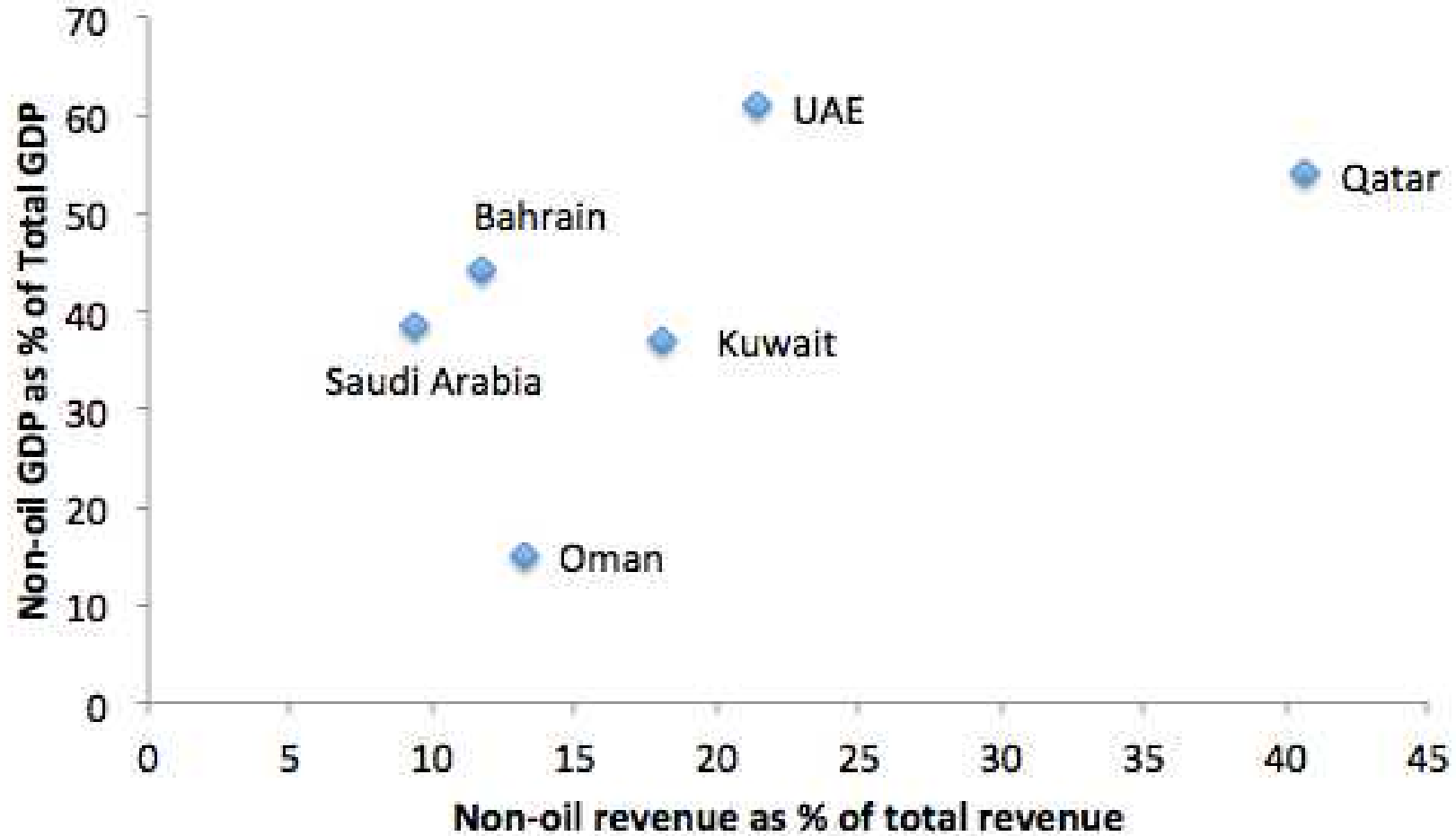
Oil Exporters:

- Decline in Oil Revenues
- Greater fiscal constraints & budget deficits
- Decline in Current Account Balances & Net Foreign Asset accumulation
- Need for Greater Economic & Revenue Diversification

