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THE OTHER FACE OF ARAB WEALTH: DOMESTIC INVESTMENT OPPORTUNITIES

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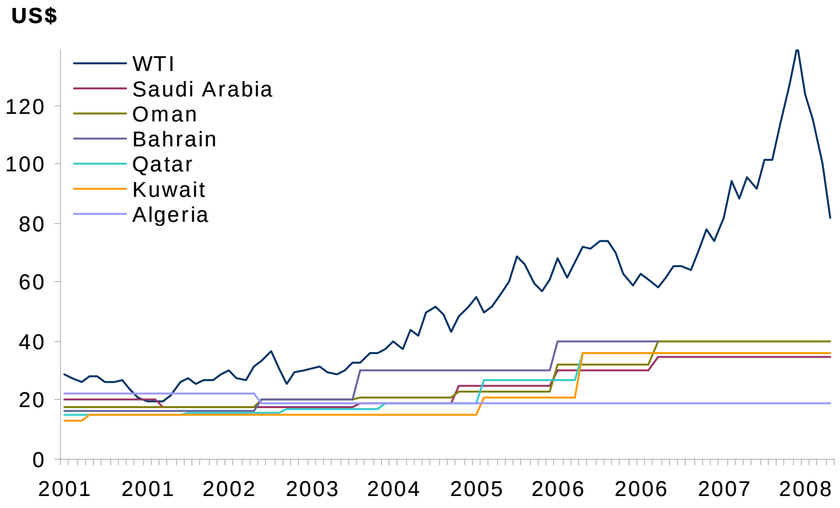
Overview

Context: Where MENA is coming from and where it is going

- **The 1990s: a "lost decade"[1]**
  - Dismal average growth of 3.6%
  - Job creation at 2.6%
  - Unemployment ~15% in 2000; 2x global average
    - 35% under 25yrs
  - 100mn jobs needed by 2020 to absorb labor force growth[2]

- **This decade: a "renaissance of sorts"?**
  - Oil boom leveraged to tackle old problems in new ways
  - Regional GDP growth now at 6-7%
  - Job creation > 4% during 2002-2005
  - MENA unemployment now down to 12%
  - World Bank has revised *down* its estimate for job creation needs, 68mn by 2020
  - Sustainability of higher job creation rates is now key

MENA budgeted oil price assumption[1]



- **A quiet transformation is certainly underway**
  - Reforms across the region, e.g. MENA OECD and more
  - Oil revenues being deployed for structural diversification
    - *Saudi Arabia:* An estimated US$600bn in domestic investment in pipeline over 20 years, incl. 20 universities[3]
    - *Algeria:* Launched US$150bn development plan and is using record reserves to pre-pay external debt[3]

- **Prudent budgeted oil price assumptions**
  - The GCC average, US$34[1], remains well below WTI, despite doubling since 2002

[1]Source: MEED, Bloomberg
[2]World Bank, 2004
[3]IMF, MEED

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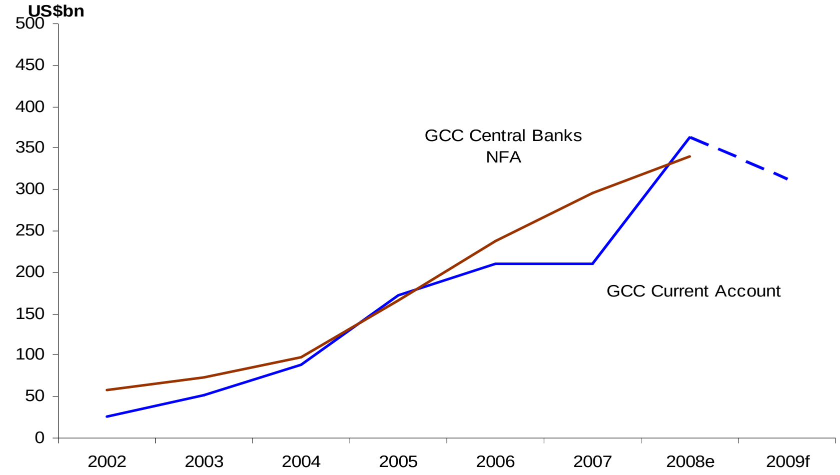
A new age of petrodollar recycling

