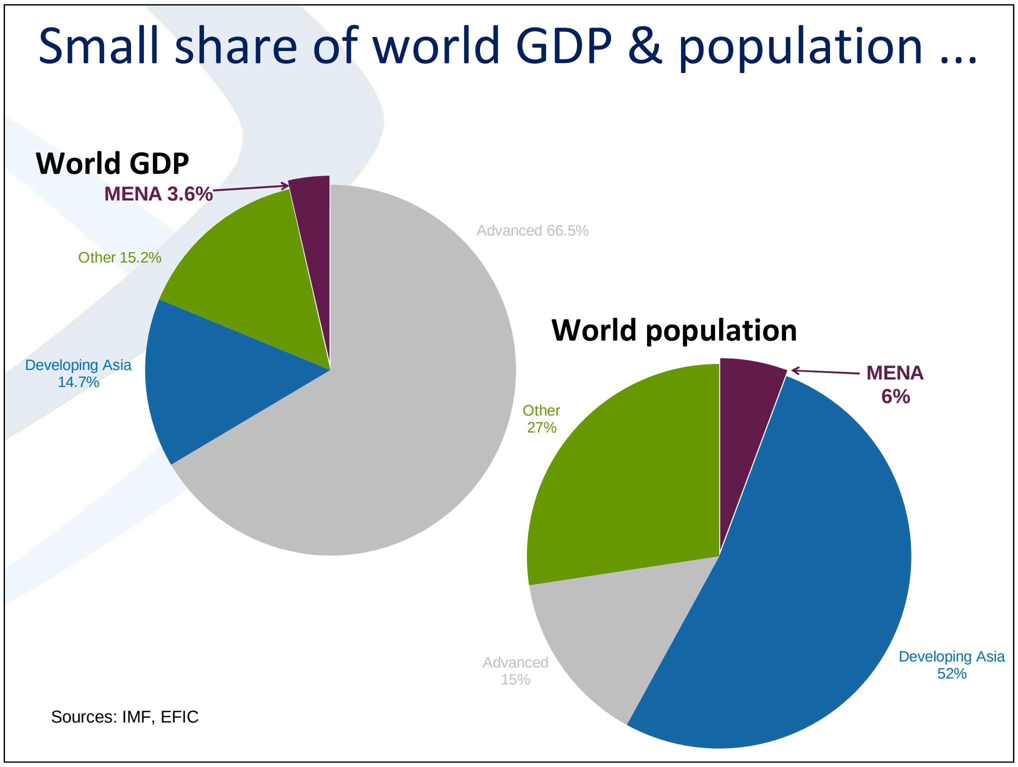
So ... is MENA – the Middle East & North Africa – nosediving, surviving or thriving in the aftermath of the Arab Spring?

The answer I will give is: All of the above ...

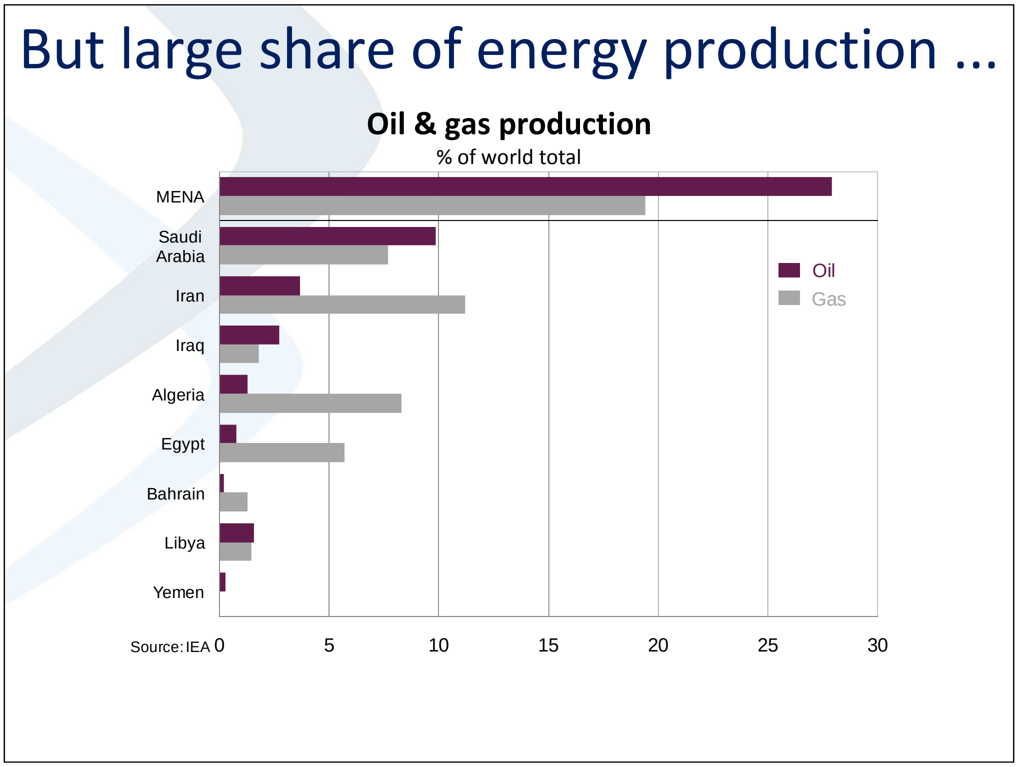
Before I elaborate, though, let me give some background – on MENA's place in the world economy and as a trade and investment partner of Australia.



MENA is not that significant in population or GDP terms.

It might come as a bit of a surprise that the region has a larger share of world population than GDP, when you think of all those rich countries in the Gulf, eg Qatar with a per capita income > $100,000 a year.