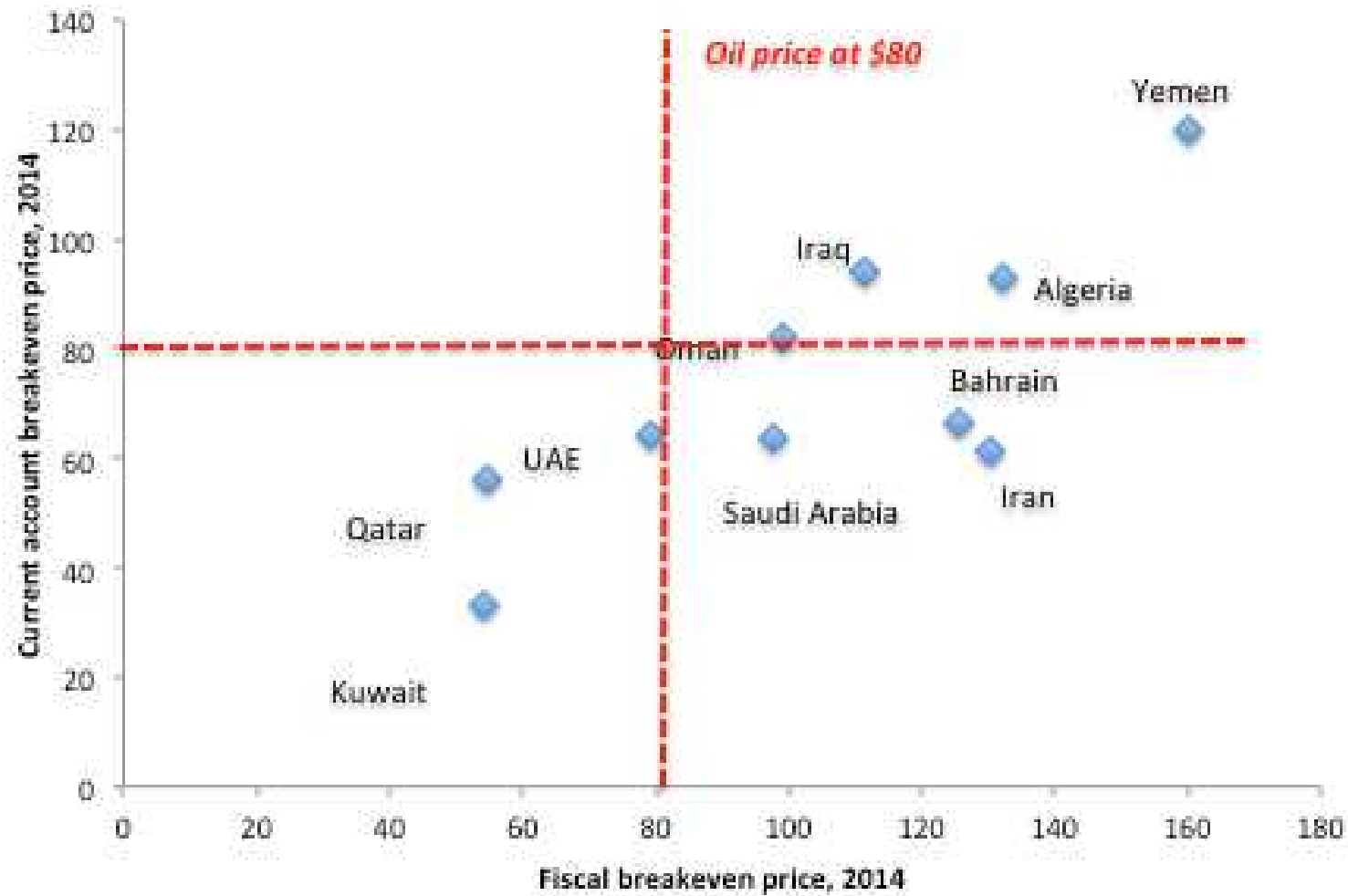
Oil Importers:

- Lower spending on oil imports improves current accounts
- But lower FDI & remittances from oil exporters outweigh CA benefit
- Aid levels are likely to decline as well => fall in oil prices hurt oil importers as well as exporters

GCC economic diversification is a strategic priority for job creation, private sector expansion & international competitiveness. But **revenue diversification a priority** to avoid dependence on volatile oil revenues



Deteriorating Fiscal Balances Across Region, with Oil Exporters Vulnerable to Cheaper Oil



Source: IMF Regional Economic Outlook, 2014

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Risks to GCC/Oil exporters vs. 'Firestorm' countries/labour exporters/oil importers

ACTs/Oil Importers

- ✓ Geopolitics: spreading unrest from Syria/Iraq into Turkey/Jordan
- ✓ Growing economic & social unrest
- ✓ EU stagnation negatively impacting trade, employment & remittances in Maghreb
- ✓ High oil prices & high fuel+food subsidies
- ✓ Budgetary deficits threatening macroeconomic stability, inflation & exchange rate depreciation
- ✓ Lack of access to international banking & financial markets

