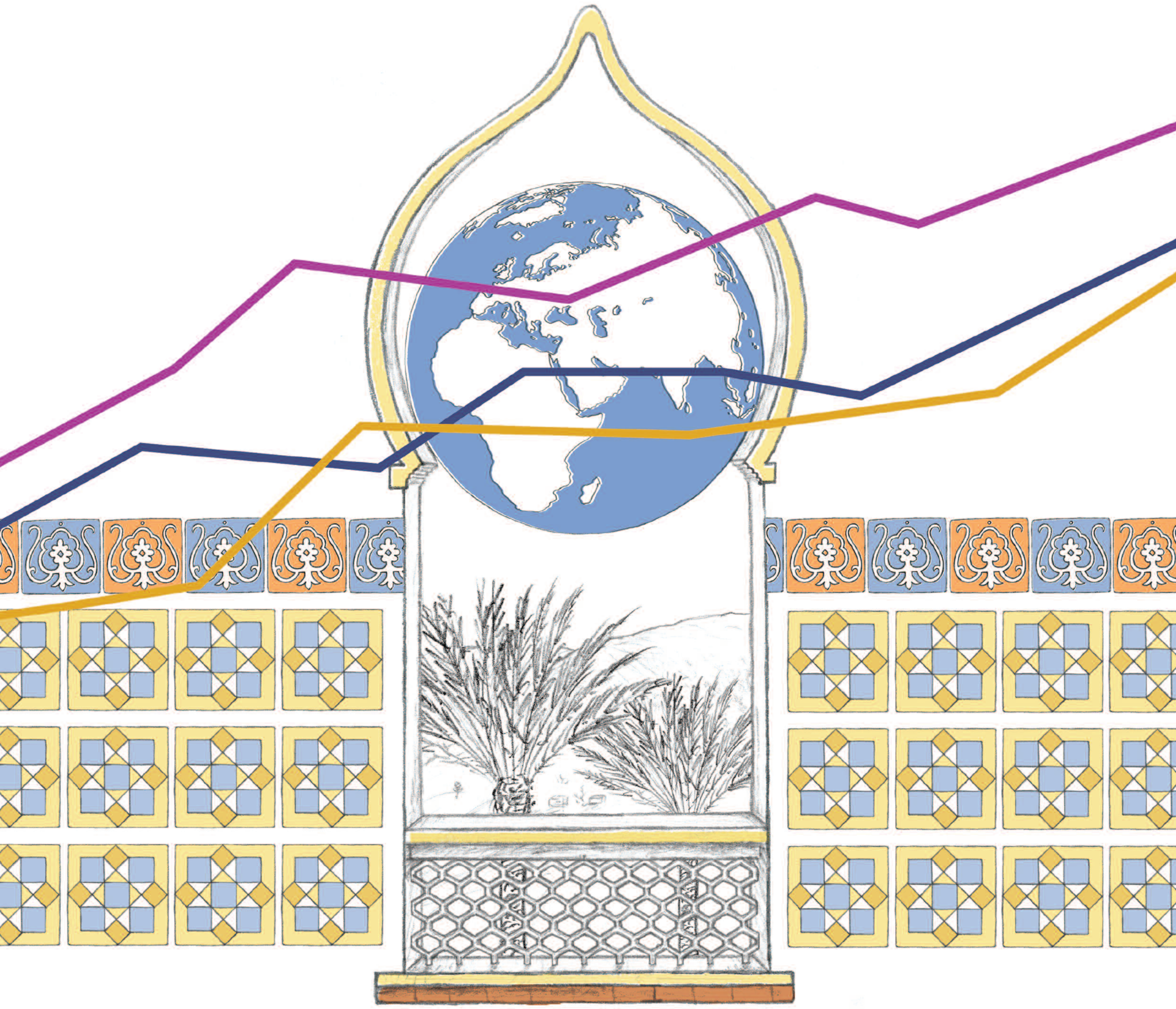
Grant Thornton

Middle East: towards innovation and transparency.

Capital Markets Guide 2009



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Methodology

The 2009 Middle East Capital Markets Guide from Grant Thornton International Ltd (Grant Thornton International) analyses the performance of the 14 largest stock markets competing to list company stocks in the Middle East between 2006 and 2008. All markets are listed in the directory at the back of this guide. Information in this report was prepared by Grant Thornton International and was current at 31 January 2009. Grant Thornton International makes no representation as to the accuracy or completeness of information included in this report. Opinions in this report constitute the current judgement of the authors at the date of this report and should not be construed as advice to adopt any particular investment strategy. All figures have been converted into US dollars using the exchange rate prevailing at the time.

Foreword

Capital markets in the Middle East are going through a period of unprecedented change as the region's economies undergo diversification and liberalisation. Until mid-2008 the region seemed almost immune from the forces acting upon developed and emerging markets elsewhere in the world. Supported by high oil prices and heavy public sector spending, the region's economies were growing strongly and capital markets remained buoyant. Middle Eastern stock exchanges were growing in number, size and complexity, especially in the Gulf Cooperation Council (GCC) states. The region was also experiencing considerable inflows of capital and expertise as investors in other parts of the world sought to profit from its strong growth.

Since mid 2008, it has become apparent that the Middle East will not escape the effects of the global financial crisis. Regional stock markets have given up much of 2007's gains, real estate prices have fallen and several governments have taken action to support local banks.

Even so, many markets in the region remain well positioned to weather the downturn and to take advantage of future recovery. Middle Eastern capital markets have become increasingly sophisticated and only a fraction of the expertise that the region has gained in recent years is likely to be eroded by the current downturn. The region's exchanges are becoming steadily more integrated with global capital markets, and increasingly innovative. The ongoing evolution of Islamic finance is a central element of growth as is heavy government involvement in the development of capital market infrastructure, and this is development very much on Middle Eastern terms. The Islamic finance industry has not been unaffected by the financial crisis, but there seems little doubt that it will continue to grow in size and maturity.

Transparency and corporate governance are emerging as a critical issue for Middle Eastern capital markets. The financial crisis is accelerating the agenda, as international investors demand greater openness from listed companies, regional banks and public sector bodies. There is no doubt that real progress has been made, but far greater openness will be a prerequisite of further development. Governments and companies need to view improved transparency as an opportunity, not a threat. If the region's capital markets can make significant progress in this area during the global downturn, they will be far better placed to benefit from eventual recovery and to play a greater role in the development of a more balanced global financial system.

The capital markets of the Middle East have great potential for further growth. This guide reviews the key themes of change sweeping through the region, provides specific insights into four key Middle Eastern markets and compares the performances of the region's major stock exchanges.

The 2009 Grant Thornton capital markets guide for the Middle East is part of a series of capital markets guides that Grant Thornton International has compiled over seven years. If you are interested in obtaining other Grant Thornton International capital markets guides, please visit the publications section of www.gti.org.

Regional overview

Expansion and maturity of Middle Eastern capital markets

Until the middle of 2008, economic growth in the Middle East appeared to be unaffected by the global financial crisis. Rising oil and gas prices were the dominant theme, but not the only story. Unprecedented levels of government spending were boosting economic diversification and stimulating consumer spending. The consequent flood of liquidity in the GCC states spilled into the wider region – and the wider world – as sovereign and private sector capital looked for investment opportunities.

Since August 2008 it has become clear that the Middle East cannot escape the global downturn. Falling oil prices have hurt government revenues and capital has been withdrawn from the region as international investors reduce their risk appetite. In response, regional stock markets have fallen dramatically and real estate values have declined. Local banks have come under liquidity and solvency pressures, accentuated by foreign investors abandoning their speculation in local currencies. Governments in Kuwait, Abu Dhabi and Qatar have made a variety of interventions to support local banks.

In this environment, it is important to remember the strides Middle Eastern capital markets have made in recent years. On average, total equity values have grown hugely since the start of the decade, and in some countries now exceed the total value of Gross Domestic Product (GDP). Trading volumes, market liquidity and index volatility on the major Middle Eastern exchanges compare well with other emerging markets in Asia and Latin America. True, most of the region's main indices are dominated by a handful of companies, and some of the Middle East's smaller exchanges are struggling to attract international capital, but privatisation should continue to drive Initial Public Offering (IPO) activity. The occasional lack of liquidity for small and medium enterprises (SMEs) is beginning to be addressed with the establishment of Nilex in Egypt and other initiatives for the promotion of SMEs in Qatar and UAE.

Although international capital flows are currently at a low ebb, in the medium to longer term the Middle East's attractive demographics, increasing affluence and economic liberalisation will continue to attract inward investment. The region also stands to benefit from the relative decline of American and European economic power and the growing importance of developing markets. This shift is illustrated by the number of Middle East and North Africa (MENA) investment funds in the developed world, and the increasing proliferation of Exchange Traded Funds (ETFs) offering Middle Eastern exposure to global investors. If the region's stock markets can continue to attract foreign investment during the downturn, they will have taken a further significant step towards maturity.