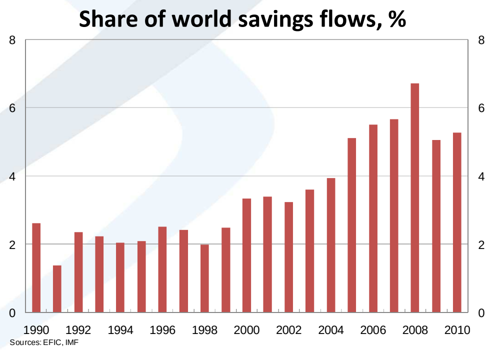
But more than offsetting the rich countries are the poorer, more heavily populated countries in North Africa, led by Egypt, that pull down the region's overall per capita income.



Where the MENA region does punch above its weight is in two areas: first, as a supplier of energy to the rest of the world; and second, as a supplier of capital.

The region is responsible for 28% of world oil production ... And almost 20% of world gas production. That's mainly, but not entirely, thanks to the Gulf countries, led by Saudi Arabia; North Africa also makes a contribution.

And growing share of world saving/capital flows ...



Net foreign assets
$ billion

	2009	2010
Total net assets	1634	1810
% of GDP	112	109
o/w GCC	1129	1268
Troubled countries*	385	420

*Algeria, Bahrain, Egypt, Iran, Jordan, Libya, Tunisia

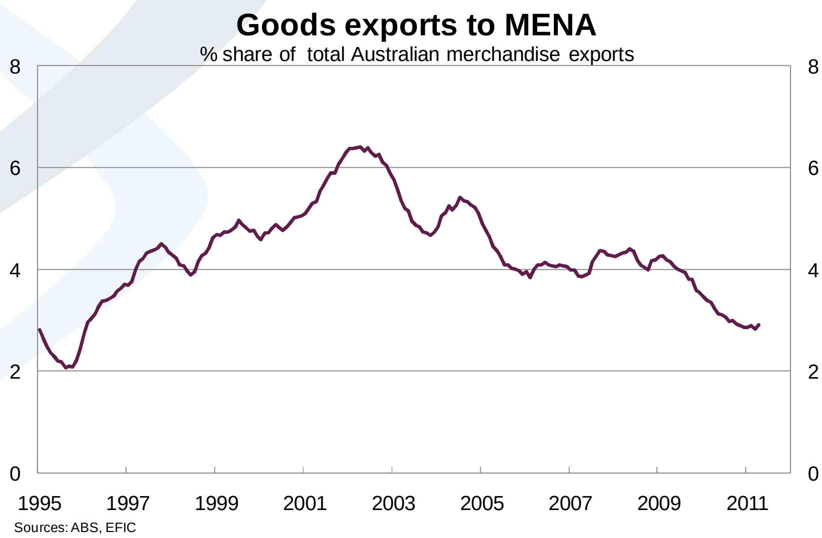
Source: IIF

The region is also responsible for > 5% of world saving flows.

It also has a large hoard of foreign assets worth more than region-wide annual GDP.

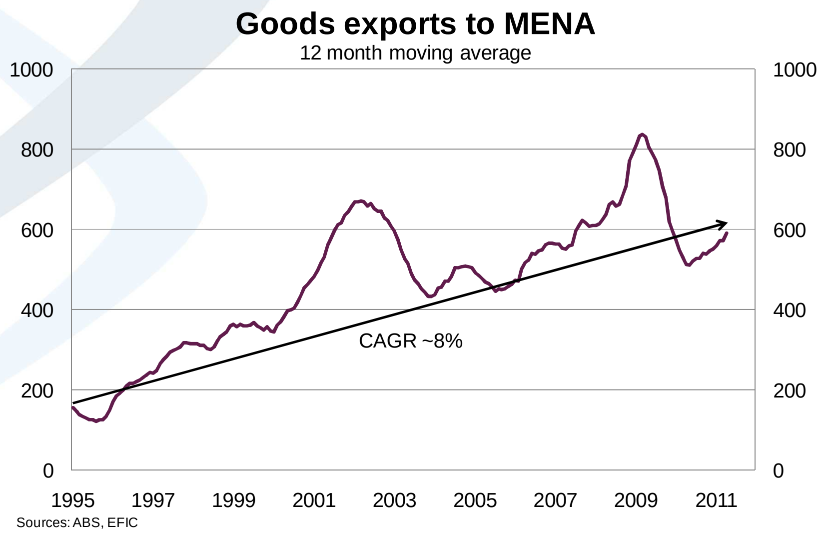
Notice that even the troubled countries have net foreign assets (though Libya's have been frozen). Which is another way to say they are net creditors to, and net owners of assets in, the rest of the world.

MENA's not a big Oz export destination, & its relative significance has been declining...



How important is the region as a destination for Australian exports? Actually not that important in overall terms. And the importance has been declining.

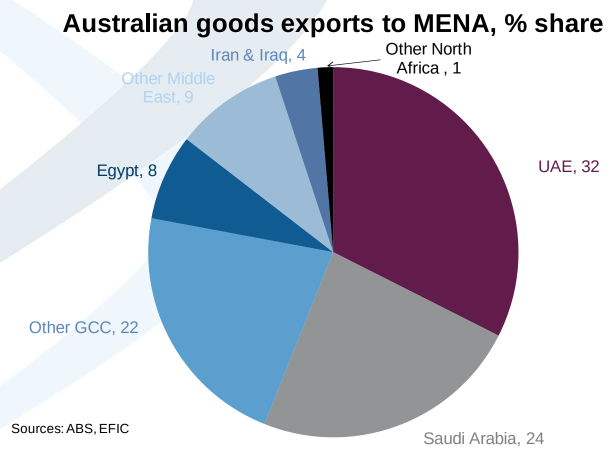
Yet Australian exports have been growing strongly ...



However, that doesn't mean that Australian exports have been growing sluggishly ... or that they can't continue to grow briskly.

How is it, by the way, that our exports to the region have been growing strongly, yet they have been dwindling as a percentage of the overall export pie? The explanation, I think, is that at least over the past decade our resource exports to East Asia have been growing even more rapidly.

