"Financial Market Developments in the Middle East"

FINANCE FOCUS BREAKFAST

With
Dimyanos Kattar
Independent consultant, former Finance Minister of Lebanon

In the first Finance Focus Breakfast session of 2009, Bruegel welcomed Dimyanos Kattar, former Finance Minister of Lebanon, to share his inside views of the financial market developments in the Middle East and North Africa (MENA).

As an introduction, our speaker highlighted that MENA region has undergone a lost decade in the nineties and a renaissance in this decade. In the recent years the economic growth rate in the region has doubled, job creation has also accelerated and external debt has been gradually reduced in most countries. The challenge ahead is to create by 2020 one hundred million jobs to reduce high unemployment rates.

More important, these countries have accumulated large amounts of reserves that are used for the first time to invest in the region, following a well planned and long term strategy. As a result, economic growth is promoted by a solid trend of diversified domestic investment rather than by consumption and the economic outlook is promising in spite of the current crisis.

The current financial crisis is present perhaps only in Dubai, which was the only financial centre to follow an 'Anglo-Saxon' model. The rest of the financial system is fairly stable, with a low mortgage penetration ratio, little leverage in banks, and a strong deposit base based on traditional business models.

Dimyanos Kattar presented then some features of the financial markets on MENA region and how the current crisis has affected this area. First, this is a geographic area with strong links with Europe, starting with the Barcelona Agreement and followed by EU neighbourhood policies, with a component of migration policies.

Even though financial markets' integration in this region is lagging, structural and institutional reforms in some countries provided investment opportunities for countries with liquidity abundance (Gulf States), creating for the first time large amounts of intra-Arab flows (17 billion dollars in 2006). There is a very positive reaction to hedge funds and structured products among private and institutional investors, in spite of the boundaries fixed to interest payments under strict Islamic law.

The global financial crisis has also affected capital markets in the region, with losses up to one half of the total market capitalisation, in addition to the markets' correction from 2005. However, the outlook is positive since the region still has strong fundamentals and the spillover effects from other markets are still limited due to an incomplete integration with international capital markets.

Capital markets in the region are young and thus growth potential is significant. New markets have been created, privatisation is being promoted by international institutions, especially in the telecom industry, and there is a wide potential investor base.

To conclude his presentation, Dimyanos Kattar talked about the two main elements behind the strength of the financial system in the MENA region, namely sovereign wealth funds and Islamic finance. Recovery from the current crisis is backed by huge reserve funds accumulated in the

past 5 years. Sovereign Wealth Funds can deploy over 1.5 trillion dollars to support regional growth in case the economic situation remains gloomy. They are also designed to boost economic growth over the next 20 years.

Finally, Islamic finance is growing, with around 500 billion dollars in sukuk (bonds) and new issues expected (100 billion by 2010), all sharia compliant. These developments are a privilege for the region because the financial capacity stays in the region.

The round of questions and answers tackled first the possible scenarios for privatization in the region. The telecoms sector has undergone a fast and successful process of privatization. In banking there is no clear trend, since the crisis has triggered a wave of nationalisations in the sector internationally. In the oil sector, as in infrastructure, there is a contradiction between the will to attract foreign capital to make strong and liquid companies and the aim to protect sectors deemed strategic by the political establishment. The services sector is therefore relatively more prone to be privatized.

The second question addressed the deregulation drivers in the region. The attitude of policy makers towards deregulation will depend primarily on oil prices in the near future. If the price of a barrel falls below certain levels, in spite of interests in sectors' lobbies, the governments are likely to hold the process. [are you sure? I understood the contrary]

Another question addressed the buffering impact of sovereign wealth funds in the context of crisis and investment commitments. There is no relation between sovereign wealth funds and national budgets in the selected GCC countries with SWF in place. The cushion provided by sovereign wealth funds takes place in the transformation of the economy. In a worst case scenario, the economic growth project based on SWF will slow down but it will continue in place. However, the challenge is whether these countries will be in need to use them to face the current crisis, which depends on the oil price and the debt level.

On the enthusiasm towards structured financial products in the region, our speaker argued that structured finance, in particular, forex structured in recent times, is still very popular for institutional investors in spite of recent market developments.

Another question tackled the future GCC monetary union. On this respect, there is political will but some reluctance from national central banks. It is not clear yet where the future common central bank will be located or what model it will follow. In addition, there is an unsolved issue about the custodian for foreign investment in the area. Finally, the exchange rate regime and the shift from the peg to the dollar are other important pending issues to be solved before 2010.

To conclude the session, some comments about the Lebanese economy were made. On one hand, Lebanon faces two challenges, namely the constant aggression between Israel and Hezbollah and the short term economic growth perspectives. The economy was healthy in 2008 and only a slight slowdown is expected in 2009 if there is no large return of migrants to the Gulf. Only a negative mood and bad economic policies could put at risk this positive scenario.

Lebanon has the advantage of counting on a resilient private sector and strong and constant investment inflows from the Lebanese Diaspora. These two elements build up permanent and solid advantages for the country.