Global Imbalances from the GCC Perspective

I am very pleased to be with you today, and to have the opportunity to address this gathering of the 2006 Spring IIF Membership Meeting. I would like to thank the IIF for inviting me to participate in the meetings, and to address fellow bankers, regulators and policymakers from around the world. In my remarks, I shall focus on certain issues facing the global economy from the perspective of the oil-producing countries, with particular reference to the countries of the Gulf Cooperation Council, the GCC.

1. Global Imbalances

Let me first start with a few words about global imbalances and oil prices. As we all know, a key challenge facing the world economy today is the growing external financial imbalances. These global imbalances manifest themselves in the form of large and growing current account deficits and rapidly increasing debt, mainly in the United States, with corresponding large current account surpluses in other countries such as Japan, other industrial countries such as Canada, many Asian countries, particularly those with emerging market economies, and oil-producing countries such as Russia and some Middle Eastern countries. The unsustainability of these global imbalances has raised some fears of increased global risks.

Furthermore, one might say that the current increases in oil prices have not produced significant negative impacts on world economic growth or inflation so far, largely because productivity growth and improved energy-efficient technologies are driving today's increasingly vibrant world economy. Nonetheless, external accounts deficit and surplus countries should work together to develop policy initiatives to prevent, or minimize, the costs of evident risks associated with global current account and financial imbalances.

It is worth noting that the recent rise in oil prices can play a role in financing investment in expanded production capacities in the oil-exporting countries. Surely, the supply-demand mismatch in the world oil market is partly a result of limited investments in production, a result partly of the lower oil prices of the past. It follows, therefore, that higher oil prices will allow supplies to grow with demand, thereby supporting sustainable global growth. The International Energy Agency (IEA) estimates that the global energy sector will require about US$ 16 trillion in investments to expand oil production capabilities from now until the year 2030.

As a matter of fact, many GCC countries plan to invest part of their oil revenues in order to expand the capacity of their oil industries. Tens of billions of US dollars will be required to achieve this plan in a region that holds more than half of the world's proven oil reserves. In the medium term, plans are underway for some 100 projects costing close to US$100 billion in OPEC countries, the majority of which are GCC countries.

2. Challenges to the GCC Countries

I will focus my comments now on the policy response of the GCC surplus countries, and particularly Kuwait, to the challenges which they will face in coming years.

When oil prices averaged US$ 40 a barrel in 2004, oil-exporting countries ran an external collective surplus of US$ 207 billion, almost three times their external surplus in 2001. Oil prices soared in 2005, and the IMF now estimates the collective external surplus to be almost US$ 400 billion. Oil-exporting countries, however, are understandably concerned that today's elevated prices may not last. They are trying not to repeat the experience of the past, when painful budget cuts were required in many oil-exporting countries, as oil prices fell below $10 a barrel in 1998. The GCC countries realize, therefore, the importance of fiscal prudence, despite the consensus that oil prices will remain firm for some time.

Also, some of the GCC countries use their oil revenue surpluses to cushion any negative impact of falling oil prices that may occur. The principal challenge for the GCC countries now, as I visualize it, is to use their external surpluses to increase productive spending and diversify their economies, while avoiding the type of spending patterns that further deepen structural imbalances. Since GCC oil revenue surpluses are coming from a depletable resource, this requires more prudence in managing these surpluses, particularly with regard to spending policies.

On the other hand, recent policy initiatives in some GCC countries should reflect, in my view, important changes in macroeconomic objectives and priorities, such as:

1- Emphasis upon market-based policies and structural reforms, to promote private sector activities.

2- Attention to macroeconomic policies, to facilitate the productive absorption of a rapidly increasing national labor force.

It is clear, however, that conditions must be created to encourage the private sector to take a more active part in domestic economic activities. Needless to say, sustained and efficient diversification of the economy calls for the strengthening of policies regarding privatization, subsidies, and the provision of public goods and services, particularly utilities. Education and training must also be developed and strengthened to meet future requirements and encourage creativity and productivity.

At present, the GCC countries are in the midst of a period of exceptional economic performance. Real GDP grew at an average annual rate of 7.3% between 2003 and 2005, its fastest pace in 15 years. In this situation, prudent management of surpluses, together with changing dynamics in the region, suggests that the current oil revenue surpluses could pave the way for a period of sustained growth. It was noticed that rapid economic growth combined with low interest rates has generated a substantial expansion in demand for credit. However, a mismatch between the demand for and the supply of assets has prompted concerns over increased risks developing in asset markets, and the potential impact on the banking sector if a major correction in these asset markets takes place.

I would like to recall that in the 1970's and 1980's, equity markets barely existed in most of the GCC countries. Increased liquidity flows in the past few years have resulted in sharp increases in asset prices in these markets. Stock exchange indices in some GCC stock markets more than doubled in 2005, reflecting soaring liquidity, outstanding corporate earnings, low interest rate levels, and increased confidence owing to the improved regional security and investment climate. The combined GCC market capitalization grew by 117 percent in 2005, breaking the one trillion US dollar mark. Regional regulators are indeed aware of the risks; some of them have responded with policy initiatives, and consequently the supervisory and the regulatory frameworks have been strengthened.

I would like to add that the rapid economic expansion in the GCC, and the associated acceleration in asset prices, poses for the monetary and supervisory authorities additional challenges in their pursuit of monetary and financial stability. Besides continually modernizing and upgrading their policies, GCC authorities must deal with highly active and sometimes volatile asset markets. Recent events in many GCC equity markets highlight this point. For the past few weeks, many GCC equity markets were experiencing a significant correction that is more pronounced in some markets than others. Balancing the needs of a growth-friendly environment with the risks of an inflated asset market requires vigilance and prudence. The current challenge, then, is not to find a soft landing, but rather to cruise through turbulences. On this journey, autopilot is not an option.

As you know, the GCC economies, particularly banking and financial services, are increasingly integrated with the global economy. In Kuwait, for example, four foreign banks have entered the local market for the first time in the past few months. As a matter of fact, all GCC countries have ambitious plans to attract foreign investments. Therefore, international financial institutions can play a pivotal role, with their expertise and variety of products. Partnerships with local institutions can be forged, and opportunities realized.

3. Prospects and Outlook for Kuwait

In conclusion, let me say a few words about Kuwait. The Kuwaiti economy is recording large internal and external surpluses for 2005 and 2006, as a result of higher oil prices. This will mark the seventh consecutive year of budget surpluses since the fiscal year 1999/2000. Currently, Kuwait is spending more on infrastructure, including port expansion, petrochemicals, refining and a pipeline network. For the future, there are ambitious investment plans for oil exploration and greater oil production capacity.

Finally, in light of the sharp increases in asset prices in the Kuwait Stock Exchange and the real estate market during the past two years, associated with rapid economic growth and a resulting increase in credit demand, the Central Bank of Kuwait initiated a number of measures, beginning in June 2004, the most significant of which was the imposition of a loan-to-deposit ratio ceiling of 80% on commercial banks. The expansionary environment at present certainly carries with it greater risks, and as a regulator, we believe that our increased vigilance and prudent practices can minimize these risks.