Oil Exporters

- ✓ Geopolitics: spreading unrest from Syria/Iraq; Sunni-Shia divide
- ✓ Lower oil prices
- ✓ Lower growth in EMEs/ Asia/ China
- ✓ Crowding out of private sector
- ✓ Insufficient diversification & job creation for nationals
- ✓ Trade finance & capital market refinancing risks from end of QE policies and CB deleveraging

Transformational Factors

- A. Socio-Demographics: Job Creation, Women Empowerment & Need for Collective Action**
- B. Fiscal Reform & Energy Subsidies**
- C. Development of Local Financial Markets**
- D. Détente with Iran**
- E. Islamic Finance**

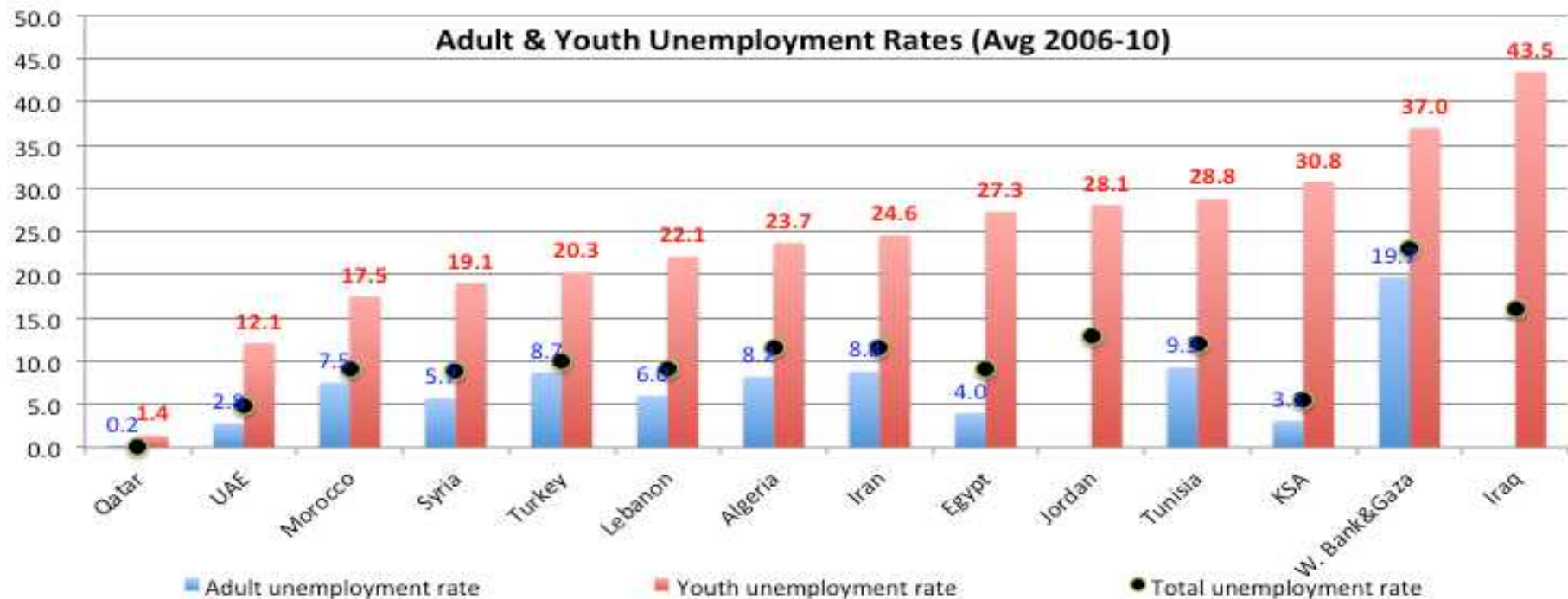
Explosive Demographics: Growth & Job creation are policy priorities to counter extremism

✓ Arab Demographics:

- ❖ Pop: 355 mn but 500 mn by 2025
- ❖ 55% below 24yrs, 2/3 below 30yrs
- ❖ **Need growth rates of 6-8%**

