GCC Trade and Investment Flows

A report by The Economist Intelligence Unit

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Contents

About this report

GCC Trade and Investment Flows is an Economist Intelligence Unit report. The findings are based on desk research and interviews with experts, conducted by The Economist Intelligence Unit. This research was commissioned by Falcon and Associates.

The Economist Intelligence Unit would like to thank the following experts who participated in the interview programme:

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Summary and key findings

The Gulf Co-operation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) is an increasingly important node in the global economy, and its future depends heavily on how its trade and investment relations with each world region now advance.

In 2011 our study showed how emerging markets were rapidly growing their share of trade and investment with the GCC, while the recession-hit developed world's share declined. As the final quarter of 2014 unfolds, the picture has become more complex. Emerging economies have entered a period of lower growth, while the economies of several high-income countries are starting to pick up. What do these shifts mean for the GCC?

From the historically dominant blocs of North America and Europe to the emerging markets, the GCC's external relationships are continuously shifting as a result of internal growth dynamics and global headwinds. This report maps the Gulf's shifting trade and investment relationships with each world region since 2011, and looks ahead to growth drivers and forecasts through to 2018. It seeks to understand why these relationships are changing and how this will shape the GCC economy to 2018.

Key findings

GCC members are increasingly diverse in terms of external market integration and investment friendliness. The United Arab Emirates (UAE) and Qatar have proven the most outward-oriented members of the GCC. Saudi Arabia, a massive market, has been less outward-facing; it is more focused on inward development as a result of a larger domestic market and more limited foreign investment flows, but quickening liberalisation and favourable market dynamics suggest that it will attract high levels of foreign direct investment during the period to 2018. GCC members' business environments are heterogeneous, with the UAE in the higher tier, Saudi Arabia, Bahrain, Oman and Qatar ranking middle, and Kuwait several tiers lower.

China-GCC trade ties are strengthening at a faster rate than investment. By 2020, China will be the biggest export market for the GCC, and Chinese investment in the GCC is on the uptick, mostly in wholesale and retail trade, with a marked increase in Saudi Arabia. Gulf companies have secured comparatively few refinery projects in China, in contrast, and portfolio investments have been limited.

GCC trade and investment with India has grown rapidly over the last decade, and Indians are major investors in the UAE, but Gulf investment flows are held back by the business environment. GCC exports to India have increased by 43% annually over the last decade, the highest rate with any major trade partner, and imports from India have increased by 26%. Indian investment is a growth driver for the UAE, but Gulf investment in India remains low, owing to the challenging business environment, including unclear land rights and cronyism. The investment reform pledged by the new prime minister, Narendra Modi, will be critical to supporting GCC investment into India.

The Gulf's push into Africa is broadening, by sector and geographical location. Gulf companies are placing more attention on new and unfamiliar markets in east, west and southern Africa. From telecommunications and private equity in West Africa to energy projects in South Africa and Mozambique, investment flows are diversifying, concentrated in small to medium deals. The GCC's geographical proximity to the continent and its good air links are helping to grow trade, and Gulf investors are seeking both equity and direct investment opportunities, although the surge of investor interest has made for a crowded field.

The Commonwealth of Independent States (CIS) is a rising market for the GCC. From a low base, and flowing in both directions, the CIS has increased its trade and investment engagement with the GCC in energy, petrochemicals, leisure, infrastructure and tourism. Notable increases are the Russia-Dubai relationship in consumer goods and hospitality, and the infrastructure opportunities heralded by the renovation of the "Silk Road" trading route linking China to northern Europe.

Free-trade deals are under-utilised. Free-trade agreements (FTAs) could deepen the GCC's integration into the global economy. Many were frozen in 2009 at the height of the global financial crisis. A key sticking point has been concerns about the threat of cheap GCC imports to local petrochemicals industries—stalling the India, China and Mercosur FTAs. A long-debated deal with the EU has overcome many obstacles, but the GCC's wish for a free hand on export duties on petroleum products remains a barrier. Completion of these agreements would facilitate the Gulf's deeper trade integration and reduce tariff and non-tariff barriers.

1 The GCC and the world economy

The Gulf Co-operation Council (the GCC, comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) is a critical node in the global economic system, as its larger economies diversify beyond hydrocarbons and into financial services, infrastructure, tourism, agriculture and private equity, to name a few.

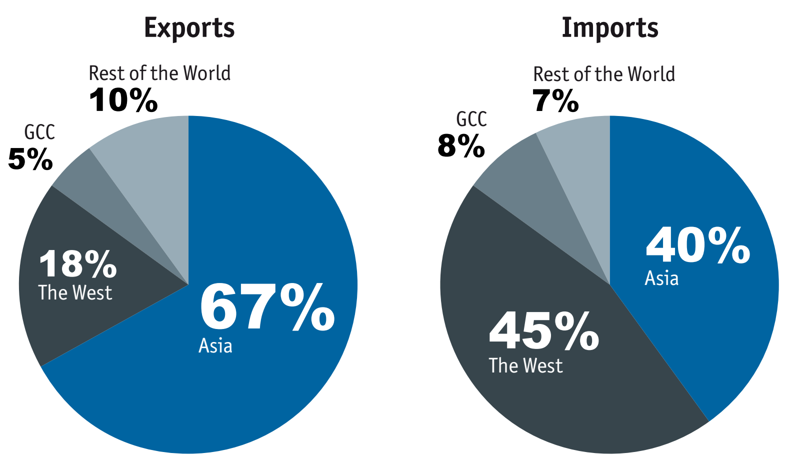
"If you look at the GCC members, they have been increasingly important in the world economy over the past 15 to 20 years, not only because of their massive oil and gas reserves, but also because of the way that the countries are positioning themselves as important hubs," says Rassem Zok, CEO of Standard Bank, Middle East and North Africa region.

Transport and trade infrastructure led the charge. While the UAE and Qatar moved first and fastest, others are following. Oman is developing transshipment capacity, there are plans to develop logistical capacity in Kuwait, and Saudi Arabia is investing in its Red Sea ports. The long-term ambition of these transport hubs is to move away from being a transit point for international trade and travel to become business locations.

Chart 1: Looking East

GCC export and imports: share by region, 2013

(%)



Source: IMF Direction of Trade Statistics, Economist Intelligence Unit.

Ben Simpfendorfer, founder and managing director of Silk Road Associates, a consultancy, says it is not just transport connectedness that attracts businesses to the region, but also "the professional support services on offer, the accountants, the lawyers and the commercial banks". These are strongest in Dubai, Abu Dhabi and Qatar, but such services are increasing in other Gulf capitals.

The ability of GCC members to transition from linking hubs into business locations in their own right will depend partly on domestic reforms. Free zones have been set up to encourage companies to build operations, with low or zero direct tax regimes and concessions implemented to encourage business relocation. This is most pronounced in the UAE, which has 40 such zones, and the hosting of Expo 2020 provides an opportunity for the emirates to encourage more international businesses to lay down roots.

Scores in the World Bank's Doing Business indicators vary markedly, from the UAE (22) at the upper tier, to Saudi Arabia (49), Qatar (50) Bahrain (53) and Oman (66) in a middling score, down to Kuwait (86)[1]. The ease of doing business reflects variety in terms of the GCC's openness to foreign trade and investment. The UAE, Qatar and

Bahrain have been the most outward-looking and investor-friendly, although political uncertainty in Bahrain has reduced its appeal somewhat. Saudi Arabia has hitherto been less outward-looking, yet remains a market of great investor interest relative to its size, demography and wealth. "Saudi Arabia, while a massive market, is more focused on inward development rather than external investment, as the Saudi market is far from saturated," says Mr Zok.

James Reeve, deputy chief economist at Samba Financial Group, agrees: "Unlike the other GCC countries, Saudi Arabia has a big population—around 30m—and that creates a basis for consumption. Unlike Qatar and the UAE, which have to rely on export markets, such as tourism or logistics, Saudi Arabia has potential, if salaries pick up, because it has a young demographic profile that is prone to consume, and that offers foreign investors a tempting proposition."

New infrastructure development in transport, construction and mobile telephony is beginning to alter the country's investment profile. This potentially has a knock-on positive effect on Bahrain. The state already allows 100% foreign ownership in most sectors and levies no corporate, income, capital gains or sales taxes. Proximity to Saudi Arabia, together with the lack of customs duties on trade in most goods within the GCC, make Bahrain attractive for investors in export-oriented industries, as do free-trade agreements (FTAs) with the US and Singapore.

