

April 2009

# **The Arab Gulf Economies Looking Forward – Pragmatic. Dynamic.**

**APCO**  
worldwide®



## **Introduction to APCO Worldwide**

APCO Worldwide is a global consulting firm and a leading provider of corporate advisory, government affairs and strategic communication services. We have been present in the Gulf region since 2007. Today our Gulf team, based in Dubai, includes more staff from a diverse range of backgrounds, including business, government, journalism, academia and civil society. Our clients include multi-national corporations from a broad array of sectors who engage APCO for stakeholder engagement and strategic communication counsel.

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## EXECUTIVE SUMMARY

Over the past few years, Arab countries in the Gulf region have undertaken ambitious economic and development plans that have led to sustained high growth rates, unprecedented GDP earnings and an unparalleled infrastructural boom accompanied by a growing influx of investment and migrant workforce. Most importantly, the Gulf region succeeded in positioning itself as a key regional and international financial and trade hub and, until recently, this was mainly accredited to its rising oil and gas revenues.

However, like the rest of the world, the Gulf could not be insulated from the impact of the financial and economic downturn. Some Gulf Cooperation Council (GCC) governments, for the first time, have forecasted budget deficits, regional markets have had significant losses, investments have been pulled out and there is a severe liquidity shortage that has led to project delays, cancellations and other consequences.

In these challenging times, the key priority for policy- and decision-makers will be to protect their achievements and establish the foundations that will allow them to overcome the crisis, sustain their future economic growth and ensure the social and economic well-being of their local population. Governments in the region have already started taking initiatives to regain trust and confidence in their markets, including using fiscal and economic stimulus packages to support their most vulnerable sectors. Other policy and regulatory reviews are expected, which will have significant impact on their future investment and project finance decisions (both inward and outward), including their choices of and engagement with partners. The crisis will also push forward the region's agenda for economic integration and the creation of a common market and currency.

Supported by their strong macro-economic fundamentals and accumulated reserves, governments are expected to pursue their focus on diversifying their economies, increasing their competitiveness and managing sustained economic growth and development. Forecasts about the region are very positive; recovery is likely to happen earlier than in other regions in the world. This will also translate into a new upsurge of business and investment opportunities that are more sustainability-focused and in line with international corporate governance best practices.

The future growth, wealth and power of the region is premised on governments' ability to develop the necessary tools and frameworks that will allow them to emerge together as a stronger and more influential region on the international scene.

## OVERVIEW OF THE GULF REGION

The Gulf region, sometimes referred to as the Persian Gulf or Arabian Peninsula, is made up of the kingdoms of Saudi Arabia and Bahrain, the Sultanate of Oman, the states of Kuwait and Qatar, and the United Arab Emirates (UAE), which includes Abu Dhabi, Dubai, Sharjah, Ras Al Khaimah, Ajman, Fujairah and Umm el Quwain. These six countries form the members of the Cooperation Council for the Arab States of the Gulf or the Gulf Cooperation Council (GCC).



Covering four-fifths of the Arabian Peninsula, Saudi Arabia is the largest country in the region, and Bahrain is the smallest. All GCC states are represented by hereditary monarchies with ruling families. Only Bahrain and Kuwait have legislatures with elected members - the Majlis al-Nuwab and National Assembly, respectively.

## ECONOMIC PRIORITIES: SUSTAINABLE GROWTH, ECONOMIC DIVERSIFICATION & HUMAN CAPITAL

The 22 economies of the wider Arab region, including the Levant and North Africa, are highly diverse from policy, regulatory and organizational points of view. Within the region, the Gulf countries are in a leading economic position with a combined GDP estimated at US\$720 billion in 2007. Over the past five years, GDP growth in the Gulf region has averaged at 7 percent. The GDP per capita of the wealthiest country in the Gulf region, Qatar, is 73 times higher than the poorest one in the Arab region, Mauritania.

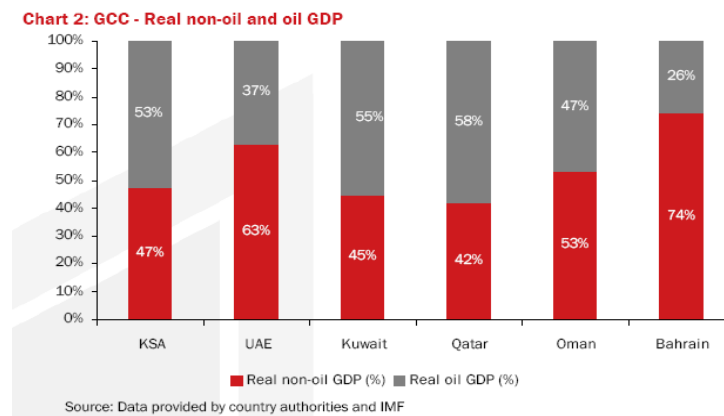
Despite economic diversification efforts, the wealth, growth and power of the Gulf countries is mainly attributed to oil and gas reserves. The region controls more than 40 percent of the world's known oil reserves and more than 22 percent of the world's natural gas, but accounts for fewer than 3 percent of total world oil consumption.