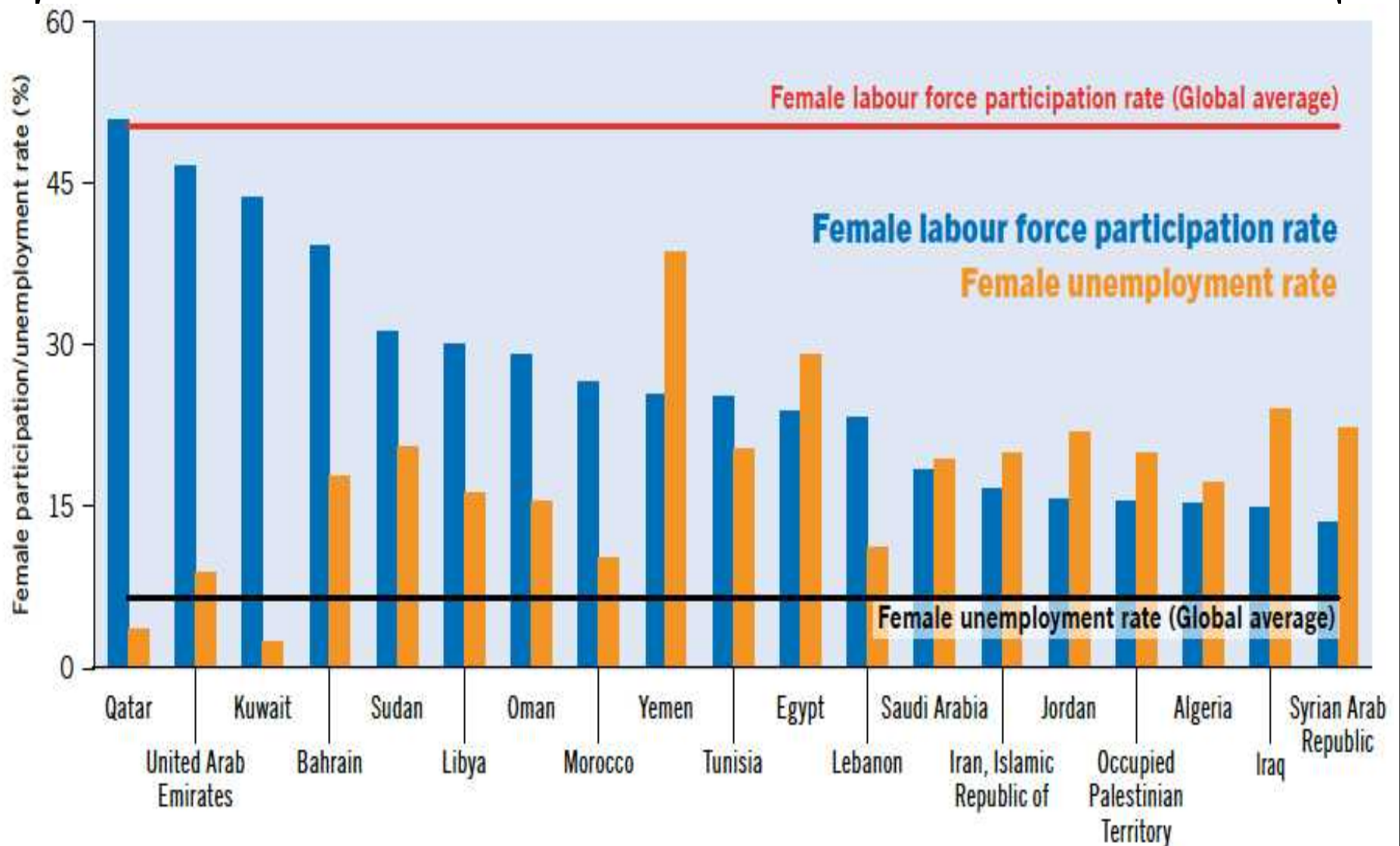
✓ Unemployment:

- ❖ 18-20mn unemployed; 18% U rate; Youth U rate 35%, Female U rate 45%
- ❖ Lost generations



Source: ILO Global Employment Trends 2013, ILOSTAT

Raising Female Labour Participation Rate is a Transformational Necessity



Reduction in LFPR Gap would lead to a Growth Explosion in MENA!