Most Australian exports go to Gulf …



Gulf = 78% of total goods exports

Key exports:

Agricultural products
- Live animals
- Wheat
- Barely

Motor vehicles

80% of Aust motor vehicle exports go to the Gulf

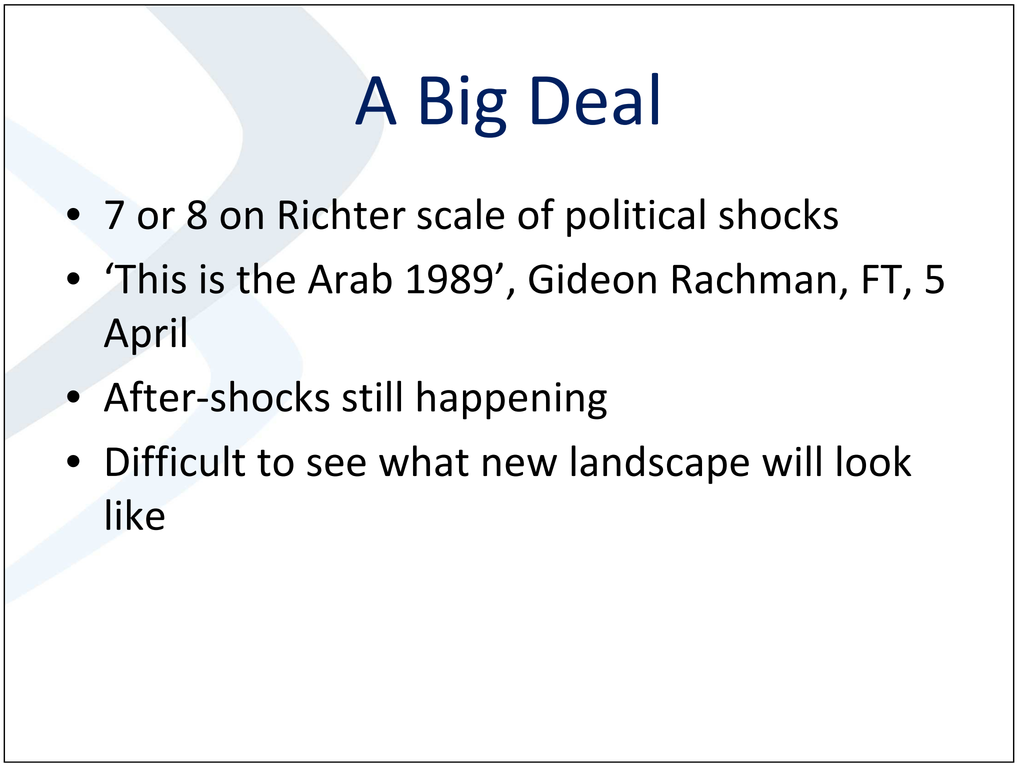
Minerals

Alumina, zinc, gold, other metals

When we talk about exports to the Middle East and North Africa, we largely mean exports to the Gulf. The Gulf takes more than three quarters of total exports to the region.

Unfortunately the ABS doesn't provide data on service exports to the Gulf. But ...

Arab Spring



In anyone's book, the intifadas are a big deal – a 7 or 8 on the Richter scale of economic and political shocks.

They bear some resemblance to that other ground-shaking event in recent history, the Fall of the Iron Curtain in 1989. As the *Financial Times* columnist Gideon Rachman has written, 'This is the Arab 1989'.

At the moment, we are seeing a lot of after-shocks from the initial earthquake in Tunisia. And a post-intifada landscape that is still difficult, if not impossible, to make out.

If worse comes to worst, we could see two worrying developments.

1/ An oil supply disruption ... that other oil producers can't make up ... that delivers a severe knock to a still-fragile world economy.

2/ A confrontation between the Gulf Arab states and Iran. In that event, you would have to ask: Would America invoke the so-called Carter Doctrine, under which it reserves the right to intervene militarily to safeguard its oil imports?

I stress this is not my central case. But as a risk analyst, I'm paid to worry, and those are certainly thinkable downside cases it behoves us all to ponder.

Were we caught entirely by surprise?

- No
- But experts called several 'false positives' & 'false negatives'
  - False positive: Algeria // False negative: Tunisia
  - OECD *up*grades Libya 6→5 in Jan 2011, then *down*grades 5→7 in March!
  - Oxford Analytica, 25 Jan: 'The political scene in Libya is stagnant, and at present faces little pressure for change, despite dramatic events in neighbouring Tunisia.'
- Timing & domino effect *were* genuine surprises

Could we have anticipated events better? I'm presuming they did come as somewhat of a surprise to you.

I don't believe the intifadas did arrive out of a blue sky. They weren't so-called 'black swans' or 'unknown unknowns'. There were actually plenty of warning signs if you were paying attention.

The snag was, the assessments beforehand were guilty of a number of 'false positives' and 'false negatives'. In other words, they flashed warning lights about countries that didn't succumb to crisis. And they remained silent on ones that did.

• A false positive? Algeria

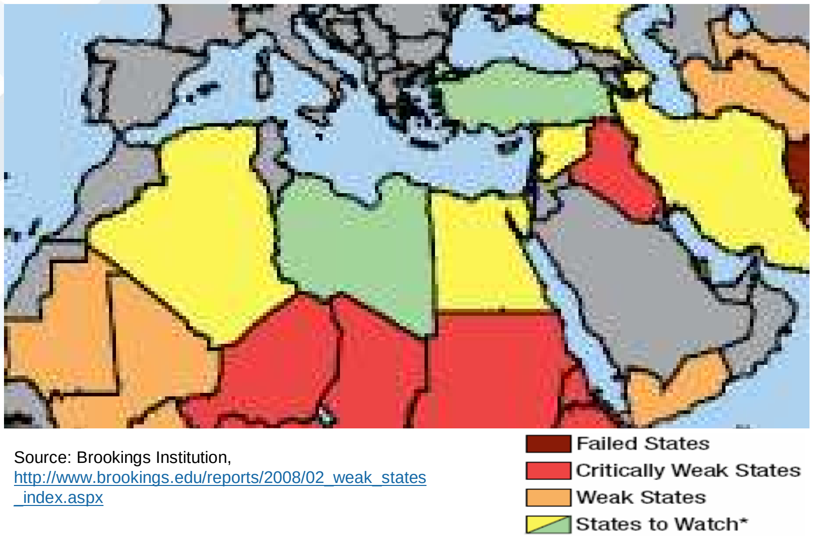
• A false negative? Tunisia

That very clever organisation Oxford Analytica said as late as 25 January in a story entitled *LIBYA: Erratic rule likely to survive 'Tunisia effect'* : 'The political scene in Libya is stagnant, and at present faces little pressure for change, despite dramatic events in neighbouring Tunisia.'