- Petrodollar “recycling” today *vs.* 1970s: pick-up of GCC flows to emerging Asia and rest of MENA
- Large majority of GCC capital outflows still invested in developed markets
- Petrodollar “recycling” through both “absorption channel” and “capital account channel”

Aggregate GCC current account, CB NFA[1]



GCC Current Accounts (% of GDP)[1]

	2001	2002	2003	2004	2005	2006	2007	2008e	2009f
Bahrain	2.8	-0.7	2.0	4.2	11.0	13.8	16.7	18.0	15.0
Kuwait	23.9	11.2	19.7	30.6	46.6	52.2	43.1	44.6	39.3
Oman	9.8	6.7	3.8	2.4	15.2	12.1	8.0	10.1	5.6
Qatar	27.3	21.9	25.3	22.4	33.2	28.4	29.2	42.9	35.6
Saudi Arabia	5.1	6.3	13.1	20.8	28.7	27.9	25.1	32.5	23.8
UAE	9.5	4.9	8.5	9.1	18.0	22.6	20.5	22.6	18.8
GCC[2]	9.4	7.3	12.8	18.2	27.9	29.0	25.8	31.6	25.0

[1]Source: IMF, IIF, government statistics.
[2]GCC figure is the total current account surplus divided by the region’s total nominal GDP

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Petrodollar recycling today vs. ’70s

- **The 1970s focused on developed markets**
  - Financial flows simple to track pre-intermediation
  - In 1974-79, US$108bn (47% of identified investments) in bank accounts or in US, UK T-Bills
  - Rest were bilateral, multilateral loans to Latin America and EU countries with CA deficits

- **Today, a more regional focus is perceptible**
  - A much broader domestic investment set exists
  - Bank deposits as a share of total identified stock of external assets declined to 27% at end-2006, from over 45% in 2001[3] (Note data shortcomings)

- **One aspect is bound to change only slowly**
  - Although primary destination of GCC investments is difficult to determine, the bulk still ends up in the US, directly or indirectly (NY Fed, Dec 06)
  - Rise in US CA deficit is closest counter-measure to the rise in CA surplus of oil exporters

Fuel exporters’ deployment of current account surpluses, 1974-79[1]

Type of financial instrument	Amount (US$bn)
Bank deposits and money market instruments	108
Dollar deposits in the US	10.9
Sterling deposits in the UK	2.4
Deposits in foreign currency markets	88.8
Treasury bills in the US and the UK	5.9
Long-term instruments	124.2
Bilateral agreements	69.7
Loans to international agencies	9.5
Sovereign securities in the US and the UK	9.2
Other (inc. Equity, real estate inv. in US & UK)	35.8
Total	*232.2*

GCC estimated geographical distribution of capital outflows, 2002-06[2]

Destination	Amount (US$bn)
US	300
Europe	100
MENA	60
Asia	60
Other	22
Total	*542*

[1]Source: BIS, IMF.
[2]Source: IIF
[3]Source: BIS

The true blessing: Unprecedented intra-regional FDI

- **Intra-regional flows supported by reforms across MENA**
  - Strong regional growth prospects coupled with large populations and low penetration of goods and services are attracting GCC corporates
  - In North Africa, GCC inflows have mostly gone toward developing infrastructure, real estate and tourism projects

Decomposition of GCC regional investment transaction flows (average 2002-07, US$mn)[1]