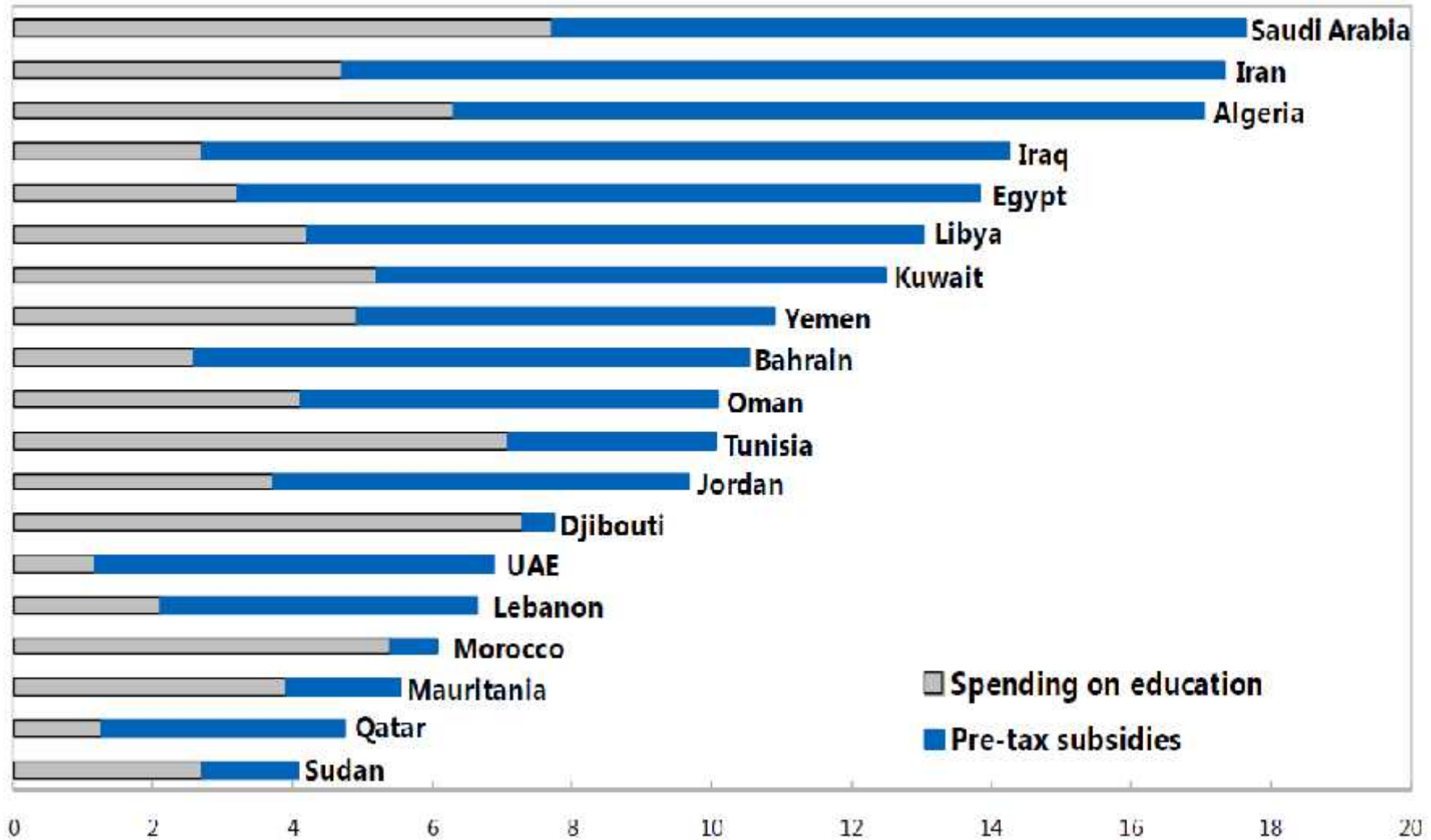
			Projected average annual growth rate in GDP		
	Male LFPR	Female LFPR	Male and female LFPR gap reduced by 50%, by 2030	Male and female LFPR gap reduced by 75%, by 2030	Male and female LFPR gap reduced by 100%, by 2030
Algeria	75.4	15.7	8.73	9.25	9.78
Bahrain	88.5	40.6	7.00	7.42	7.85
Egypt	78.1	25.3	7.72	8.18	8.65
Iraq	71.7	15.2	8.26	8.76	9.26
Jordan	68.9	16.3	7.69	8.15	8.62
Kuwait	84.5	44.7	5.82	6.17	6.52
Lebanon	75.3	24.8	7.38	7.83	8.28
Libya	79.9	32.0	7.00	7.42	7.85
Morocco	78.3	26.4	7.59	8.04	8.50
Oman	81.6	29.2	7.66	8.12	8.59
Palestinian Authority	68.6	15.4	7.78	8.25	8.72
Qatar	95.6	53.0	6.23	6.60	6.98
Saudi Arabia	76.1	18.3	8.45	8.96	9.47
Syrian Arab Republic	74.7	13.7	8.92	9.46	10.00
Tunisia	74.0	27.5	6.80	7.21	7.62
United Arab Emirates	92.4	44.0	7.07	7.50	7.93
Yemen	73.6	25.8	6.99	7.41	7.83

Source: Nasser Saidi & Associates (based on OECD estimates)

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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 on education!