Islamic economy

Although the world's first fully Islamic bank, Dubai Islamic Bank, was set up in the GCC in 1975, the region has lagged behind Malaysia, and to some extent London, in terms of developing Islamic finance opportunities and promoting Islamic bonds, or sukuk. As signalled in the recent World Islamic Economic Forum hosted in Dubai, this is slowly starting to change as the UAE, in particular, moves to promote sharia-compliant finance and turn Dubai into a hub for all aspects of the Islamic economy, which - beyond banking - includes family-friendly tourism, Halal food and lifestyle sectors. In so doing, the city hopes to attract industry-specific manufacturing, investment and services, and take a lead in setting global Halal standards, as currently certification varies country to country. Abdulla Mohammed Al Awar, the CEO of Dubai Islamic Economy Development Centre (DIEDC), comments: "The Halal pillar does not only include promoting trade but is also about attracting factories and processing plants to set up here and to encourage and convince global players to base their Halal operations in the UAE."

The promotion of an Islamic economy hub also ties in with the UAE's strategy to boost trade with Africa, which has a rapidly growing Muslim population and a new and emerging middle class hungry for consumer items and banking services. Islamic tourism is also a key component of the economy of Saudi Arabia, home to two of Islam's holiest cities, Mecca and Madina, to which millions make pilgrimage every year. According to the Saudi Tourism and Antiquities Committee (SCTA) in 2013, of the 17m tourists who visited Saudi Arabia in 2013, just under 7m (around 40%) did so for religious reasons, drawing investment into facilities and hotels for pilgrims.

GCC growth drivers to 2018

- We forecast a GCC-wide GDP growth rate of 4-5% over the period to 2018.

- Consumer spending power is rising across the region. Average GDP per head, measured at purchasing power parity, will shift from US$54,690 in 2011 to US$67,120 in 2018. The sharpest increase will be Kuwait and Saudi Arabia.

- Saudi Arabia has the greatest potential to change the investment dynamics of the region, largely thanks to its mega-projects pipeline requiring major external project finance and further steps towards liberalisation. The country is looking to set itself up as a regional hub in the generic pharmaceuticals, food-processing and, eventually, automotive manufacturing subsectors. Chinese investment into Saudi Arabia is growing at a fast clip, with around US$18bn of project investments.

- The promotion of Qatar and the UAE to "emerging market" status by MSCI, the index compiler, which increases foreign ownership limits, and the planned opening up of Saudi Arabia's Tadawul Stock Exchange in 2015 should boost equity investment. The Tadawul Stock Exchange has also signed Memoranda of Understanding (MOUs) with the Abu Dhabi Securities Market and the Bahraini stock market. While a combined Gulf stock exchange is unlikely in the medium term, these MOUs could serve as a foundation for harmonisation.

- Qatar has moved quickly to encourage investment and ascended the league table in the global competitiveness indices such as those produced by the World Economic Forum. The latest amendments to its investment law allow for full foreign ownership in consultancy services, information technology, services related to sports, culture and entertainment, and distribution services. With its small population, FDI will remain crucial in delivering the government's ambitious programmes, from electricity and water to oil and gas. Our forecasts show that the impact of FDI on the country's economy is set to broaden in railways, roads and public works; industry, water and electricity, including a deep-sea port; hotel construction; and further investments in education and healthcare.

- After the property crisis of 2009, investment flows to the UAE have recovered, rising to US$10.5bn in 2013 from a low of US$4bn. Abu Dhabi's largest non-oil sector is construction. Manufacturing and finance (including insurance) are the second- and third-largest non-oil sectors respectively. In Dubai, wholesale and retail trade are now contributing the most to the emirate's GDP growth trend, followed by manufacturing, and transport, storage and communications, partly relating to increasing light manufacturing and transshipment activity in the free zones in Jebel Ali. Manufacturing is posting the fastest growth of any sector, as small and medium-sized manufacturers leverage Dubai's patchwork of free zones and port facilities[2]. Dubai is expected to spend up to US$18bn[3] in preparation for the Expo 2020 trade fair; the authorities have committed to US$8bn in capital spending, including on roads, rail lines, an airport and an exhibition centre, opening opportunities in the construction, infrastructure and tourism sectors[4].

- Oman's growth is expected to increase by 2018. High domestic demand, a still expansionary fiscal policy and gains in the non-oil economy will ensure that economic growth remains robust, averaging almost 4% over the period. While the local content policy poses challenges for foreign investors, there are indications that the government will encourage foreign participation, particularly in the manufacturing and oil and gas sectors. Last year, the government announced that more than US$50bn worth of development projects was planned for the next few years.

Aviation

Aviation has become a leading sector for several GCC members, leveraging a resource—location—that does not deplete. The region sits between Europe, Asia and Africa, with one-third of the world's population living within four hours' flight. Traditionally, Gulf airlines focused on the domestic market, but by the turn of the millennium Emirates had begun leveraging geographical advantage to capture transit flows. That connectivity helped the airline to move into freight and supported Dubai's growth. This business model was soon emulated by Qatar Airways and Etihad.

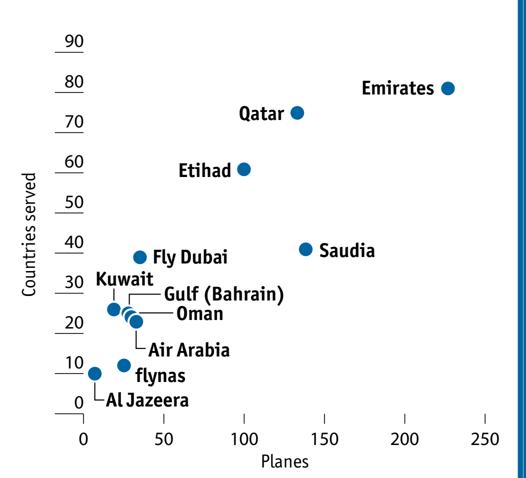
These three air carriers have emerged as major players globally (Saudi, while also sizeable, is focused on its domestic market), benefiting from the rise of emerging markets, driving growth in intercontinental travel, and taking market share from the struggling European flag carriers. Aside from location, they have benefited from ready access to capital, fuel and space to grow in their hub airports, such as Doha's Hamad International Airport. Subsidies from government have helped the industries to develop in a difficult commercial environment for the sector.

The big three maintained double-digit growth during the difficult years after the global financial crisis, but as competition between them has intensified they have adopted different strategies. Emirates is the dominant player, as large as Qatar Airways and Etihad combined and ranked first globally for the amount of cross-border kilometres flown with both freight and passengers. Given this, it has focused on organic growth in routes and a few key alliances, particularly with Qantas in 2012, which shifted its hub for European links to Dubai from Singapore, bringing millions of passengers through Dubai Duty Free (one of Emirate's core profit centres). Etihad is the newest of the three, founded in 2003, and has been scaling up through acquisitions of minority stakes in other airlines. The landmark deal was US$2.3bn for 49% of Al-Italia in August 2014, but it has also taken stakes in airlines in Australia, the Seychelles, Germany, India, Serbia and Ireland. Finally, Qatar Airways has differentiated itself by becoming the first of the three to join an international alliance, entering oneworld, an airline alliance, in 2013.

Looking ahead to 2020, it seems likely that Qatar Airways and Etihad will join Emirates in the global top ten lists. They are facing challenges in short-haul markets from low-cost carriers such as flydubai and Air Arabia, which will dent profits, but high capacity utilisation rates suggest that there is space for growth in their core long-haul transit routes, and their order book plans to more than double their combined fleets (from over 450 planes currently). The main barrier to growth is not capital or demand, but access to landing slots, particularly in already crowded markets like Europe and North America. There are also restrictions in Asia.

Omar Hashmi, an aviation specialist with ASM, a global consultancy, believes that the problem is "the lack of open skies and restricted air service agreements with China and India", but "once these are relaxed you will see significant growth to secondary and tertiary cities". The apotheosis of Gulf ambitions is Maktoum International Airport, intended to be by far the world's busiest airport and situated within the 220-sq km Dubai World Central logistics free zone.

Chart 2: Gulf airlines, 2013



Sources: Airfleets.net and ch-aviation.com

2 Regional trade and investment flows

Asia

Asia is the region which has the greatest potential to re-shape the GCC's economic profile, with China and India the most critical economies. The GCC's most visible Asian relationship is with South Asia, which provides the bulk of the Gulf's expatriate workers, and whose remittances are significant to their home economies. Trade and investment flows with the Association of Southeast Asian Nations (ASEAN) are increasing but the game-changer is China.

China

By 2020, the largest share of GCC exports will go to China, at around US$160bn, with other emerging markets growing their share at the expense of the West and East Asia. China will also dominate the import market, providing about US$135bn of goods to the Gulf, nearly double the value in 2013.

China's increasing share of GCC exports matches its economic rise, with growth tripling since 2001 to reach 12% in 2013, and now providing 14% of GCC imports. GCC trade with China grew more rapidly during 2010-13 than with any other significant trade partner, at a rate of 30% for exports and 17% for imports. The stronger growth in exports, from higher energy prices and rising Chinese demand, caused the GCC's 2009 trade deficit to turn into a sizeable surplus.