According to a recent report<sup>1</sup>, the combined economies of the GCC will reach an aggregate of \$2 trillion by 2020. While the global financial crisis will impact the GCC, slow down their economies and reduce growth rates in 2009, in the long term, GCC's share of the world economy is expected to increase from one percent in 2000 to 1.7 percent of world GDP by 2020. The Gulf states' estimated annual average growth will be 4.5 percent compared with the aggregate global rate of 3.3 percent.

## ECONOMIC DIVERSIFICATION

Strongly aware of their need to decrease dependency on oil export receipts, over the past years, governments in the Gulf region were forging ahead with an unprecedented number of policies and economic reforms focused on diversifying their economies, increasing their competitiveness and maintaining sustainable economic growth.

The effects of these policies are already being seen. The non-oil sector's contribution to real GDP has grown to more than 50 percent, with the UAE having the most diversified revenue base with non-oil sectors accounting for 63 percent of real GDP. Fiscal surpluses accumulated through strong oil-export earnings have allowed governments in the Gulf region to invest heavily in infrastructure projects as well as in the industrial and services sectors.



For example:

- Bahrain has carved a niche in financial services, especially as the leading centre for Islamic banking.
- Saudi Arabia has embarked upon a highly ambitious plan for the development of its infrastructure over the next ten years.
- Kuwait is pursuing an “open skies” policy to facilitate growth in the transportation sector and is investing heavily in its tourism market.
- Qatar and Oman are also leveraging their natural gas input through investments in the construction sector and development of banking and business districts.

### Policy Snapshot: Abu Dhabi's Economic Vision 2030<sup>ii</sup>

The Government of Abu Dhabi recently released its Economic Vision 2030, which sets out the Emirate's long-term key priority areas for economic development, including a set of macroeconomic targets and socioeconomic goals for the next 22 years. The report also outlines the strategy which will be adopted, key resources to be developed and the core policy reforms that will be implemented in order to achieve the Emirate's economic development. This long-term strategy will be translated into a five-year economic plan.

#### **The Vision**

By 2030, Abu Dhabi intends to build a sustainable and diversified, high value-added economy that is well integrated into the global economy and that provides more accessible and higher value opportunities for all citizens and residents.

Abu Dhabi is not only seeking to develop its economy but also to position itself among the most successful economies of the world by 2030. In developing its strategy, the government benchmarked itself against economies such as Norway, Ireland, New Zealand and Singapore.

#### **Opportunities & Challenges**

The Abu Dhabi policy agenda was defined by taking into consideration a number of opportunities and challenges.

The Emirate is conscious about the need to reduce its high dependence on oil and consequent cyclical swings. Its young national population presents both an opportunity and a challenge in terms of creating high added value employment opportunities. To support this new generation, focus will be placed on upgrading the quality of the education system and increasing educational attainment rates.

In order to reinforce its integration within the global economy and optimize its geopolitical status, the Emirate is also looking into achieving higher global rankings in terms of global competitiveness and ease of doing business. The Emirate will look into increasing its participation in global growth of trade in services as well as stimulating research and development and local innovation.

#### **Policy Objectives**

The government will seek first to build a sustainable economy mainly through diversification. This includes enlarging its enterprise base and encouraging entrepreneurs, small businesses and foreign direct investment (FDI) as well as enhancing competitiveness and productivity.

The second main objective is to ensure that all sections of the population benefit from economic growth through balanced social and regional development. A special focus will be placed on equipping the youth with the necessary skills to enter the labor market, maximizing women participation, continuing to attract skilled labor from abroad and stimulating faster economic growth in regional areas.

#### **Seven Economic Policy Priorities**

In order to achieve the above objectives, the government has identified seven areas of ongoing economic policy priorities:

1. Build an open, efficient, effective and globally integrated business environment
2. Adopt a disciplined fiscal policy that is responsive to economic cycles
3. Establish a resilient monetary and financial market environment with manageable levels of inflation
4. Drive significant improvement in the efficiency of the labor market
5. Develop a sufficient and resilient infrastructure capable of supporting the anticipated economic growth
6. Develop a highly skilled, highly productive work force
7. Enable financial markets to become the key financiers of economic sectors and projects

#### **Strategic Sectors**

The following strategic sectors are expected to form the Emirate's engines of economic growth and diversification:

- Energy – Oil and Gas
- Petrochemicals
- Metals
- Aviation, Aerospace and Defense
- Pharmaceuticals, Biotechnology and Life Sciences
- Tourism
- Health care Equipment and Services
- Education
- Media
- Financial Services
- Telecommunications Services

## DEMOGRAPHICS AND THE HUMAN CAPITAL CHALLENGE

The local population of the Gulf region is expected to grow at more than 2 percent annually until 2025, adding almost 18 million to the current population total of 54 million. There are two key trends defining the region:

1. Sixty-five percent of the population falls under the age of 25. This young population is experiencing high unemployment levels, mostly due to a severe lack of skills and experience. It is estimated that regional economies must create 80 million new jobs over the next 15 years to improve current rates of unemployment and living standards. Unemployment rates in Bahrain, Oman and Saudi Arabia range between 12 and 15 percent. This is expected to worsen with the financial crisis. In the UAE, 65 percent of the workforce is in the construction and retail sectors; the first being significantly affected by the crisis<sup>iii</sup>. Another challenge is that the public sector employs the majority of the local population (e.g., 90 percent in the UAE) and in the long term, the public sector will no longer be able to absorb the expected labor increase.
2. Given the talent gap exacerbated by the region's rapid growth, Gulf countries have become an attractive location for skills migration from neighboring regions, mostly from South Asia. Regionally expatriates from all continents make up between 30 to 40 percent of the total population, though in places like Qatar, Kuwait and the UAE it is estimated to be higher than 60 percent.