In % of GDP



Timid Subsidy Reforms in MENA

Countries	Recent Measures	Main Mitigating Measures	Next Steps
Egypt	<p>2012–13: prices for 95 octane gasoline increased by 112% for high-end vehicles; fuel oil prices for non-energy-intensive industries increased by 33% and for energy-intensive industries by 50%</p> <p>January 2013: electricity prices to households increased by 16% on average; natural gas and fuel oil prices for electricity generation increased by one-third.</p>	<p>No electricity tariff change for the lowest consumption bracket;</p> <p>Temporary subsidy for the tourism sector to finance the conversion to more efficient and cheaper fuel sources, and promote switching to natural gas for transport.</p>	<p>Adopt smartcards;</p> <p>Expand priority social programs and targeted cash transfers.</p>
Jordan	<p>June 2012: electricity tariffs increased for selected sectors (banks, telecommunications, hotels, mining) and large domestic corporations and households;</p> <p>November 2012: elimination of fuel subsidies</p> <p>January 2013: monthly fuel price adjustment mechanism resumed;</p> <p>August 2013: electricity tariffs increased by 7.5–15% for selected nonhousehold consumers.</p>	<p>Cash transfers to families below a certain income threshold (70% of the population) if oil prices are above \$100 per barrel.</p>	<p>Gradually increase electricity tariffs and develop new energy sources with lower generation costs.</p>
Morocco	<p>June 2012: diesel prices increased by 14%, gasoline by 20%, and industrial fuel by 27%</p> <p>September 2013: started implementation of a partial indexation mechanism for certain petroleum products. As a result, diesel prices increased by 8.5%, gasoline by 4.8%, and fuel by 14.2%.</p>		<p>Launch a comprehensive subsidy reform combined with cash transfers.</p>
Tunisia	<p>September 2012: gasoline and diesel prices and electricity tariffs increased by 7% on avg</p> <p>March 2013: further 7–8% price increase for the same products.</p>	<p>Plans to strengthen the existing cash transfer program with the introduction of a unified registry and improved targeting system.</p>	<p>Replace energy subsidies gradually with a well-targeted social safety net;</p> <p>Introduce an automatic price mechanism for fuel products in 2014.</p>

Building Local Financial Markets

- Current landscape: **underdeveloped financial markets; absence of government debt markets; banks dominating finance (65%)**
- Banks facing growing regulatory pressure & cannot provide **long-term finance for development & infrastructure projects**
- Broad, Deep, Liquid Financial Markets in Local Currencies allow:
 - ✓ **Finance reconstruction (\$1.4tn) & infrastructure (\$2.8tn) over 10 yrs**
 - ✓ **Provide institutional investors with instruments** that satisfy their demand for safe and stable long-term yields;
- **MSCI Reclassification of Qatar, UAE with Saudi next** can be transformational: institutional investors, encourage IPOs, improve governance & liquidity
- Oil-rich GCC countries should finance infrastructure by issuing securities backed by future cash flows from the infrastructure services
- GCC markets should open to regional/international government, corporate issuers

Détente with Iran would be Game Changer for the Region, a 'defining moment'

- Opens up very substantial trade, investment and financial opportunities in Iran
- Change in regional **Energy Infrastructure** with growing links to Asia/China
- Détente with Iran + resulting stabilization in Iraq => **infrastructure and reconstruction expenditures of some \$1.4 trillion that would be 'growth lifting' and create jobs across the region**
- Lowers risk of supply interruptions leading to reduction of oil price premium & sovereign risk premia and cost of borrowing for Gulf
- Key to **stabilisation** in Afghanistan-Pakistan-Iraq-Syria-Lebanon
- Changes long-standing Geo-Strategic and Political equilibrium of Gulf and ME
- Potential to lead to the creation of a **Zone of Peace & Prosperity in the Gulf**

Could Iran & Saudi Arabia become the France & Germany of the Gulf?

