



**Gulf Research Centre Cambridge**  
Knowledge for All

## **The 2010 Gulf Research Meeting**

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### **Workshop 4**

## ***The GCC Banking and Financial Sector***

### **Workshop Directors**

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### **Abstract**

Rapid economic growth in the GCC countries has led to large and variant financing needs, which in turn meet a relatively underdeveloped financial sector. It is characterized by a lack of bond and derivative markets, difficult access of small and middle enterprises (SMEs) to credit, a dominance of international banks in the project finance market and heavily concentrated equity markets in terms of sectors and ownership. The aim of this workshop is to analyze the different segments of the GCC financial markets and assess their future development prospects. Additionally, it takes a look at the foreign investments of the GCC countries and their petrodollar recycling via sovereign wealth funds. Special emphasis is laid on the reaction of GCC monetary authorities to the global financial crisis and the policy options they face as they are planning for a GCC monetary union.

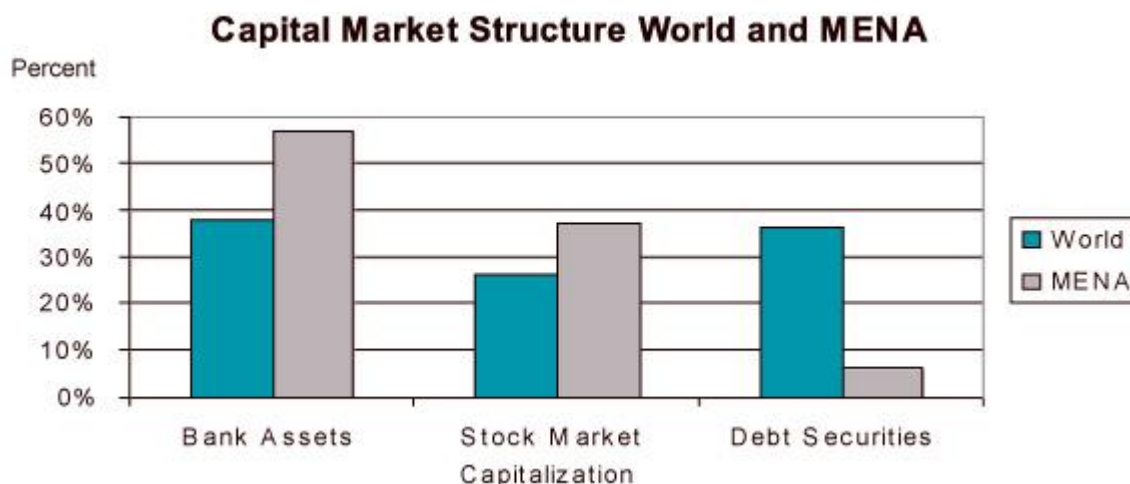
### **Workshop Description and Rationale**

#### **Economic Development and Increased Need for Finance**

Based on high oil prices and a more diversified economic structure, the countries of the Gulf Cooperation Council (GCC: Saudi Arabia, UAE, Kuwait, Qatar, Bahrain and Oman) currently witness one of the highest GDP growth rates worldwide with a concomitant development of domestic financial markets. A growing population has caused a boom in local real estate and consumer markets and multibillion infrastructure investments are needed. From oil up- and downstream projects to heavy industries, transport, power plants, water desalination and waste treatment there is hardly a sector that does not require an increased amount of financing, financial services and insurance.

### **Underdeveloped GCC Capital Markets**

The increased need for finance meets underdeveloped capital market in the GCC. While world capital markets show on average a balanced capital structure of 36 percent debt securities, 26 percent stock market capitalization and 38 percent bank assets, the MENA's balance is heavily skewed towards bank assets (57 percent) with a strong stock market component (37 percent). Debt securities still play a minor role with only 6 percent (see graph). In the GCC, the percentage of corporate bonds issued in comparison to GDP equaled 3.2 percent in 2007. In the US, the ratio was 112 per cent and in China, it was 10 percent. An increase of the relative importance of bond markets in the overall capital structure of the GCC and other MENA countries is certainly warranted. It could lead to better capital access, efficiency gains and improved price discovery and risk assessment. Derivatives have fallen from grace in the wake of the global financial crisis, still the nearly complete lack of derivative markets in the GCC could be a disadvantage which needs to be carefully assessed.