According to an International Monetary Fund (IMF) report, the GCC's industrial and financial sector ranked the shortage of human capital as the first challenge in the region. Labor quality surveys also indicate that overall quality of labor supply in domestic markets is low. Therefore, GCC's business leaders face a dilemma as to whether invest in domestic human resources or pay a higher cost of labor for expatriates.<sup>iv</sup>

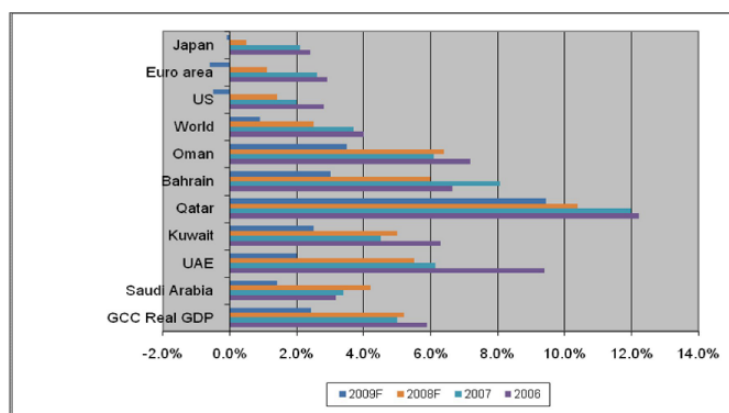
As a result, the priority of governments in the region is to ensure the availability of a stable supply of high quality labor to support their economic growth. They are working on two fronts: first, aiming to reduce unemployment among their population and equipping the latter with education and skills to facilitate their integration in the labor market, particularly the private sector; and second, continuing to seek expertise and skills from abroad while also focusing on retaining talents by improving labor market conditions and services provided to all their residents.

## THE GULF REGION AND THE GLOBAL FINANCIAL CRISIS

### DECLINING OIL PRICES AND THE END OF RECORD FISCAL SURPLUS ERA

It is only since the last quarter of 2008 that governments in the region have come to grasp the impact of the global financial crisis on their economies. They are now addressing the challenges that threaten the unprecedented growth they had seen over the past five years as a result of record high oil prices that reached over \$140 per barrel by mid-2008.

Chart: 01 Real GDP Growth Rates of GCC countries



*Estimates for GCC countries for 2008 & 2009 are Global's own estimates and for other countries are from World Bank Reports  
Source: World Bank and Global Research*

The collapse of oil prices in the second half of 2008 – at less than \$35 per barrel by the end of the year – signaled clearly that the days of accumulated oil revenues, current account surpluses and capital investments were coming to an end.

In 2009, the GCC region is expected to go through a sharp deceleration with significant impact on its real economic growth. The combined GDP of the GCC countries is expected to contract to 11.1 percent from 26.4 percent in 2008, and its growth rate to decline to about 2.4 percent from 5.2 percent in 2008.<sup>v</sup> The largest economy in the region, Saudi Arabia, will be the most affected in real terms with one of the slowest growth rates (1.4 percent) it has seen in several years. Qatar, on the other hand, will remain the most insulated despite a slight decline in its growth rate to 9.4 percent.

The decline in oil revenues as a result of lower oil prices and reduced oil production will have serious impacts on GCC governments' budgets, which are still heavily dependent on these revenues (representing over 80 percent). The Organization of the Petroleum Exporting Countries (OPEC) estimated that lower oil prices have resulted in a loss of around \$350 billion to its members. Should oil prices remain around \$40 per barrel, OPEC projects a 50 percent income loss in 2009.<sup>vi</sup> As a result, GCC current accounts are expected to nearly balance in 2009 and their fiscal balance will decline from 10.3 percent of their combined GDP, compared to 29.4 percent in 2008.

## TIGHT LIQUIDITY AND IMPACT ON INVESTMENTS AND PROJECT FINANCE

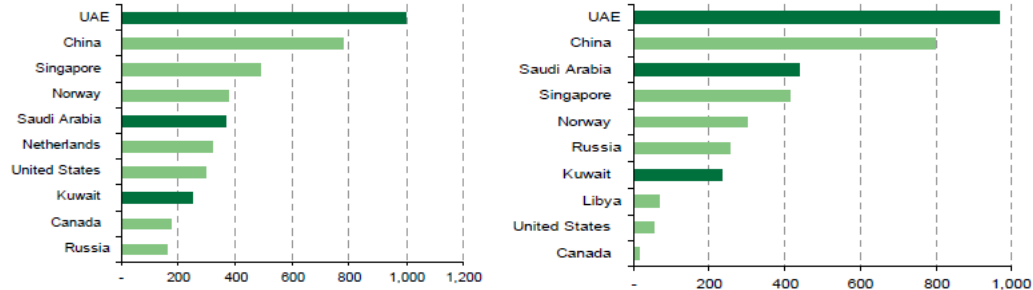
Overall, the region's number-one concern has been the resulting constrained fiscal environment reflected in tighter liquidity availability in the markets. This directly impacted project finance and led to delays and/or cancellations of projects, particularly in the real estate and oil and gas sectors.