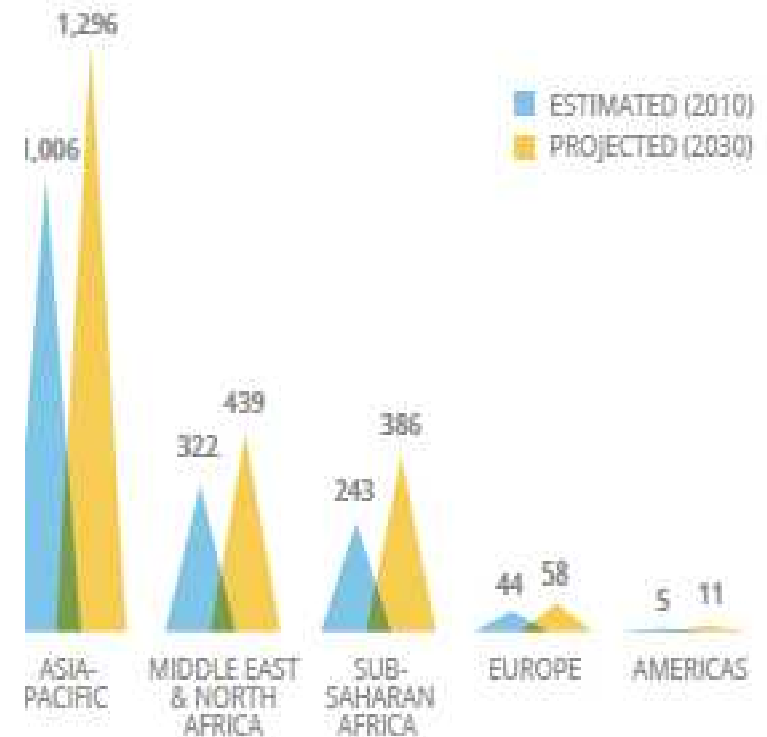
	Iran	KSA
Size (sq km)	1,648,195	2,149,690
Nominal GDP (USD bn)	366.3	745.3
GDP per capita	4750.7	24847.2
Non-oil GDP growth (% change)	7.3%	5.0%
Oil reserves (thousand mn barrels)	157.0	265.9
Oil reserves (% share of global reserves)	9.4%	15.9%
Government total expenditure (% of GDP)	14.8%	36.1%
Non-oil fiscal balance (% of non-oil GDP)	-8.6%	-54.1%
Imports (% of GDP)	19.8%	30.1%
Exports (% of GDP)	27.4%	50.8%
Non-oil exports (% of total exports)	9.6%	7.3%
Current account balance (% of GDP)	8.1%	17.4%
Gross official reserves (USD bn)	108.20	718.40

Source: IMF database, BP Statistics
 Figures represent 2013 data, except for oil reserves (2012).

