

GCC FDI flows decline for second consecutive year in 2010

- Foreign direct investment flows to the GCC in 2010 fell by 15.3% to \$39.8 billion—the second consecutive year of decline since the end of the financial crisis.
- Lingering post-crisis investor caution coupled with the suspension or cancellation of a number of FDI mega projects in Saudi Arabia and Qatar are the major contributing factors.
- FDI outflows from the GCC have also declined for the second year in succession, from \$23.3 billion in 2009 to \$10.5 billion in 2010, on the back of major divestments by GCC firms.
- Prospects for GCC FDI flows in 2011 will largely be determined by oil price performance, continued budget surpluses, regional events and the performance of the global economy.
- The Arab unrest of 2011 will have a definite negative impact on FDI flows, as will further concerns over US economic growth and the Euro- zone's sovereign debt crisis.

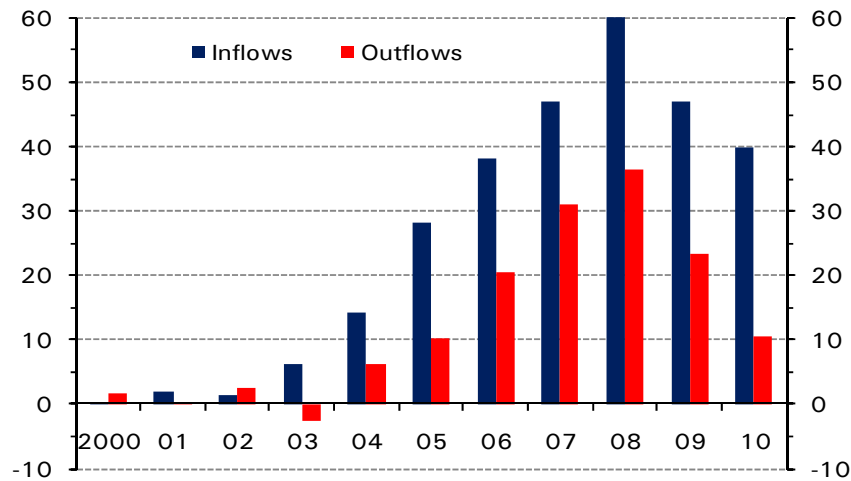
In IBQ's latest GCC Brief: In 2010 foreign direct investment flows (FDI) to the GCC declined for the second consecutive year since the end of the financial crisis to level at \$39.8 billion, according to UNCTAD's World Investment Report 2011 (Chart 1). The GCC, however, still accounts for more than 60% of all foreign investment flows to the Arab world.

In spite of the improved economic conditions in 2010, FDI flows to the region registered a drop of 15.3% compared to 2009. Lingering caution by private investors in the wake of the financial crisis, constrained credit to the private sector, and the suspension, cancellation or completion of a number of mega-projects that had hitherto been responsible for sizeable investment flows, are cited as major contributing factors .

The decline in FDI inflows to Saudi Arabia—the historically pre-eminent destination for FDI in the GCC—by 12.4% to \$28.1 billion in 2010, for example (see Chart 2), came in part as a result of certain joint-ventures with foreign partners, such as those petrochemical projects between Saudi Aramco and Conoco Phillips and Dow Chemical being cancelled or suspended.

In Qatar, the completion of the last of the LNG Qatargas trains in 2010 resulted in a significant drop in FDI of almost 32% from the previous year.

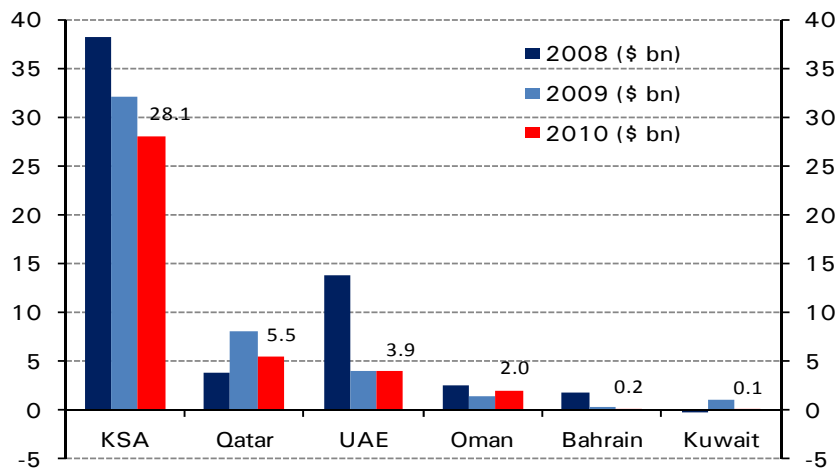
Chart 1: GCC FDI inflows and outflows (\$ bn)