According to the OPEC Secretary General, members have put on hold to after 2030 as many as 35 out of the 135 projects due to come on stream in the next few years. Among others, Saudi Arabia has delayed four refinery projects including the \$1.2 billion project restart production at its oil field. Other GCC countries have also modified their investment plans, mostly in terms of delays, on high-profile projects such as Dubai's Palm Deira and Dubailand as well as Saudi Arabia's \$80 billion King Abdullah Economic City.<sup>vii</sup>

Other factors that have exacerbated countries' overall financial and economic situation include:

- A major slowdown in the levels of **foreign direct investments (FDI)** into the region, which gradually became an important driver of growth as FDI inflows in the GCC had grown by 20 percent reaching \$43 billion in 2007 over one year. They were mainly concentrated in Saudi Arabia and UAE, together accounting for 87.5 percent of the total FDI for the region and placed in energy and construction related projects. Similarly FDI outflows from the region, which supported governments' diversification efforts, increased by 90 percent reaching \$41.5 billion, nearly four times the figure of 2005, with Kuwait, Saudi Arabia, UAE and Qatar accounting for 95 percent of the total outflow. While the United States attracted the largest share of Gulf investments, there was growing GCC capital placed within the MENA region (Jordan, Lebanon, Egypt, Tunisia and Morocco) in sectors such as telecom, real estate and manufacturing. A slowdown in GCC investments regionally is particularly expected to worsen the situation in the other Arab countries.<sup>viii</sup>
- The **sovereign wealth funds (SWF)**, which represent a major proportion of these FDIs, have also been impacted seeing the value of their holdings falling significantly. Different sources estimate that Gulf SWFs lost in the range of 25 to 30 percent on their investment portfolio or suggest that they have shrunk by 8 percent as a result of the global crisis.<sup>ix</sup>

Graph 6: Swinging fortunes of the SWFs and comparable government funds (at the end of 2007 and 2008)



Source: SWF Institute, World Bank, NCBC Research

Saudi Arabia, which did not establish a large-scale, formal SWF, was the least impacted due to the conservative investment policies of its government bodies. On the other hand, the Abu Dhabi Investment Authority (ADIA), the largest SWF in the region, was hardly hit with an estimated loss of over \$100 billion in 2008, partly due to its stake in Citigroup, which saw its share price fall by more than 95 percent. The Kuwait Investment Authority (KIA), the oldest fund in the region, also suffered losses worth billions; the Qatar Investment Authority (QIA) is reported to have lost almost half of its investment in equities and portfolios, including investments in UK real estate.

- The investment portfolio of the Gulf is expected to further decline in the absence of signs of improvement in **equity markets**. Domestically, the GCC combined market capitalization contracted from \$547 billion at the end of January to around \$525 billion markets with the loss of another \$22 billion in February 2009. The worst performers included Saudi Arabia, Kuwait and Qatar while Bahrain and Oman declined to a lesser degree. Exceptionally, UAE markets gained in value following the announcement of Dubai's government announcement of a \$20 billion bond program (see box below). Uncertainty about the economic revival and loss of investor confidence continue to heavily weigh on the five regional bourses (Saudi Arabia, UAE, Kuwait, Bahrain and Qatar).

**Snapshot: The Case of the Arab Developing Economies**

Unlike the GCC countries, the impact of the global crisis on the other economies in the Arab region will be more significant. According to the IMF's forecast, growth rates are expected to decline from 6.5 to 3.5 percent. There are several considerations that distinguish these countries from their GCC neighbors:

- These countries do not have the capacity to sustain their spending, as they cannot rely on accumulated reserves like GCC does and, therefore, face worse fiscal tightening.
- They will also face increased pressure as they see their trade, remittance and investments affected by the global downturn. North African countries are heavily reliant on their close ties with Europe and already seeing significant drops in their export numbers and in the external current account balances. While impact on the remittances has not yet been assessed, considering that construction and real estate sectors have been severely affected, this will also soon be reflected in the revenue balances.

**Example: Egypt**

Over the past few years, Egypt has built up its current accounts and benefited from foreign investments. Also ranked as top reformer by the World Bank, Egypt is recognized to be better equipped to face the crisis. The economic reforms undertaken by the government have led to more currency flexibility; there has been a loosening of fiscal and monetary policies and the country's banks have sufficient liquidity to pick up the slack without relying on international aid.

