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Foreign Investments in the GCC and Investments of GCC Countries Abroad

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Abstract

The investment options of the GCC countries have narrowed since the decline in oil prices in the second half of 2014 and they have had to reconsider their fiscal spending. They have repatriated foreign assets and cut down their foreign portfolio investments. At the same time, they have maintained their strategic foreign direct investment and occasionally expanded it in sectors that they deem strategic for the diversification of their domestic economies, such as petrochemicals, renewables, and logistics. While Western countries continue to receive the lion's share of GCC foreign investments, emerging markets in Asia, Africa, and Latin America are receiving significant investments in recent years. Inward foreign direct investment (FDI) to the GCC has been declining since the global financial crisis in 2008 and the rise in political unrest in the region since 2011. Besides the petrochemical industries, other heavy industries, such as aluminum and phosphates, have been in focus. The GCC countries have managed to expand complementary downstream industries, such as car manufacturing, and attract related foreign direct investment. They have also attracted investments in infrastructure, real estate, and services such as the hospitality industry. After 2008, public investments have become more important in gross fixed capital formation and the role of the private sector has declined. This article gives an overview of the financial impact of the oil price decline in the GCC countries and outlines the developments in outward and inward foreign investment in recent years.

Introduction

Since the second half of 2014, prices of the oil benchmark Brent have declined from over $100 reaching below $40 at the end of 2015. As a result, current account surpluses of the GCC countries have all but vanished, their investment options have narrowed, and they have had to reconsider their fiscal spending. They have started to issue debt, sought to reschedule large projects, stretch payment profiles, and cut subsidies. They have repatriated foreign assets and cut down their foreign portfolio investments. At the same time, they have maintained their strategic foreign direct investment and occasionally expanded it in sectors they deem strategic for a successful diversification of their domestic economies.

The Gulf countries have also attracted inward foreign direct investment (FDI), albeit at a declining rate since the global financial crisis in 2008 and the rise in political unrest in the region since 2011. Petrochemical and other heavy industries, such as aluminum and phosphates, have been in focus. The GCC countries have managed to expand complementary downstream industries, such as car manufacturing, and attract related foreign companies such as Isuzu. They have also attracted investments in infrastructure, real estate, and services such as the hospitality industry. This article gives an overview of the financial impact of the oil price decline in the GCC countries. It also outlines the developments in outward and inward foreign investment in recent years and shows the continuities and changes therein.

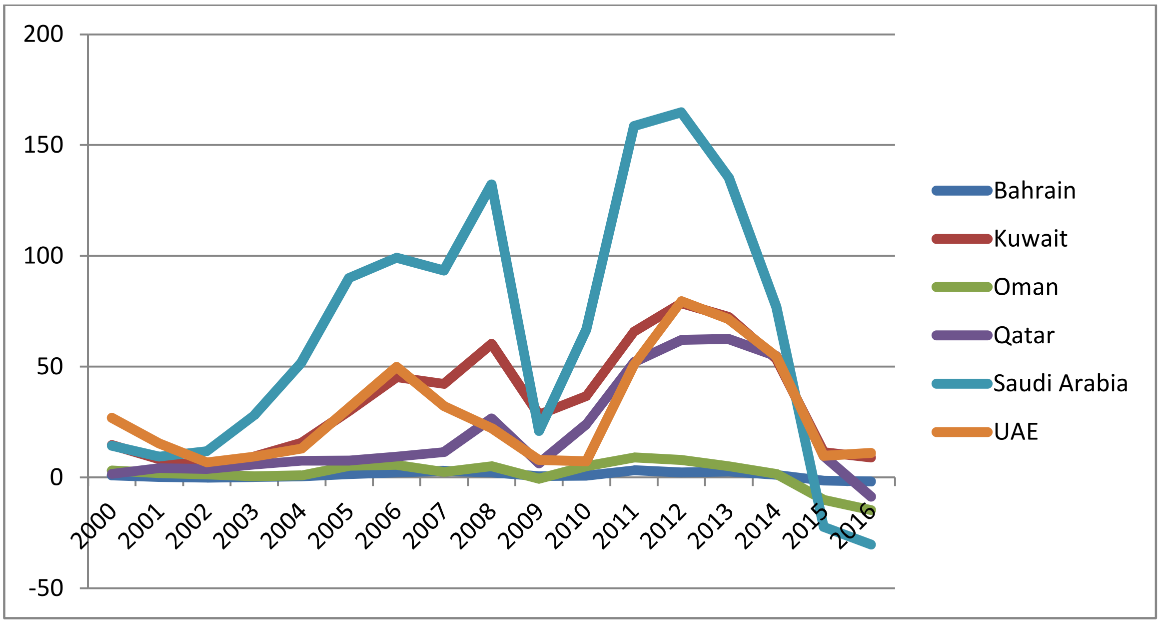
Economic Effects of the Oil Price Decline: Current Account, Fiscal Retrenchment, and Repatriation of Assets

