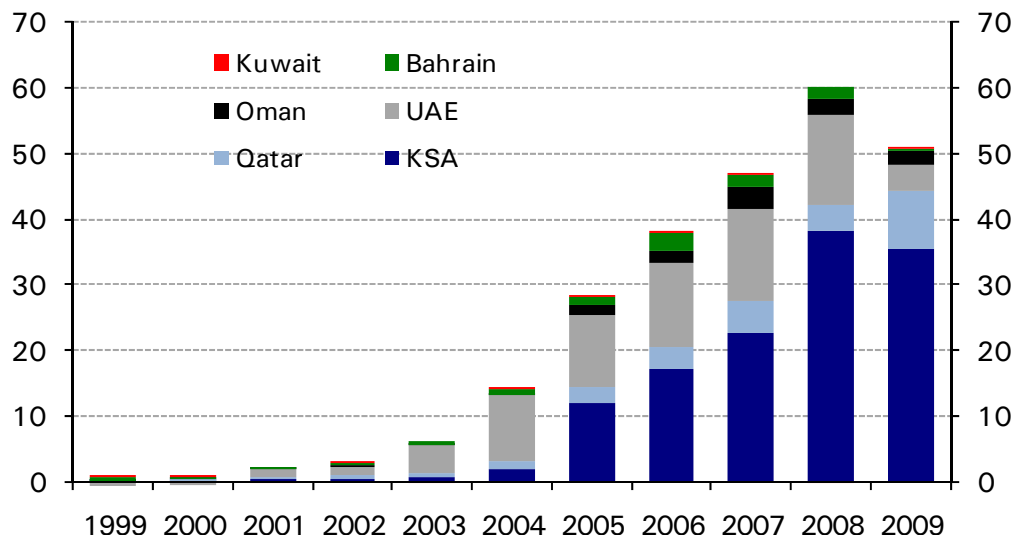


GCC FDI inflows lower in 2009 but outlook remains optimistic

- Foreign direct investment inflows into the GCC region declined by 15% to USD 50.8 billion in 2009, from a high of USD 60.1 billion in 2008 – ending 9 consecutive years of aggregate GCC FDI growth.
- With the worldwide financial crisis causing global investment flows to plummet, the GCC witnessed a less dramatic fall in FDI than other developing markets– a reflection of the region’s emergence over the last decade as a destination for investment.
- While Kuwait was the only GCC country apart from Qatar to witness FDI growth in 2009, it continued to lag significantly behind the rest of the GCC countries in attracting foreign investment.
- In its investments overseas, however, Kuwait became the GCC and MENA region’s largest outward investor in 2009 with USD 8.7 billion.
- Prospects for regional FDI flows are cautiously optimistic on the expectation of GCC and emerging markets growth. Sovereign wealth funds are expected to feature significantly in GCC FDI outflows.

In IBQ’s latest GCC Brief: As the full effects of the global financial crisis reverberated in the region, foreign direct investment inflows into the GCC markets witnessed a significant slowdown in FDI in 2009, following 9 consecutive years of growth. According to the World Investment Report 2010 (WIR), published by the United Nations Conference on Trade and Development (UNCTAD), aggregate GCC FDI inflows declined by 15% in 2009 to reach USD 50.8 billion, having peaked at USD 60 billion in 2008. The UAE, historically the region’s second largest recipient of FDI behind Saudi Arabia, experienced the largest decline in FDI by 70%, as the Dubai World debt crisis adversely affected investments in the Emirate. Saudi Arabia, despite a decrease of 6.9%, continued to attract the largest volume of FDI in the GCC with USD 35.5 billion. The Kingdom continued to receive sizeable foreign capital from regional and international investors. Kuwait invested USD 4.3 billion, the United States USD 5.8 billion, France USD 2.6 billion, and Japan USD 2 billion. Saudi Arabia’s substantial energy, industrial, transportation, financial and real estate sectors provide significant size and scope for compelling investment projects.