*Source: IMF Global Financial Stability Report 2008*

### **Areas of Regulatory Reform, Monetary Policies and reaction to the Global Financial Crisis**

The GCC stock market crash of 2006 and the current impact of the global financial crisis have pointed the attention to necessary areas of regulation and reform ranging from corporate governance to credit bureaus and monetary policy. The worry of monetary authorities in the GCC about high inflation rates has given way to an accommodative stance in the second half of 2008 as the global credit crunch has raised the potential threat of a deflationary contraction. One task of the workshop is therefore the assessment of central bank policies and how a

coordinated reaction of the GCC countries to the global financial crisis might help a reformulation of policy options.

The most visible effects of the global financial crisis thus far have not been caused by direct exposure to troubled subprime assets but in indirect form, as the GCC countries and their burgeoning project finance markets have been affected by the rising costs of borrowing and declining availability of large credit facilities. While GCC central banks had been preoccupied with runaway credit growth and inflation during the first half of 2008, they have now started to react to the liquidity crunch by monetary easing and other stabilizing efforts such as guarantees on bank deposits. However, they have acted unilaterally thus far and have not found a common policy like the European Union. If interbanking rates start to differ considerably due to different policies and their differing reception in each country, the more successful one country is in bringing down rates the more likely it will attract borrowers from neighboring countries. Authorities will need to address this, otherwise they may be tempted to impose some kind of capital controls to make sure that the accommodative measures they are undertaking will benefit their own economies and do not evaporate via open capital markets.

### **Foreign Investments and Sovereign Wealth Funds**

The domestic investment boom has been unable to absorb all oil generated revenues, which has led to a large current account surplus, rivaling the one of China. This has in turn caused increasing demand of management services for steeply rising foreign assets. The appetite of GCC companies for (foreign) M & A has also grown tremendously, all GCC countries now being members of the WTO and with a string of expected free trade agreements over the coming years. GCC companies operate in an increasingly competitive and globalized environment with a corresponding need to restructure businesses and focus on core activities. Companies like Sabic and Emaar have clearly stated their intention to become global leaders in their respective fields and have already undertaken corresponding acquisitions (e.g. GE Plastics, DSM, Huntsman Petrochemicals, John Laing Homes). The recent merger of Emirates Bank and National Bank of Dubai and the current interest of GCC investors in Dow Chemical also bear witness to this trend. In the wake of the global crisis GCC SWF face multiple challenges as they have started to support local markets and have been called upon to provide additional capital to the IMF at the same time.

### **Possible Future Developments for the GCC Banking and Finance Sector**

- Growing **investment and corporate banking services** for domestic companies and project finance
- **Increased M & A of GCC companies** and **increased FDI of foreign companies in the GCC**
- **Development of capital markets**, notably bond and derivative markets, this includes a **nascent fund industry** reaching from mutual funds to pension schemes and private equity funds. Tackling of associated regulatory issues
- Development of **private banking services** for a growing number of high net worth individuals, who have become more sophisticated
- Advanced asset management solutions for **sovereign wealth funds**, which manage the increasing oil wealth. Trend towards strategic equity stakes instead of mere portfolio investments?
- **White labeling of products** (e.g. funds, structured products) and know-how acquisition by **national banks**

- Venturing of national banks into the project finance market, which is thus far dominated by international banks
- **Back office and custodian solutions** for GCC capital markets, which have more intersections with international markets and show a tendency towards unification
- Growing role of **Islamic banking**, although growth rates are likely to level out as we approach a higher statistical base. Potential of local banks acquiring international status via this niche market (e.g. cooperation with Asia/ Malaysia). Specific requirements in regulation (Basle II), customer care and risk management solutions. Controversial discussions about Sharia compliance of various products