Oil prices came under pressure in the second half of 2014. The unconventional oil revolution in North America added about 4 million barrels of oil to global supplies between 2010 and 2014 —mostly US tight oil from shale formations, but also tar sands from Canada. Within OPEC, Saudi Arabia did not cut production as many had expected and started a price war to push marginal producers out of the market and retain market share.1

The surge in supplies made up for shortfalls elsewhere. Conflicts in Libya, Sudan, South Sudan, Yemen, and Syria impacted oil production. Sanctions against Iran in the wake of the nuclear standoff reduced its oil exports by one million barrels per day. Additional pressures on oil prices came from China, where economic growth and oil demand slowed. At the end of 2015, renewed price corrections set in and pushed the price of Brent below $40 amidst considerable resilience of tight oil production in the US, OPEC's inability to implement supply cuts, and a potential increase in Iranian exports after a lifting of sanctions in the wake of the nuclear agreement.

The oil price decline dimmed the growth prospects of the GCC countries and affected their current account balances as Figure 1 shows. The GCC countries have constantly built up foreign exchange reserves over the 2000s. After the temporary oil price slump in the second half of 2008, this build-up resumed but collapsed again in 2014. In 2016, most GCC countries will have negative current account balances and will not accumulate foreign reserves, according to IMF estimates. Only the UAE and Kuwait will remain in slightly positive territory.

Figure 1: Current account balances of GCC countries 2000-2016, US$ billion



Source: IMF, "World Economic Outlook Dataset, October 2015," http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx (accessed December 18, 2015).

This means that the GCC countries as a whole now consume more than they produce in value terms. They do not have the kind of foreign exchange to spend on investments that they had in the past decade. Even the producer heavyweights of the GCC such as Saudi Arabia, the UAE, Kuwait, and Qatar were affected when oil prices fell below their fiscal breakeven levels. They had to resort to alternative means of funding such as asset repatriation and issuing of debt. Saudi Arabia's budget deficit grew to 21.6 percent of GDP in 2015, and it repatriated almost $100 billion in foreign assets between August 2014 and October 2015. Its public debt ratio to GDP was expected to increase from virtually zero to 33 percent in 2020. Forex markets signaled increasing pressure on dollar pegs in the region. The IMF warned that Saudi Arabia, Oman, and Bahrain would run out of fiscal buffers by 2020. They would face problems in funding their budget deficits, if oil prices continued to stay low. Only for the oil-rich and population-poor countries UAE, Qatar, and Kuwait – with their large sovereign wealth funds – this day of reckoning would be farther into the future, about 20 years from now, according to IMF estimates.2

Table 1 shows estimates of GCC budget breakeven figures. These estimates have become widespread over the last decade and have acquired a mythical quality in some media reports. They can vary considerably and can be misinterpreted.3 Methodologies differ and so do the underlying estimates of oil production, non-oil tax revenues, government spending, and exchange rate effects. They should, therefore, not be used as a tool for predicting production policies and stability of governments in oil states. Oil states have considerable levers to adjust to falling oil prices fiscally. The GCC countries have foreign exchange reserves and access to international capital markets. Less well-endowed Iran, Russia, and Venezuela, on the other hand, have flexible exchange rates. If their currencies fall alongside the oil price, their revenues in local currency might still stay the same.

Hence, fiscal breakeven prices should only be taken as a rough indicator of the fiscal health and options of oil states. As Table 1 shows, these options have narrowed for the GCC states. At the end of 2015, oil revenues could not fully cover government expenditure in any of the GCC states, even though their position was more comfortable than those of other oil producers such as Iran and Russia.