Increasing sophistication

Middle Eastern capital markets have not just been developing in size, they are also becoming much more sophisticated. The rapid flows of financial and human capital into the region in recent years have accelerated the natural evolution of local markets, several of which are becoming increasingly complex. Newly constructed financial hubs such as the Dubai International Financial Centre (DIFC) and the Qatar Financial Centre (QFC) have led the way in establishing a statutory environment designed to encourage development. In the space of just a few years, both have implemented entirely new legal and regulatory frameworks modelled on international regimes.

This groundwork has been complemented by a growing commercial infrastructure of legal, financial and accounting expertise. Global banks have developed their regional capabilities beyond sales and distribution to include research, product development and risk management. And while the financial crisis has led to a slowdown in spending, investment banks continue to move senior staff to the Middle East as developed markets decline in importance. The result is a build-up of world class intellectual capital in the region that the economic downturn will be unlikely to reverse.

Another result of international banks' investments in their Middle Eastern capabilities has been a greater connectivity between the region's capital markets and the wider world. Technology increasingly allows Gulf-based brokerages to connect with the world's exchanges and global investors to access the region's markets. Global transaction banking platforms are beginning to provide direct custody and clearing services to traders on the region's stock exchanges.

Innovation is also becoming an increasing hallmark of capital markets in the region. June 2008 saw the launch of Nilex, the Egyptian junior stock market, and Qatar is planning a similar exchange. This opens a new era for Middle Eastern equity markets, and should boost the region's economic development by supporting medium sized companies. A planned new exchange in Bahrain aims to offer the region's most effective multi-asset trading platform. Product innovation is moving forward at pace, with equity index futures being traded in Kuwait and planned for introduction in Egypt. Local derivatives markets are beginning to offer investors new hedging opportunities, and in the longer term should help to bring greater depth to the cash markets. Hedge funds and private equity firms are active in the region, and investment banks are offering clients synthetic ways to take short positions in the region's equity markets.

We should however sound a note of caution. In the long term, the development of stable and efficient capital markets will depend on greater openness. This not only requires better corporate transparency – as discussed in the transparency and governance section of this guide – but also more comprehensive disclosure by exchanges, public sector bodies, regulators and governments.

Continuing evolution of Islamic finance

The growing sophistication of Middle Eastern capital markets is being accompanied by ongoing evolution in Islamic finance. Islamic finance is not a separate sector but a regional genre which now includes banking, mortgages, insurance, reinsurance, bonds, equities and even derivatives. Financial activity in the Middle East is certainly not all Shariah-compliant – for example, the region's sovereign funds do not generally invest along Islamic lines – but the market is growing. According to Euromoney[1], 53 per cent of investment funds in Saudi Arabia, 33 per cent in Qatar and 30 per cent in Kuwait and the UAE are already Shariah-compliant.

Islamic finance is dominated by high net worth customers but Islamic concepts are becoming more influential in the wholesale arena. There is increasing demand for Shariah-compliant investments and dedicated Islamic financial institutions are providing corporate customers with new products. Islamic institutions have also been a major source of IPOs in the region, especially in Bahrain. The most significant long-term development of recent years has probably been the growth of Sukuk bond markets across the Middle East. Effective bond markets give companies more fund-raising options and are a key element of a mature financial system.

The Islamic finance industry has not escaped the effects of the global financial crisis, even if it has so far been less affected than the conventional finance sector. The partnership ethos of Islamic banks has tended to protect them from exposure to risky overseas assets such as US sub-prime, but many Middle Eastern institutions are heavily exposed to the region's real estate market. At a systemic level, Sukuk markets have also been affected by the crisis, with prices falling and global issuance declining by more than 50 per cent between 2007 and 2008[2]. Falling investor demand for new Sukuk issues has been a defining feature of the crisis, reflecting reduced risk appetite among international investors and a lack of liquidity among Islamic banks. In contrast, high yields on secondary Sukuk markets are prompting regional banks and asset managers to set up investment funds, with the aim of benefiting from depressed prices.

Bahrain, Dubai and Qatar are competing for regional leadership in Islamic finance. Bahrain is stressing its well-established expertise, Dubai is developing Islamic frameworks for the 'offshore' DIFC and Qatar hopes to capture onshore Islamic business. The availability of experienced bankers with Islamic expertise is a key limitation for many organisations, so efforts are being made to lure talent from well-established hubs like Malaysia and even from smaller markets such as Pakistan.

Islamic finance is still in the intermediate stages of its development. It is comparatively fragmented and remains relatively unpopular outside the Gulf. The tendency of Shariah experts to contradict one another can have unpredictable effects on specific financial products, both wholesale and retail. A true regional market remains a long way off, but growth is likely to continue in the foreseeable future.

1 Source: 'Shariah-compliant market tests perceptions' Euromoney, 6th August 2008
2 Source: 'Few takers forecast for offers of sukuk', Financial Times, 4th February 2009

Focus on transparency and governance

The Middle East is engaged in a growing debate over transparency and corporate governance. Commentary on Middle Eastern transparency often focuses on sovereign wealth funds, but improvements in the region's banking and corporate sectors are arguably more pressing and would serve as a further catalyst for development. The disclosure of reliable financial information is critical for promoting activity on a stock exchange, and poor transparency has been a key obstacle for the establishment of stock markets in Yemen and Syria. Libya is trying to overcome the difficulty, having established its first trading platform – the Libyan Stock Market – in 2007.

The transparency agenda has been accelerated by the global financial crisis which has seen international capital withdrawn from the Middle East. Government involvement is vital, given that most of the region's banks and many of its largest corporations remain state-owned. If governments in the region can drive forward corporate governance reforms and achieve greater transparency, the Middle East will be well placed to gather a larger slice of international capital markets activity when the global economy begins to recover.

It is important to remember that improvements in governance and transparency have already been made. Many exchanges and regulators have introduced stricter requirements for listed companies and in Egypt this has led to hundreds of companies being de-listed from the stock market. In a parallel development, the new financial centres of the Gulf have set up regulatory regimes specifically intended to achieve world class standards of transparency. Saudi Arabia's Tadawul is also progressing towards international transparency standards, and introduced a new rule in August 2008 requesting the disclosure of listed companies' shareholding information.

All the same, standards of transparency vary widely. The Regulatory Quality indicator published by the World Bank (Governance Matters 2008), measures the ability of governments to formulate and implement regulations for private sector development. It also measures the rule of law and control of corruption from a wide range of international sources, giving an approximation of the willingness of international investors to do business in the country. Corruption is notoriously difficult to measure and much of the available research is based on the perceptions of foreign investors. The challenge for these young stock markets is to introduce measures that will change current investor perception that the region is high-risk.

Measuring and improving regulation and governance

The table shows how regulation and governance are often closely connected and ranks countries on a 0-100 scale. The index considers regulatory quality in Bahrain, UAE, Oman and Qatar to be the best in the Middle East, although still a long way from best practice. Jordan, Kuwait and Saudi Arabia are judged to have an average regulatory quality, while countries in the rest of the region are seen as corrupt and lacking appropriate regulatory environments.

Even in the region's more transparent jurisdictions, further improvements are required for markets to reach their full potential. Commentary on the UAE in this guide, one of the highest scoring markets in the region, describes how the goals of world class transparency and governance are not always matched by reality. A recent study by the International Finance Corporation and Dubai's Hawkamah corporate governance institute[3] highlighted some positive practical steps, such as improving the independence of boards, separating chairman and CEO roles, professionalising corporate secretariats, improving non-financial disclosure and strengthening internal audit functions. Governments and companies in the Middle East should look on improved transparency not just as a point of compliance, but as an opportunity to sustain the pace of recent development into the longer term.

Governance Indicators

Denmark	100.0	98.6	99.0
Singapore	98.5	95.2	96.1
United Kingdom	98.1	92.9	93.7
New Zealand	96.6	98.1	98.1
Australia	96.1	94.8	94.7
Canada	94.2	96.2	95.7
Germany	92.7	94.3	93.2
Chile	91.3	88.1	90.3
United States	90.8	91.9	91.3
France	85.9	89.5	89.4
Japan	83.5	90.0	84.5
Bahrain	79.1	69.0	72.9
Italy	74.3	61.4	71.0
United Arab Emirates	71.8	69.5	81.6
Oman	70.4	72.4	73.4
Qatar	67.5	80.0	82.1
Mexico	63.6	34.3	48.8
Jordan	62.1	64.8	66.7
Kuwait	61.2	71.4	72.0
Tunisia	56.8	60.0	60.4
Brazil	53.4	43.3	52.2
Saudi Arabia	51.9	58.6	58.0
Lebanon	47.6	30.0	31.4
Kenya	47.1	15.7	15.5
India	46.1	56.2	47.3
China	45.6	42.4	30.9
Egypt	43.2	51.9	35.7
Russia	35.0	16.7	16.4
Yemen	23.8	18.1	33.3
Libya	17.5	32.4	21.7
Ecuador	14.6	14.8	19.8
Syria	10.2	36.7	18.8
Iraq	7.3	1.0	1.9
Iran	3.9	21.4	37.2
Myanmar	1.5	5.2	1.4

- 90th-100th
- 75th-90th
- 50th-75th
- 25th-50th
- 10th-25th
- 0-10th

Indicates rank of country among all countries in the world. 0 corresponds to the lowest rank and 100 to the highest rank.