An FTA could boost trade, but has been held up by disagreements over the petrochemicals sector, where China (like India) is concerned that low-cost Gulf producers could undermine an industry in which it has investments. "China and the GCC have both invested heavily in their petrochemicals sectors and they are producing similar products at a time when growth rates are slowing across the region on a structural basis, and so perhaps there are concerns about the risk of oversupply in the market," says Mr Simpfendorfer. However, there appears to be growing willingness to conclude an FTA, emphasised by the president, Xi Jinping, during a visit to China by the king of Bahrain, Hamad bin Isa Al Khalifa, in 2013.

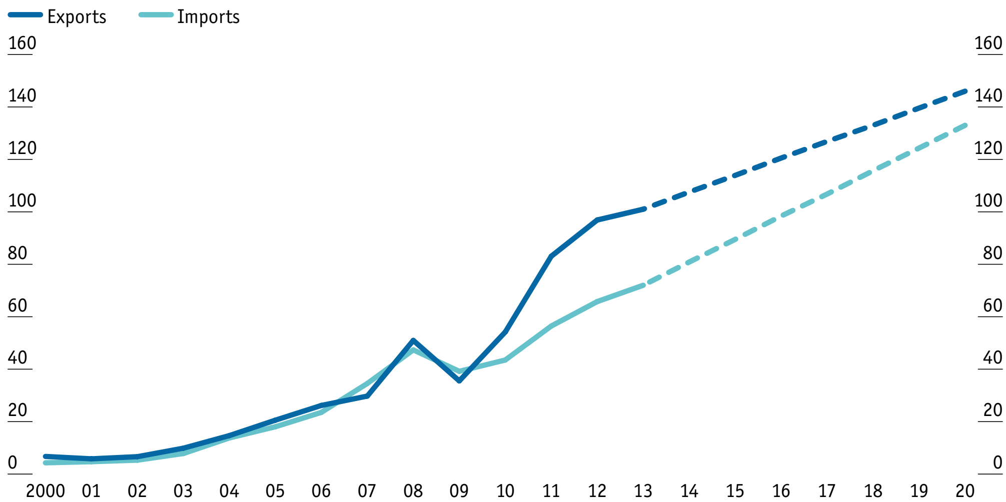
Chinese construction firms are active in the Gulf. Data from the Heritage Foundation, a US think tank, count US$30bn worth of Chinese contracts in the region between 2005 and 2014, or 8% of China's worldwide contract wins, with February 2014 bringing the US$3.7bn Waad Al Shamal phosphate project in Saudi Arabia[6]. Telecoms and consumer goods are another lucrative area. The GCC is a significant market for Huawei, the Chinese telecoms giant, in terms of telecoms infrastructure, although less so for consumer products given the modest population.

In the UAE, there is growing wholesale and retail trade, particular Chinamex, which helped to develop Dubai's Dragonmart in 2004, and is now involved in the Dragon City mall in Bahrain. A smaller Chinese mall opened in Qatar in July 2014. There are around 3,000 Chinese companies

Chart 3: Enter the Dragon

GCC exports to and imports from China

(US$ b)



Source: IMF Direction of Trade Statistics, Economist Intelligence Unit

in Dubai (up from just 18 in 2005), some of them catering for the local market and others utilising Dubai as a regional base.

GCC to China investment

GCC players are engaged in forays in China. Dubai-based Jumeirah Hotels has management agreement for five projects under development in China, the most in any country outside the Gulf. The president and CEO, Gerald Lawless, explains that in China there are "many secondary cities today that in the future will be primary cities when you look at the population dynamics".

There have been a spate of investments in petrochemicals and oil refining, but these have faced problems. The only one up and running is a Sinopec facility in Fujian, with Saudi Aramco. Both Aramco and Qatar Petroleum have planned joint ventures (JVs) with PetroChina, but the projects have been delayed by environmental concerns and PetroChina's refocus on upstream operations. A Sinopec refinery is set to open in Ziangian in 2017, which was supposed to be a JV with Kuwait Petroleum Company, but Kuwait faced resistance to bringing in a Western junior partner and to marketing fuel directly, although a renewed co-operation deal in June 2014 suggests that the partnership might be back on track. Another Chinese firm, Sinochem, had contracted Kuwait Oil for a refinery in Quanzhou that opened in 2014, but has largely shifted its sourcing to cheaper Iraqi crude.

"It's a surprise that Middle Eastern energy companies have not built or invested in more refineries in China. There are just two or three to date. Even for these, negotiations were complex. In my view, the oil majors have had an easier time in China than have GCC firms," explains Mr Simpfendorfer. "There just isn't the evidence over the last ten years that China and the GCC have a special relationship when it comes to collaborating on refining and other energy projects, and the extent of the investment remains very small." Gulf portfolio investment in China, meanwhile, has been limited by restrictions on foreigners holding stocks in mainland China. A number of Gulf SWFs have been given "qualified investor" status, but with lower limits than requested[7].

In conclusion, says Mr Simpfendorfer, there is "absolutely no doubt that China's ties with the GCC are strengthening and they will continue to strengthen over the long term. But it would be wrong to equate that to an easy relationship or a relationship that will develop overnight. It's a long and evolutionary process. Ultimately, both regions have priorities elsewhere. China has to focus on the US, Europe, and other Asian countries before it starts to think about the Middle East. And even then considerations on the Middle East are mixed up with those on Africa or Russia, for instance. The GCC naturally also has its own priorities."

Growth drivers

- Telecoms, consumer goods and construction will draw Chinese companies to the GCC, its most lucrative Middle Eastern market, while Chinese retail will show high growth in the UAE. China is quickly ascending as a top-tier investor in Saudi Arabia.

- Gulf entities are investing in Chinese stocks, including through sovereign vehicles, although mainland China restrictions means more funds flow into firms listed in Hong Kong.

- Dubai and Oman will play a greater role in mediating Chinese trade west, acting as a hub linking China, Africa and Europe. Expanded facilities for renminbi payments in Dubai are one financial development to watch.

- China-Gulf trade will encourage the development of banking relations[8].

- China's GDP growth will moderate, from 7.7% in 2013 to 5.9% is 2018, and FDI inflows will be less impressive in 2014-18, when they will average US$260bn a year. FDI inflows relative to GDP will fall from an estimated 3.5% in 2013 to 1.8% in 2018. However, some provinces are predicted to attract higher levels of FDI, including Chongqing, where Sabic, a Saudi industrials giant, has a presence. To respond to the spatially uneven development pattern, China is seeking greater investment in interior regions where input costs are lower and markets are less saturated. Rising costs in China's eastern region have prompted foreign investors to look to western China, and Gulf investors are starting to explore this market.

India

The Gulf has been trading with the Indian subcontinent for over 4,000 years and Oman used the Indian rupee as its currency until 1970. This relationship diminished once the Gulf's oil age commenced, in favour of more energy-hungry advanced economies; as recently as 2005, India only received 2% of GCC exports[9].

There were also political factors clouding bilateral relations, given close Gulf relations with Pakistan. A landmark shift was the invitation of King Abdullah Al-Saud of Saudi Arabia as chief guest at India's Republic Day celebration in 2006, at which a range of agreements were signed. Since then, there have been high-level visits in both directions with most Gulf countries.

This political thaw, together with India's economic growth and rising energy needs, saw GCC exports to India grow at an annual rate of 43% over the last decade, by far the highest rate with any major trade partner, and now comprising 11% of total GCC exports[10]. A GCC-India FTA would boost many categories of trade and has been under discussion since 2004.

There are at least 6m Indians working in the Gulf[11] and Indians are increasingly setting up businesses, with Indian membership of the Dubai Chamber of Commerce rising by 41% between 2009 and 2012. Data from Alpen Capital, an Indian Dubai-based investment bank, suggest that India is the third-largest investor in the UAE[12]. As well as its small and medium-sized companies, Indian entities have also made heavy industry investments[13].

However, India has lagged other markets in attracting Gulf money, owing to red tape and bureaucracy which has hampered the business environment[14]. Investment could receive a boost if India's economy picks up and the new prime minister, Narendra Modi, uses his electoral mandate to move ahead with pro-business reforms. "Hopefully in the new India, under Modi, there will be more opportunities for the GCC countries," says Nasser Saidi, former chief economist at the Dubai International Financial Centre, who believes stronger tax agreements and a conclusion to trade-building FTAs could be helpful[15]. India also needs to renovate its infrastructure as a business environment boost, according to Paras Shahdadpuri, president of the IBPC in Dubai and chairman of the NIKAI Group, who points out that India needs US$1trn in the next four years to upgrade its infrastructure.

Growth drivers

- A new government has arrived with a pro-business mandate, prompting Standard and Poor's, the international ratings agency, to move its outlook from negative to stable in September 2014. If Mr Modi delivers on his reforms, including breaking up the "'Licence Raj", it would directly affect the GCC, and the UAE in particular, which have modest investment in India despite strong trade ties and close proximity.

- We forecast GDP growth in India of between 6% and 7% through to 2018.