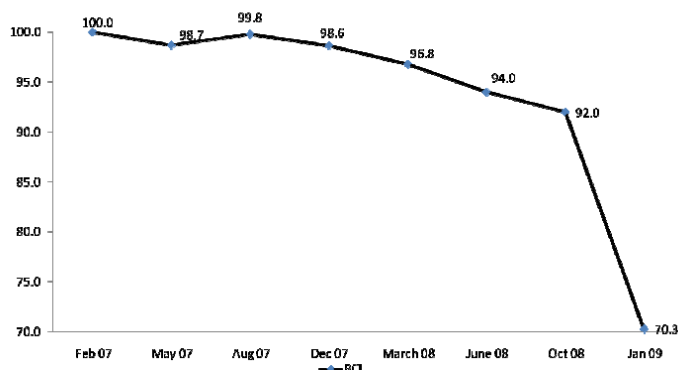
However, this will not lessen the impact on Egypt primarily because its economy is driven by external demand – mostly from tourism and the Suez canal remittances. This is leading to a direct erosion of its GDP. There is also a significant deceleration in investment due to internal market slowdown and a reduction of FDI especially from EU and GCC expected by 50 percent. Egypt will not have the capacity to sustain its spending and even the slightest reduction particularly on infrastructure will have serious repercussions. On the monetary side, cutting interest rates presented a good sign but will have a limited impact because the private sector did not build up savings and are now holding off on investments. The crisis has shed particular light on the fact that the Egyptian reforms did not have yet a trickle-down impact. The main risks lie in rising unemployment and its social impact.

**SIGNIFICANT LOSS OF CONFIDENCE**

According to the latest HSBC Gulf Business Confidence Index, the level of business confidence in the region is continuing to trend downward, moving from 70.3 in the final quarter of 2008 to 69.7 in the first quarter of 2009.<sup>x</sup>

Business people did not express clear causes for their lack of confidence. More than 42 percent cited “the economy generally” as the greatest challenge to their business this year. As for the duration of the slowdown, 28 percent expect things to turn around within a year, while more than one-third saw improvements and economic recovery within two and more years.

*Trend of overall Business Confidence Index*



The level of uncertainty is also reflected on an individual level. Companies seem to have difficulties foreseeing and/or communicating about their own future performance, with one in four responding “don’t know” when asked about their profits, turnover and investment budgets for 2009.

However, the survey highlighted differences in outlooks within various sectors. Half of the businesses in automotive and retails sectors saw their investments shrinking or their growth margins eroded (e.g., construction), while the consumer, industrial and banking sectors anticipated growth in their investments.

Within the region, the UAE had the most significant loss of confidence, dropping from 91.5 to 62.2 (based on last quarter of 2008). In the first quarter of 2009, Kuwait, despite recent events, and Oman were the only two countries which saw an improvement in terms of business confidence.

### Industry Snapshot: The Future of GCC Projects

By December 2008, GCC projects reached \$2.54 billion, an increase of 57.5 percent within a year. Investments were mostly concentrated in real estate, oil and gas, and power. Together Saudi Arabia and the UAE represent the biggest project markets, making up about 73 percent of the total projects in the GCC.

Due to several factors, including increased cost of building materials, decreased liquidity and global economic slowdown, many projects have been delayed, particularly from the real estate and oil and gas sectors, which represent 81.1 percent of the total projects in the region. According to Proleads, a research firm, 150 projects are currently on hold, 88 of which in the UAE, 45 in Saudi Arabia and 15 in Kuwait.

The lack of funding and tight liquidity has particularly affected the private sector. Companies in real estate have announced layoffs, delayed future projects and seen their stock prices at an all-time low, including major players such as Emaar, Nakheel and Arabtec.

This trend is expected to continue in 2009, particularly in the construction sector, where unemployment could increase due to layoffs, property prices are expected to go down due to less demand and less liquidity will enter the sector as investors back out, resulting in a slowdown in the projects activity.

Other sectors impacted to a lesser degree include petrochemicals, as in the case of Kuwait's cancellation of a \$17.4 billion joint venture with Dow Chemical. On the other hand, projects in the power sector are ongoing, with the Rabigh and Ras-Alzour projects in Saudi Arabia and Salalah project in Oman.

While project markets in the GCC have clearly been hit by delays, in the long term, they are expected to continue to perform very well mainly because of the region's strong macro-economic factors and the continued government support to infrastructural related projects.

**Table 02: GCC projects in 2009**

(US\$ mn)	Jan 5.2009	Dec 22.2008	% Chg.	Jan 5. 2008	YoY Chg. (%)
Bahrain	64.3	64.2	0.2	27.9	130.5
Kuwait	303.6	303.9	-0.1	275.0	10.4
Oman	107.1	107.2	-0.1	50.7	111.1
Qatar	222.6	222.4	0.1	156.7	42
Saudi Arabia	618.1	615.3	0.4	390.2	58.4
UAE	1,232.3	1,231.2	0.1	714.5	72.5
<b>GCC Total</b>	<b>2,548.0</b>	<b>2,544.3</b>	<b>0.1</b>	<b>1,615.0</b>	<b>57.8</b>

Source: MEED Projects

### POLICY RESPONSE TO THE CRISIS

It is only within the last quarter of 2008 that the Gulf region felt the contagion effect of the crisis mainly in terms of the repatriation of capital, impact on trade and on the financial and credit markets. The GCC countries have since focused their responses on meeting the challenges of decreased demand on their products and services and the decline in consumer and investor confidence in their domestic markets.