Key Drivers of Islamic Finance: young, largely unbanked EME Muslim population



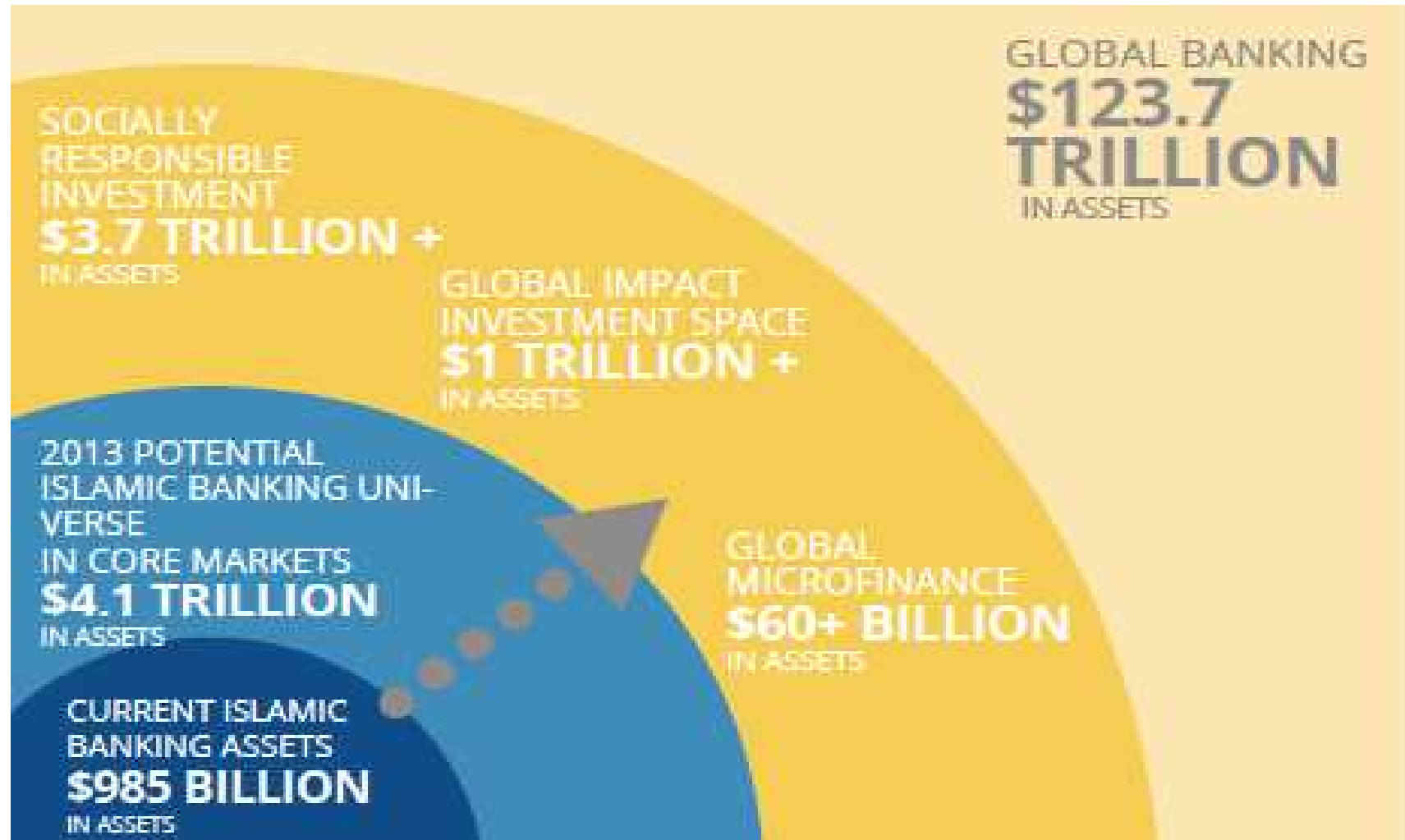
Current & projected Muslim population estimates by region => scope for housing & development finance



Source: State of the Global Islamic Economy 2013, Thomson Reuters.

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Islamic Finance has large growth potential



Source: State of the Global Islamic Economy 2013, Thomson Reuters.

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7 Policy/Structural Reform Priorities to Move Forward

Region needs to **change the development & investment model**

1. **Focus on private sector involvement** – through PPP, privatisation and other direct investment: Need to develop legal/regulatory/operational framework;
2. **Grow Region's financial markets to finance reconstruction & Infrastructure**
 - ❖ Move away from using current revenues to finance infrastructure
 - ❖ Develop Local Bond & Sukuk Markets to finance Infrastructure with focus on local currency financing
 - ❖ Bond, Sukuk and other instruments can benefit from MDB guarantees for eligible countries and projects
 - ❖ Consider Diaspora bonds for 'transition countries'
3. **Policy reforms for Energy Subsidies, Energy Efficiency, RE**

7 Policy/Structural Reform Priorities to Move Forward

4. GCC Moment: FTAs, engine for regional economic/financial integration

5. Integration of Regional Infrastructure: large benefits can result from economies of scale, network externalities + lower maintenance costs

- ❖ Integrate GCC core infrastructure and link with ACT: transport, electrification, oil & water pipelines, solar/renewable energy
- ❖ Integration of MENA infrastructure with Central Asia/New Silk Road infrastructure to enable MENA countries to be part of new global supply chains

6. SWFs should re-balance investment strategies towards local & regional economic & financial development; Regional MNEs & SOEs could spearhead infrastructure spending, financed by regional SWFs

7. Establish an Arab Bank for Reconstruction & Development

Main Messages & Key Takeaways

1. Region in transition and turmoil. There is no 'road map' and no unified vision or leadership: no fast transitions.
2. Fundamentals remain strong but focus of economic development must switch to the private sector for job creation: change role of State; focus on infrastructure investments for job creation; build local financial markets; empower women; fiscal reform & reduce subsidies
3. Infrastructure, Reconstruction, Energy/Renewables, Health, Education, Water & Finance will be major sectors in coming decade
4. Gulf region will be focus of economic growth and regional integration with growing links to Asia and Africa
5. Détente with Iran can be a game changer for the region

Growth, Turmoil & Transformation in the MENA region

*"If we want everything to stay the
same, everything must change"*

Tomaso di Lampedusa in Il Gattopardo

Thank you

Dr. Nasser Saidi



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