

Evolving opportunities in the Middle East

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Ladies and Gentlemen, four years ago, I left Korea and began working in the Middle East and North Africa. It has been both a challenge and a privilege to witness first hand a time of extraordinary and unprecedented change.

No-one knows with any certainty how recent events will resolve themselves. In much of the region, uncertainty is simply a fact of life. The murder of the American ambassador to Libya last month was a shocking reminder that many live under the daily threat of violence and hardship.

But my argument today is simple. I believe, in the medium to long term, that there are sound reasons to be confident about the region's prospects for prosperity and growth.

First, a little history.

In December 2010, a Tunisian street vendor made a desperate protest against officialdom, setting himself alight in front of the local Governor's office. Mohamed Bouazizi died of his burns, but not before his example had inspired popular uprisings across Tunisia.

As we now know, this action would be the inspiration for a wave of unrest to sweep across the region. Almost every country in the Middle East and North Africa has now seen some form of popular protest as part of this "Arab Spring".

Governments have been overthrown in Yemen, Libya and Egypt. New administrations are finding their feet. Elsewhere, conflict continues. As we speak, rebel and government forces are fighting on the streets of Syria. In some instances, violence has spilled over into the north of neighbouring Lebanon. Public protests carry on in Bahrain.

The constant backdrop to this is the ongoing tension between Israel and its neighbours. This is a familiar story, but it has reached a new stage, with leaks about the Israeli cabinet contemplating military force to curtail Iran's nuclear plans.

Citizens, neighbours, policymakers and businesses are still coming to terms with what the Arab Spring means now and for the long term.

Indeed, there is considerable disagreement over the nature of the forces that have got us where we are today.

Time Magazine named "Arab Youth" their person of the year for 2011, seeing in the Spring the coming of age of a new generation; the American President has described the Arab Spring as a movement for "self-determination" and "basic human rights"; the Ayatollah Ali Khameini of Iran sees it as an "Islamic awakening"; Tawakul Karman, meanwhile, joint winner of the 2011 Nobel Peace Prize for organising protests in Yemen, describes it in rather more practical terms - as a struggle against "corruption, poverty and unemployment."

So perhaps it should not come as a surprise that even in the countries that have made the most progress towards establishing stable new institutions, the long-term ramifications are unclear.

How stable will new institutions be? Will the tribal system give ground to broader meritocratic societies? What will be the balance between autocratic and democratic forms of government? What will be the role of religion in public life? And what will be the response to the needs of a growing demographic?

These uncertainties have had a significant short-term impact on economic activity and investors' confidence. Since 2008, foreign direct investment into the region has fallen every year, from a high of USD 100 billion, to USD 44 billion last year.

It is true that this decline reflects, in part, the global financial crisis, but it also reflects a significant drop in inflows to Egypt and Libya - in 2011 in particular - as investors have stood back and waited for the dust to settle.

Yet recent events have done nothing to detract from the region's underlying fundamental strengths.



In fact, if you subscribe to Warren Buffett's maxim that the best time to be interested is when others interests are elsewhere, then this is a good time to look seriously at the Middle East and North Africa.

I would argue that four factors will underpin the region's medium to long-term economic success. Four pillars support the case for being confident about the region's prospects.

The first pillar is natural resources. The Middle East and North Africa are home to large commodity suppliers. They sit above 58% of the world's proven oil reserves and 45% of the world's gas reserves.

It's true that shifting oil prices will always be a source of volatility for a region whose economies rely to a significant extent on petroleum. Over the past five years, oil has hit highs of over USD 140 per barrel, and lows of less than USD 40. However, over the same five-year period, the states of the Gulf Cooperation Council recorded a cumulative budget surplus of some USD 550 billion. And largely as a result of oil and gas revenues, six of the world's largest sovereign wealth funds are in the Middle East.

Under existing constraints, no matter how extensive the policies in favour of low-carbon and renewable energy, it is hard to envisage a scenario where it isn't a major asset to be rich in hydrocarbons.

The second pillar is the region's enviable demographics. More than three in five citizens are aged under 25, a far greater proportion than in Europe, the Americas or China. It means the countries' dependency ratio should be relatively low for decades, with many more people of working age than in retirement. Egypt's working population is expected to grow more than 50% by the middle of the century, Turkey's by 20%.

This youthful population will represent a market of consumers as well as a potential workforce. As economic development progresses, they will have more expectations of their living standards, more spending power and increasingly sophisticated tastes.