- The infrastructure, energy, telecoms, IT and insurance sectors are magnets for FDI. Producers of cars and automotive components are re-evaluating India's potential, as are biotech firms. Special economic zones are expected to play an increasingly important role in attracting FDI into India. There is also the potential for asset sales by the government, which could be attractive opportunities for GCC sovereign wealth funds (SWFs).

ASEAN

The South-east Asia countries were the destination for 11% of GCC exports in 2013, just behind China. The majority go to Singapore and Thailand; new liquefied natural gas (LNG) contracts between Qatar, Thailand and Malaysia should boost exports to ASEAN going forward. The share of GCC imports from the region has also been relatively stable for over a decade, at around 6% of the total. The GCC's FTA with Singapore, its first with a country outside the Middle East and North Africa (MENA) region, came into force in September 2013 and could serve as a model for a future GCC-ASEAN FTA.

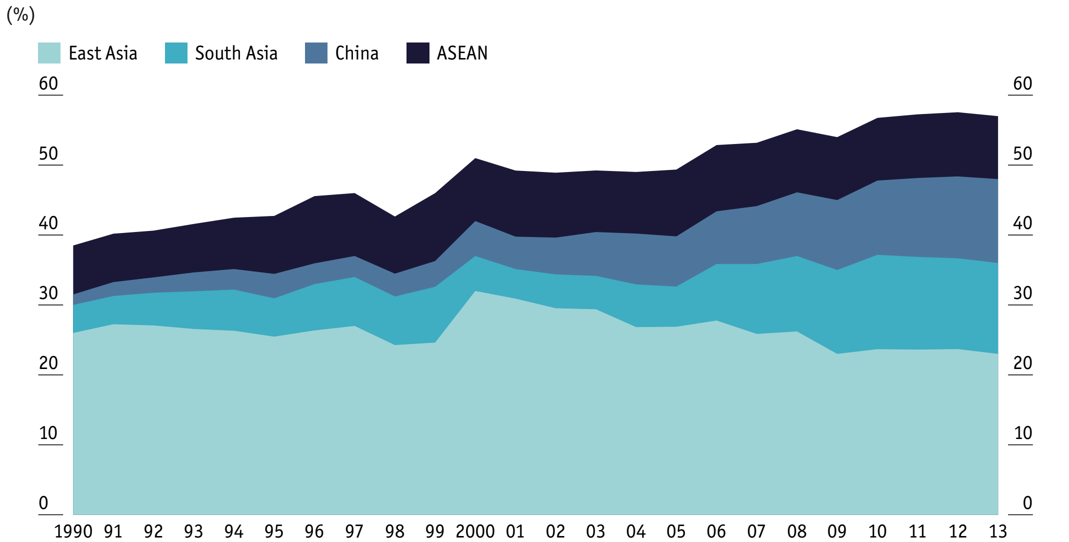
There are notable policy relationships, as several Gulf countries look to Singapore as a model of how a state with a small national population can develop effectively and diversify. Gulf delegations often visit Singapore for advice on economic policy and government administration, and, increasingly, Gulf sovereign wealth funds are co-investing alongside their Singaporean counterparts.

There are significant GCC investments in ASEAN, given its fast growing economies and greater openness to foreign investment than China. Qatar signed agreements for billion-dollar co-investment vehicles in 2010-12 with Malaysia, Indonesia and the Philippines. Similarly, the UAE and Malaysia signed deals in 2013 for the development of a new financial district in Kuala Lumpur and an oil storage facility in Johor.

GCC state-owned oil firms have been investing in ASEAN. Mubadala Petroleum of the UAE has energy production in Indonesia and Thailand and exploration efforts in Vietnam and Malaysia. In Vietnam, Qatar is a partner in a major petrochemicals project and Kuwait in a refinery. However, talks between Indonesia, Kuwait and Saudi Arabia to build two refineries fell through in late 2013 as the Gulf investors requested

Chart 4: The Asian Share

Asian sub-regions' share of total trade with GCC



Source: IMF Direction of Trade Statistics, Economist Intelligence Unit.

greater tax concessions than Indonesia was prepared to grant. There has also been interest from GCC SWFs in farmland across the ASEAN region.

Gulf private sector interests in ASEAN include real estate and finance[16], given that Malaysia is a leader in Islamic finance and Indonesia the largest Muslim nation. Telecoms are another sector of interest, and in August 2014 Ooredoo of Qatar launched a network in Myanmar, which attracted over 1m subscribers in its first month of operation.

Lastly, the Philippines and Indonesia are increasingly key suppliers of migrant workers to the GCC. The Philippines government estimates suggest that there are over 2.7m Filipino workers in the GCC, about 12% of total migrants to the region, and triple the 4% share recorded in 2000. While many work in domestic service on low salaries, a significant share is in the broader services sector, particularly retail, and in white-collar sectors. Filipinos are highly regarded in the GCC for their English language and professional skills.

Growth drivers

- Some Filipino workers in the Gulf are moving from low-wage services to white-collar employment. As with India, this brings an increase in entrepreneurial activity and private investment, with inroads already made in clothing, retail and fast food.

- As the GCC grows its Islamic finance sector, relations with Malaysia will prove critical. A framework trade deal between Malaysia and the GCC in January 2011 had a slow start but the Gulf's shift towards Asia and an increasing emphasis on the Islamic economy is strengthening momentum. Malaysia's economy is forecast to accelerate from 4.7% growth this year to 5.9% in 2018. Saudi Arabia and the UAE are the GCC's top investors in Malaysia.

- The Philippines plans to ramp up public spending in ports, which could benefit the likes of DP World, already present in the Philippines.

East Asia

Developed East Asian countries (Japan, South Korea and Taiwan) are providing the Gulf with significant imports, particularly in the high-tech and automotive sectors. Toyota Land Cruisers and Samsung phones are ubiquitous across the Gulf, and Japan and South Korea have been a source of capital equipment in the hydrocarbons sector. The LNG tankers transporting Qatari gas around the world are manufactured in South Korean shipyards. In 2013 Japan and South Korea were respectively the fifth- and seventh-largest sources of imports for the GCC (Taiwan was less important, in 16th place) and the combined share of the three East Asian countries was 9% (down from 11% in 2010 and a peak of 25% in 1985).

Japanese oil firms have invested in Gulf hydrocarbons, largely as minority non-operating partners, such as Jodco, which has stakes in offshore fields in Abu Dhabi, and power companies have taken small stakes in LNG-exporting companies in Qatar. South Korean construction and engineering firms have been successful in winning major Gulf infrastructure contracts, and were part of three consortia awarded elements of the US$12bn Clean Fuels refinery project in Kuwait this year, and another major tender win was an orbital highway in Qatar by Daewoo.

Interestingly, East Asian companies are competitors for Gulf companies in projects in their own backyards. Mr Reeve notes that Saudi "clients have suffered a lot from fairly cut-throat competition from South Korea". Jorg Wojahn, the EU's Trade Counsellor in the Gulf, sees South Korean firms as serious competitors in the Gulf "because they can also offer innovation and quality for lower prices".

Growth drivers

- South Korea's capacity in heavy industry and construction has led to its firms beating Western incumbents in contract bids, especially in energy infrastructure and transport, while the GCC's high consumption patterns in electronics and vehicles mean that the trade relationship with the GCC has mileage beyond the historical mainstay of oil. A Memorandum of Understanding between the GCC and South Korea, inked at the UN General Assembly in September, advocated closer cooperation in renewable energy, higher education, environment, information and communications technology, the defence industry, and power plants.

- Saudi Arabia can count on oil sales to Asia for revenues, and shipped 68 percent of crude exports to Asia last year compared to 19 percent to the US. With price pressure in the US due to the shale gas revolution, Asia now represents a premium market.

Sub-Saharan Africa

Africa boasts some of the world's fastest-expanding economies, driven by natural resources, a young population, rising consumer needs and major infrastructure requirements. The GCC's geographical proximity and good air links are growing trade[17], and investors are seeking new equity and investment opportunities.

There are opportunities for Gulf players to invest in infrastructure, where, according to World Bank estimates, US$96bn a year is required to bridge the gap[18]. GCC entities are active, through a mix of private money and development loans. DP World and Agility of Kuwait are present in ports and terminals; Bin Laden Group (Saudi Arabia) and Kharafi Group (Kuwait) have been building airports and roads; TAQA (Abu Dhabi) is erecting a power plant in Ghana; and Saudi Arabia's ACWA has recently invested in a coal plant in Mozambique, a solar facility in South Africa, and is bidding for plants in Botswana and Namibia. In September 2014, the Investment Corporation of Dubai announced that it would be investing US$300m in Dangote Cement of West Africa, which has a market capitalisation of about US$23bn, and the following month the ICD CEO announced they were looking at further investment opportunities in African agriculture and infrastructure.