Source: World Bank

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organisations, and international organisations.

3 Source: 'Few takers forecast for offers of sukuk', Financial Times, 4th February 2009

Market insights

Bahrain

Like its GCC neighbours, Bahrain has enjoyed a period of strong economic growth in recent years. However, the global credit crunch has impacted Bahrain's large banking sector and falling oil prices are putting pressure on overall revenues.
In response the government is putting renewed emphasis onprivatisation and diversification. Public sector debt is relatively low although – if ever required – the potential cost of supporting the large domestic banking sector would be heavy. This led a rating agency, Moody's Investors Services, to put the Kingdom's credit rating under review[4].

Bahrain is competing with Dubai and Qatar to channel capital flows around, into and out of the Middle East. Bahrain's capital markets no longer match Dubai's in size, but the Kingdom's strategy i to specialise in niche areas such as investment funds, Islamic banking and Islamic insurance. Bahrain's ke advantages are its long experience in financial service the expertise of its domestic workforce and the long-term goals of typical Bahraini investors. The Bahrain Stock Exchange (BSE) has a history of attracting loca and foreign capital and is one of the most open markets in the region. The Bahrain All Share Index (BASI) climbed by 24 per cent during 2007 and declined by 35.6 per cent in 2008, one of the least volatile performances of the major Gulf bourses.

The BSE has seen several new listings since 2006, most of which were financial companies undergoing privatisation. Bahrain has been a pioneer of Islamic finance regulation, and the value of the BSE's Sukuk listings has more than doubled in five years. The government has also recently approved the launch of a new exchange, the Bahrain Financial Exchange, which will list a full range of conventional and Shariah-compliant instruments including currencies, commodities, equities and fixed income.

Transparency is relatively good in Bahrain, but there is scope for improvement in standards of corporate governance. Overall, Bahrain's capital markets are well placed for further development, and should benefit from the continuing evolution of the Islamic finance industry.

4 Source: 'Credit agency lowers outlook on Bahrain's debt rating', Financial Times, 7th January 2009

"Bahrain's key advantages are its long experience in financial services, the expertise of its domestic workforce and the long-term goals of typical Bahraini investors. The Bahrain Stock Exchange (BSE) has a history of attracting local and foreign capital and is one of the most open markets in the region."

Jassim Abdulaal
Grant Thornton, Abdulaal Gulf Audit, Bahrain

> "The Egyptian economy and capital markets offer strong opportunities for long term investors. If the government, regulators and central bank can improve regulatory oversight and price stability, there is no reason why this potential should not be realised."

Amr Fathalla
Grant Thornton Consultants, Egypt

Egypt

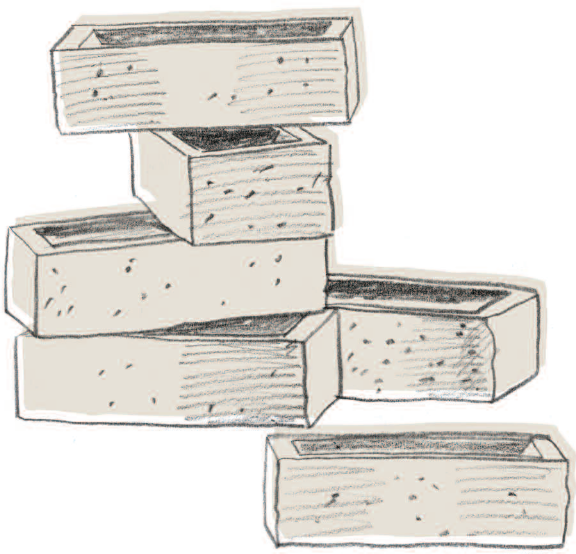
Egypt's economic growth rates have expanded in recent years, driven by ongoing macro reforms and growing non-hydrocarbon and service exports. Foreign Direct Investment (FDI) grew strongly up until 2007, attracted by Egypt's growing diversification and its large and increasingly affluent population. In 2007 the economy grew by more than 7 per cent and the Cairo and Alexandria Stock Exchange (CASE) index climbed by 53.3 per cent. Growth in market capitalisation was slightly lower at 43.9 per cent, as the Capital Markets Authority continued to tighten its listing criteria and remove companies from the exchange.

In contrast, 2008 was not such an easy year for the Egyptian economy or stock market. Growing inflation prompted the central bank to increase interest rates early in the year, cooling Egypt's real estate boom and hurting property development companies. Rising food prices put government finances under greater strain, and foreign investors reacted negatively when the tax framework for enterprise zones was unexpectedly changed. Activity in the tourism sector also declined as European consumers tightened their belts. Reflecting these factors, the CASE 30 Index fell by 56.4 per cent during 2008.

Despite Egypt's ongoing economic liberalisation, the country is judged by the World Bank to be one of the weakest in the Middle East when it comes to transparency, corporate governance and the control of corruption. The regulatory authorities have taken some steps to improve the transparency of listed companies, but much remains to do and corruption, and investor perception of corruption levels, remain a challenge when competing for international capital. These issues will need to be addressed robustly if Egypt and its capital markets are to realise their full potential.

Despite these difficulties, the outlook for Egypt's capital markets is encouraging. The economic reforms begun during the early years of the decade continue to open the country to foreign capital and expertise, and the government is planning to press on with privatisation, announcing plans to distribute shares to all adult Egyptians.

The June 2008 launch of the Nilex junior stock market offers a new fundraising route for medium sized companies, and illustrates CASE's ambition to act as a force for innovation in the region. Another innovation planned by CASE is to launch the Middle East's first Exchange Traded Fund (ETF) during 2009.



Saudi Arabia

The 2006 collapse of the Saudi Stock Exchange (Tadawul) destroyed over US$450 billion of wealth. This stunning decline was in stark contrast to the broader Saudi economy, which was enjoying stable growth and low inflation. Oil generates the lion's share of Saudi national income, but accession to the World Trade Organisation (WTO) has helped to boost foreign investment and improve the diversification of the economy away from reliance on petrochemicals.

After the Tadawul's fall the Capital Market Authority (CMA) took several steps to reduce the influence of local retail investors. First, foreign residents in Saudi were permitted to invest. Then the market was opened up to GCC nationals and funds. Next the CMA capped the permitted total participation in IPOs by Saudi individuals at 30 per cent. These developments helped the Tadawul All Share Index (TASI) to increase by 39.1 per cent during 2007. During 2008 the CMA issued numerous licences to international investment banks, many of which have built up their Riyadh operations in anticipation of further liberalisation. A further significant step came in August 2008, with the announcement that non-residents would be allowed to acquire Saudi shares via swap agreements with registered local intermediaries.

Unfortunately, this announcement was overshadowed by falling oil prices and the global slowdown, and the Tadawul declined by 49.8 per cent in 2008. In the long term, however, the prospects for Saudi capital markets are good. Opening up the Saudi Stock Exchange will give international institutions much easier access to the Middle East's biggest market, Saudi banks have relatively low exposure to domestic and foreign real estate markets, and huge currency reserves mean that the Kingdom's industrial investment programmes will continue to support economic growth, despite a forecast budget deficit in 2009.

If there is a cloud on the horizon, it is that Saudi standards of transparency and governance are still judged to be far from ideal. The stock exchange is moving in the right direction, but at the current rate of progress it will take Saudi Arabia a long time to catch up with regional best practice, quite apart from reaching the standards of more developed markets. The Saudi market has the potential to be not only the largest in the region but also the most liquid and mature. Hopefully the progressive involvement of international institutions will drive forward transparency and openness in the Kingdom.

"The Saudi market has the potential to be not only the largest in the region but also the most liquid and mature. Hopefully the progressive involvement of international institutions will drive forward transparency and governance in the Kingdom."

Akram F El Husseini
Aldar Audit Bureau, Saudi Arabia

“Further improvements in transparency and governance will be essential to maintaining UAE’s leading position in the region's capital markets.”