As they came to realize that the global downturn was more protracted and severe and the prospect of a sustained upswing of the oil price and liquidity conditions is not likely to come soon, policy decision-makers' main question was how best to calibrate their policy response when the duration of the downturn is unknown.

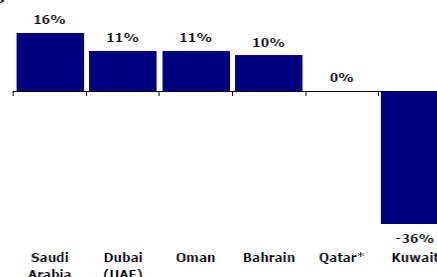
Unlike other global responses, the GCC governments have not yet launched and managed comprehensive rescue packages, with the exception of Kuwait, which is still struggling to achieve consensus over the economic stimulus package presented

to the Parliament. However, the successful implementation of this bill could set the trend in the region.

- Increasing budget spending:** In the short term, the accumulated reserves that the region amassed over the past years (including SWFs disposal of \$1.5 trillion) have provided the governments with the ability to support and sustain their economies' growth. Their response to date is still based on their broader policy strategies which are largely based on the need for economic diversification. The recent budgets adopted by governments in the region (except for Kuwait) clearly reflect their commitment to stay on course in terms of their spending and investments:

- Despite the projection of revenue decline, the Saudi Arabia government's expenditure was increased by 16 percent, which is expected to result in a budget deficit of \$17 billion compared to a budget surplus of \$11 billion in 2008.
- Dubai also announced an 11 percent increase in its government spending, resulting in a budget deficit which will reach for the first time 1.3 percent of Dubai's GDP.<sup>xi</sup>

Figure: 2 – Government Expenditure - % change 2009 Budget Vs 2008



Source: Central Government Websites, Press releases, Analyst Estimates  
 Note: Change in Qatar's government expenditure is based on analyst estimates

- Supporting the financial sector:** Initiatives have been taken across the region to support banks and financial institutions. In Qatar, the Qatar Investments Authority has been acquiring 10 and 20 percent in the local Qatari banks. In the UAE, Abu Dhabi issued an emergency bank fund plan of \$32.67 billion to protect the banks and guarantee deposits. More recently, the Dubai government announced a \$20 billion bond program aimed at supporting distressed companies (see below).
- Reviewing policy and regulatory frameworks:** While the Gulf region clearly is not facing the same issues as the West, particularly in terms of losses relevant to toxic assets, in the long term, governments in the region key will be challenged to deal with the absence of relevant policy and regulatory tools to address this crisis. The latter revealed that there is an important need for a comprehensive financial policy framework covering monetary, fiscal and financial issues. It is a time when issues relevant to supervision and monitoring of financial institutions, risk management, corporate governance have come to the forefront of policy agenda and will be placed under more scrutiny. This is also expected to be a period of regulatory uncertainty and more comprehensive reviews.

### Snapshot: Government Intervention in the United Arab Emirates (UAE)

Since the last quarter of 2008, the UAE government carried out a number of interventions focused on protecting and supporting their banking and financial systems. The measures were taken gradually and not as part of a comprehensive economic stimulus package.

From a political perspective, the liquidity and bond injections into the markets denotes Abu Dhabi at the forefront of shaping longer term vision with tools and processes to safeguard its own and Dubai's emergence from the economic crisis. Rumors for a rift between Abu Dhabi and Dubai were quickly addressed, and communication announcements continue to make reference to a "federal response" to the economic crisis.

From an economic perspective, the key objective was to regain trust and confidence of the business community (local and international) in the markets by ensuring that the financial institutions have sufficient capital to sustain economic activity, particularly in the real estate and construction sectors, the worst hit by the crisis. Dubai's announcement of a bond program (c.f. third intervention below) was received positively, while there is an expectation for strategic plan review and implementation – one that can sustain a longer term turnaround from this crisis.

#### First Intervention

- Establishment of an emergency bank funding plan of DHS 120 billion (US\$32.67 billion) pulled together by the Central Bank (50 billion) and Federal Bank (70 billion) in September 2008
- The funds were deposited in the UAE's 24 national banks and 28 foreign units, all members of the Emirates Banks Association (EBA) to counterbalance liquidity shortages
- Modification of the terms governing equity stakes making them more restrictive by the Federal Bank following criticism and hesitance of banks to tap into the plan

#### Second Intervention

- Capital injection of DHS16 billion by the Abu Dhabi government into the market through the banking system in January 2009
- The beneficiaries of this capital were limited to five Abu Dhabi banks (National Bank of Abu Dhabi, Abu Dhabi Commercial Bank, The First Gulf Bank, Union National Bank and Abu Dhabi Islamic Bank)
- This initiative aimed at reflecting government's commitment to adequately equip the banking sector in driving the Emirate's diversification plan as outlined in its 2030 economic development plan

It also aimed at supporting banks to sustain their lending considered crucial to growing the economy