In banking, there has historically been little synergy between the GCC and Africa, but in September 2014 Qatar National Bank (QNB), which already has a presence in North Africa, acquired a stake in Ecobank Transnational. Gulf companies, particularly those run by families, prefer using known banks and this move by QNB is well calculated. The growth of Islamic finance in Africa is another facilitator for GCC investment. South Africa, Kenya and Senegal are planning sovereign sukuk (sharia-compliant bonds) and these could open the door to a new flow of capital markets activity.

Africa's tourism industry is attracting attention. The Dubai-based Jumeirah Group, which has begun growing in North Africa, signed a management agreement for a hotel in Mauritius and Mr Lawless says they are discussing deals in Nigeria, Angola, Kenya and South Africa. The Investment Corporation of Dubai has bought a stake in Kerzner International, responsible for resorts such as Atlantis and the One & Only.

"Africa is on the radar screen of a lot of the countries in the Middle East," notes Mr Zok. "Africa is regarded by many developed economies as one of the final remaining frontier markets with significant opportunities ... and the GCC countries are very aware of this." Mr Zok says fast-moving consumer goods (FMCG) is a "hot sector" but mining, oil and gas are also increasingly being targeted for GCC investments.

George Abed, senior counsellor and director Africa and the Middle East at the Institute of International Finance, agrees that there are significant opportunities for GCC investors in Africa, but cautions that the "sudden surge in interest has made for a crowded field" and there are "probably now more funds than fundable projects". Similarly, Rachel Ziemba, director of global emerging markets at Roubini Global Economics in London, also says that Africa markets are "quite shallow, particularly from a portfolio point of view" which could be a barrier for GCC investors. Dubai-based Abraaj has navigated this by using its 2012 merger with Aureos Capital to build up an extensive continental portfolio worth close to US$2bn across sectors including mining, tourism, manufacturing and healthcare.

One of the barriers to greater GCC investment in Africa is a perception of high political risk. But Mr Saidi believes that Africa offers high-yield opportunities. “Why should the GCC countries invest in US Treasury bills at 0.5% yield when next door you can have risk-adjusted returns on investments of 15-30%?” he asks, adding that more can be done to capitalise on the Gulf’s geographical position between Africa and China. “The UAE has the locational comparative advantage of being closer to Africa than China, but institutional structures need to be put into place to maximise this opportunity,” he says.

Mr Zok acknowledges that Africa is not always the easiest place to do business and says a careful analysis of markets and local partners is required. “Political instability is something you have to work around; it is better if it is not there, but it does not rule out opportunities. You have to study a country, see how you can mitigate risk.”

Growth drivers

- Telecoms and power have been the primary infrastructure investment drivers of Gulf companies in Africa to date. Gulf-based entities, both public and private, are currently contributing around 10% of infrastructure investment in Africa.

- FMCG is one of the fastest-emerging opportunities on the continent, as spending power at the bottom of the pyramid increases. GCC countries have an opportunity to tap into this market and use their good logistics infrastructure and geographical proximity to Africa to take advantage of a new customer base.

- Liberalisation of the agribusiness value chain in key African markets presents an opportunity for foreign investors to look beyond land acquisition and into direct agribusiness investment. Nigeria’s reforms are particularly eye-catching, from reductions in red tape and supply chain corruption to risk mitigation guarantees through a multi-stakeholder facility with the Central Bank. Ethiopia’s innovations in agricultural co-ordination and infrastructure have led to particularly impressive gains in productivity.

- Political risk and instability have been traditional barriers for GCC investors, but stronger government-to-government relations, more institutionalised support and an increasing familiarity with the market should facilitate easier and more confident investing.

- Bond issuance in foreign currency has grown strongly in the past two years, both in large economies like Nigeria and Ghana, and smaller economies including Rwanda and Zambia. Investors have been attracted by yields higher than those available in developed markets, and African policymakers are keen to attract large amounts of capital at lower rates and longer maturities than available domestically. The growth of Islamic finance in Africa—which has a Muslim population of around 500m—is another opportunity for GCC investors to enter new markets via sukuk and other sharia-compliant financing.

- The GCC is well placed to capitalise on its hub capacities and has an opportunity to become an important base and link point for China, which is investing heavily in the continent, while a recent deal between Emirates and TAAG Angola Airlines will improve to Central and South Africa.

- Although Africa’s equity markets remain quite shallow—and according to some increasingly crowded—firms like Abraaj have shown that it can be done and more moves by GCC private equity into the continent can be expected.

The West

Europe and North America, along with Australia and New Zealand to a lesser extent, are bracketed together as "The West" in this report[19], and form a dominant trade and investment partner to the GCC, accounting for 18% of GCC exports and 45% of its imports in 2013.

While the GCC's relationship with many emerging economies is growing, the West is holding its own in absolute terms, although its relative share of Gulf trade is falling. Between 2009 and 2013 its exports to the GCC grew by 11.4%, and imports from the GCC were up by 22.9%.

"The EU remains the largest trading partner for the GCC in terms of numbers," explains Mr Wojahn. "Obviously we are observing increasing competition from the Far East and China ... and while one should never be complacent, I don't think we are really worrying."

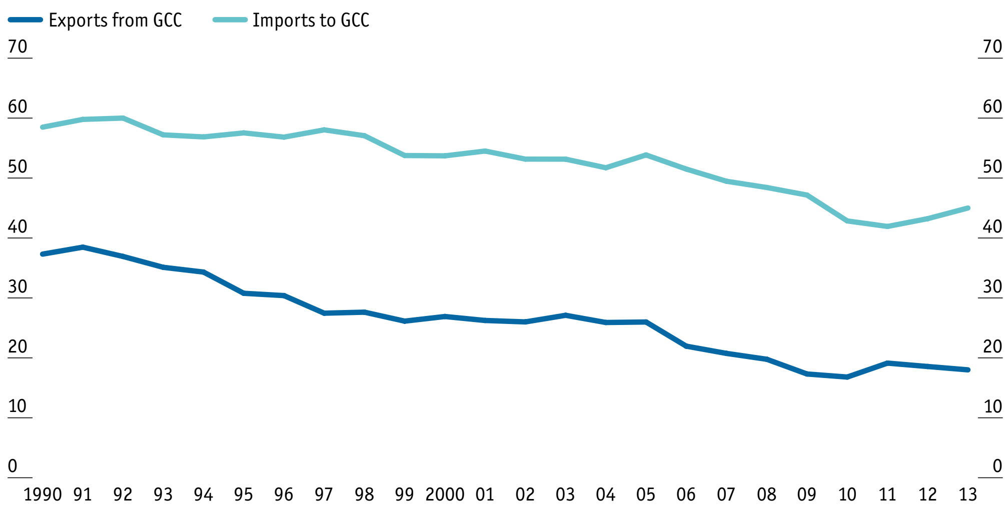
In 2013 total trade flows from the West were just over US$393bn, led by Europe, which accounted for over one-half (US$249bn). GCC exports were dominated by hydrocarbons and petrochemicals, and imports by machinery, industrial products, and precious stones and metals. In 2013 US exports[20] to Arab nations grew by 7.5%[21], compared with export growth of 2% to global markets, and the UAE and Saudi Arabia accounted for one-half of exports, with the UAE positioned as America's top partner, importing goods to the value of US$24.6bn. The main GCC imports from the US were transportation equipment, computer and electronic products, and non-electrical machinery.

Large European and North American banks and multinationals have set up Middle East and North Africa hubs in Dubai or Abu Dhabi, cities that offer good regional and global connectivity and a high level of services and institutional capacity. The stability of the Gulf region has also made it attractive, notes Mr Abed.

Chart 5: Slipping

The West's share of GCC trade

(%)



Source: IMF Direction of Trade Statistics, Economist Intelligence Unit.

"The turmoil from the Arab Spring has made the GCC countries into a safe haven, spurring capital inflows and a rise in asset prices, especially in the stock markets and real estate," he adds. Dubai's role as a re-exporter to harder-to-reach markets like Iran, for instance, makes it a possible base for Western companies should Iranian sanctions be lifted.

GCC mega-projects have long been enticing for Western firms, and with a pipeline of projects in Saudi Arabia, Qatar and the UAE, the GCC remains an attractive market for the likes of Atkins, Balfour Beatty, Bechtel, Hochtief AG, Technip and Vinci. These companies have already been involved in flagship projects such as the Burj Khalifa and metro system in Dubai, the Bahrain World Trade Centre, Hamad International Airport in Qatar, Khalifa Port and Kizad in Abu Dhabi, and King Abdulaziz International Airport in Saudi Arabia, while a Spanish consortium was recently awarded contracts for a high-speed railway and metro lines in Saudi Arabia[22].

In contrast, there is limited Western equity investment in the Gulf, owing in part to restrictions on foreign ownership. But that is changing as a result of the recent promotion of the UAE and Qatar by MSCI to emerging market status, Qatar's increase in the permitted foreign ownership level from 25% to 49%, and plans to open up Saudi Arabia's Tadawul exchange to overseas shareholding in 2015.