Hisham Farouk
Grant Thornton, UAE

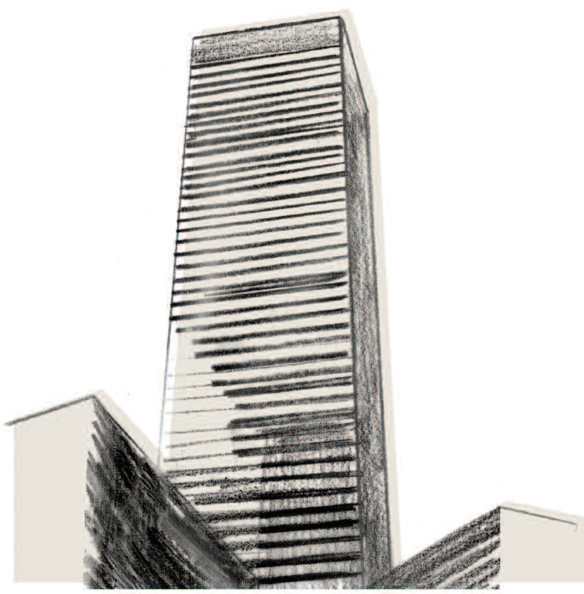
United Arab Emirates

In recent years the UAE has enjoyed one of the fastest growth rates in the Middle East. UAE governments are overseeing huge investment programmes and the economy is undergoing massive structural change, with Abu Dhabi now taking a federal role in developing the country’s regulatory system. In 2007 this picture was matched by the UAE’s main stock markets, with the Dubai Financial Market (DFM) and Abu Dhabi Securities Exchange (ADX) delivering returns of 43.7 per cent and 51.7 per cent respectively. However, after a solid start to 2008, the ADX registered a loss of 47.7 per cent during the year and the DFM declined by a remarkable 70.9 per cent.

The fall of the Dubai market reflected concern among international investors that the end of the Emirate’s real estate boom would have a grave impact on its economic health. Dubai is one of the most open economies in the Middle East, but lacks significant oil deposits and has accumulated US$80 billion of government debt, equivalent to more than 140 per cent of GDP[5]. Banks in Dubai are also more dependent on wholesale funding than many of their regional counterparts, resulting in a miniature ‘credit crunch’ in the Emirate during the second half of 2008. Nonetheless, consumers are not panicking. Dubai’s two mortgage lenders have been combined with well-capitalised Abu Dhabi banks, and most observers agree that in the most extreme case Dubai could fall back on the immense reserves of its sister Emirate. The government of Dubai is expanding its infrastructure spending to keep the economy going.

Overall, the long term prospects for capital market development in the UAE are good. As well as the DFM and ADX, the UAE has a new stock exchange in the shape of NASDAQ Dubai, formerly the Dubai International Financial (DIFX). Based in the Dubai International Financial Centre (DIFC) free zone, NASDAQ Dubai aspires to be the leading international capital market between Europe and Asia and lists shares, structured products, sukuks and conventional bonds.

Transparency is central to the UAE’s pursuit of regional financial leadership. The DIFC has a dedicated regulator aiming to provide world class regulation and the DFM is also tightening up its requirements. So far the DIFC has attracted far more regulated entities than its rivals in Qatar and Bahrain, but there is no room for complacency. Even on NASDAQ Dubai, standards are not always ideal; international investors researching Dubai Ports World’s IPO were surprised by how little they could discover about the company. Further improvements in transparency and governance will be essential to maintaining the UAE’s leading position in the region’s capital markets.



5 Source: ‘Has the bubble burst?’, The Economist, 27th November 2008

Economic overview

The economies of the Middle East differ hugely. This is true both in terms of absolute national income (see table A) and in terms of population, which ranges from about 70 million in Egypt and Iran to less than one million in Bahrain and Qatar (see table E). The differences are at their most extreme when comparing GDP per capita (see table C). On this measure Qatar is the second richest country after Luxembourg, while Yemen ranks among the world's poorest countries.

Levels of economic growth across the Middle East are more comparable, and in recent years have generally been strong. Every country has its own features, but some common themes have underpinned the region's strong economic expansion. High oil prices prior to August 2008 generated large government surpluses among exporting nations, driving heavy investment in infrastructure. Public sector wage bills expanded, which in turn stimulated consumer spending. The resulting tide of liquidity spread across the region, so that even countries without significant hydrocarbon reserves benefited from an economic boost.

This picture has changed considerably since mid-2008. At the time of writing the price of oil has fallen from a peak of US$140 per barrel to US$50 per barrel by the end of the year, and the region has not escaped the chill winds blowing through the global economy. Nonetheless, many economies in the Middle East are relatively well positioned. Oil exporters' current account surpluses are falling fast, but most have built up huge reserves which will permit ambitious public spending plans to continue.

The International Monetary Fund (IMF) expects growth in the GCC states to fall from 6.8 per cent in 2008 to 3.5 per cent in 2009[6], a notable contraction but still a growth rate that many economies would envy. However, Middle Eastern countries without large financial reserves could find 2009 more challenging. Levels of FDI in the region have fallen rapidly, and tourism is declining. Until these sources of investment capital revive, countries such as Egypt will need to rely on further economic reform as a stimulus for growth.

One result of the recent growth in regional consumption has been high inflation, compounded in some cases by US dollar pegs which limit central banks' room for manoeuvre (see table D). Several states experienced annual inflation in double figures in 2008, putting the Middle East's more fiscally constrained countries under considerable pressure. This was illustrated in March 2008 when the Egyptian government was forced to raise interest rates and push up taxes. However, falling commodity costs and a cooling global economy should help to ease inflation, and the issue may not be a serious threat to long-term growth in the region.

6 Source: 'Growth in Gulf states set to halve in 2009', Financial Times, 9th February 2009

This economic data has been incorporated to provide context for the market activity featured in this guide.

A: Gross Domestic Product current prices (US$ billions)

	2005	2006	2007	2008*	2009*
Bahrain	13	16	17	20	20
Egypt	90	107	128	158	203
Iran	188	222	285	382	443
Jordan	13	14	16	19	22
Kuwait	81	99	112	160	163
Lebanon	22	23	25	28	31
Libya	42	55	70	108	112
Oman	31	36	40	56	60
Pakistan	110	127	144	161	172
Qatar	42	57	73	117	144
Saudi Arabia	316	357	382	528	569
Syria	29	35	39	44	46
United Arab Emirates	135	164	191	270	294
Yemen	17	19	22	28	34

B: Gross Domestic Product annual growth (%)

	2005	2006	2007	2008*	2009*
Bahrain	8	7	6	6	6
Egypt	4	7	7	7	6
Iran	5	6	6	6	5
Jordan	7	6	6	6	5
Kuwait	11	6	5	6	6
Lebanon	1	0	4	6	5
Libya	10	7	7	7	8
Oman	6	7	6	7	6
Pakistan	8	7	6	6	4
Qatar	9	15	16	17	21
Saudi Arabia	6	3	4	6	4
Syria	3	4	4	4	5
United Arab Emirates	8	9	7	7	6
Yemen	6	3	3	4	8

C: Gross Domestic Product per head (US$ millions)

	2005	2006	2007	2008*	2009*
Bahrain	18,324	21,123	22,771	25,245	25,607
Egypt	1,270	1,489	1,739	2,109	2,652
Iran	2,746	3,152	3,981	5,247	5,974
Jordan	2,304	2,518	2,766	3,267	3,616
Kuwait	27,013	31,014	33,687	46,397	45,814
Lebanon	5,898	6,147	6,569	7,376	8,029
Libya	7,764	9,225	11,484	17,468	17,731
Oman	12,335	14,032	15,714	21,704	22,828
Pakistan	719	817	909	1,000	1,048
Qatar	53,333	67,922	78,754	106,460	118,263
Saudi Arabia	13,658	15,050	15,724	21,221	22,291
Syria	1,560	1,844	2,088	2,238	2,242
United Arab Emirates	32,927	38,804	42,501	56,667	58,612
Yemen	798	882	979	1,199	1,453

Source: International Monetary Fund, World Economic Outlook Database, October 2008.

*IMF staff estimates

D: Inflation (%)

	2005	2006	2007	2008*	2009*
Bahrain	2	3	4	10	6
Egypt	5	7	9	20	12
Iran	10	15	23	24	22
Jordan	4	7	6	16	6
Kuwait	4	4	5	9	7
Lebanon	1	7	6	9	4
Libya	10	3	7	12	10
Oman	3	5	9	10	8
Qatar	9	12	14	15	13
Saudi Arabia	1	3	4	11	10
Syria	5	7	5	-10	7
United Arab Emirates	–	–	–	–	–
Yemen	20	16	9	16	13

E: Population (millions)

	2005	2006	2007	2008*	2009*
Bahrain	1	1	1	1	1
Egypt	71	72	74	75	77
Iran	68	70	72	73	74
Jordan	5	6	6	6	6
Kuwait	3	3	3	3	4
Lebanon	4	4	4	4	4
Libya	6	6	6	6	6
Oman	3	3	3	3	3
Qatar	1	1	1	1	1
Saudi Arabia	23	24	24	25	26
Syria	18	19	19	20	20
United Arab Emirates	4	4	4	5	5
Yemen	21	22	22	23	24