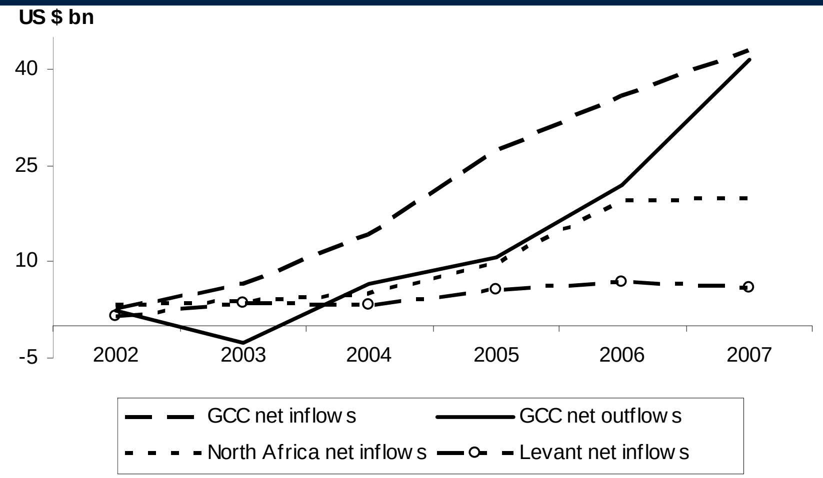
From \ to	Lebanon	Egypt	Tunisia	Syria	Morocco	Yemen	Jordan	Libya	Algeria	WB & Gaza	Iraq	MENA, exc. GCC
UAE	284.2	578.9	393.5	103.7	216.9	5.2	10.2	12.7	1.6	0.0	0.0	1,607.0
Saudi Arabia	675.4	101.9	5.7	191.9	219.8	217.4	184.0	0.8	2.4	17.6	0.2	1,617.2
Kuwait	359.2	216.5	32.9	77.6	43.8	0.2	21.4	28.2	52.6	0.0	10.4	842.8
Qatar	101.6	2.1	0.0	0.0	28.9	1.3	12.2	2.1	2.4	0.0	0.0	150.7
Bahrain	2.5	24.3	2.8	0.0	1.7	0.0	74.2	1.6	6.0	0.0	0.0	113.0
Oman	0.0	11.9	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	12.0
GCC	1,423.0	935.5	435.0	373.2	511.2	224.2	302.0	45.3	65.0	17.6	10.6	4,342.6

[1] Inter-Arab Investment Guarantee Corporation. Data is on an approval basis, not on a BoP basis. Inter-Arab investments refer to private and licensed investment flows conducted by Arab investors from one Arab country or more into another Arab country that depicts both private and pure public or government investments, based on their nationality. Latest available data is through2007.

Investment is the main driver of change, and SWFs are playing a part

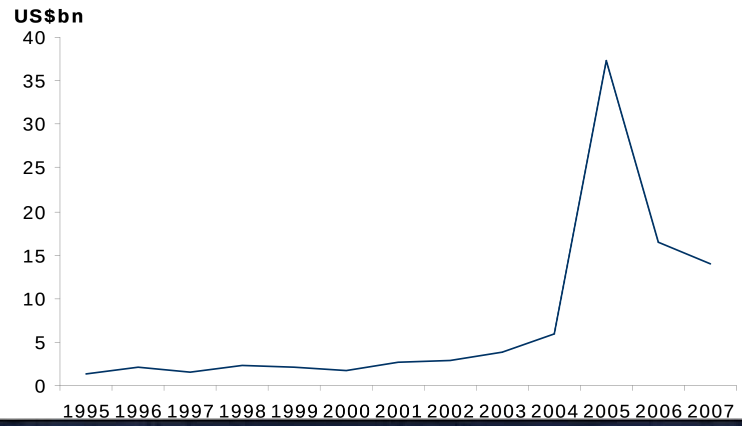
- **Net FDI inflows: US$69bn (2007), a 10.4% increase oya[1]**
  - GCC both a source of high net inflows and net outflows
  - *Saudi Arabia:* Highest net inflows (US$24bn); *Kuwait*: Highest net outflows (US$14bn) in MENA in 2007
- **Unprecedented intra-regional flows[2]**
  - The GCC invested US$60bn over 2002-06 in the rest of MENA
    - This represented 13% of the 2006 GDP of MENA, exc. GCC
    - In contrast, GCC invested US$300bn over 2002-06 in the US
    - This represented 2% of 2006 GDP in the US
- **Intra-regional investment[3] is clearly growing**
  - At US$14.0bn in 2007 vs < US$5.0bn before 2004
  - Kuwait, Saudi Arabia and UAE accounted for 69% of outward intra-regional investment in 2006
  - Highest recipients in 2006: Lebanon, Egypt, Jordan, Tunisia and Saudi Arabia