GCC in the West

The GCC's investment presence in Western markets is the faster changing part of this relationship. The ubiquity of UAE and Qatar air carriers in Western geographies has led the globalisation of their national brands. As far as North America is concerned, new Qatar Airways non-stop services have been launched to Philadelphia, Miami and Dallas, on top of existing Emirates and Etihad services including Los Angeles, New York, Boston, Chicago, San Francisco, Houston and Seattle[23].

In terms of direct investment outside of the Gulf, one notable shift is the collaboration of GCC and Western energy companies in non-Gulf regions. TAQA, a UAE-based power company, has gas projects in the Netherlands, oil and gas exploration rights in Canada and the North Sea, and stakes in power plants and wind farms in the US. Aramco of Saudi Arabia, Qatar Petroleum International (QPI) and Kuwait Petroleum Corporation (KPC) are partnering with BP, Exxon Mobil and Shell in exploration and production of oil and gas, refining and transportation, while sovereign funds are eyeing European renewable energy opportunities, with Mubadala of Abu Dhabi holding a stake in the London Array wind farm.

Gulf SWFs have grown the GCC's footprint in Western markets. Despite a well-publicised intention to seek higher return opportunities in emerging growth markets, they continue to hold significant European and American assets, financial and fixed[24].

Looking ahead, the West's historical dominance in the GCC faces several challenges. The trade share is falling. "Six or seven years ago the EU accounted for about 31% of Saudi's imports, but now that is down to 25%, while China has doubled its share during the same period," says Mr Reeve.

Secondly, Asian providers are acquiring more refined technology capabilities and skill sets, muscling in on areas dominated by Western companies. In 2009 a South Korean consortium led by Korea Electric Power Corporation (Kepco) beat French firms and a US-Japan alliance to win the contract for the UAE's first nuclear power plant.

One challenge, according to Mr Wojahn, is a fixation among some GCC members on awarding tenders to bidders with the lowest price irrespective of quality considerations, which can make it harder for European companies to compete. But Asian prowess in technology and construction presents a greater competitive challenge to Western firms than ever before.

On the trade side, negotiations for an EU-GCC FTA remain slow. Despite the benefits to be had from reducing tariff barriers, the EU is reluctant to accept the GCC's proposal for a free hand over its export duties. "The EU position is that we can offer some compromise and give some possibilities, but we cannot allow a completely free hand, otherwise it is not a real FTA," explains Mr Wojahn.

Growth drivers

- GCC mega-projects will play into the hands of experienced Western construction and engineering firms, while the defence industry is a continuing source of contracts for European and North American firms that lead the sector. Regional security challenges suggest that there will be continued high spending on building up defence capabilities.

- Newfound collaborations will strengthen between Western and Gulf energy firms in non-Gulf energy projects.

- Renewable energy is an increasing investment priority for the likes of cash-rich Abu Dhabi and Qatar, and European economies are some of the most active reformers in this space.

- The UAE's role as a re-exporter to Iran makes it a possible base for Western companies should Iran sanctions be lifted. We forecast UAE re-exports increasing from 39.6% share of exports in 2011 to 46% in 2018.

- Although GCC SWFs have shown their interest in emerging markets, real estate and other tangible fixed assets in Europe and the US remain popular purchases and this is likely to be the case for some time.

Latin America and the Caribbean

The synergies between Latin America and the Gulf suggest grounds for stronger ties. The GCC has a food security deficit, while Latin America has—in Brazil, Argentina and Peru—a strong food export profile, and Gulf oil is a key supply for Latin America.

Trade flows between the GCC and Latin America increased from US$3bn in 2003 to US$17bn in 2013, and GCC exports to the region posted the largest global rise over the last four years of 32.7%, albeit from a low base. Unsurprisingly, the bulk of this trade is exports of hydrocarbons from the GCC and exports of food from Latin America. At the diplomatic level, a number of Arab and South American chambers of commerce have been set up and Etihad, Qatar Airways and Emirates have direct routes to Rio, São Paulo and Buenos Aires, plus new routes planned into Mexico and Columbia.

But despite the synergies and the trade uptick, the relationship remains under-realised. Negotiations for an FTA between Mercosur (Argentina, Brazil, Paraguay, Uruguay and Venezuela) and the GCC have yet to conclude. As with India and China, opposition from local petrochemical companies is a barrier. Another reason for the stall is the political situation in Brazil, which faces low growth and domestic unrest, and Argentina, which is in sovereign default.

"Since 2012 there has been a lot less attention on the GCC, and that coincides with the beginning of the decline of Brazilian growth, the turn towards protectionism, and the rise of domestic and social issues," says Elena Lazarou, assistant professor at the Centre for International Relations School of Social Sciences (CPDOC) at Brazil's Fundação Getulio Vargas.

"Suddenly with the eruptions of the 2012 protests, Brazil went through a large domestic crisis and the government seemed to retreat from its internationalisation programme to refocus on domestic issues ... the GCC is more on the fringe now in terms of Brazilian interests." The government has become "very protectionist in terms of the national economy", she adds, with "an abandoning of ideas of free trade" and little prospect for FTA negotiations restarting in the near future. "If we had a new government that relieved the constraints of investment, then perhaps we might see a renewed vigour in trying to bring in GCC investment via a new circle of engagement and discussions," Ms Lazarou notes, but Dilma Rousseff's electoral victory in October will see the continuation of the same regime.

Several of Brazil's globally facing multinationals have still sought out opportunities in the GCC. Odebrecht has carried out civil works in the UAE, including a runway extension at Abu Dhabi airport; Vale, a mining giant, has invested more than US$1.25bn into the Sohar industrial complex in Oman; and Magnesita, a materials producer, is looking to the region[25].

For GCC countries, which import most of their food, security of supply is a key strategy and acquiring productive agricultural land overseas is a way to boost food security. However, despite some earlier high-profile announcements about plans to purchase land in Latin America—and allegations by activists about "land grabbing" —it appears that few deals have actually gone through, or at least those that have, have not been widely publicised. In Latin America and Africa, GCC countries appear to have shifted away from the land-purchase model hyped up in 2008; they are more interested in investments in food-producing companies.

GCC money has, however, flowed into Latin America though sovereign vehicles and direct investment. Aabar Investment (Abu Dhabi) and the Qatar Investment Authority (QIA) both have interests in Banco Santander Brasil, while Abraaj, a Dubai-based private equity house, has used its 2012 acquisition of Aureos Capital to gain exposure to chemicals, catering, pharmaceuticals, real estate and other sectors across a number of Latin countries including Mexico, Costa Rica, Peru and Panama. Sharjah-based Gulftainer has port operations at Recife, a gateway to the region's industrial north-east, and DP World in Dubai, whose portfolio on the continent already includes Chile, Suriname, Argentina, Brazil, Peru and the Dominican Republic, wants to grow its regional footprint.

Perhaps seeking to exploit the gap at the negotiating table left by its Mercosur neighbours, Mexico is keen to build ties with the GCC. After years of mostly US-facing trade, the country is opening up its economy globally, passing new laws to facilitate investment into its oil sector. Mexico's president, Enrique Peña Nieto, is tipped to make his country's first official visit to the UAE during 2014, and there are plans to sign MOUs with Mubadala Petroleum and Abu Dhabi National Oil Company[26]. Chile also wants closer ties with the UAE. The president, Michelle Bachelet, visited Dubai in April 2014, one month after her re-election, to hold talks with the UAE's prime minister and the ruler of Dubai, and inked several bilateral agreements[27].

Growth drivers

- Brazilian officials are keen on finalising a free-trade deal with the GCC, and exempting petrochemicals is one way of speeding the conclusion of the deal, which would reduce the significant red tape currently affecting trade.

- Mexico is repositioning itself to avoid over-reliance on the US trade relationship. Relations with the GCC have been modest but diplomatic initiatives suggest hopes for increased commerce in tourism, electronics and energy, and Mexico is poised to open its oil industry to foreign companies. Mexico has signed investor protection and tax agreements with the UAE over the last two years.

Commonwealth of Independent States (CIS)

Sitting between China and Northern Europe and spanning one of the old "silk routes", the CIS region[28] has a combined population of more than 282m and some of the world's fastest-growing economies. In 2013 exports to the CIS from the GCC accounted for only 0.2% of the bloc's overall export basket, with imports at 0.8%, but over the last four years exports have grown by 24% (to US$6bn) and imports by 31% (to US$4bn).

These high percentages are partly a product of a low base but also point to an emerging relationship that officials are promoting. Saeed Al Mansouri, the UAE's minister of economy, visited Moscow in June 2014, calling for more trade and engagement. He said that more than 40 Russian companies had representative offices in the country—still modest compared with over 3,000 Chinese firms—and that Russian and Emirati businessmen have partnered in more than 350 joint ventures .

Both GCC and CIS countries have oil and gas reserves and technical knowhow, so while they may not need to trade hydrocarbons, there is scope for industry synergies. As yet, however, there have only been a handful of investments[29].