Market performance

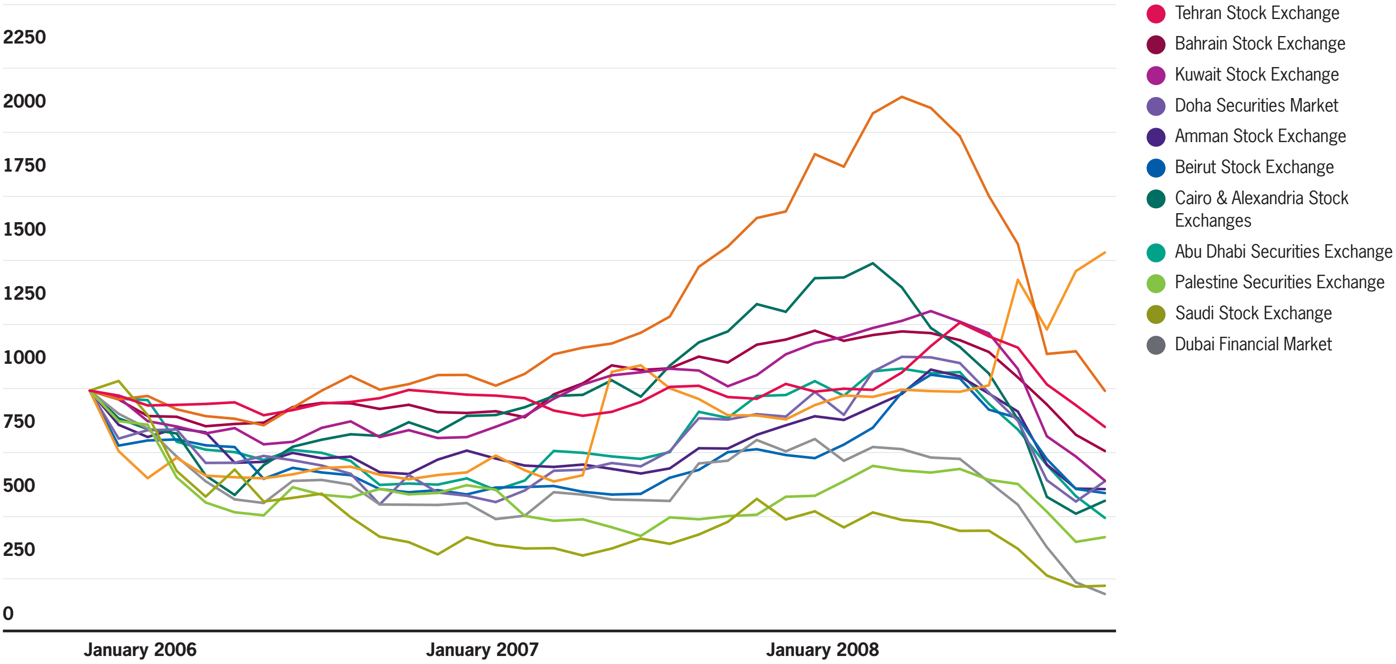
Market indices

For much of the past three years, the performances of Middle Eastern stock markets differed considerably. After climbing rapidly in 2005 the main indices of the Saudi Arabian, Dubai, Abu Dhabi, Lebanese and Palestinian exchanges fell back steeply in 2006, with the main Saudi index contracting by over 50 per cent during the year. In contrast, the Kuwaiti, Omani and Bahraini indices avoided such speculative behaviour and enjoyed a relatively steady year.

In 2007, local investors began to recover their nerves and most of the region's stock markets stabilised. During the second half of 2007 and the early part of 2008 almost all the region's major indices recorded steadier appreciation, and by June 2008 most indices had returned to the levels of early 2006.

However, everything changed in the second half of 2008. Global economic forecasts began to fall and oil prices followed, tumbling from a peak of more than US$140 a barrel to less than US$50 by the end of the year. As international investors reined in their risk exposure, the region's stock market indices began to show uncharacteristic correlation. Local investors started to sell, and most regional indices fell steeply. The most dramatic decline was that of the DFM, which lost 71 per cent

Figure 1: Market indices



The market indices for all markets have been re-based to 1000 at 1 January 2006
Source: Stock Exchanges, Bloomberg and Federation of Euro-Asian Stock Exchanges.

of its value during 2008 and 78 per cent over the three year period. The only regional exchange to have grown during 2008 or over the three year period was the tiny Iraqi market.

After November 2008 some of the region's main indices made a cautious recovery, but most fell further during January 2009 and it is far too soon to judge whether markets have stabilised. Middle Eastern stock markets retain many of their distinctive features, but in common with their global counterparts they remain uncertain about what 2009 will bring.

Total market capitalisation

Collectively, the stock exchanges of the Middle East represent one of the largest emerging markets in the world. Individually, they vary considerably in size. The Saudi Arabian stock market (Tadawul) remains by far the largest in the region, accounting for roughly 35 per cent of total market capitalisation during 2008. Although the data shown here shows a decline in total market capitalisation in 2007, this is slightly misleading since figures for 2006 included some exceptionally high market values in the early months of the year.

After the Tadawul, the next largest markets in the Middle East are the DFM, the Abu Dhabi Securities Exchange, the Kuwait Stock Exchange (KSE) and the CASE. The Doha Securities Market also expanded relatively quickly during 2008 to join this group. These exchanges have enjoyed several years of growth and were all valued at over US$100 billion on an average monthly basis in 2008, indicating the increasing breadth and depth of the region's capital markets. It is also notable that the newly established Dubai International Financial Exchange (DIFX) achieved a market capitalisation in excess of US$50 billion at the end of its first operational year, making it the seventh largest exchange in the Middle East at the end of 2007. Behind the seven or so larger markets, the region's less valuable exchanges are relatively small in size, although most have grown in total value over the past three years.

The growth in total values means that total market capitalisation is comparable with total GDP in Kuwait, Qatar, the UAE and Bahrain, indicating the growing importance of the capital markets in the GCC states.

Figure 2a: Average total market capitalisation (US$m)

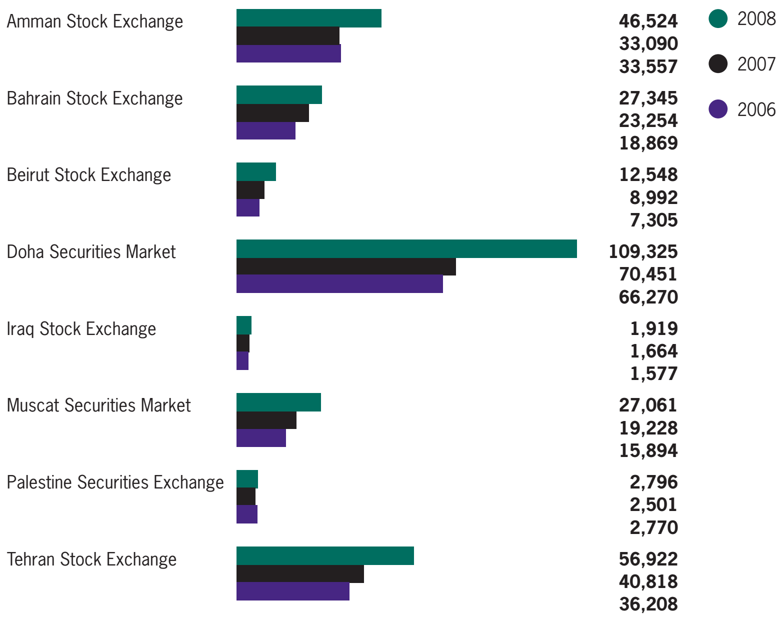
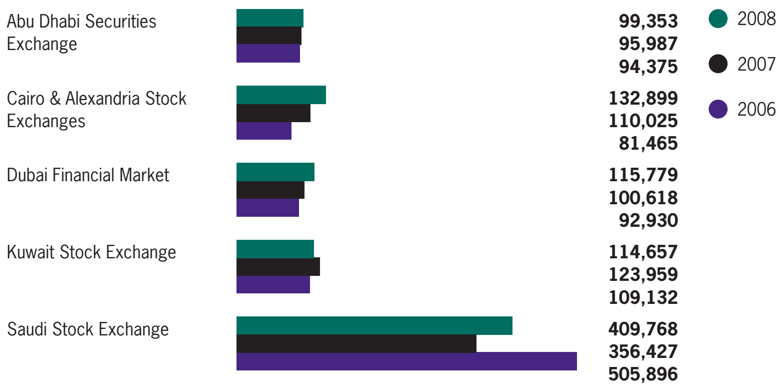


Figure 2b: Average total market capitalisation (US$m)



This is the sum of the total market capitalisation at the end of each month in a given year, divided by 12.

Information was not available for DIFX

Number of companies listed

The stock exchanges of the Middle East do not just vary in size, but also in numbers of companies listed. The Egyptian, Iranian, Omani and Jordanian markets have the largest listings in the region, but of these only the Egyptian market is significant from a market value perspective. In the past, the CASE listed hundreds of companies, but this has changed as the Egyptian CMA has sharpened regulatory and transparency criteria. Hundreds of companies have been delisted since 2005 and this trend is continuing.

Away from the long established exchanges of Egypt and Iran the trend is for a steady increase in listings across the Middle East. The larger stock markets of the GCC have opened up to new entrants, as regional governments pursue privatisation and privately owned businesses take advantage of inward investment flows. NASDAQ Dubai is one example of a market which has recently benefited from the listing of government owned companies, and which hopes to attract further public and private sector IPOs.