Source: World Investment Report 2011, UNCTAD

Kuwait would certainly not have experienced such a sizeable drop in FDI were it not for the uncharacteristically high FDI inflows of \$1.1 billion the country received in 2010 due to the recapitalization of Gulf Investment Corporation (GIC), a Kuwait-based but wholly GCC owned investment company that was especially hard hit by exposure to toxic assets. The country's basic level of FDI over the last decade—a mere \$313 million a year on average—is by far the lowest in the GCC (GCC average is \$44 billion per annum) and among the lowest in the wider MENA region.

Chart 2: GCC FDI inflows 2008-2010 (\$ bn)



Source: World Investment Report 2011, UNCTAD

FDI outflows

FDI outflows from the GCC, which comprise almost 72% of all Arab FDI outflows, have also declined for the second year in succession, dropping by 55% in one year alone, from \$23.3 billion in 2009 to \$10.5 billion in 2010 (see Chart 1). These are, according to the World Investment Report 2011, primarily related to divestments by GCC firms. Zain Group's \$10.7 billion sale of their African operations to Bharti Airtel of India and International Petroleum Investment Company's \$2.2 billion sale of their 70% stake in Hyundai Heavy Industries Co are notable examples.

While private transnational firms from the GCC do take part in overseas mergers and acquisitions (M&A), by far the most significant players in outward FDI are state-backed enterprises and sovereign wealth funds (SWFs). Companies such as Dubai World, Saudi Basic Industries Corporation (SABIC) and Mubadala, as well as notable SWFs such as the Qatar Investment Authority (QIA), the Abu Dhabi Investment Authority (ADIA) and the Kuwait Investment Authority (KIA), have accounted for more than 73% of all M&A activity since 2004.

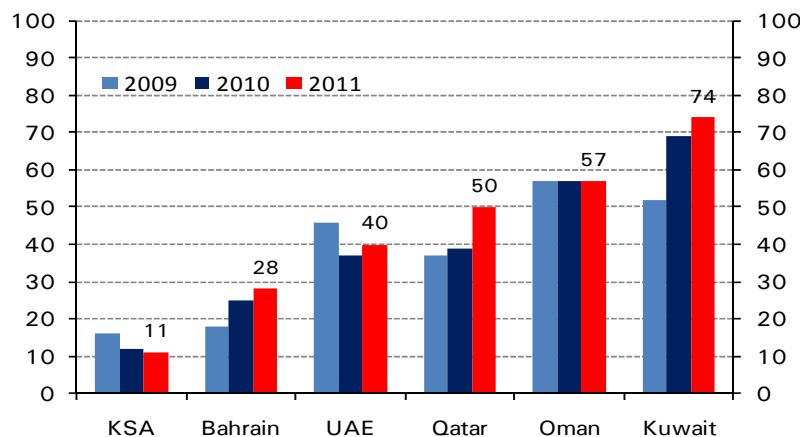
Flush with the proceeds from buoyant hydrocarbon prices in recent times, these state-backed organizations have pursued multi-pronged investment strategies that are not just limited to traditional diversification and rate of return considerations. Increasingly, outward FDI is being viewed as a means through which international strategic partnerships can be cultivated, facilitating the transfer of investment, technology and expertise back to GCC economies, thereby leading to domestic productivity and competitiveness gains. For example, QIA's investments in Germany's Volkswagen and Hochtief companies as well as in France's Vinci were also accompanied by agreements to widen the scope of their activities in Qatar, whether in the form of research and development collaboration, new testing and training facilities or increased business opportunities .

The prospects for FDI in 2011

Given the positive correlation between hydrocarbon revenues and FDI flows, both inward and outward, a rebound in FDI will ultimately depend on oil prices, the continued capacity of GCC countries to amass budget surpluses and the overall health of the world economy. That global growth outlook has recently been subject to serial downward revisions relating to concerns over the employment and growth potential of the US economy as well over the sovereign debt crisis that is plaguing the Euro zone.