Table 1: Fiscal breakeven prices: GCC, Iraq and Iran, 2015, US$ per barrel of oil (Brent)

Kuwait	49.4
Bahrain	99.8
Qatar	64.1
UAE	73.8
Oman	106.3
Saudi Arabia	87.2
Iraq	68.1
Iran	107.4

Source: IMF, *Regional Economic Outlook Update. Middle East and Central Asia, Statistical Appendix* (Washington D. C., 2015).

Besides repatriation of foreign assets and issuance of debt, the GCC countries started to cut back subsidies. Kuwait reduced diesel subsidies, while retaining those for gasoline; the UAE on the other hand, cut back gasoline subsidies, which mainly benefit individual consumers, while retaining diesel subsidies that benefit businesses and their transportation needs. At the end of 2015 Oman, Bahrain and Saudi Arabia also embarked on a course of reform of fuel and electricity subsidies.4

By the end of 2015, the GCC countries' investment options had changed compared to the ample current account and budget surpluses of the preceding decade. At the same time, these countries were anxious to maintain spending for reasons of political legitimacy. In the wake of the Arab Spring, the late King Abdullah ploughed $130 billion into Saudi Arabia's economy to quell any potential unrest. Upon assuming the throne, the present king Salman gave bonus salaries and other handouts to the tune of $32 billion.5 There was also keen interest to maintain foreign direct investment, whether outward or inward, in industries deemed strategic and crucial for the creation of jobs for a burgeoning youth population. For the same reason, infrastructure investments continued to be given high priority, although some of them had to be postponed as a result of the cash crunch.

GCC Investments Abroad

GCC investments abroad have been dominated by Saudi Arabia, the UAE, Qatar, and Kuwait, states that have a significant current account surplus and large foreign reserves in sovereign wealth funds or in the case of Saudi Arabia at the Saudi Arabian Monetary Agency (SAMA), the country's central bank (see Table 2).

Table 2: GCC Sovereign Wealth Funds' assets, 2015, US$ billion

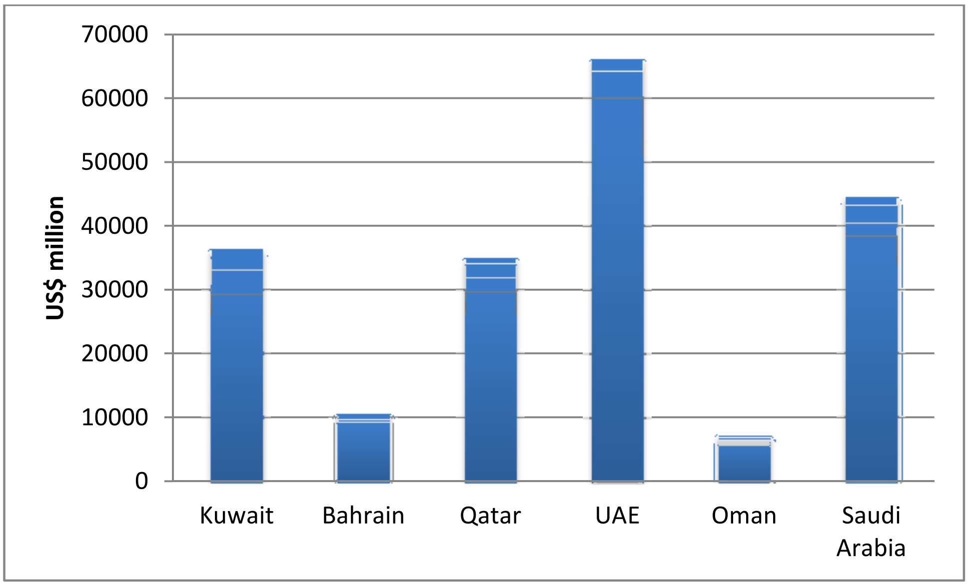
Abu Dhabi Investment Authority (ADIA)	UAE	773
SAMA Foreign Holdings	Saudi Arabia	667
Kuwait Investment Authority (KIA)	Kuwait	592
Qatar Investment Authority	Qatar	256
Investment Corporation of Dubai (ICD)	UAE	183
Abu Dhabi Investment Council (ADIC)	UAE	110
International Petroleum Investment Company (IPIC)	UAE	66
Mubadala	UAE	66
Emirates Investment Authority	UAE	15
State General Reserve Fund	Oman	13
Mumtalakat Holding	Bahrain	11
Oman Investment Fund	Oman	6
Public Investment Fund (PIC)	Saudi Arabia	5
Ras Al Khaimah Investment Authority	UAE	1