Figure 3a: Number of companies listed (average in year)

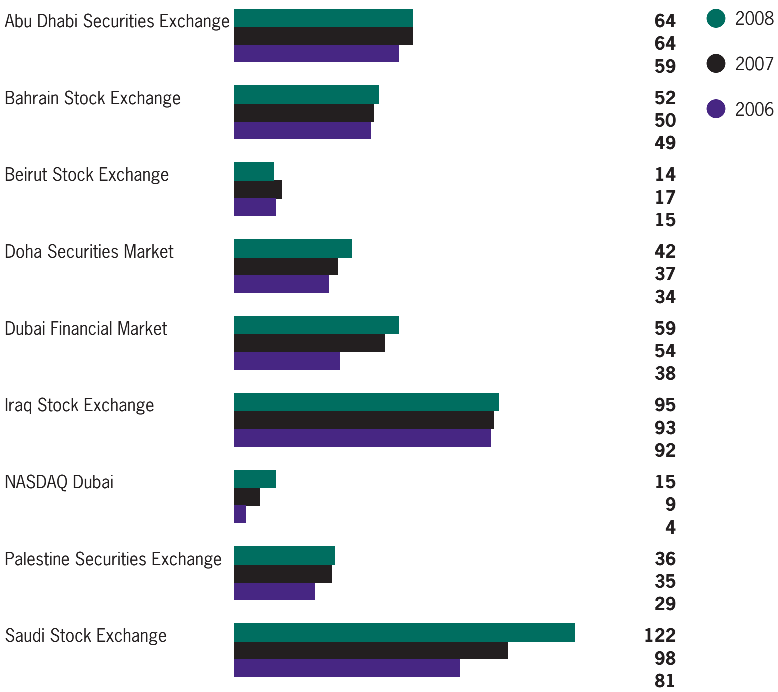
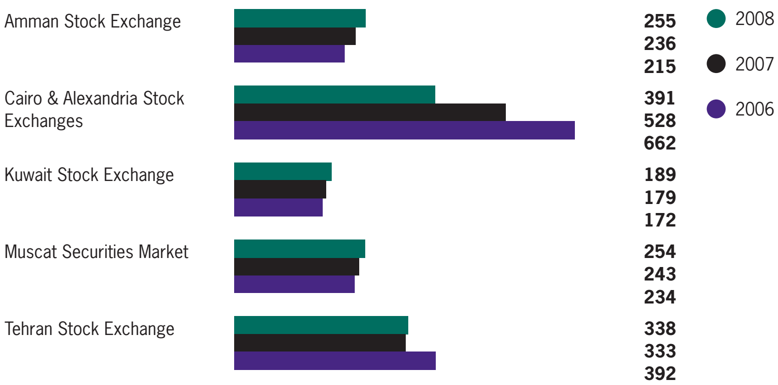


Figure 3b: Number of companies listed (average in year)



This is the sum of the number of companies listed at the end of each month in a given year, divided by 12.

Average market capitalisation per company

The polarisation of Middle Eastern stock markets in terms of listing numbers and market capitalisation leads inevitably to wide variations in average market capitalisation per company. The Saudi, Dubai, Abu Dhabi and Qatar exchanges feature far larger companies than the rest of the region's markets, with average company values well above the US$1 billion mark. Although not shown on the graph owing to lack of historical data, NASDAQ Dubai should soon join this group, having attracted a handful of large companies to list since its launch.

In comparison, figures for most other Middle Eastern exchanges are far smaller and in some cases average company capitalisation falls below US$100 million. Although these are not exceptionally small values by the standards of other developing markets, they can deter major global institutions with billions to invest, limiting investment appeal to smaller, local players.

Furthermore, average company values are deceptive since exchanges in the Middle East are frequently dominated by a handful of local giants. The Saudi and Egyptian exchanges are just two examples of markets where half a dozen or fewer companies represent almost half of total market value. If these hyper-capitalised companies were to be stripped out, average company values would fall much further. This concentration is not unusual in emerging markets, but moving past this stage will be a crucial indicator of maturity for the region's stock markets.

Figure 4a: Average market capitalisation per company (US$m)

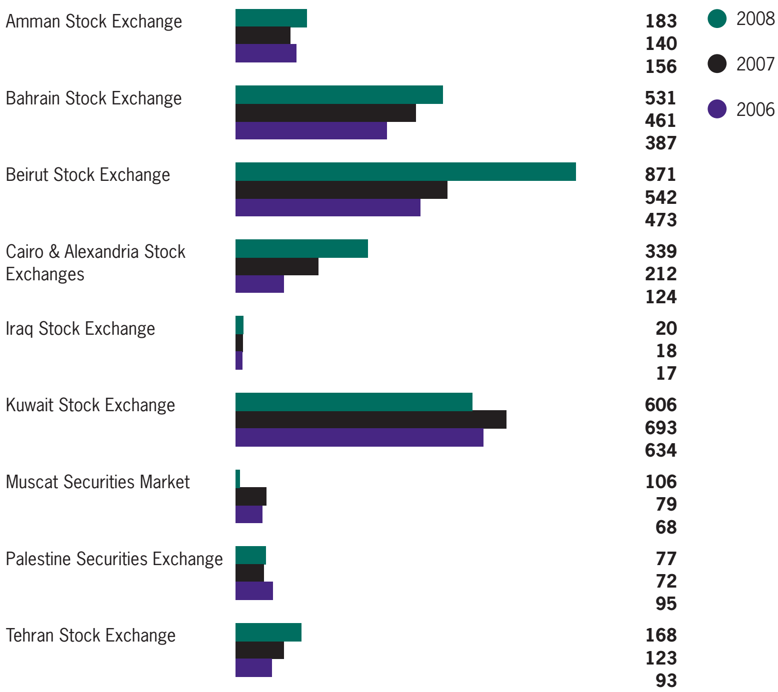


Figure 4b: Average market capitalisation per company (US$m)

This is the average total market capitalisation divided by the average number of companies listed.

Information was not available for DIFX

Monthly average turnover

The picture of turnover across Middle Eastern exchanges reveals a high degree of concentration. The Saudi stock market remains by far the most active, boasting 55 per cent of the region's total turnover in 2008 on an average monthly basis. This reflects the exceptional levels of liquidity in the local economy and the continuing dominance of the Tadawul by retail investors.

The Kuwaiti and Egyptian stock markets are distant runners up to the Tadawul in the turnover stakes, with the Qatari, Abu Dhabi, Jordanian and Dubai bourses still further behind. The region's smaller exchanges have exceptionally low levels of trading. Up to a point, this polarised pattern illustrates the network effect at work among developing stock exchanges. Success breeds success, and larger markets will often expand faster as they attract large investors. In contrast, bourses failing to reach a critical mass struggle to attract significant amounts of secondary trading.

All the same, patterns of turnover are not set in stone. The Tadawul's share of regional turnover has fallen rapidly from 81 per cent in 2006 to 55 per cent in 2008. In retrospect, the Saudi market's rapid boom and bust may have given a false impression of regional dominance. It will be interesting to see if the regional spread of trading volume shifts again as other GCC states compete for investment by international financial institutions.

Figure 5a: Monthly average turnover (US$m)

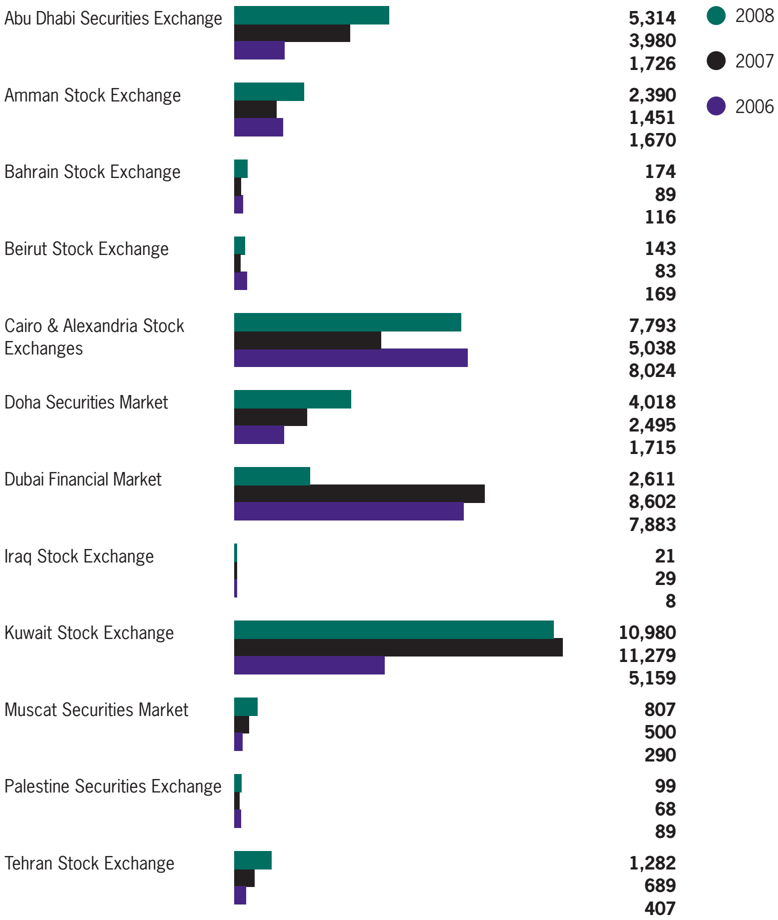


Figure 5b: Monthly average turnover (US$m)

This is the annual value of share trades, divided by 12.