- Contrary to what was expected, markets reacted negatively because this was perceived as a unilateral move by Abu Dhabi to leave behind Dubai in an unclear and difficult position adding to the exiting concerns about Dubai's ability to repay its debt obligations
- According to EFG-Hermes estimates, Dubai has an outstanding debt of \$74.2 billion comprising \$62.9 billion from wholly or majority owned entities and \$11.4 billion from minority owned entities
- In the corporate sector, Dolphin Energy and Borse Dubai, owned by Investment Corporation of Dubai, are the largest debtors, having an outstanding debt obligation of USD4.8bn and USD3.4bn, respectively, to be paid this year.
- The ratio of loans to deposits in the UAE grew to 112 percent in January 2009
- Total deposits in the UAE fell to DHS 905.7 billion in February (US\$246.58 billion) from 922.5 billion in December, while loans and advances increased to DHS 1.02 trillion, compared with 1.01 trillion in December 2008.
- In November 2008, Dubai advisory council estimated the sovereign debt obligations at \$10 billion, and sovereign assets to more than \$90 billion. While the debt obligations of government owned companies equaled \$70 billion, their combined assets were estimated at \$ 260 billion

#### Third Intervention

- Launch of \$20 billion unsecured bond program by Dubai government in February 2009
- The first tranche of the \$10 billion was subscribed by the UAE Central Bank. Dubai bonds carry a fixed yield of 4 percent per year over five years
- The proceeds of the issue will mainly support the refinancing of Dubai's loan repayments, which total about \$14 billion and are due this year
- The bonds are also expected to assist companies to refinance their obligations, The funds will be administered on a case-by-case basis, depending on negotiations with the companies and assessment of their needs. The cash injection will either be done directly or through local banks
- Priority beneficiaries of the funds will be companies in the real estate sector, government-owned entities and SMEs
- The stimulus was essentially seen as a policy move to reassure investors and markets about Dubai's economy and ability to meet its financial obligations and reiterate Emirates' unity

## FUTURE TRENDS AND INVESTMENT PRIORITIES

### POST-CRISIS OUTLOOK: A STRONGER REGION WITH INTERNATIONAL ASPIRATIONS

Over the past years, the Arab region, led by the GCC, has strengthened its position on the economic international scene, driven by its economic diversification policies, improved management of its resources and higher productivity.

Despite the impact of the economic downturn, the region is expected to move forward much faster than Europe and the United States by relying on its strong macro-economic fundamentals and key drivers which include its demographics and its spill-over effect (Arab labor market); its continued investments in production and capacity; and a strengthened financial and banking sector, including Islamic finance, which proved to be more resilient to the crisis as a result of its share risking practice.

Additionally, as the GCC works its way through a closer economic integration with a common union and the creation of a common currency, the region is expected to play a global stabilizing role. Generally economists foresee that, should the governments in the region succeed in managing the crisis with the appropriate policy framework and tools, the Gulf will emerge stronger and have a more influential role on world growth.

This positive outlook is premised on a number of trends to be followed by key policy- and decision-makers in the region:

#### 1. Sustained economic stimulus

- Governments remain committed to economic diversification and this will guide their decisions, including maintaining their spending on key sectors (e.g., upstream gas, power, water, transport) and developing human capital to sustain economic growth.
- The stimulus packages are expected to improve the liquidity and credit situation and in turn support the long term growth of projects in the region.
- Key investments will focus on:
  - **Energy:** According to the Arab Petroleum Investment Corporation (APICORP) review report 2009-2013, the region requires energy investments of about \$650 billion in the coming years.<sup>xii</sup> Upstream oil and gas investments will continue in the region (mostly for already approved projects) with few new ventures coming online beyond 2012 including in the UAE, Qatar and Kuwait. Generally governments will aim at turning more of their oil into refined products and petrochemicals and to use oil and gas resources as feed stocks for industries that will add more value and provide more jobs.

- **Utilities and transport:** Governments will continue to support and invest in sectors that cater to their growing population, including power, water, electricity and transport. In Qatar, General Electricity and Water Corporation (Kharamaa) is considering expanding its power network that will cost \$18 billion in the next seven years. It is planning to build 29 high voltage substations. About 45 percent of the Dubai budget 2009 has been earmarked for infrastructure and public transport, with beneficiaries being the Road and Transport Authorities, Dubai Metro, Dubai Municipality projects and Dubai Ports Authority.<sup>xiii</sup>
- **Financial services:** The latter will continue to be a major contributor to the region’s economy, as it aspires to become a regional hub and Islamic finance will represent significant growth area.
- **Industrial and manufacturing:** In the UAE, the sector grew by 40 percent within the past four years with the investment volume more than doubling. A recent statement by the UAE Minister of Economy reflected UAE’s ambition to become the “preferred destination for investments in high-tech and heavy industries for global investors.”<sup>xiv</sup>
- **Health care and education:** There is significant need for investments in these areas, considered still underdeveloped to serve a growing young population. Projects contributing to ensuring access, quality and capacity building are given priority.
- **High-tech:** GCC also aspires to develop into a centre for technology. The region is working on establishing more research and development platforms, including opening new research centers.<sup>xv</sup>

## 2. Policy and regulatory reviews and development

- The impact of the economic downturn has prompted governments in the region to take a closer look at their economic and financial systems and seriously engage in the review of their policies and regulations.
- Reviews have already begun including on the national strategic plans (e.g., Dubai’s five-year strategic plan). Focus will be placed particularly on the financial sector and the need to develop a more comprehensive financial policy framework that covers fiscal, monetary and financial issues.