Source: Sovereign Wealth Fund Institute, "Sovereign Wealth Fund Rankings," http://www.swfinstitute.org/sovereign-wealth-fund-rankings/ (accessed December 18, 2015).

Some of these SWFs, such as ADIA, KIA and SAMA, explicitly focus on a diversified strategy of portfolio investments. In contrast, the QIA has shown a readiness to eye strategic equity stakes as its high profile acquisitions such as Volkswagen, Glencore, Agricultural Bank of China, Barclays, Siemens, and Royal Dutch Shell have shown.6 Yet other funds, such as Mubadala and IPIC in the UAE, have a pronounced private equity orientation and a clear mandate to invest in industries that can benefit the diversification of their domestic economy. Stakes in CEPSA, the Spanish refining company, a bauxite and alumina production site in Guinea for Emirates Global Aluminum, the US chip producer AMD, or Italian Piaggio Aerospace may be seen in this context.7

The largest stocks of FDI are again held by the four richest GCC countries, with the UAE leading the field. As in portfolio investments, Bahrain and Oman lag behind (see Figure 2).

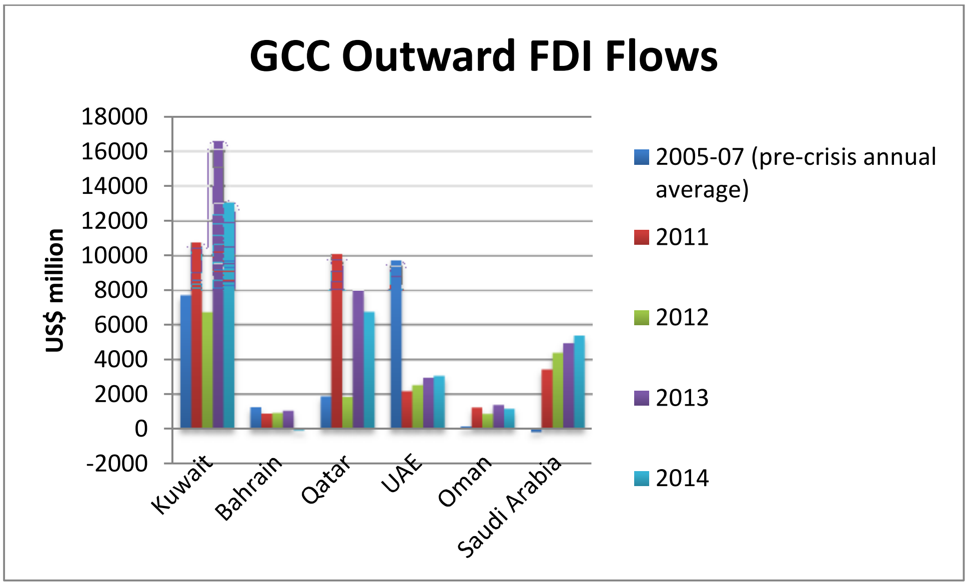
Figure 2: GCC outward FDI stocks, 2014



Source: UNCTAD, *World Investment Report 2015* (Geneva, 2015).

In terms of inward FDI, Kuwait is a laggard as will be seen in the next section; in terms of outward FDI flows, however, the country has taken a lead role within the GCC in recent years (see Figure 3). The UAE has not managed to reach its pre-crisis levels of outward FDI that were prevalent in 2005-07. In contrast, Saudi Arabia has witnessed a steady rise between 2011 and 2014.

Figure 3: GCC outward FDI flows



Source: UNCTAD, *World Investment Report 2015* (Geneva, 2015).

