

GCC to experience sharpest dip in capital flows

<http://archive.gulfnews.com/articles/09/04/04/10300926.html>

04/03/2009 11:01 PM | By **Syed A Basher**

About a year ago the Gulf economies were concerned of dealing with extensive capital inflows.

Until mid-2008, capital was pouring in regional markets on the back of possible revaluation of GCC currencies and by means of portfolio investments that were directed to stock market and real estate investments. Cross-border bank lending also soared, and most importantly the price of oil was higher by historical standards. Now capital flows have reversed.

From its peak of nearly \$1 trillion (Dh3.67 trillion) in 2007, net private capital flows to emerging economies (including GCC countries) are now projected to be just \$110 billion in 2009, down from \$411 billion in 2008. While the fall in capital flows will adversely affect the emerging countries in varying degree, according to the Institute for International Finance (IIF), the GCC region will experience the sharpest fall in capital flows (see Table).

Several factors seem responsible for this sudden shift in capital flows. First, the world is deleveraging at the moment.

It is a process of cutting back on the amount borrowed as compared to equity. As a result, international and regional banks are being forced to reduce credit lines in order to shore up capital, as they must deal with subprime-related problems.

The consequence of the deleveraging can be so severe that the entire country can implode. Take for example, Iceland. As we can see from the table, the GCC region will experience much reduced net capital flows from abroad, especially through the banking sector.

Second, foreign direct investment (FDI) had been a good source of funds to finance many activities in the region. However, the flow of FDI to the GCC region is projected to fall in 2009.

On one hand, falling corporate profits and higher cost of finance has diminished the capability of foreign firms to invest with the same vigor as before. On the other hand, the propensity to invest will decline naturally on the back of a severe global recession. Persistent negative economic prospects will lead corporations in the developed world to extensively curtail their costs and investment programmes to become more resilient to any further deterioration of the business environment and their balance sheet.

The fact that many multinational enterprises can easily shift financial resources from GCC region to another, adds another degree of uncertainty, contributing to the macroeconomic instability in the

region.

Third, the collapse in oil prices after September 2008 has hit the GCC economies hard. Both public and private entities in the region had increased borrowing in order to finance ambitious projects.

While the shift in oil price is playing an important role in helping resolve some of the imbalances that have proven to be a threat to global stability, the loss in income as reflected in a declining current account balance will test the region's ability to finance the expansionary fiscal budgets.

On a comparative scale, though, the Gulf region is well placed to handle external capital market shocks, as it did save a lot during the expansion phases in the form of the Sovereign Wealth Fund (SWF), allowing it to deal with a joint deterioration in both real and financial external conditions.

By contrast, other regions such as Eastern Europe and Latin America appear relatively vulnerable to the financial crisis, in large part because of their relative carelessness in the post 2002 global credit boom.

The present economic crisis also offers an opportunity to the region to address more fundamental problems besetting the regional economies.

For example, if lack of residential housing units is to be blamed for higher aggregate inflation in the region, particularly in Qatar and UAE, policy makers should better focus on building more affordable housing units rather than building shopping malls or hotels based on borrowed money.

Thus, if Dubai hadn't sunk \$4.3 billion into the troubled Las Vegas City Centre project, it could currently use some of those funds to sort out its own financial problems. Clearly, addressing the core issues of economic dysfunctions should be the main priority for the regional economies.

The author is a research economist at Qatar Central Bank. Views are author's own.

Source of External Financing in GCC Economies

(billions of U.S. dollars)

	2006	2007	2008e	2009f
Current account balance	210.6	206.1	315.7	20.6
Non-resident flows	147.2	212.6	119.3	29.5
Equity investment, net	38.8	47.5	42.3	34.0
Direct investment, net	37.5	44.9	41.3	32.7
Portfolio investment, net	1.2	2.6	1.0	1.3
Debt flows, net	108.5	165.0	76.9	-4.5
Official flows, net	-0.2	-0.6	2.1	0.2
Commercial banks, net	86.8	159.7	68.3	-9.9
Other creditors, net	21.9	5.9	6.5	5.1
Resident flows	-274.9	-276.1	-307.6	-48.3
Equity investment, net	-139.4	-132.1	-171.6	-84.9
Direct investment, net	-35.9	-43.9	-41.4	-36.3
Portfolio investment, net	-103.6	-88.1	-130.2	-48.7
Resident lending/other, net	-135.5	-144.0	-136.1	36.7

e = estimate, f = forecast

Source: Institute of International Finance, January 2009