It wasn't just the timing of the intifadas that caught even the experts offguard; it was the domino effect ... In spite of such domino effects having happened in the past.

Brookings issued some weak warnings ...

Index of State Weakness



Source: Brookings Institution, http://www.brookings.edu/reports/2008/02_weak_states_index.aspx

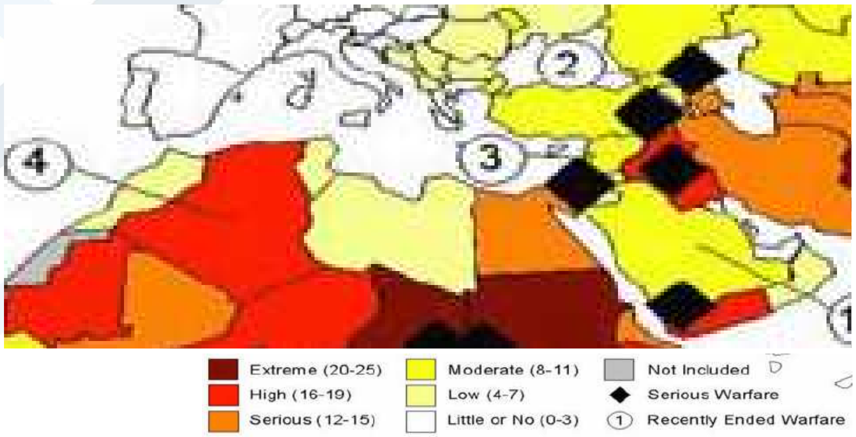
The Brookings Institution issued some weak warnings beforehand that trouble was brewing

• listing Libya and Egypt as ‘states to watch’

• as well as Algeria.

Polity IV: 'Libya? Relax'

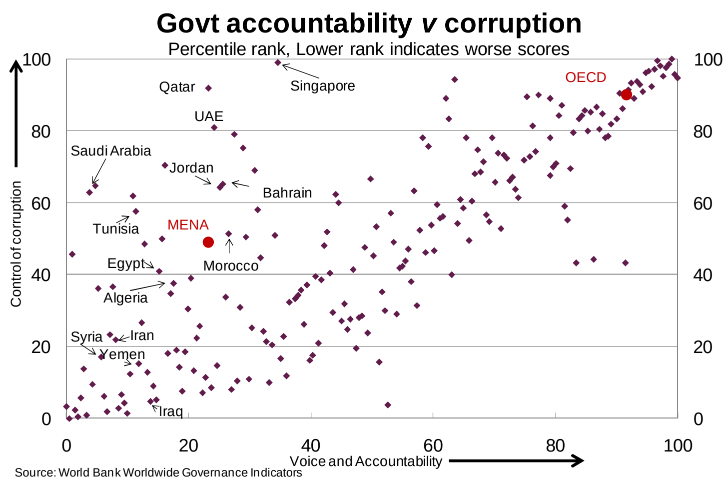
State Fragility & Warfare



Polity IV project, Centre for Systemic Peace, George Mason University, http://www.systemicpeace.org/polity/polity4.htm

But another widely-watched set of state fragility indexes from the Centre for Systemic Peace said the risk of war or state fragility was 'low' in both Libya and Tunisia.

Democracy may – or may not – lift growth & governance ...



A lot of the media and academic commentary on the intifadas suggests that they will usher in more representative, more accountable, more democratic government, which should in turn prompt a shift to more open, contestable, rules-based markets. Which should eventually lift GDP growth.

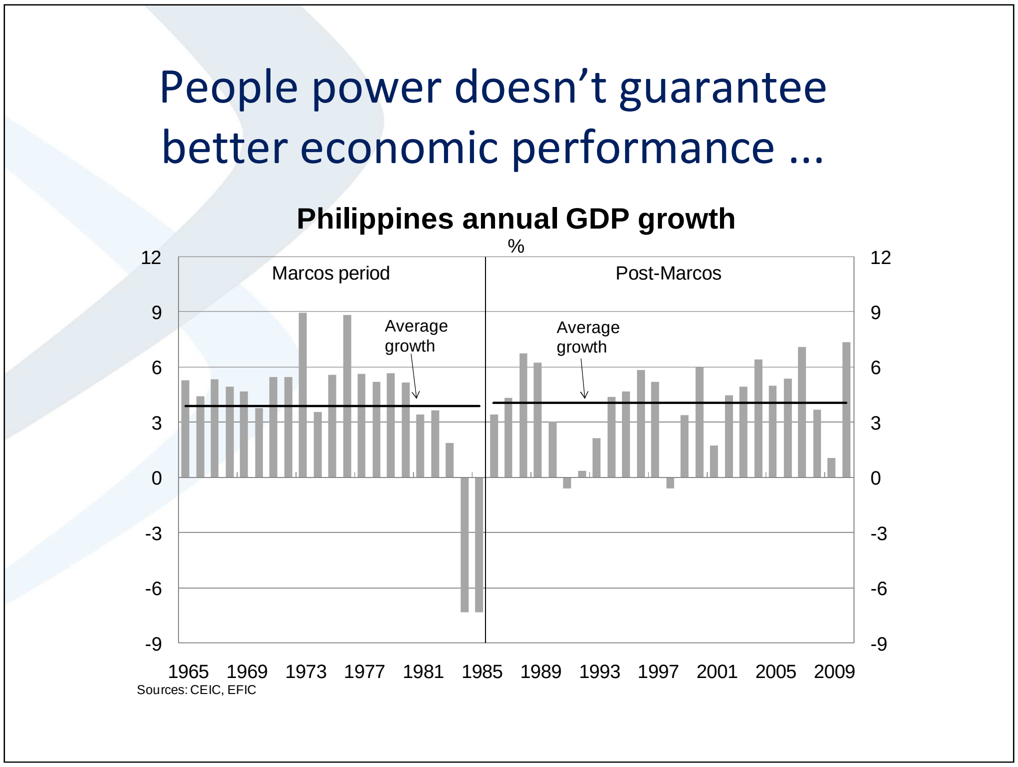
That may happen.