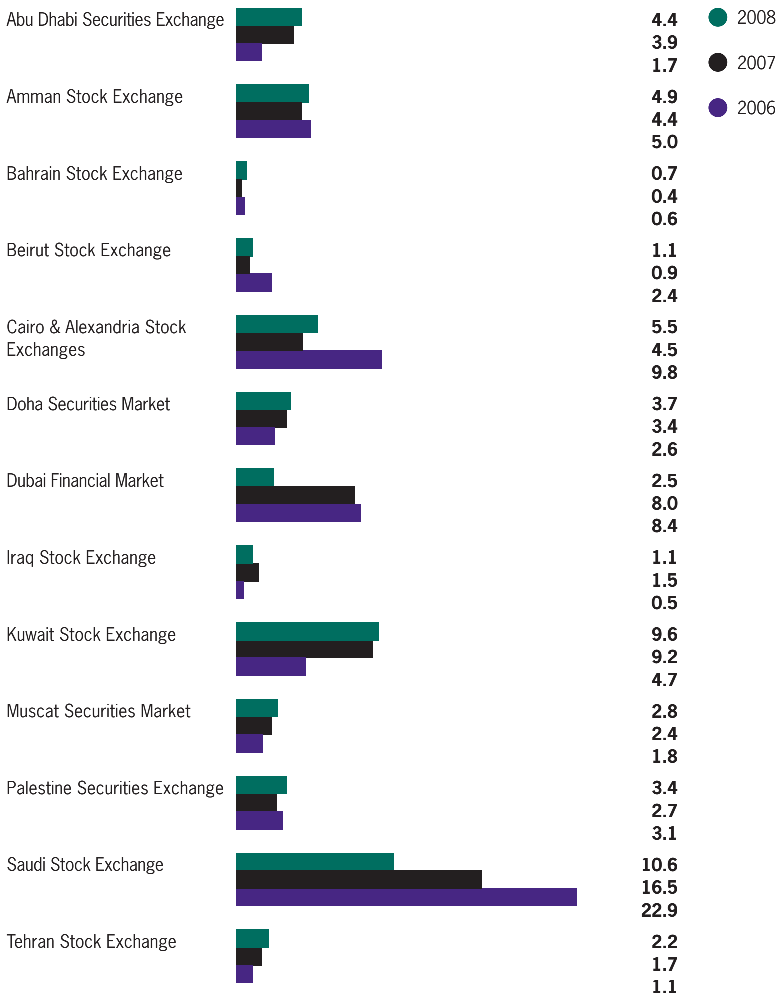
Information was not available for DIFX

Monthly average liquidity

Liquidity gives investors an indication of the ease with which they can convert securities into cash without suffering a price discount. In the data shown here, liquidity levels are a function of average monthly turnover and average market capitalisation, and once again show a wide variation across the stock exchanges of the Middle East.

There is some loose correlation with total market values, with the Saudi exchange enjoying the highest level of liquidity in the region. Ratios here compare favourably with other developing markets such as Korea or Taiwan, although restrictions on foreign ownership have tended to limit the number of investors making use of that liquidity. The KSE is the next most liquid market in the region, followed by the Egyptian and Jordanian exchanges. Most of the region's other markets are characterised by relatively thin levels of liquidity.

Figure 6: Monthly average liquidity: turnover of shares as a % of total market capitalisation



This is the sum of the US dollar value of all share trades in that month divided by the total market capitalisation at the end of each month in a given year, divided by 12.

Information was not available for DIFX

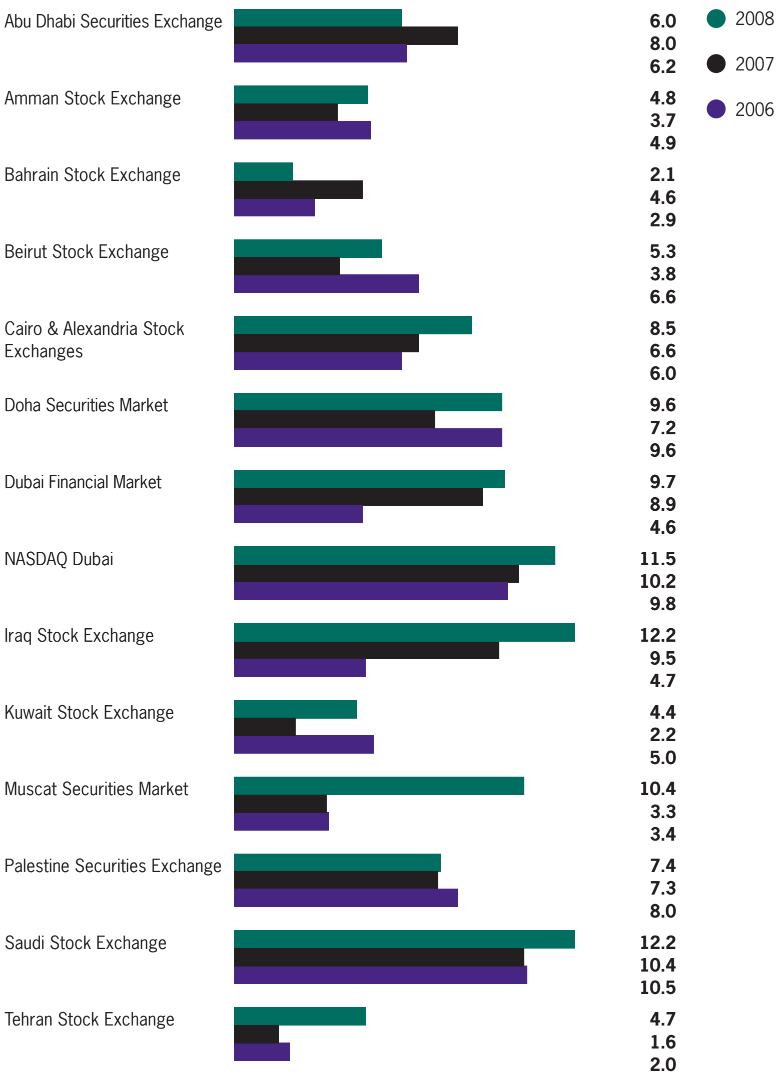
Volatility

Volatility figures reflect the rate at which market prices move up and down. Higher volatility tends to be correlated with less mature economies and less well-established exchanges, and although it can deter some investors it is also a natural stage in the development of many markets. As more investors seek to take advantage of the speculative gains which volatility can offer, market size and liquidity increase and prices become more stable. However, the opposite sometimes holds true – in other words, low volatility can also be a reflection of extremely low levels of trading activity.

Both of these factors are at work in the volatility figures for the Middle Eastern stock markets. Owing to the exceptional market volatility of late 2008, data for 2007 is arguably more helpful. Several of the region's more developed markets in Saudi Arabia, Dubai, Abu Dhabi and Qatar recorded month-on-month volatility of 7 to 10 per cent in 2007. This is a fairly typical figure for emerging stock markets around the world and would be unlikely to deter experienced institutional investors looking for long term returns. However the exceptionally low volatility of the Tehran exchange (1.6 per cent in 2007) is not so much an indicator of economic maturity as a sign of an extremely shallow market.

In 2008 most of the markets experienced an increased volatility with the exception of the BSE; this might be due to the low levels of trading rather than stability of the market. In fact, smaller markets show lower levels of volatility.

Figure 7: Volatility (%)



This is the annual average of the month-to-month percentage variation in the index value.

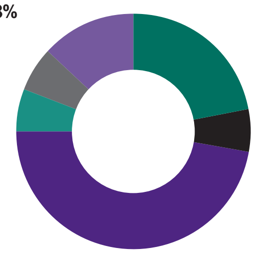
Information was not available for all markets for all years
Source: Stock Exchanges, Bloomberg and Federation of Euro-Asian Stock Exchanges.

Sector analysis

This analysis is based on the number of companies in each sector, as defined by each stock market.