Geographically, GCC outward FDI has been increasingly diverse and has made forays into hitherto underexplored areas such as Africa, where limited market capitalization and political risks pose challenges. GCC companies have invested in an array of fields such as telecoms in West Africa and a power plant in Mozambique; investments in port facilities have been made by the Kuwait-based Agility and Dubai Ports World. The Dubai-based Jumeirah Group signed a management agreement for a hotel in Mauritius and the Investment Corporation of Dubai bought a stake in Kerzner International, which runs resorts such as Atlantis and the One & Only.

Among the GCC ventures in Latin America have been investments in agriculture and mining. Abu Dhabi-based Mubadala joined forces with Trafigura, the world's second largest metal trader, to acquire a controlling stake in a Brazilian iron ore port in 2014.8 Saudi Almarai purchased a farming operation in Argentina. Latin America is a major food exporter to the GCC countries. Brazilian meat and poultry exports to the Middle East and North Africa increased six fold between 2001 and 2014.9 Though many of the agro-investments that the GCC countries have announced since the global food crisis of 2008 have not been implemented or have been reduced to a fraction of the announced scale,10 these countries have put money on the table in relatively developed agro markets in the West, Australia, and Latin America. They have also invested in the value chains of food markets and strategic storage rather than in outright land acquisitions. The acquisition of a majority stake in the former Canadian wheat board by the Saudi government-owned SALIC together with international grain trader Bunge is a case in point. Future joint ventures between the GCC countries and some countries in Latin America, such as Argentina and Brazil, in the field of food production and processing are a distinct possibility.

The GCC countries also sought to solidify their relations with Asia, where two thirds of their energy exports go.11 Saudi Aramco owns 65 percent in South Korea's Onsan refinery and holds interests in a number of other refining and storage ventures in the region. Mubadala invested in energy production in Indonesia and Thailand and in exploration efforts in Vietnam and Malaysia. In Vietnam, Qatar partnered in a major petrochemicals project and Kuwait invested in a refinery. The UAE and Malaysia signed a deal in 2013 for the development of a new financial district in Kuala Lumpur, aiming to join forces in their bid to become regional financial hubs and centers of Islamic finance. On the occasion of a state visit by Abu Dhabi's Crown Prince Shaikh Mohammad bin Zayed Al-Nahyan to China, Dubai Ports World inked a deal to invest $1.9 billion in Chinese logistics, and both countries launched a $10 billion Joint Strategic Investment Fund.12

However, trade with China did increase much more than investment flows and the GCC countries did not invest as much in refinery capacity as expected. The regulated downstream market in China obliges producers to sell at subsidized prices that can make ventures unprofitable; additionally, there are environmental concerns and restrictions on foreign stock holdings. A difficult business environment hampered investment relations with India as well and trade relations with the subcontinent have expanded much more than investments.13

The Western world is the second largest export market for the GCC countries with a share of 18 percent and its most important trade partner for imports accounting for 45 percent of the total.14 It is also the major investment destination for the GCC countries, although it has faced growing competition from emerging markets in recent years. GCC assets in the EU grew from €8.8 billion in 2004 to €73 billion by the end of 2014.15 The GCC countries have invested in a string of high profile real estate assets, particularly in the UK. Most of these foreign real estate investments were undertaken by the UAE. Between 2007 and 2015, it had a share of 65 percent of the total investments, followed by Qatar with 18 percent.16 The GCC countries have also invested in renewable energies in Spain and Germany, besides a number of industrial companies and football clubs such as Manchester City and Paris Saint Germain.

The repatriation of assets has affected portfolio investments of the GCC countries more than their foreign direct investments, which they have sought to maintain. Distress sales of assets, such as Dubai was forced to undertake after its debt crisis in 2009, are not common so far. However, it is expected that GCC investors will significantly reduce their real estate investments in 2016. Pressures on Qatar might be pronounced, as it has to maintain infrastructure spending as part of preparations for the FIFA World Cup in 2022. Qatar Investment Authority sold its 10 per cent stake in the German construction company Hochtief, its stakes in French construction conglomerate Vinci, and two London office buildings. It has also been in talks to sell the film studio Miramax and is preparing a public offering of Italian fashion house Valentino, which it owns.17