MENA net FDI inflows and outflows[1]



Note 1: The Levant area comprises Iraq, Jordan, Lebanon and Syria.
Note 2: UNCTAD reports FDI on a net basis (capital transactions' credits less debits between direct investors and their foreign affiliates). UNCTAD reports both net increases in liabilities (inward FDI) and net increases in assets (outward FDI) with a positive sign, unlike balance of payments data. A negative UNCTAD net FDI outflow figure represents a disinvestment (one of the three FDI components - equity capital, reinvested earnings and intra-company loans - is negative and larger than the others).

MENA intra-regional investment[2]



[1]Source UNCTAD. Latest available through 2007.
[2]Source: IIF
[3]See footnote 1, page 6

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Sovereign wealth is behind a quiet transformation, & a stabilizer…

Beyond ADIA, the QIA and the KIA…

- *Saudi Arabia*:
  - KAUST, 3rd largest endowment in the world; 20 other universities and colleges underway; Centennial Fund
- *UAE:*
  - Mubadala & ADIC Council are sovereign wealth funds, so is the Emirates Foundation
- *Qatar:*
  - The Qatar Foundation is a SWF; so are several other related educational funds
- Kuwait, Bahrain, Oman, Egypt, Jordan, Syria, Lebanon, Tunisia, Morocco: similar smaller scale initiatives underway

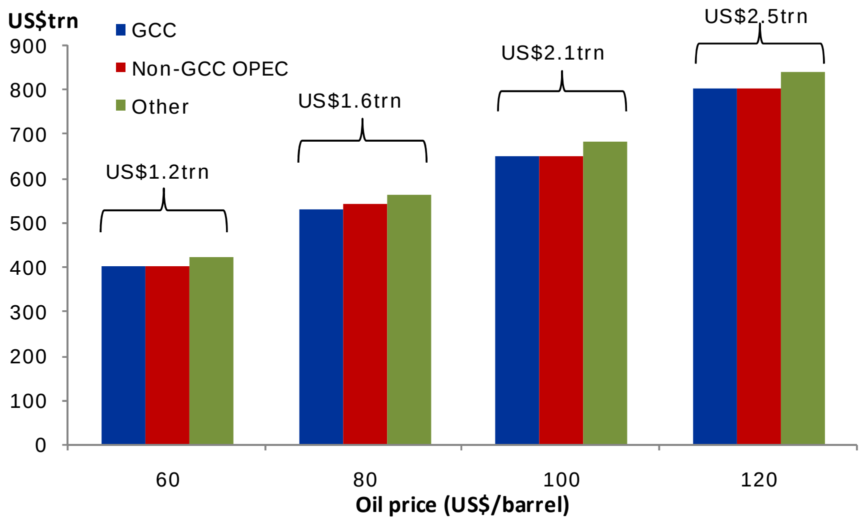
Challenges: The divide between oil exporters/non-oil exporters remains key, with only nascent "regional" policies

- Oil exporters
  - Must learn to ride market volatility despite macro policy constraints
  - Must manage recent rapid credit growth, along with continued inflationary pressures
  - Must ensure broad private sector participation in diversification efforts
- Oil importers
  - Must adapt to varying terms-of-trade conditions
  - Must ensure continued regional liquidity flows in, as FDI
    - Privatization (Egypt, Tunisia, Lebanon)
    - Infrastructure development (Jordan, Algeria, Libya)
    - Business/tourism expansion (Egypt, Lebanon, Tunisia, Morocco, Syria)