## 3. Closer economic integration

- The crisis has given a stronger impetus to the advocates of accelerating economic integration within the region starting by the establishment of a monetary union.
- The deadline for the establishment of a common currency (2010) has not yet been postponed, and efforts are concentrated on establishing the necessary institutions (e.g., GCC Central Bank) to manage the common market.

- A review and harmonization of financial, fiscal and monetary issues is already engaged in closer coordination among the GCC countries.

#### **4. Inward investment and stronger Eastern ties**

- In light of a draw-down of their reserves resulting from lower oil prices and increased government spending and budget deficit, disengagement is likely to occur gradually as GCC investors and authorities turn more toward domestic priorities.
- Regional or intra-Arab trade will also expand quickly, helped by closer economic integration (for GCC monetary union) as well as improved transport connections (e.g., new rail networks) and increased links forged by Arab migrant workers, who will form a larger part of the GCC expatriate labor force.
- At the same time, in the long term, the GCC countries will maintain their recent interest and move toward Asia and particularly China and India to diversify their investment portfolios. The Kingdom's Saudi Arabia's "look East" policy (since 2006) is starting to pay its dividends. China is now the Kingdom's fifth-largest export market, while China represents the second-largest importer of goods and services to Saudi Arabia. In addition to its access to Saudi oil, China has become an active player in the Kingdom's infrastructure and construction projects with more than 70 companies already.
- In terms of outward investments, the GCC's SWF will remain key players even though their growth depends heavily on the future of oil prices. For the time being, they have adopted a more cautious attitude in their investment decisions. In the short term, there will be a pressing need for them to invest within their own region to offset the impact of falling foreign investment and tight international credit markets. However, investment opportunities within the region will be limited and therefore SWFs will seek again that their assets are geographically diversified and look for international opportunities.

#### **5. Corporate sector consolidation**

- In 2008, the number of deals in the GCC region had doubled (to 188) compared to the same period in 2007. The UAE represented the largest share of M&A transactions (53 percent) followed by Qatar (12.4 percent) and led the region in terms of value of deals with 72 percent share of the \$9.2 billion total.<sup>xvi</sup> The financial services industry was the most popular deal target and accounted for the largest transactions.
- While the credit crunch and tight liquidity conditions are likely to impact and slowdown M&A market, the latter is expected to grow, with the real estate, banking and financial services being the main target sectors.

- The M&A activity will be driven by governments' initiatives to stabilize the real estate and equity markets and their efforts to boost market conditions.
- Corporate consolidations among small and mid-sized firms are also expected in order to face the current crisis as they look to benefit from synergies emanating from economies of scale.

## ABOUT APCO WORLDWIDE IN THE ARAB REGION

APCO Worldwide is an award-winning, international strategic communication consultancy. APCO's office in Dubai is at the heart of our network across the Arab region and is an integrated part of APCO's network of 575 communication professionals in 29 offices around the world.

Our executives in the Arab region and internationally are the very best in their fields. Drawn from media, business, politics and non-governmental organizations, our specialist teams offer an unparalleled understanding of regional markets and issues, which, when coupled with a wealth of experience in international best-practice, delivers the best solutions to issues affecting our clients.

### A LOCAL APPROACH GLOBALLY

APCO Worldwide develops strategies that are driven by a wealth of local and international experience, professionalism and integrity. At the highest level, we facilitate international outreach for Arab corporations and provide local expertise to international organizations embedded in the Arab region's markets or to those wishing to enter the markets. At the core of our service offering is an absolute understanding of today's business imperatives and a drive to deliver tangible results. For more information about our services, please visit our Web site [www.apcoworldwide.com](http://www.apcoworldwide.com) or contact us at +971.4.401.9768.

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<sup>i</sup> « The GCC in 2020 : Outlook for the Gulf and Global Economy »

<sup>ii</sup> The Abu Dhabi Economic Vision 2030

<sup>iii</sup> The National, 17 December 2008

<sup>iv</sup> GCC Economic Outlook January 2009, KMEFIC Research Department

<sup>v</sup> « GCC Macroeconomics – Changing Paradigms », Global Investment House, January 2009.

<sup>vi</sup> « Policy stumbles and (renewed) market fears », GCC Economic Monthly, NCB Capital, March 2009

<sup>vii</sup> Idem as iii

<sup>viii</sup> Idem as ii

<sup>ix</sup> Idem as iii

<sup>x</sup> Zawya, 25 March 2009

<sup>xi</sup> «Markaz Strategic Research : Shelter in a storm », Markaz, March 2009

<sup>xii</sup> « Policy stumbles and (renewed) market fears », GCC Economic Monthly, NCB Capital, March 2009

<sup>xiii</sup> Gulf News, 10 January 2009

<sup>xiv</sup> Gulf News, 28 January 2009

<sup>xv</sup> Gulf News, 19 March 2009

<sup>xvi</sup> « GCC Macroeconomics – Changing Paradigms », Global Investment House, January 2009.