In aviation, cities across the CIS are well served by Gulf carriers, including smaller low-cost firms such as Air Arabia and flydubai, helping to link the two regions as well as promoting the flow of people and goods. There is empirical evidence to suggest that the increase in flights has made the GCC a useful hub for CIS travellers heading to other markets.

But the Gulf is not only a transit route. Russia is an increasingly important tourism market for Dubai. According to Mr Lawless, the CEO of the Dubai-based Jumeirah Group, which has more than a dozen luxury hotels across the UAE, almost one-fifth of their guests are of Russian origin and spend about 25% more per person than other guests.

In retail, there are a handful of Russian food and retail outlets catering to tourists and diaspora in the GCC and the Kuwaiti Alshaya Group runs scores of retail franchises across Russia for high street favourites such as Starbucks, H&M, Mothercare and The Body Shop. Jumeirah, already in Azerbaijan, is currently developing a new hotel via a management contract in St Petersburg, which will be the brands' first in Russia.

Infrastructure presents a major opportunity in the CIS. Although DP World exited Russia in 2012 during its debt consolidation period, last year it signed two deals with the government of Kazakhstan[30]. In a move away from its marine expertise, DP World is managing a new freight route marrying ancient Silk Road trading routes with modern demand, linking China to northern Europe, via the railroads of Kazakhstan. According to Mohammed Sharaf, CEO of DP World, early tests have shaved off as much as ten days from the 25 it usually takes to move freight by sea from China to Europe. He explained that DP World saw investment into infrastructure and logistics as a way to increase trade flows. "It's win-win for two sides; you build the local economy of the country where you're operating and you are also connecting China with Europe via land."

On a government-to-government level, there has been recent investment by GCC sovereigns into the Russian Direct Investment Fund (RDIF). To date, the RDIF has received US$5bn from Abu Dhabi's Department of Finance, US$2bn from Mubadala Development Company, US$500m from the Kuwait Investment Authority (KIA) and US$2bn from the QIA. The GCC investments make up the main share of the fund's US$10bn pot.

Investing into the RDIF matches the GCC funds' strategies to target growth markets, but given the current events in Ukraine, there are risks. The RDIF has stated that the sanctions do not affect its investments, and GCC countries are not bound by policy stances of the EU or the US. However, the funding could create tensions, especially for Saudi Arabia, Kuwait and the UAE, which have the closest political ties with the US.

Growth drivers

- A new Silk Road trading route is emerging, linking China to northern Europe via the railroads of Kazakhstan, and DP World is supporting the Kazakh government in the development of logistics and infrastructure.

- Russia is a growing source of tourists for Dubai and per head spend outstrips other nationalities. The growth of air connections between the GCC and CIS countries has helped to encourage people flows.

- The UAE has been working to promote relations with Russia, with Mr Al Mansouri visiting Moscow in June 2014.

- There has been significant investment by GCC sovereigns into the RDIF, a state entity formed in 2011, and to date the RDIF has received US$5bn from Abu Dhabi's Department of Finance, US$2bn from Mubadala Development Company, US$500m from the KIA and US$2bn from the QIA.

MENAT (Middle East, North Africa and Turkey)

The MENAT region is the GCC's backyard, yet trade is limited—comprising only 6.6% of GCC exports and 3.1% of imports in 2013. About one-half of the exports are re-exports to Iran via Dubai, and the rest is mainly oil. A significant portion of imports are food items as MENA countries cannot compete on price against Asian providers; Egypt was the largest import source in the region but only the 27th most important import source for the GCC overall, providing US$4bn of goods. Moreover, some non-tariff trade barriers remain despite the Greater Arab Free-Trade Area (GAFTA) launched by the Arab League in 1997. Other financial flows are more important than trade. The oil-importing Arab countries are heavily reliant on the Gulf for worker remittances, aid, investment and—particularly for Jordan and Lebanon—tourism revenue.

After three difficult years, the outlook for some countries is slightly more positive. MENA should see an acceleration of economic growth in 2015 as political conditions stabilise somewhat in several of the large countries. In 2014 regional performance has been held back by political uncertainty and sectarian violence, which will limit growth to 3.2%, well below pre-Arab Spring levels. By next year, however, Egypt's economy should be on a more stable footing as business confidence returns, and Iran will continue to edge out of two years of recession experienced in 2012-13.

Mr Saidi believes that reasonable growth and stability in the GCC could help to lift the region, especially in providing work opportunities. "Labour from Arab countries comes with advantages of language and shared customs and cultures ... if the GCC reduces the barriers to labour mobility, they would stimulate economic development and promote stability in those countries, providing countervailing forces to extremism."

GCC aid (including grants and soft loans) and investment flows fluctuate depending on the political climate. In the last four years, flows have been significantly affected by conflicts and political transitions. Direct bilateral support includes GCC or bilateral initiatives or the funds deposited in the Central Bank of Egypt. Public-sector funding comes from bodies such as the Saudi Development Fund and multilateral agencies like the Arab Fund for Economic Development, largely capitalised by the GCC. These also provide funding for the private sector or grants to civil society, and there are flows to civil society and religious groups from private Gulf charities. The Palestinian economy is particularly dependent on Gulf aid, which is expected to play a major role in rebuilding Gaza once more.

Investment flows from the GCC to the MENA region are difficult to map. A large share of listed equity in many MENA countries is held by GCC investors, including governments, corporations, funds and private individuals[31]. Conversely, there are sizeable MENA investments in the GCC, particularly in real estate, with Iranians major buyers in Dubai, although their role has diminished in the last few years owing to tighter sanctions.

Lastly, Turkey, which sits between MENA and Europe in more ways than just geography, is developing as an economic partner for the GCC. Exports to Turkey increased from US$1bn in 2003 to US$8bn in 2013 and imports from US$2bn to US$10bn over the same period (peaking at US$14bn in 2012). According to the Gulf Petrochemicals and Chemicals Association

(GPCA), chemicals exports to Turkey in 2012 reached 2m tonnes. Abraaj has identified fast-growing Turkey as a key investment opportunity and by December 2013 had put equity into seven businesses there and exited four of them with attractive returns. Politically, Turkey has been the closest to Qatar in recent years, particularly in relation to its position on Syria, but its significant population of around 70m also makes it too important an export market to ignore.

Conclusion

The current and future trade and investment flows of the GCC are shaped by a combination of internal reforms and market dynamics, as well as external headwinds. Within the group, the UAE and Qatar have hitherto led the outward drive and their recent promotion to emerging market status by MSCI, which increases foreign ownership limits, provides further evidence of their reform momentum. GDP growth of 4-5% in the region is among the healthier rates in a global economy that currently appears sluggish. Consumer spending is forecast to rise throughout the region, while major infrastructure programmes in Saudi Arabia, Qatar and the UAE—and the region's stability compared with its surrounding countries—suggest that it will lay a reasonable claim on global FDI flows.

Within the Gulf, the future of Saudi Arabia and Iran are significant game-changers in determining external trade and investment to 2018. Saudi Arabia represents the largest domestic market in the GCC, with high growth in consumer spending forecast out to 2018, while the public investment programme has opened up infrastructure to foreign participation. Iran has a bearing on the group's fortunes. Should the country cast off international sanctions as part of its current rapprochement, it would affect the UAE, potentially supporting its re-export role, although a shift could also see the flow of Iranian investment in Dubai return to its source. Iran's potential engagement of foreign oil companies would also shift the regional dynamic.

Turning to the GCC's external commercial relations, emerging markets have been steadily growing their share of trade and investment in the GCC, especially China, India and Africa, as well as the ASEAN group and the CIS. While the outlook for emerging economies is cloudier than it was in our last report in 2011, their importance for the GCC has not dipped. The GCC's transition towards Asia in particular has grown strongly, especially through its trade and investment ties with China and India, and is spreading into the ASEAN group, with Malaysia and the Philippines standing out, the former owing to its role in global Islamic finance and the latter owing to its provision of workers to the Gulf, who are increasingly evident in professional and entrepreneurial as well as lower-paid sectors.

The GCC's interest in Africa has grown since 2011 with the UAE and Saudi Arabia leading the charge south of the Sahara. Telecommunications and power have been primary infrastructure drivers. FMCG is an attractive sector in Africa's higher growth markets, as spending power increases. Risk aversion among most GCC investors suggests that the largest investment flows will be in consumer-facing sectors where reliance on government is lessened.

Latin America continues to be a market of potential rather than realisation, and Brazilian ties have weakened owing to the latter's internal challenges. Relations with Mexico are strengthening. After years of US-facing trade, the country is opening its economy, passing new laws to facilitate investment into its oil sector. Mexico's president is tipped to make his country's first official visit to the UAE during 2014 and there are plans to sign MOUs with Mubadala Petroleum and Abu Dhabi National Oil Company[32]. Chile wants closer ties with the UAE, as Ms Bachelet visited Dubai in April 2014 and inked several bilateral agreements[33].