The scattergram shows how countries measure up against two of the World Bank's widely-watched governance indicators – 'control of corruption' and 'voice & accountability'.

The good news is: there is a broadly positive relationship on display – the more the 'voice & accountability', the better the 'control of corruption'.

But it is only a loose relationship.

So the bad news is: more 'voice & accountability' doesn't necessarily lead to greater 'control of corruption'.



Here's another perspective on how a people power revolution might – or might not – change economic performance.

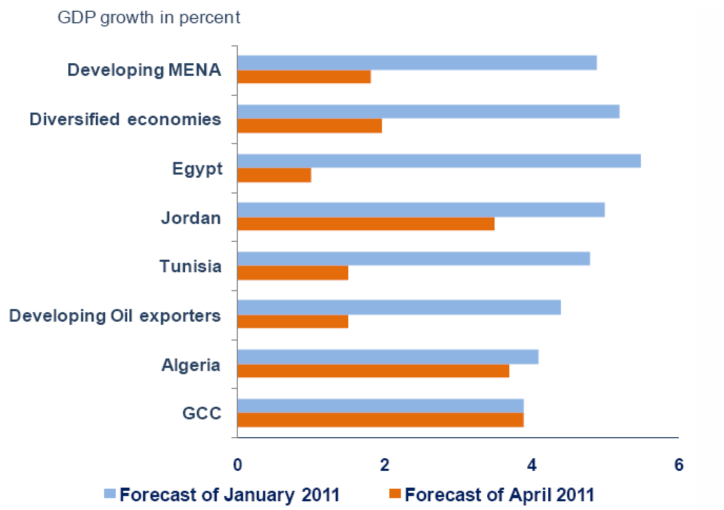
Look at the Philippines – which had its people power revolt in 1986 against Ferdinand Marcos.

The Philippines certainly has more democracy now. But alas, its growth performance has not improved – and by virtually any standard it underperforms relative to its potential.

So this history lesson – and the previous cross-country comparison – suggest that we ought to be a bit cautious about proclaiming the dawn of a new era in MENA.

All of the countries still have two important hurdles to surmount. First, getting a new democratic government in place. And second, ensuring that that government delivers more open, contestable markets and growth-promoting economic management.

Arab Spring will be a big drag, except on GCC ...



Source: World Bank Global Economic Prospects June 2011

It is clear that the Arab Spring will exert a considerable drag on the region's GDP growth this year.

Here are some recent World Bank forecasts ...

- **Developing MENA**: Algeria, Egypt, Iran, Jordan, Lebanon, Morocco, Syria, Tunisia, Yemen

- **Developing oil exporters**: Algeria, Iran, Syria, Yemen

- **Diversified economies:** Jordan, Lebanon, Egypt, Morocco, Tunisia

The IMF projects overall growth in MENA at 4.7% in 2011.

- **Oil exporters (excluding Libya):** 6%

- **Oil importers:** 2½%

The good news in the chart is that the GCC countries will weather the storm well.

Who's been hardest hit?

- Libya, Yemen, Syria
  - Ruling regimes resist revolution
  - Libya, Yemen in civil war
  - Sanctions imposed on Libya, Syria
  - Libya, Yemen at risk of becoming failed state
- Egypt, Tunisia
  - Have had to seek support from IMF etc
  - What role will Muslim Brotherhoods play?
- Bahrain
  - Economic ambitions have received severe knock

Who's been hardest hit? The countries where the uprisings have been most severe – and most severely repressed.

By and large, that doesn't mean the Gulf states. But it does mean Bahrain.

Even in the two countries that have had successful revolutions – Egypt and Tunisia – the road to democracy is proving bumpy. Egypt has had to seek emergency funds from the IMF and others.

And we will need to watch the role the Muslim Brotherhoods play. Will they accept the separation of mosque from state that Turkey's AK Party accepts?

Who's least affected?

- Kuwait, UAE, Qatar: little or no unrest
- Algeria: demos & strikes, but no uprising
- Saudi Arabia, Morocco, Jordan, Oman: monarchs respond to protests with political, economic concessions
- Iraq: no big protests, but country is drifting

The countries least affected have been of two kinds. First, those where discontent has been little or moderate. Second, those where incumbent regimes have elected to respond to unrest with significant political and economic concessions.

The judgment that these countries will avoid revolution is a provisional one that will need to be kept under review.

Financial windfalls as well as losses...

- Distinguish between hydrocarbon exporters & importers
  - Algeria, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, UAE, Yemen: windfall from higher oil prices & production
    - » Two exceptions to this rule: Libya, Bahrain
  - Egypt, Jordan, Lebanon , Morocco, Syria, Tunisia: higher energy import bills

Not all of the economic and financial effects of the uprisings have been negative.