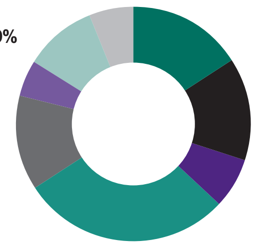
Abu Dhabi Securities Exchange

- Basic industries: **22%**
- Consumer industries: **6%**
- Financial services: **48%**
- Retail: **6%**
- Telecoms: **6%**
- Others: **12%**



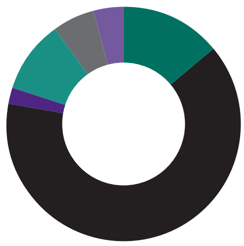
Amman Stock Exchange

- Basic industries: **16%**
- Consumer industries: **14%**
- Energy & mining: **7%**
- Financial services: **29%**
- Property: **13%**
- Retail & leisure: **5%**
- Transport: **10%**
- Others: **6%**



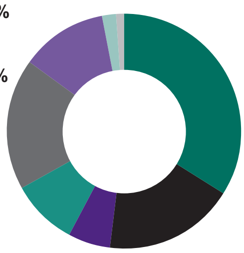
Bahrain Stock Exchange

- Basic industries: **14%**
- Financial services: **64%**
- Property: **2%**
- Retail & leisure: **10%**
- Telecoms: **6%**
- Transport: **4%**



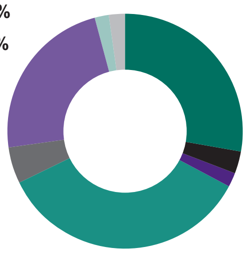
Cairo & Alexandria Stock Exchanges

- Basic industries: **34%**
- Consumer industries: **18%**
- Drugs & healthcare: **6%**
- Property: **9%**
- Financial services: **18%**
- Retail & leisure: **12%**
- Telecoms: **2%**
- Others: **1%**



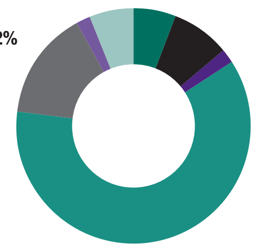
Doha Securities Market

- Basic industries: **28%**
- Consumer industries: **3%**
- Drugs & healthcare: **2%**
- Financial services: **35%**
- Property: **5%**
- Retail & leisure: **23%**
- Telecoms: **2%**
- Transport: **2%**



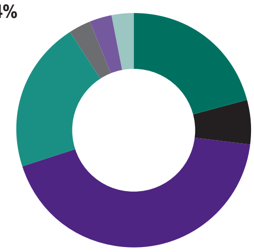
Dubai Financial Market

- Basic industries: **6%**
- Consumer industries: **8%**
- Energy & mining: **2%**
- Financial services: **62%**
- Property: **15%**
- Telecoms: **2%**
- Transport: **6%**



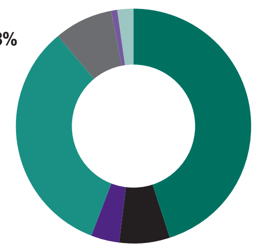
Kuwait Stock Exchange

- Basic industries: **21%**
- Consumer industries: **6%**
- Financial services: **44%**
- Property: **21%**
- Retail & leisure: **2%**
- Telecom: **3%**
- Others: **3%**



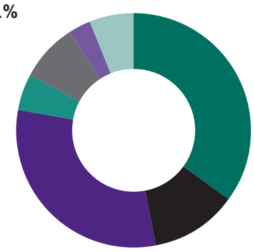
Muscat Securities Market

- Basic industries: **45%**
- Consumer industries: **7%**
- Energy & mining: **4%**
- Financial services: **33%**
- Retail & leisure: **8%**
- Transport: **1%**
- Others: **2%**



Saudi Stock Exchange

- Basic industries: **35%**
- Consumer industries: **12%**
- Financial services: **31%**
- Property: **5%**
- Retail & leisure: **8%**
- Transport: **3%**
- Others: **6%**



Source: As reported by individual markets.
Information was not available for all markets.
Due to rounding – all figures may not add up to 100.

Sector analysis (continued)

In terms of sector composition, Middle Eastern capital markets differ from many other emerging markets. Bourses in Asia or Latin America have typically been defined by the development of heavy industries and consumer goods, in response to domestic development needs and overseas demand for cheap export goods.

Middle Eastern economies tend to be dominated by the hydrocarbons industry but most exploration and production assets are state owned. As the region's governments seek to diversify their economies, it is mainly non-oil sectors that have been coming to market. With nearby Asian economies churning out consumer goods, investment has been heaviest in financial services and public sector infrastructure.

The natural consequence is that stock markets in the region tend to be dominated by banks, insurers, finance companies and 'basic industries'. The latter definition includes private companies working in the oil and gas sector and heavy industry supporting the development of public infrastructure such as roads, airports, schools and hospitals. Also, the introduction of mandatory insurance classes by some governments has contributed to the growth of the insurance markets. However, the increasing reliance of the region's market on banking and real estate has fuelled the recent recession in these countries.

Some of the other significant sectors in the region are leisure and tourism, especially in Egypt, Dubai and Qatar; telecommunications; and property and real estate – most notably in Kuwait and the until-recently booming market of Dubai.

Admission requirements

	Exchange	Paid-in capital (US$)	Years of business activity	Minimum number of shareholders
Bahrain	Bahrain Stock Exchange	1.3m	2	100
Egypt	Cairo & Alexandria Stock Exchanges	3.6m	3	150
Iran	Tehran Stock Exchange	21.8m	3	1,000
Iraq	Iraq Stock Exchange	0.9m	1	–
Jordan	Amman Stock Exchange	0.7m	1	100
Kuwait	Kuwait Stock Exchange	36.2m	2	–
Lebanon	Beirut Stock Exchange	3.0m	3	50
Libya	Libyan Stock Market	–	3	100
Oman	Muscat Securities Market	5.2m	2	–
Palestine	Palestine Securities Exchange	1.4m	2	100
Qatar	Doha Securities Market	11.0m	1	30
United Arab Emirates	Abu Dhabi Securities Exchange	5.4m	2	–
	Dubai Financial Market	6.8m	2	–
	Dubai International Financial Exchange	50.0m	3	–

Listing requirements refer to the main board of the above stock exchanges
Some markets may have additional requirements; for example most markets state that the shareholders' equity should not be lower than the paid-up capital. A company might be required to list on the second board before being admitted to the main board
Foreign companies: In some cases these are subjected to stricter admission requirements in terms of capital, assets and shareholders: they must already be listed on the home country's stock exchange and have a representative office in the country/territory.
Foreign companies are not admitted to listing on the Tehran Stock Exchange
Source: Individual markets

Directory of main markets

	Exchange/Market	Established	Number of companies 31 Dec 06	Number of companies 31 Dec 07	Number of companies 31 Dec 08
Bahrain	Bahrain Stock Exchange (BSE)	1989	50	51	51
Egypt	Cairo & Alexandria Stock Exchanges (CASE)	1903	595	435	373
Iran	Tehran Stock Exchange (TSE)	1968	332	339	356
Iraq	Iraq Stock Exchange (ISX)	2004	93	94	96
Jordan	Amman Stock Exchange (ASE)	1999	227	245	262
Kuwait	Kuwait Stock Exchange (KSE)	1983	181	189	194
Lebanon	Beirut Stock Exchange (BSE)	1996	16	17	–
Libya	Libyan Stock Market	2007	–	–	–
Oman	Muscat Securities Market (MSM)	1988	235	250	251
Palestine	Palestine Securities Exchange (PSE)	1996	33	35	37
Qatar	Doha Securities Market (DSE)	1997	36	40	43
Saudi Arabia	Saudi Stock Exchange (Tadawul)	2001	–	111	127
UAE	Abu Dhabi Securities Exchange (ADX)	2000	60	64	65
	Dubai Financial Market (DFM)	2000	46	62	64
	Dubai International Financial Exchange (DIFX)	2005	6	12	19

Source: Individual markets and Federation of Euro-Asian Stock Exchanges.
Information was not available for all markets for all years.

Total market capitalisation 31 Dec 06 (US$m)	Total market capitalisation 31 Dec 07 (US$m)	Total market capitalisation 31 Dec 08 (US$m)	Ave market capitalisation 31 Dec 06 (US$m)	Ave market capitalisation 31 Dec 07 (US$m)	Ave market capitalisation 31 Dec 08 (US$m)	Website	Telephone
21,122	27,088	19,947	422	531	391	bahrainstock.com	+973 17261 260
93,501	139,288	85,864	157	320	230	egyptse.com	+20 2 23928698
37,787	44,230	49,040	114	130	138	iranbourse.com	+98 21 66708385
1,472	1,753	1,978	16	19	21	isx-iq.net	+964 7174484
29,730	41,262	35,808	131	168	137	ase.com.jo	+962 6 5664109
105,949	135,362	70,104	585	716	361	kuwaitse.com	+965 2992190
8,304	10,894	9,609	519	641	–	bse.com.lb	+961 1 993555
–	–	–	–	–	–	lsm.gov.ly	+218 21 336 5026
16,159	26,690	21,052	69	107	84	msm.gov.om	+968 24823600 808
2,727	2,476	2,121	83	–	57	p-s-e.com	+970 9 234 5555
60,909	95,512	76,624	1,692	2,388	1,782	dsm.com.qa	+974 4333666
326,814	518,897	246,295	–	4,675	1,939	tadawul.com.sa	+966 1 218 9090
29,729	121,089	–	495	1,892	–	adx.ae	+971 2 6277777
84,742	136,024	63,069	1,842	2,194	985	dfm.co.ae	+971 4 305 5555
–	–	–	–	–	–	difx.ae	+971 4 361 2222

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