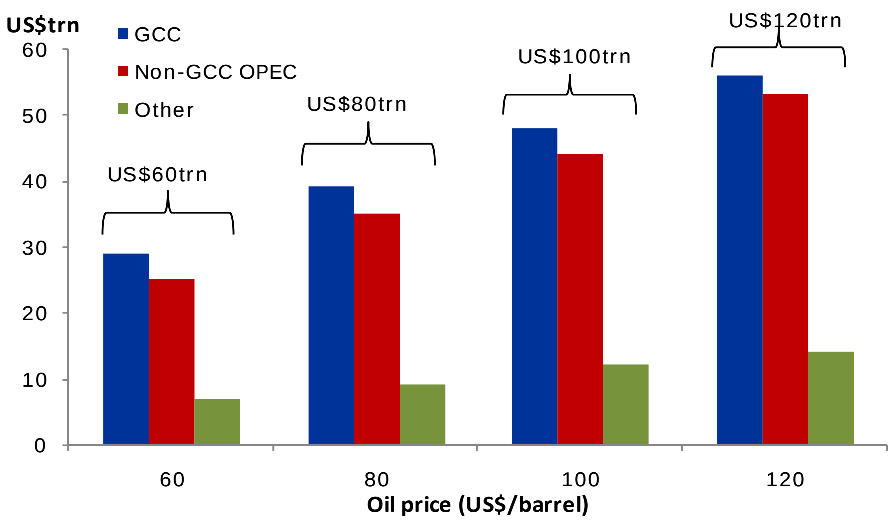
As for sovereign wealth funds, they are destined to grow

- **How large?**[1]
  - IMF estimates SWFs hold US$2-3trn in assets
  - Merrill Lynch estimates AUM will reach US$7.9trn by 2011
  - IMF projects AUM will reach US$6-10trn by 2013
  - Morgan Stanley projects SWFs to reach US$12trn in size by 2015
  - Standard Chartered projects SWFs' assets to reach US$13.4trn over the next decade

Market value of annual flow of oil exports[2]



Market value of proven oil reserves stock[2]

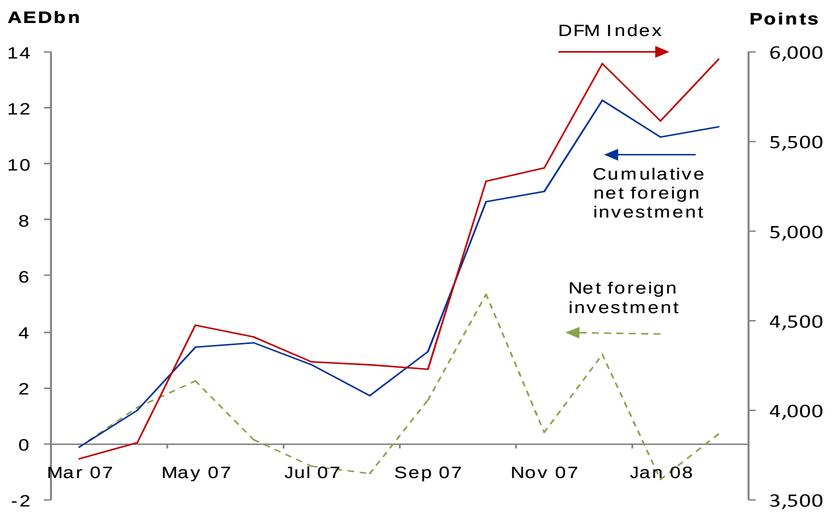


[1]Source: IMF, IIF, government statistics.
[2]Source: Morgan Stanley

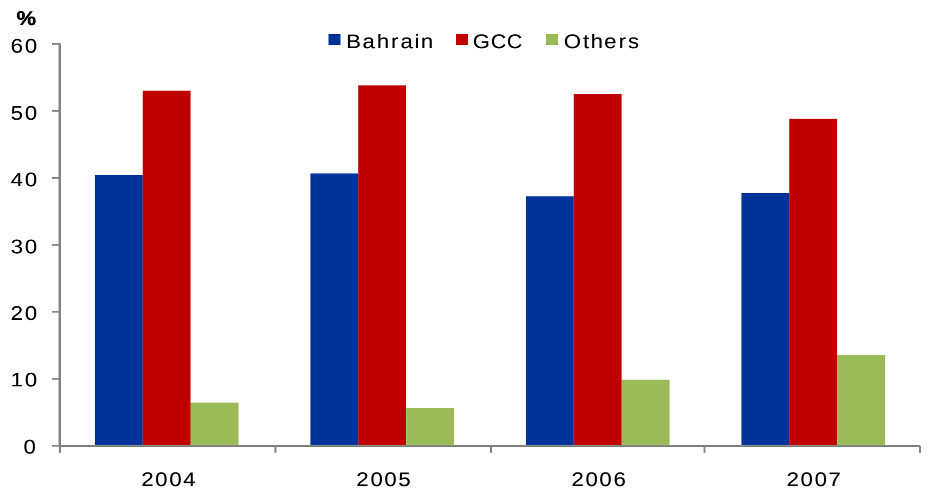
Secular rise in foreign investor participation...