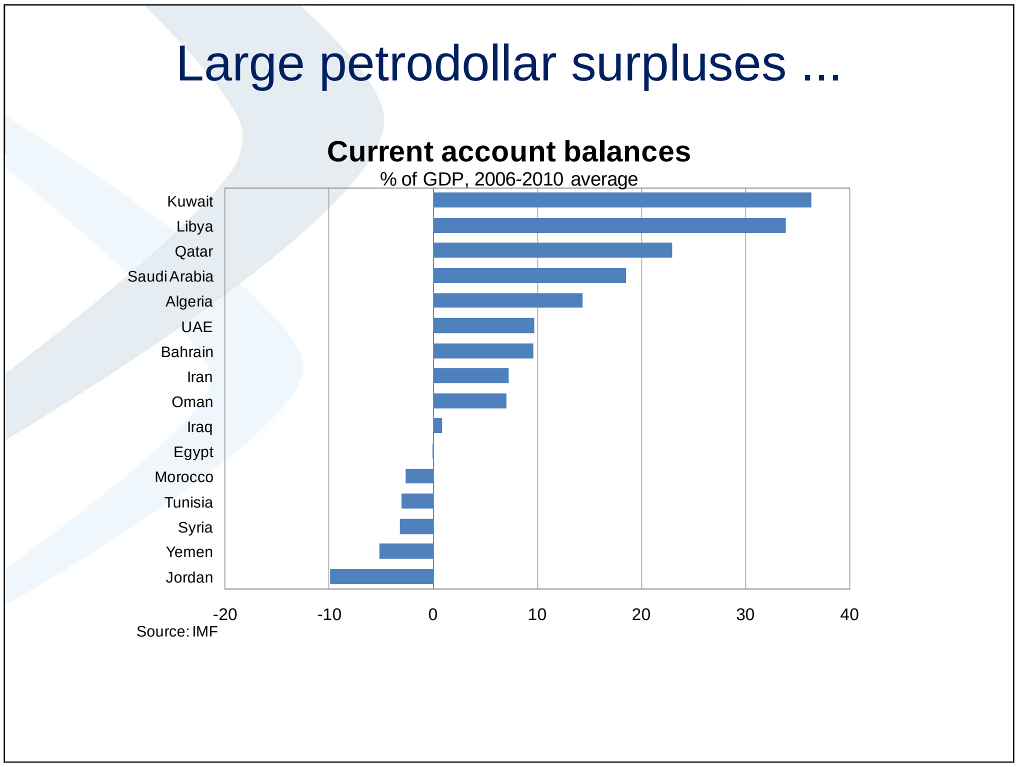
Ironically, the Arab Spring has delivered financial windfalls to MENA oil exporters by triggering a rally in oil prices.

• Except for Libya whose oil exports have collapsed.

• And Bahrain where the windfall is more than offset by other dislocations and setbacks.

Alas, for oil importers, higher oil prices mean higher import bills and additional financial strain.

• Notice that three of the countries suffering the biggest protests – Tunisia, Egypt, Syria – are also oil importers.

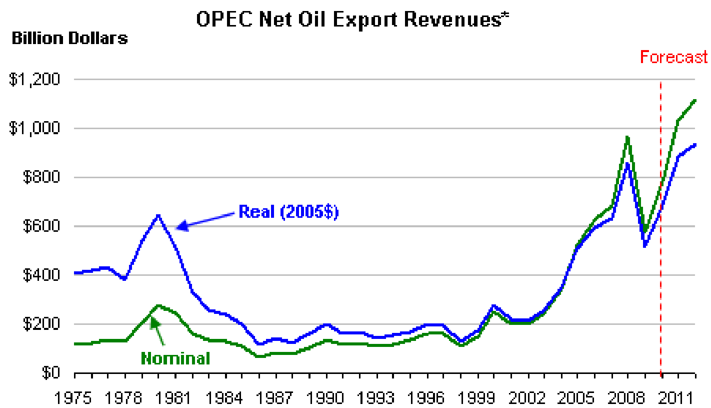


Here are some additional slides supporting the points I have just made.

This chart shows that for most oil exporters the windfall revenues are gushing in faster than they can be spent, and so countries are generating large external financial surpluses.

By the same token, oil importers, especially those hard-hit by revolution, are suffering increased deficits.

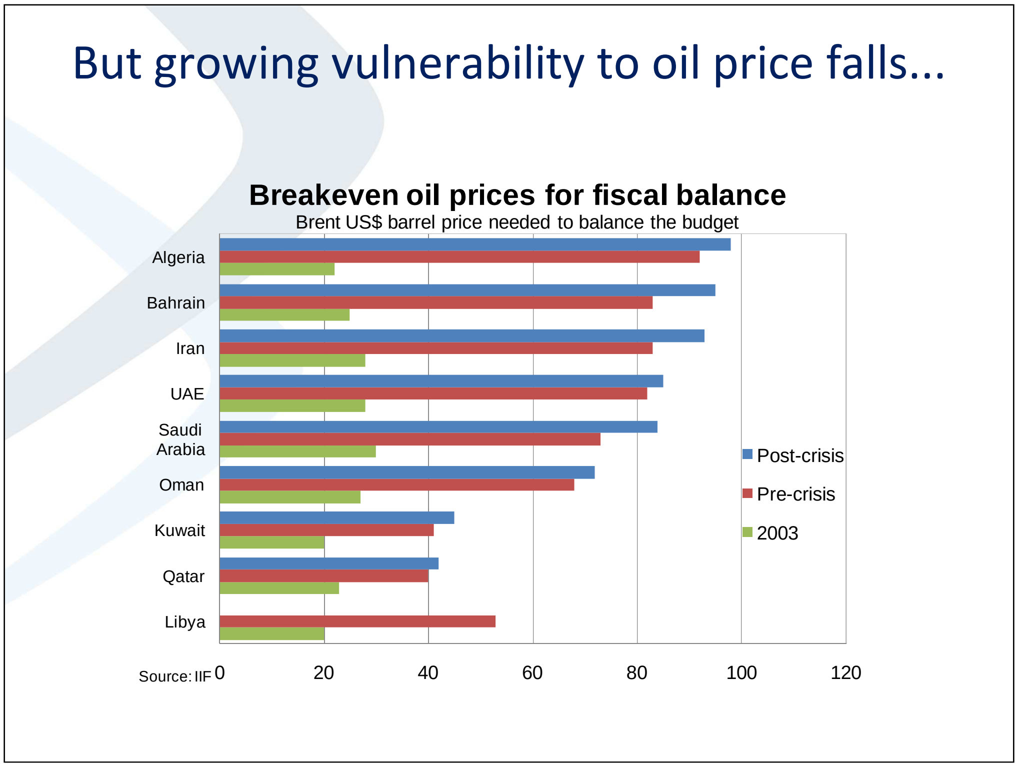
OPEC revenue forecast to top US$1trillion in 2011 ...