For the MENA region, 2011 has been defined by the so-called 'Arab Spring' and its impact on local socio-political and economic environments. FDI flows in countries such as Egypt, Tunisia and Libya have been especially hard hit.

Chart 3: Ease of doing business rankings 2009-11



Note: The higher the ranking (i.e. lower number) the easier it is to do business in the country (out of 181 countries in 2009 and 183 countries in 2010/11).

Source: World Bank Doing Business Reports 2009-11

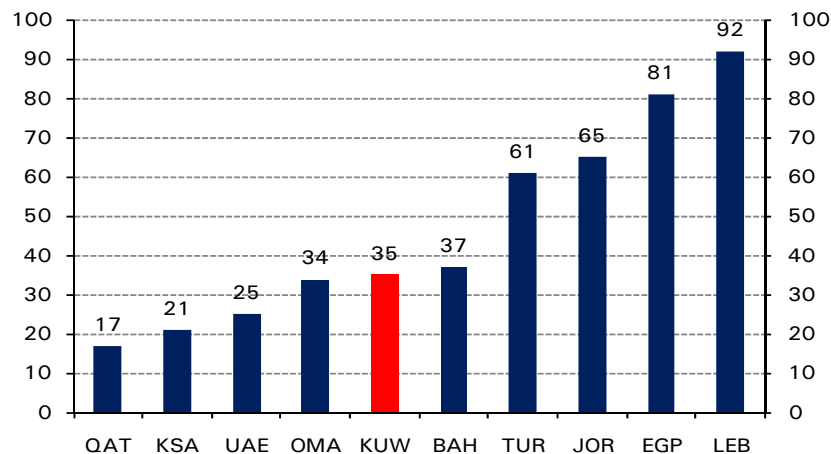
In large part, the GCC has not been affected as severely, although FDI inflows to the region may still be affected. The raft of spending by GCC governments on national development programs (made possible by massive surpluses accumulated over the past decade) and employment and subsidy-based measures to absorb rapidly growing national labor forces and offset inflationary pressures on household income may, on the other hand, be

expected to temper outward FDI flows. SWFs could thus be subjected to pressures to reorient their portfolios away from traditional Western and Asian destinations, and back towards their own domestic economies.

Moreover, in terms of GCC FDI inflows, the attractiveness of the region as a destination for FDI will also be affected by regulatory frameworks, whether they are either conducive or unhelpful to business and FDI. In that regard, Saudi Arabia and Qatar will continue to be among the best placed to capitalize on FDI, thanks to the impressive strides both countries have made recently in improving their business, regulatory and cross-border trading environments. Saudi Arabia is the highest placed MENA country in the World Bank’s ‘Doing Business’ rankings (Chart 3) while Qatar is the most competitive country in MENA in the World Economic Forum’s ‘Global Competitiveness’ index (Chart 4 .)

Qatar will also stand to benefit immensely from the numerous projects being planned for the 2022 World Cup, which should be especially attractive for GCC and foreign firms. This should be a boon for the performance of its non-hydrocarbon sector, a key aim of the country’s national development strategy.

Chart 4: Inflation



Note: The higher the ranking (i.e. lower number or lower index) the more competitive is the country (out of 133 countries in 2009, 139 countries in 2010 and 142 countries in 2011-12).

Source: World Economic Forum, Global Competitiveness Index Reports 2009-12

Kuwait, on the other hand, continues to lag behind the rest of the GCC in the ease of doing business and in terms of overall competitiveness. Limited foreign ownership, a restrained private sector, rigid laws, and a bureaucracy that hampers business are the commonly cited complaints that are preventing the country from achieving its potential. These are among the many issues to be potentially tackled by the recently appointed Amiri advisory commission.

Once Kuwait’s five year Development Plan is off the ground, however, opportunities for investment should be forthcoming. The government seems keen to entice foreign investors to take part in the country’s development projects—especially through public-private partnerships (PPPs)—and stimulate the private sector. Also, large-scale infrastructure projects such as those intended to develop the country’s power sector may hold further promise for foreign investors.