- Cumulative net foreign investment on the DFM reached US$3.2bn over 2007, from negligible levels at the start of the year
- Locals took their cue from foreign investors during the DFM's 4Q07 rally
- Foreign investors now own more than 10% of the outstanding equity stock in Bahrain, likely higher in the rest of the GCC[2]

Foreign investment on the DFM[1]



Stock ownership in Bahrain by nationality[2]



[1]Source: Morgan Stanley, Deutsche Bank, Dubai Financial Market, Bloomberg.
[2]Source: Central Bank of Bahrain.

… despite stringent foreign ownership limits (FOLs)

- FOLs have the potential to curtail participation over the longer-term, but this is being assessed regularly by regulators
- Few UAE firms have touched their FOLs
- Saudi Arabia opened its banking and insurance sectors to GCC investors
- Implementation of common market will scrap FOLs on GCC-based investors

GCC foreign ownership limits[1]

	GCC-based investors	International investors
Saudi Arabia	49%	0%
UAE	between 0 and 49%	between 0 and 49%
Kuwait	49%	49%
Qatar	25%	25%
Bahrain	100%	49%
Oman	between 25% to 70%	between 25% to 70%

[1]Source: MSCI.

Syria: On a sustainable growth path

- **Higher growth, through reforms from the current development plan**
  - Exchange rate unified, FX peg to IMF's SDR, current account mostly liberalized, stock exchange and OTC market imminent
  - Growing banking, real estate and tourism sectors
  - Inflation set to moderate, along with pressures on government expenditures
  - Improvements to business climate, tariff cuts
  - Strict fiscal discipline, tax system streamlined
  - Participation in the IMF's GDDS* as of Dec 07

- **Challenges, as Syria turns into a net oil importer**
  - Large impact on budget revenues projected; VAT and further oil subsidies cuts key to fiscal sustainability
  - Reform momentum central to ensuring broader-based growth, private investment and productivity gains
  - Oil & gas, real estate and industrial sectors are magnets for further FDI
  - Financial sector deepening is at the heart of higher intermediation

Syria: Economic Indicators[1]

	2004	2005	2006	2007e	2008e	2009f
Nominal GDP (US$bn)	25.0	28.6	34.9	39.0	44.5	45.7
Real GDP growth (%)	2.8	3.3	4.4	3.9	4.2	5.2
Non Oil real GDP growth (%)	5.0	6.0	6.5	5.8	5.5	5.5
CPI inflation (%, avg)	4.4	7.2	10.4	14.3	13.5	11.2
Crude oil production (mn bpd)	0.5	0.4	0.4	0.4	0.4	0.4
Net oil exports (mn bpd)	0.2	0.2	0.2	0.2	0.1	0.1
Overall fiscal balance (%GDP)	-4.2	-4.4	-5.7	-4.3	-4.0	-3.0
Gross government debt (%GDP)	109.7	56.8	52.1	44.4	40.7	40.5
of which, domestic (%GDP)	36.5	33.5	32.7	28.1	25.5	24.9
of which, external (%GDP)	73.2	23.3	19.4	16.3	15.2	15.6
Current account balance (%GDP)	-1.9	-2.1	-2.9	-1.4	-2.7	-2.9
FDI (%GDP)	0.9	1.5	1.6	2.1	2.2	2.3

[1]Source: IMF, EIU, Bank Audi, Passport Capital.
*GDDS stands for General Data Dissemination System.

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