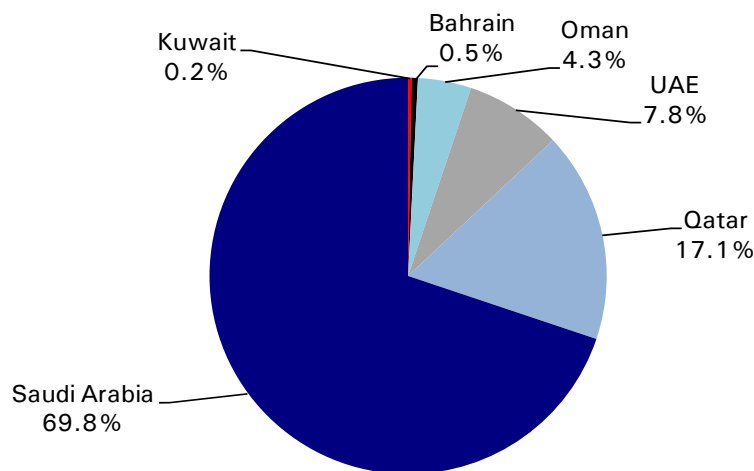
Chart 1: GCC FDI inflows (1999-2009)
(USD bn)



Source: World Investment Report 2010, UNCTAD

Bucking the negative trend in 2009 were Qatar and Kuwait, which were among the few countries in the GCC and wider MENA region to register FDI increases during 2009. Qatar, with USD 8.7 billion in FDI received, and Kuwait, with a mere USD 145 million received, saw growth of 112% and 145% respectively. Qatar's liquefied natural gas (LNG) project and associated industrial plans - due to come on-line in the coming year - were a significant beneficiary of investment flows. It should be noted, however, that Kuwait's positive FDI performance in 2009 was from a very low base; the state continued to lag significantly behind the rest of the GCC as the least attractive destination for FDI in the region. FDI inflows to Kuwait over the last decade were USD 733 million, compared to Bahrain's USD 10.2 billion, the UAE's USD 72.3 billion and Saudi Arabia's USD 129.7 billion. This represents a mere 0.3% of total GCC inflows over the last 10 years. Bureaucracy, stringent regulations, limited foreign ownership, and inflexible labor laws, are frequently cited as the major obstacles.

Chart 2: Share of GCC FDI inflows (2009)

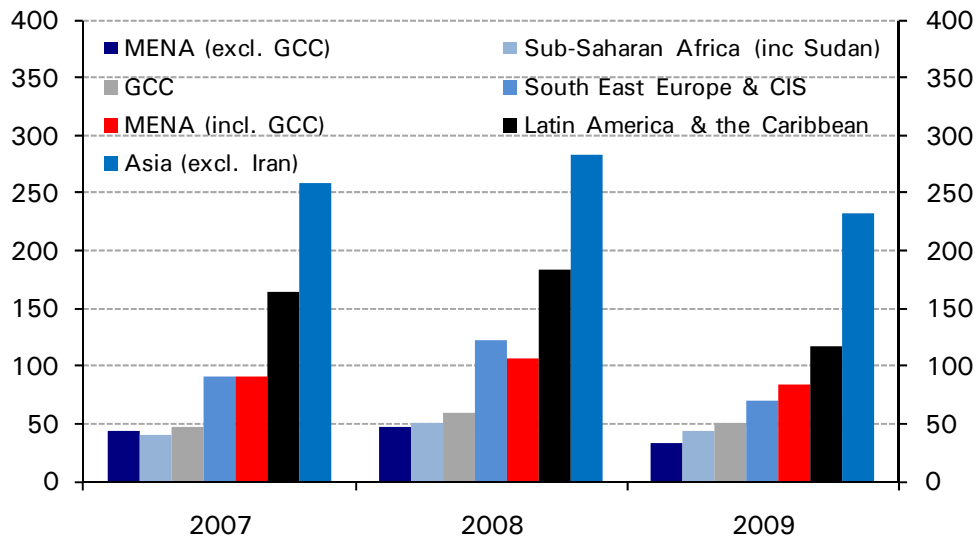


Source: World Investment Report 2010, UNCTAD

In the context of international FDI flows, the GCC's 15% decline compared favorably with the decreases registered by other emerging markets during the economic recession. The wider Middle East and North Africa region (MENA) attracted 30% less FDI in 2009, falling to USD 33 billion. As a result, the GCC's overall share of total MENA FDI inflows has steadily increased over the last few years from 52% in 2007 to 60% in 2009. FDI flows to developing economies experienced significant declines. FDI flows to Asia decreased by 17.5%. FDI flows to Latin America/Caribbean fell 36.4% while South East Europe/CIS plummeted by 42.9%. Consequently, the GCC's share of total emerging market FDI flows rose from 5.8% in 2007 to 7.7% in 2009.

