FINANCIAL STABILITY REMAINS STRONG AND VIABLE

The GDP of the GCC region is on a growth path despite oil price decline with KSA, UAE and Qatar taking the lion's share.

Regional economies have been on an accelerated growth trajectory for the period 2011-14, which has been mainly fueled by record oil prices with the banking sector being the largest beneficiary of the economic boom.

In a detailed report compiled by Al Masah Capital Limited, non-core income recovery, a strong investment-led credit growth coupled with a soaring population were some of the key areas that were instrumental in bolstering the balance sheets of Saudi Arabia (KSA), Qatar, and United Arab Emirates (UAE) lenders.

Capital earnings were also improved significantly mainly as a result of public sector deposits, which in turn improved capital ratios for the lenders. All these gains came against a backdrop of a liquidity boost from the respective governments into the system, a move that shielded the regional financial sector from the 2009 financial crisis.

Petro-dollar revenues and stringent yet strategic policies by the Central Banks also played a key role in ensuring that the three economies' financial stability remained strong and viable.

The regional banking sector still remains a preserve of domestic lenders with cross-border presence still facing strict licensing restrictions for foreign banks. However, with increased competition, local banks are on a footprint expansion spree.

But even with a booming economy the financial sector continues to face some challenges more so in the form of ballooning deficits. Some key economic sectors have also experienced slow growth primarily as a result of slackening economic activity.

One key challenge being a low oil price environment, which still continues to exert pressure on the government revenues. Government spending, as a result, consequently remains in special focus as it's still aligned with the regional long-term vision.

There were also mixed reactions with the government's decision to draw down deposits and issue local denominated currency notes with the objective of funding deficits. Although this move helped the banking sector remain resilient until 2015, it also drained liquidity out of the system.

Money supply

Cash supply remained under pressure as growth continued to decelerate. M2 of the GCC region grew by one and a half points to stand at 2.2% in 2016 compared to 3.7% during the previous year.

On its part, the CAGR growth stood at 8.3% between 2011 and 2016 and 5.4% between 2013 and 2016. The slowdown in money creating cycle indicates the magnitude of slowdown and impact of oil prices on the liquidity environment of the region.

According to the Al Masah Capital report, the slowdown in money supply growth can be attributed to government-related

deposits. The report also indicates that these deposits have been decelerating since 2014 even as the government's continued utilization of internal reserves in a bid to fund expenses.

Out of the three nations, Qatar was the most impacted with the liquidity squeeze mainly as a result of oil price decline and a drop in government deposit. KSA and UAE were the most dominant players in the region registering a 3.3% and 3.6% growth respectively.

Foreign reserves

KSA recorded the highest foreign reserve decline of 27% from $724.3 billion in 2014 to $528.6bn in 2016. Qatar recorded a 26.5% drop in two years from $42.7bn in 2014 to $31.4 billion in 2016.

But even with shrinking foreign reserves being registered for the most part of 2016, the UAE and Kuwait recorded an increase in their foreign reserves during the past two years having increased by 10.2% and 6.4% respectively, the Al Masah Capital report highlights.

The report also cites that although the liquidity situation in the region remains on a recovery path in the past three quarters, its vulnerability still lingers and it remains a cause for concern for the Central Banks.

The temporary measures adopted are however expected to fade out, as the governments utilize the funds to cushion deficits brought about by a persistent decline in oil prices.

Banking penetration

The GCC continues to experience a robust banking sector with penetration increasing since 2011 mainly due to an enabling macroeconomic environment, buoyant energy prices, and benign interest rate scenario.

GCC's loan to GDP and deposits to GDP ratio in 2016 stood at 84% and 85% respectively – a clear indication that aggregate banking penetration is likely to increase over the foreseeable future as the economies continue to grow.

Banking assets are also on a growth path and will mainly be driven by credit deployment as banks continue to extend loans to both public and private sectors to support the broader economic activity.

Banks performance

Performance in the banking sector continued to experience steady growth with the banks under review accounting for more than 90% of the total assets.

Qatar National Bank took the leadership position with $197bn in asset size, representing a 9.4% market share. First Abu Dhabi Bank (FAB) and Emirates NBD (ENBD) asset size stood at $181.3bn and $122bn respectively, representing a market share of 8.6% and 5.8% respectively.

Other notable bank that featured in the top ten included National Bank of Kuwait, with $80.7bn in asset size, representing a 3.8% market share and Riyadh Bank with $58bn in asset size representing a 2.7% market share.

According to the report, total assets of the UAE banks grew at 10.2% CAGR during the period from AED1,202.3bn in 2007 to AED2,610.8bn in 2016. Overall, the bank assets growth has accelerated, post the surge witnessed during 2013, growing by impressive margins during the past three years. In 2016, the average monthly growth was clocked at 0.4%.

Regional deals acquisition

For over a decade, the GCC region has attracted several key deals with the most lucrative ones happening between 2006 and 2016. During this period, a total of 69 deals estimated to be worth well over $27bn were recorded.

However, 2016 remained the most lucrative, in terms of value, with $14,869m from just two deals.

Customer deposits

Despite subdued oil prices, customer deposits in the UAE grew at a CAGR of 9.1% from AED716 million to AED1,562.9 billion in 2015.

The Al Masah Capital report noted that public sector deposits registered growth, increasing from 72.8% in 2014 to 76.5% in 2016. Private sector deposits contribution to overall deposit base increased from 23.9% in 2010 to 27.2% in 2014.

FAB holds the highest share of customer deposits with 30.4% followed by ENBD with over 16%, and ADCB with a little over 10%.

Islamic banking

The Islamic banking sector continued to register impressive growth in comparison to the conventional banking. Even with a slow 2016, Islamic banking largely continues to outperform national and international conventional lenders.

This is because the institutions are supported by proactive regulations, enhanced recognition of Islamic finance, and wider adoption of Sharia products especially in retail.

In 2016, the financial assets in the UAE were estimated to represent almost 30% of the system, up from around 20% in 2010. This was mainly achieved by the accelerated growth of Islamic windows through which conventional banks have captured additional market shares and clientele over the years.

Credit demand

Lending remained strong thanks to the public sector and the government's effort to diversify the economy through infrastructure projects.

In Qatar, gross credit for both resident and non-resident has increased to QR839.3bn in 2016 from QR110.9bn in 2011, registering a CAGR of 15.8% during the period. Qatar reported a much faster growth compared to 9.7% by the GCC region during the past five years.

According to the report, the public sector credit demand will remain strong, as the government looks to finance large-scale investments into infrastructure projects linked to the 2022 FIFA World Cup and the National Vision 2030 diversification programme. bq