Russia and the CIS trade and investment have grown from a low base. Dubai has curried favour with high-spending Russian tourists, while infrastructure opportunities in the CIS, and especially the renovation of the Silk Road trading route, open up major infrastructure opportunities nearby to the GCC.

MENA should see an acceleration of economic growth in 2015 as political conditions stabilise in several large countries. In 2014 regional performance has been held back by political uncertainty and sectarian violence. By next year, Egypt's economy should be on a more stable footing as business confidence returns, and Iran will continue to emerge from two years of recession in 2012-13. The situation in Syria and Iraq, however, has deteriorated.

While the emerging markets continue to deepen their ties to the GCC, the West continues to be a major trade and investment partner. A pipeline of GCC mega-projects will play into the hands of experienced Western construction and engineering firms, while the defence industry is a continuing source of contracts for European and North American firms, although there is growing competition from lower-cost East Asian competitors in construction and engineering. Regional security challenges suggest that there will be continued high spending on building up defence capabilities where Western firms are the incumbents. Renewable energy is an increasing investment priority for the likes of cash-rich Abu Dhabi and Qatar. Although GCC SWFs have shown their interest in emerging markets, real estate and other tangible fixed assets in Europe and the US remain popular purchases and this is likely to be the case for some time.

Footnotes

[1] http://www.doingbusiness.org/rankings

[2] http://www.dsc.gov.ae/Reports/GDP%20Constant%202013%20Q4.pdf

[3] "United Arab Emirates, Selected Issues", International Monetary Fund, IMF Country Report No. 14/188.

[4] http://www.bloomberg.com/news/2014-08-04/dubai-investments-bullish-on-ending-junk-status-islamic-finance.html

[5] Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar (Burma) and Vietnam.

[6] Chinese Ministry of Commerce data record only US$1.2bn in Chinese FDI (0.5% of the total) in the GCC between 2004 and 2010, mainly in the UAE and Saudi Arabia, and primarily in hydrocarbons, both upstream and downstream. However, actual figures are thought to be higher, with the Chinese ambassador to Saudi Arabia, Li Chengwen, claiming in late 2013 that there are 140 Chinese firms working in Saudi Arabia alone, on projects worth an estimated US$18bn.

[7] Qatar was the largest investor in the Agricultural Bank of China's initial public offering (IPO) in 2010, buying US$2.8bn of stock, and bought a 22% stake in Citic Capital, a state-backed private equity firm, in 2012. Qatar has been permitted to buy US$1bn in Chinese stocks, against its request for US$5bn. There has been more investment in Chinese firms listed in Hong Kong, which fall outside of these restrictions.

[8] Recent developments include a Qatar National Bank (QNB) office in Beijing and a banking licence in Kuwait for China's ICBC last May.

[9] Two data constraints apply to GCC-India analysis. First, some Indian investment in the Gulf may not be allocated as Indian because it was made through Mauritius or Singapore shell companies, which are commonly used for tax advantages. Second, the FDI data do not include the acquisitions of some sizeable equity stakes in major companies: examples in 2013 include Qatar Foundation Endowment in BhartiAirtel (US$1.3bn), Etihad in Jet Airways (US$339m) and Hassad Food in Bush Foods Overseas (US$100m). There are no firm data on GCC portfolio investments in India, by both sovereign wealth funds and private funds (particularly from Kuwait), but this is believed to total over US$10bn.

[10] Imports from India have grown by 26% over the last decade, doubling their share to 10%. Major categories include clothes, food and refined oil, with two-way trade in gold. Trade with the UAE has recently been hit by the 10% increase in gold import duties in India, causing gold imports from the UAE to drop as much as US$10bn a year. The new Indian government is expected to reduce the duty, although it has not done so yet.

[11] Estimates from Indian embassies.

[12] On the corporate side, one of the largest Indian investments in the UAE was of Ultratech Cement in 2010 (for about US300m), and another Indian firm has built a US$150m cement plant in the Fujairah free zone. There is also significant investment in real estate—Indians were the most active investors in Dubai property in the first half of 2014, making US$3bn in transactions (Pakistanis were in third place, at US$1.2bn).

[13] The Oman India Fertilizer Company in Sur, opened in 2006, is a US$1bn joint venture between the Oman Oil Company and two Indian farmers' co-operatives. Jindal Steel of India acquired Shadeed Iron & Steel in Oman (which, unusually for the Gulf, permits some fully foreign-owned firms) for US$464m in 2010.

[14] Total FDI from the GCC, including from Indian residents in the Gulf, was just US$3.2bn (1.4% of the total) between 2000 and mid-2014, mainly originating from the UAE (including six Indian ports operated by DP World of Dubai).

[15] A UAE-India Bilateral Investment Protection Agreement (BIPA), signed in December 2013, comes into force this year (the other GCC countries signed BIPAs with India in the period 1997-2006), and should facilitate Abu Dhabi's plans to invest an initial US$2bn in Indian infrastructure. The UAE and Kuwait are in negotiations to lease part of India's soon-to-be commissioned strategic oil reserve. India is looking for US$500bn in private-sector infrastructure investment over the next five years.

[16] QNB bought a majority stake in Indonesia-based Bank Kesawan in 2011.

[17] Exports from the GCC to Sub-Saharan Africa reached US$21bn in 2013, while exports hit US$6bn, up from just US$1bn in 2003. South Africa accounted for one-third of trade, receiving just over 40% of GCC exports, 89% of which were oil and related products, indicating that there is still work to be done to diversify the relationship away from hydrocarbons.

[18] Risk and reward: The Gulf's push into African infrastructure, The Economist Intelligence Unit, September 2014.

[19] Data in this chapter include Turkey in Europe figures.

[20] The US has a trade and investment framework agreement (TIFA) with each GCC member state and with the GCC bloc as a whole.

[21] National US-Arab Chamber of Commerce data.

[22] https://id.wsj.com/auth/proxy/refresh?url=http%3A%2F%2Fonline.wsj.com%2Fnews%2Farticles%2FSB10001424052970204555904577162941765572360

[23] There is direct competition between Western and Gulf players in aviation. Gulf operators brought much-needed investment to failing European carriers, such as Etihad's liquidity injections into debt-laden Air Berlin and Alitalia. In addition, the GCC's hunger for new Airbuses benefits Europe, where they are manufactured. At the same time, Gulf companies are also acquiring global landing rights, taking market share previously enjoyed by incumbents like Lufthansa and British Airways.

[24] The Kuwait Investment Authority (KIA) has 75% of its investments in Europe and North America. Between 55% and 85% of Abu Dhabi Investment Authority (ADIA) holdings are in these markets. ADIA has a growing portfolio in Australia and New Zealand. Mubadala has built up American assets as part of its US$61bn pot, including stakes in EMI, a music publishing house, GE, an engineering giant, and Carlyle Group, a private equity firm.. Qatar, through a range of sovereign vehicles, has made a number of "trophy" purchases, including prime real estate in London and Washington DC, and high end hotels across Europe.

[25] One of the more significant recent Latin America-GCC deals was the US$145m investment into a food-processing plant at Khalifa Industrial Zone Abu Dhabi (Kizad) by Brasil Foods (BRF) in 2013. BRF, which was already exporting large quantities of frozen meat (mostly poultry) into the region under the Halal brand Sadia through a partnership with UAE-based distributor Federal Foods, now aims to produce 80,000 tonnes of food in Abu Dhabi for local and regional consumption.

[26] http://www.thenational.ae/business/energy/two-energy-deals-in-the-pipeline-between-uae-and-mexico#ixzz3CLqkJErz

[27] http://gulfnews.com/news/gulf/uae/government/uae-and-chile-pledge-to-boost-bilateral-relations-and-trade-1.1324340

[28] A grouping of states comprising Russia, Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, Uzbekistan and Ukraine.

[29] Mubadala Petroleum has been doing exploration work in Kazakhstan since 2009. Lukoil of Russia has entered a joint venture with Aramco of Saudi Arabia to drill for gas in Saudi's vast Empty Quarter. In 2011 Stroytransgaz completed a gas pipeline from the Abu Dhabi coast across the country to Fujairah on the eastern seaboard.

[30] One is to support Aktau port, Kazakhstan's main terminal on the Caspian Sea, and the other is the development of the Khorgos Special Economic Zone (SEZ) and Inland Container Depot (ICD). Located on the border with China, Khorgos aims to become Kazakhstan's leading manufacturing and logistics hub.

[31] Major recent deals include Etisalat of Abu Dhabi's US$5.4bn purchase of a 53% stake in Maroc Telecom in May 2014 and QNB's US$2bn acquisition of NSGB in Egypt in December 2012 (interestingly, both were bought from French firms divesting from North Africa).

[32] http://www.thenational.ae/business/energy/two-energy-deals-in-the-pipeline-between-uae-and-mexico#ixzz3CLqkJErz

[33] http://gulfnews.com/news/gulf/uae/government/uae-and-chile-pledge-to-boost-bilateral-relations-and-trade-1.1324340

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