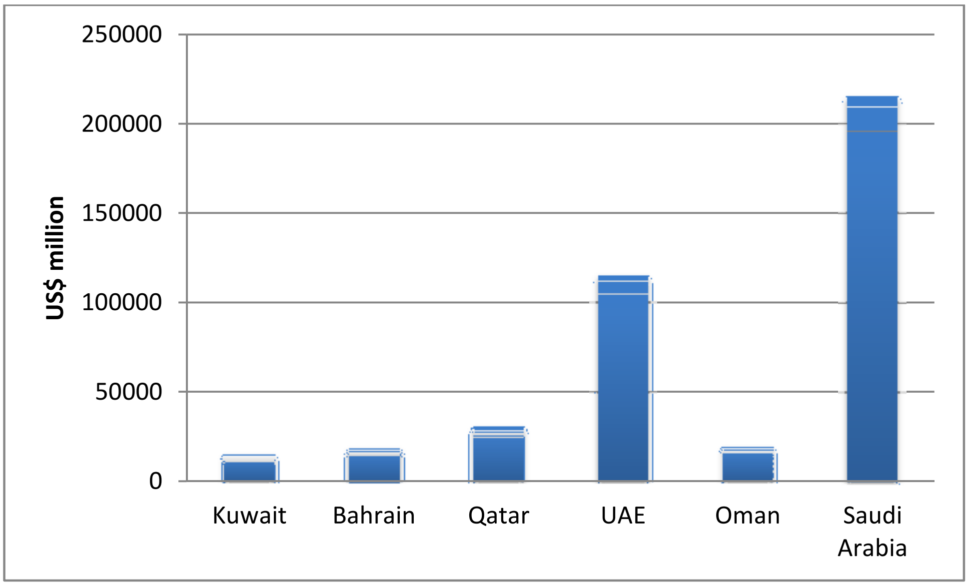
Foreign Direct Investments in GCC Countries

The GCC countries account for the lion's share of outward FDI in West Asia, with some sizable numbers also coming from Turkey. While they attracted about half of all inward FDI in West Asia in 2014, there has been a constant decline in absolute and relative terms since 2008.18 By far, Saudi Arabia and the UAE have the largest inward FDI stocks in GCC countries (see Figure 4). This is testimony to their successful diversification strategies into petrochemicals and other heavy industries, such as aluminum and phosphate mining, and in the case of the UAE also services, tourism, and logistics.19 Such projects are often undertaken with a foreign joint venture partner like the Rabigh refinery joint venture between Saudi Aramco and Japanese Sumitomo or the Alcoa stake in the Al Zabirah aluminum complex in Saudi Arabia.

The GCC countries have sought to enhance the value chains of such heavy industries by building up production capacities downstream that are more employment intensive and could provide jobs for a burgeoning youth population. To benefit from cheap aluminum supplies from the Al-Zabirah project, Isuzu has built a truck assembly plant and the Indian Tata group, which owns Jaguar Land Rover, has plans to produce 100,000 cars per year in Saudi Arabia.20

To put the GCC development model on a more sustainable footing, investments on a large scale are required in the fields of power generation, transportation infrastructure, and energy and water efficiency.21 South Korean construction firms such as Daelim, LG E&C, and Hyundai have managed to capture a large share of this market. Between 1965 and 2014, South Korean firms signed overseas construction contracts worth more than $500 billion: Orders from the Middle East represented 60 per cent of this amount and Saudi Arabia accounted for the largest share with 8,638 projects valued at $50 billion.22