*Prior to 1994 does not include Angola or Ecuador

Source: EIA *Short-Term Energy Outlook*

Net oil exports = Oil exports minus exports



One thing to watch is the oil exporters' growing vulnerability to oil price falls.

This has come about because governments have been busily lifting outlays to buy off protesters. That's fine while oil prices are high.

But trouble could be in store if oil prices fall, and spending has ratcheted up and can't be cut.

Question marks over Bahrain ...

- Ambition to take on Dubai as financial/service/event hub has received severe knock
  - March Grand Prix cancelled
- Risk of financial instability exists due to: a/ large size of Financial Harbour; b/ fiscal sustainability concerns – deficits, dwindling oil production, budgetary dependence on oil revenue.
  - Fiscal breakeven price for oil is near $100/b – highest in GCC

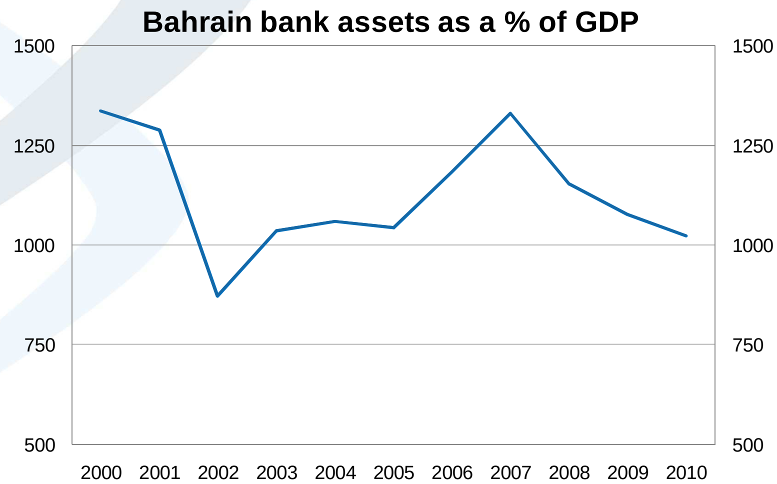
Let me turn now to some individual countries. Four in particular – **Bahrain, Saudi Arabia, the UAE** and **Qatar.**

Bahrain's outlook has dramatically changed and become more uncertain. Despite its oil exports and current account surplus, there is a risk of financial instability.

• Of all the GCC countries, Bahrain has the highest breakeven oil price for fiscal balance – nearly $100/b (see previous slide).

• It also has an outsize banking system with assets and liabilities 10-12 X the size of annual GDP – a ratio that invites comparison with Iceland. While Bahrain doesn't look as fragile as Iceland, and withstood the 2008-09 crisis better than Iceland, it is nonetheless dependent on offshore capital markets for funding, and much of its offshore borrowings have been on-lent to an exuberant onshore property/construction sector (next slide).

Large banking system could have funding difficulties ...



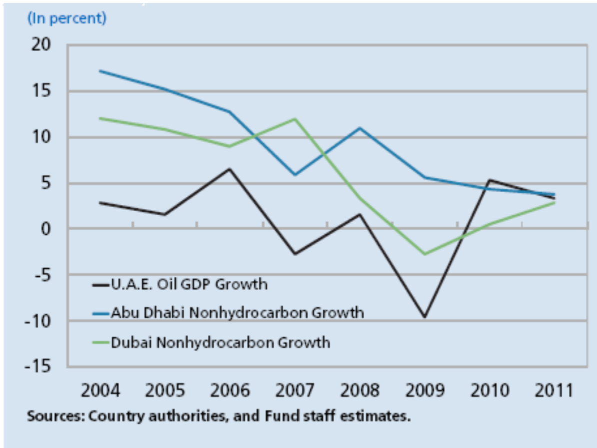
Sources: CEIC, EFIC

Saudi Arabia – Multiple challenges, some resilience ...

- Monarchy faces multiple challenges
  - Internally from: youth, women, Wahhabi clerics, Shia minority – all pulling in different directions
  - Externally from: Al Qaeda, Iran
  - Plus royal succession coming up
  - King Abdallah 87, Crown Prince Sultan 83; 78 yo Interior Minister Prince Nayef looks to be next in line
  - Against this, monarchy has some tribal & religious legitimacy (Guardian of the Holy Places) – plus ample petrodollars

Needless to say, if Saudi Arabia is dragged into the turmoil that could prove very destabilising for the world economy, as well as business within the country.

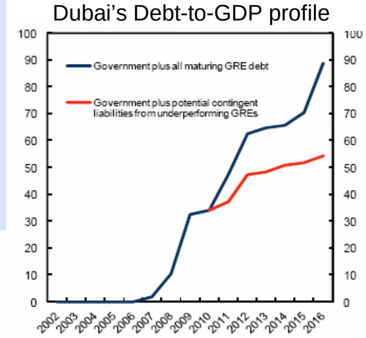
UAE – 'Fragile' recovery ... Dubai debt load remains an issue ...



Risks:

- Property oversupply
- Iran trade sanctions
- GRE debt load

Dubai's Debt-to-GDP profile



Source: IMF

DUBAI'S outlook has been more affected by GFC fallout than the Arab Spring. There is still a big property debt overhang to work off even after the Dubai World restructuring. External debt/GDP is 140% – up there with Greece.

Another drag has been the tightening of sanctions on Iran. Re-exports to Iran a lucrative business for Dubai.