Last year, research sponsored by HSBC showed that half of inward investors into the region expect a growing middle class to create business opportunities for them in the years to come.

At the same time, the need to build sustainable economic structures capable of supporting the massive increase in the working age population is driving major infrastructure investment.

The third pillar for confidence in the region's prospects is its geographic position. As economic power continues to shift East and South, the region is well placed. It matches established links to developed economies with rapidly strengthening relationships with other dynamic regions.

Current estimates suggest that south-south trade will increase at a turbocharged pace in the coming years. It could grow by as much as ten times by 2050. This would represent a modern resurgence of the Old Silk Road linking Asia and the Middle East - with the difference that the 21st-century version will tie in Latin America too.

In fact, the Middle East and North Africa are already seeing trade with other faster-growing markets increase markedly, not least Asia. Trade flows between the two regions have been growing at a compound annual rate of 18% since the turn of the century.

Since 2009, China has been importing more oil from Saudi Arabia than the US. This, in all probability, is the shape of things to come. Where commodities lead the way, it is reasonable to expect an increasing flow of manufactured goods and services to follow.

The fourth reason to be confident in the region's medium and long term economic prospects is the business environment.

In much of the region, and the states of the Gulf Cooperation Council in particular, governments are pursuing pro-growth policies.

As a result, capital markets are developing fast; currencies are relatively stable; governance is improving, and although some challenges remain, the regulatory environment is increasingly favourable.

Under the World Economic Forum's Global Competitiveness rankings, UAE is ranked above China and Spain. Both Saudi Arabia and Qatar are ahead of France and Australia.

Analysing the region's strengths - the four pillars of resources, demography, geography and business environment - we see very compelling reasons to be excited about the opportunities in the region.

Egypt has the potential to grow incredibly quickly over the next fifty years. Saudi Arabia is also likely to grow vigorously. Just a brief look at the forecasted growth in infrastructure investment for the Kingdom to the end of this year shows the scale of the opportunity. And we expect the rate of growth to continue.



UAE and Qatar start from a solid base of fiscal strength.

Indeed, at a turbulent period for the world economy as a whole, the region continues, on average, to grow more robustly than the eurozone or the US.

In 2009, though this region's economies cooled considerably, they still grew while developed economies shrank. In 2011, GDP for the Middle East and North Africa grew at 5.1%, against 1.3% for developed markets.

The region's countries are on average less burdened by debt. Gross debt was just 13% of GDP, compared to over 100% for developed economies.

Intra-regional capital flows remain strong, with oil exporters - notably Qatar, but Saudi Arabia, the UAE and Kuwait too - investing in their regional neighbours. This reflects their considerable sovereign wealth. The Qatari Investment Authority alone has said it intends to invest some USD 30 billion in 2012, with over USD 100 billion already under management.

And the region's corporate sector remains strong. Even in Egypt, which has seen its budget shortfall widen this year, the stock market has performed strongly, largely because of local sentiment. This indicates to me that Egyptian people feel confident in the future of their country. Blue chip companies such as Talaat Mustafa Group and Ezz Steel appear to be getting on with business very successfully after dramatic changes of leadership.

So I would argue that this is a time to be optimistic about the potential for investing in and trading with Middle East and North Africa.

As is the case with any emerging market, there are uncertainties and risks. While we anticipate average growth to be strong, it very rarely goes in a straight line.

After the multi-year development boom beginning in the 1990s, Dubai's near default in 2009 was a pertinent reminder that confidence can collapse, and markets fail, even in the most affluent and asset-rich locations.

But the events of 2009 highlighted resilience as well as risk. Under the rescue package from Abu Dhabi, and with strong leadership from the Dubai government, Dubai's problems are not gone, but they have been recognised and are being addressed. Tourism and business visitor levels are back to pre-crisis levels. The real estate market is beginning to see growth and increasing value again.

And actually, if we're talking about risk and uncertainty, some investors from the Middle East are actively challenging the accepted sentiment of a previous generation.

The Qatari Investment Authority has said that while conditions are still "foggy" in the States and Europe - with the uncertainty of the American election and the long-term prospects - it has no particular preference for developed markets

The attitude of the region's new leaders, in those countries which have seen changes in administration, is another element of uncertainty. But I think it's important to recognise that there are compelling reasons for them to bring down barriers to trade, and embrace investment.

Political stability requires greater levels of economic stability. Economic stability requires investment in the sytems and infrastructure to support it. Foreign expertise and investment can make a major contribution to the delivery of these systems and infrastructure essential to the region's further development - and not just economic development, but social development.