## Overview of Financial Actors and Areas

- **National Banks**

(Emirates Bank, NCB, National Bank of Kuwait, from shielded national markets to regional and international competition, defining of areas of specialization and venturing into new fields like project finance and private banking)

- **International Banks**

In depth look at different strategies and the positioning of the various banks:

- Banks with a full fledged branch system (HSBC, Citibank)
- Banks with local investment and corporate banking services as well as private banking for high net worth individuals (e.g. CSFB, Merrill Lynch)
- Banks with mere representative offices (e.g. Dresdner, West LB)

- **Islamic Banks**

- Independent Islamic banks (e.g. Dubai Islamic, Al Rajhi)

b) Islamic banking subsidiaries (e.g. Emirates Islamic, HSBC Amanah)

- **Sovereign Wealth Funds**

- Foreign Investments: ADIA, KIA, SAMA, QIA, Istithmar, Dubai International Capital, Oman State Reserve Fund, Mubadala
- Domestic Investments: e.g. PIF, Dubai Investments

- **Investment Funds:**

- Locally based private equity funds (e.g. Al Abraj, Injazat, International Financial Advisors, Investcorp)
- Mutual funds of local banks: E.g. Mashreqbank, NCB
- Sales teams of foreign funds (mutual, closed end, private equity, hedge): Mellon, Forsyth, Templeton, Man etc.

- **Stock Markets**

(Domestic stock markets, characteristics of listed stocks, turnover, IPOs, interlinkages, ownership structures, etc.)

- **Financial Centers**

(DIFC, QFC, BFH, King Abdullah Economic City, Riyadh Financial District: Complementary services or oversupply?)

- **Central banks and Capital Market Authorities**

(legal status, relative regulatory strength in the overall system, reserves, monetary policy, cooperation amongst GCC central banks etc. )

- **Insurance companies**

(Predominance of non-life insurance, Sharia compliant takaful companies, reliance on international reinsurance companies, low ratios of insurance to GDP)

- **Credit for SMEs and microcredit:**

(Disconnect of SMEs and banking system in the GCC, various initiatives for microcredit in the GCC (Al Jameel Group, PlaNet Finance, IFC etc.)

## **Workshop Director Profiles**

**Dr. Eckart Woertz** served as Director of Economic Studies at the GRC until October 2010. He has been a visiting fellow at Princeton University and has held senior positions in financial services companies in Germany and the UAE, amongst them Delbrück & Co one of the oldest German private banks. His research interests include the political economy of the Middle East, financial markets and energy issues. Dr. Woertz is a regular contributor to the region's leading newspapers and TV channels. In February 2005, he published *The Role of Gold in the Unified GCC Currency*, where he predicted a long-term bull market in the precious metal. In his GRC publication *GCC Stock Markets at Risk*, he warned at the beginning of 2006 about the following stock market crash in the GCC. He has also dealt extensively with petrodollar recycling, strategic foreign investments and the impact of the global financial crisis on the GCC countries. Since 2008 Middle East food security has been special interests of his. He holds an MA in Middle Eastern Studies and a PhD in Economics from Friedrich-Alexander University, Erlangen-Nuremberg, where he conducted research about structural adjustment politics in Egypt.

**Dr. Hatem Al-Shanfari** is Assistant Professor in the Department of Economics and Finance at the College of Commerce and Economics at Sultan Qaboos University. His research interest is focused on asset pricing models, risk management, financial markets, management of financial institutions and Trade in Services (GATS). He has published number of articles in referred international journals and participated in number of professional international conferences. Presently, Dr. Al Shanfari is the chairman of the Board of Directors of Gulf Investment Services Company and the Chairman of the Audit Committee of the Board of Al Omaniya Financial Services company; Vice Chairman of the Board of Omani Economic Association; a member of the Economics committee of the Oman Chamber of Commerce and Industry; and research associate of the Economic Research Forum for the Arab Countries, Iran and Turkey. He holds a doctorate degree in Economics from University of Strathclyde in Glasgow, Scotland. He also earned an MA degree in Economic Planning from the Institute of

Social Studies in The Hague, the Netherlands and B.Sc in Engineering from Washington University in St. Louis, Missouri, USA.