The GCC region's less dramatic decline in FDI can be explained by tracing its recent, pre-crisis trajectory. Prior to the full onset of the financial crisis and its deleterious effects on credit, consumer spending and risk appetite, the GCC region, in line with many emerging markets, had enjoyed unprecedented levels of investment inflows.

Chart 3: FDI flows by emerging market region
(USD bn)



Source: World Investment Report 2010, UNCTAD

Buoyed by high oil prices and current account surpluses, GCC economies embarked on infrastructural and investment projects designed to wean their economies away from single commodity dependence and toward a more sustainable economic future.

Building on an appreciation of the role of FDI and on the necessity of enticing foreign investment, GCC countries have introduced measures designed to attract investments: introducing free trade zones (e.g. UAE), easing restriction on foreign ownership (e.g. Saudi Arabia), reducing or removing corporate taxes (e.g. Bahrain, Kuwait), expediting the issuance of visas (e.g. Qatar), as well as improving incentives, guarantees and protection (e.g. UAE). Foreign companies, from Royal Dutch Shell and General Electric to Marriott International, for example, have consequently established operations and committed venture capital in the region. According to the World Bank, the improvements made to the GCC business environment have seen the region's countries feature highly in the organization's 'Ease of Doing Business 2010' report. Saudi-Arabia and the UAE ranked 13th and 33rd respectively, out of 183 countries assessed.

GCC FDI outflows

Over the last decade, GCC economies, flush with oil proceeds and harboring aspirations to secure non-commodity-based income, have acted as net creditors to the developed world. As the financial crisis took its toll, FDI outflows from the GCC decreased by 35.4% in 2009, from USD 34.3 billion to USD 22.1 billion. This compares with a total MENA (excluding GCC) drop of outward FDI of approx 67.9% to USD 5.6 billion. Indeed, the GCC carries a disproportionate share of total MENA outflows, accounting for 79.7% of the region's outward investment in 2009, up from 66.1% in 2008. This disparity is, of course, a reflection of the hydrocarbon economies' substantial investment capabilities.

Within the GCC, Saudi Arabia was the only country in 2009 to register positive growth in outward FDI, of 350%. Kuwait, with USD 8.7 billion in FDI outflows was the GCC and MENA region's largest outward investor. As a consequence of the Dubai debt crisis, the UAE lost its position as the region's largest investor. While the GCC countries are not expected to drastically curtail their historical bias of spreading their risk away from their local economies to mature and emerging markets through their sovereign wealth fund vehicles, the global financial crisis and its effects on capital markets in western economies in particular, has remodeled the investment landscape. GCC investors are expected to seek out more balanced portfolios, both in geography and in asset

allocation. Moreover, GCC economies harboring extensive infrastructure plans but negatively impacted by a dearth of liquidity as a result of the financial crisis, such as Dubai, may have to rely further on their own SWFs.

Prospects for FDI inflows to the GCC

The IBQ report concluded: The GCC as a destination for FDI is not only reflective of the recently adopted 'liberalizing' measures but also of an increasing appreciation of the region's demographic and economic potential. Backed by the expectation of sustained oil surpluses and considerable domestic economy restructuring, investors and transnational corporations (TNCs) are keen to tap into the region's dynamic. Having weathered the worldwide economic downturn relatively well, GCC countries' ability to attract FDI should improve over the medium term. Much will depend on the revival of demand for overseas investment projects, access to finance, and sustained efforts on the part of FDI recipient countries in the GCC to make good on their determination to diversify, develop and improve their competitiveness. Ambitious infrastructure development plans, coupled with private sector reforms, liberalization measures and regulatory framework enhancements, would thus help pave the way for significant FDI engagement. For Kuwait, having recently lowered the top marginal rate of tax on foreign corporations from 55% to 15%, the hope is that the country's ambitious development and private sector expansion plans present foreign investors with greater opportunities in the near future to achieve attractive rates of return. □