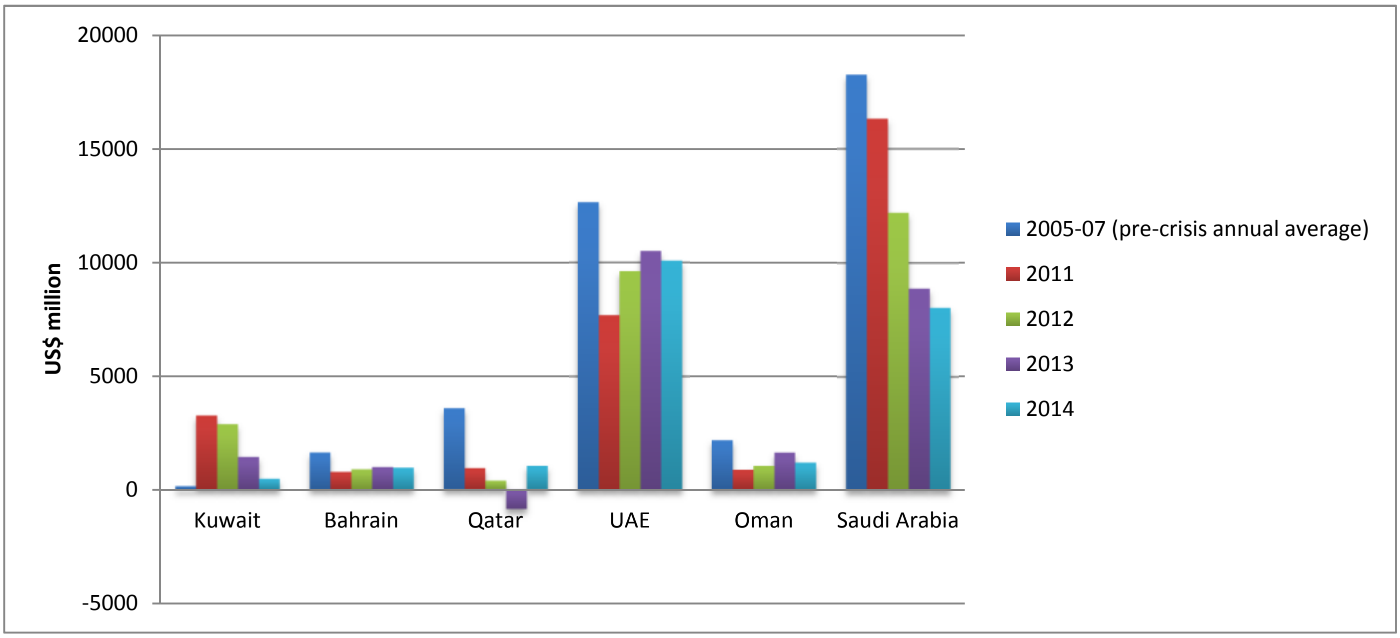
Figure 4: GCC inward FDI stocks, 2014



Source: UNCTAD, *World Investment Report 2015* (Geneva, 2015).

In terms of inward FDI, the UAE has seen steadily high inflows over the past years, while Saudi Arabia has witnessed a constant decline from a high level. The levels of inward FDI of the remaining four GCC countries were much lower. In Bahrain and Oman, inward FDI remained relatively constant, while in Kuwait and Qatar it has seen considerable decline in recent years (see Figure 5).

Figure 5: GCC inward FDI flows



Source: UNCTAD, *World Investment Report 2015* (Geneva, 2015).

Before the global financial crisis in 2008, the real estate sector was a major destination for FDI into the GCC, particularly in the UAE. Since then its importance has declined. Public investment in infrastructure and oil and gas projects has become more important in gross fixed capital formation and the private sector's share has been declining. There have been a number of project delays and cancellations that might continue to affect this investment dynamic, should oil prices remain low. Qatar Petroleum and Royal Dutch Shell canceled their planned $6.5 billion Al Karaana petrochemicals joint venture, Saudi Aramco put its plans to build a $2 billion clean fuels plant at the Ras Tanura refinery on hold, while Abu Dhabi delayed a number of signature projects such as the Etihad Railway network and the Zayed National and Guggenheim museums.23

Conclusion

Against the backdrop of low oil prices, the GCC countries will likely continue to draw down foreign portfolio assets over the coming years. They will also take recourse to debt issuance. On the expenditure side, they will try to rein in subsidies and delay some infrastructure projects while prioritizing others which are indispensable, such as the football World Cup in Qatar in 2022 and the World Expo 2020 in Dubai. At the same time, the GCC countries seem determined to maintain foreign direct investments in sectors that they deem strategic for the diversification of their domestic economies. These include downstream value chains of oil production – particularly in Asia – renewables, logistics, the hospitality sector, agriculture, food processing, and selected mining and manufacturing industries. In terms of geographical orientation, Western countries continue to receive the lion's share of GCC foreign investments, but emerging markets have gained increasing importance in recent years.

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