Still, growth is underway again in air travel and hotels, and at the financial hub, even if property remains flat. One of Emirates Airlines' strongest growth areas has been its routes between China and Latin America. Much of the increased hotel occupancy has come from the Chinese and Indian middle classes flying to Dubai for shopping. Local economists are saying that the Dubai International Financial Centre could contribute 10% to GDP by 2012 from less than 4% in 2009. They are also hopeful that MSCI Barra, the influential market index compiler, will soon promote the Dubai stock exchange from 'frontier' to 'emerging market' status, which would oblige emerging market tracker funds to invest in the emirate.

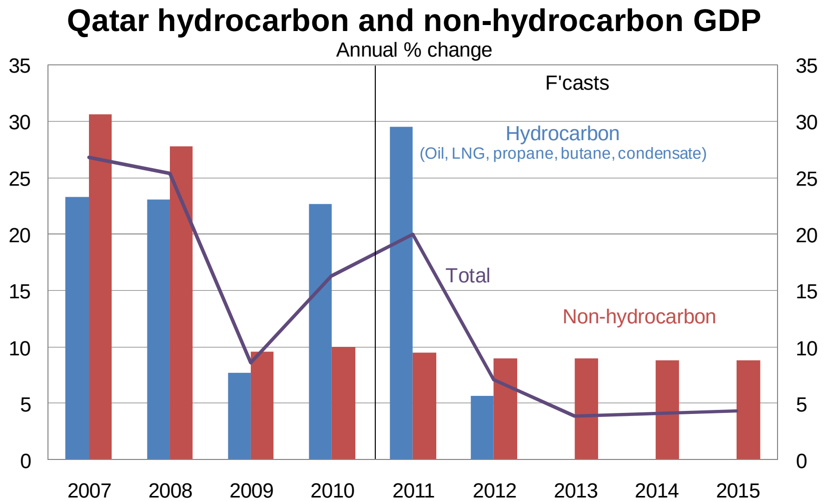
Re-exports have been booming. Not only to other Gulf Arab states, but also to Iran, Pakistan, Central Asia and East Africa. A customs union between the GCC countries is spurring Dubai's re-exports to fellow GCC members. Dubai merchants are reportedly getting bulk purchase discounts from Asian suppliers and splitting consignments into smaller packages for re-export. Re-exports to Saudi Arabia have grown especially strongly, boosted by a large Saudi fiscal stimulus. Dubai is the world's third-largest re-export centre after Singapore and Hong Kong.

The economy is expanding into new niches as well as rediscovering traditional strengths. Many foreign businesses are deciding to site their Gulf after-sales service offices in Dubai. There are now 52 Korean companies operating such offices. Dubai has also become the major departure point in the Middle East for passenger cruise liners, and serves as the regional base for Costa Cruises of Italy and Aida Cruises of Germany. Passenger numbers increased by 30% in 2010.

All of which suggests that the emirate has learnt a lesson from its previous irrational exuberance. The emphasis on deleveraging, returning to basics and reinventing oneself are good omens. They are restoring better balance to the economy and providing the foundation for renewed, if less frenzied, growth.

Meanwhile, ABU DHABI is benefiting from higher oil prices.

Qatar – Gas boost, plus non-hydrocarbon sector growing strongly…



*Moratorium on new hydrocarbon projects between 2012-15.
Source: IMF

If there is a clear winner to emerge from the Arab Spring it is the resource-rich and politically stable Qatar.

Growth is set to reach 20% this year, up from 12% last. This is the fastest rate in MENA, in fact in the world. Growth is forecast to moderate to 7% in 2012, but the outlook remains bright.

Growth is being buoyed by a significant lift in oil and gas prices and a 30% increase in LNG exports.

Infrastructure plans include the new US$11 billion Doha international airport, the US$6 billion Doha port, and a US$25 billion railway , which includes the Doha metro.

Further ahead, nine new stadiums and three stadium renovations are on the drawing boards for the 2022 World Cup.

Gulf investment to remain strong despite turmoil

Source: MEED, www.meed.com

Let me finish on a positive note: for all the turmoil, investment in the Gulf at least is set to rise strongly.

Saudi Arabia is trying to head off protest with an investment program of >US$110 billion.

Abu Dhabi is ramping up investment even as Dubai is scaling back.

• Four key sectors singled out are: infrastructure, education, health and tourism. A whole raft of projects is on the drawing boards: a tunnel; a metro; an airport expansion; hospitals and clinics to attract 'health tourists'; partnerships between local universities and prominent foreign ones like MIT, INSEAD and New York University; and an expansion of the Abu Dhabi exhibition centre to raise the emirate's profile as a conference destination. In the power industry, contracts worth US$20 billion have been awarded to a KEPCO-led consortium to build four nuclear power plants.

• One project of particular interest to Australian companies is a railway. The Abu Dhabi rail company Union Railway has plans afoot to build an US$11 billion national UAE railway linking the main centres of population and industry, and hooking into a wider planned US$60 billion GCC railway network. They are facing stiff competition from Chinese companies backed by ICBC.

And look at **Iraq**. Investment in 2011 is likely to tripled to $30 billion, with housing, energy, water and transport leading the way, as the government moves to carry out its $185 billion development plan. 30% of investment is reportedly earmarked for property development.

Concluding thoughts …

- Risk & uncertainty have increased enormously
- Even the countries that have escaped uprisings so far may not do so forever
- And even the ones where autocrats have been deposed aren't guaranteed a smooth ride to peace, democracy and the rule of law
- Some countries have clearly suffered severe setbacks, but others, ironically, are reaping windfalls
- And for all the turmoil, investment remains brisk, so opportunities abound

In the flyer she wrote for these seminars, our senior trade commissioner in Abu Dhabi, Liz Gordon, posed a good question – *Should you persist or desist?* It is not for me to make that judgment for you.

What I can say is: opportunities still abound particularly in the Gulf, even if risk and uncertainty have gone up. (Actually, some would argue that the risk and uncertainty were always lurking beneath the surface; it is just that they have now risen above the surface.)

In responding to the risks and opportunities, you will need to consider whether to take a tactical, short-term, opportunistic approach or a strategic, long-term, more engaged approach.

Clearly, the key to doing good business will be to manage the risks while you attempt to clinch the opportunities. Risk management will be paramount.