Arguably, external institutional investment could also reduce some of the volatility inherent in unseasoned markets, and improve stability.

If the region's new leaders embrace trade, and create predictable conditions for businesses, then this could be an opportunity for the region to consolidate its status as an international trade and investment partner.

There are particular areas and sectors which may represent opportunities for foreign companies.

All Middle Eastern and North African countries aspire to improve their infrastructure, to meet the economic and social needs of a young and growing population. The oil producers have serious means to do so in the form of sovereign wealth funds. Saudi Arabia alone had some USD700bn of infrastructure projects underway or in hand last year. UAE had over USD500bn.

Major projects in prospect include: over a thousand kilometres of rail across the United Arab Emirates; a colossal wastewater management facility in Kuwait; new and improved ports facilities all around the Gulf; roads, bridges and tunnels; any number of residential and commercial property developments; the facilities and venues required for the Football World Cup in 2022 – a new bridge connecting Qatar to Bahrain, a new metro for the capital, Doha.



Roads, ports, shipping, residential and commercial property are all areas where Asian companies have the credentials to bid and to win.

A second major priority for the region is education. Youth unemployment runs at 25% in some states of the Gulf Cooperation Council. This has unquestionably been a factor behind political unrest.

National leaders recognise that in the long term, the ability to develop their economies into more diversified and higher value-added sectors will depend on the quality of education.

Education is also essential to change the shape of today's industries. Some key sectors, including petrochemicals, rely on a sizeable proportion of foreign and migrant workers to fill high-skilled roles. Equipping the region's young people with the right skills, including scientific and technical skills, is the only way to achieve sustainable change here.

Some states have drawn inspiration from American and English models of education. Education City in Qatar hosts campuses for London's UCL, America's Georgetown and A&M. Weill Cornell Medical College, part of the same complex, is the first American medical school outside of the United States.

However, the region is also looking east for expertise and advice and guidance in developing its education system at all levels. Singapore's school system has attracted attention, and the decision by Korea's Ministry of Education, Science and Technology to facilitate internships for Korean students in Saudi Arabia and UAE is evidence of growing partnership and cooperation in this important field.

A third priority for the region is the further development of energy industries.

Of course, The Gulf Cooperation Council states are renowned as oil producers, but Saudi Arabia is leading the way in efforts to diversify. A research centre in Riyadh has suggested that the country could derive more than 20% of its energy from solar by 2030. Whether this will be achievable under the constraints of cost and technology remains to be seen, but the ambition is clear.

Saudi Arabia also plans to increase its nuclear capacity. So too does the UAE. KEPCO's groundbreaking deal to build USD20bn of plants for UAE - in the face of stiff rivalry from French and American contractors - is evidence that Asian companies have strong credentials in this area.

This brings me to my final point. If the medium and long term growth of the Middle East and North Africa represents an opportunity, then no other region is better placed to profit from it than Asia.

In 2000, the Middle East and North Africa did about the same amount of trade with Asia as with Europe. Since then, the region's trade flows with Europe have grown at a respectable 10% - but with Asia, they have rocketed: the Middle East and North Africa now does more than twice as much trade with Asia than with Europe, and those flows keep on growing at a faster rate. Asia is now the destination for over 50% of the region's exports.

With the backing of political, diplomatic and business leaders, trade and investment between the two regions is set to go from strength to strength. Korea, in particular, has taken the wise decision to strengthen ties with the Middle East, building on a long history of cooperation and involvement.

The opening of a new office in Doha earlier this year by the Korean Trade Investment Promotion Agency was a symbol of this commitment. The Agency's President, Mr Oh Young-Ho, showed that this is based on a long-term vision. He stressed the importance of competing not only in those industries where Korea has traditionally excelled - construction and energy - but also in knowledge-intensive sectors such as communications, management services and cultural industries.

In conclusion, any honest appraisal of the situation in the Middle East and North Africa must acknowledge risks as well as opportunities.

A prolonged fall in oil prices; a deterioration in Pakistan; further conflict between Iran and its neighbours, or further conflict inside Syria or Lebanon could all threaten the prospects for growth.

The world is also watching closely to see how the Muslim Brotherhood will choose to use the power of office in Egypt.

At a crucial period, however, with leaders new and old considering their future direction, the evidence overwhelmingly suggests that the region's best interests are served by engaging wholeheartedly in trade and investment.

We believe, then, that there will be many opportunities for the region's countries, their foreign investors, and trading partners to work together to mutual advantage.