ECONOMIC BOOM

GCC GDP on a growth path despite oil price decline

Regional economies have been on an accelerated growth trajectory for the period 2011-14, which has been mainly fuelled 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.

> **Capital earnings were also improved significantly mainly as a result of public sector deposits, which in turn improved capital ratios for the lenders**

But even with a booming economy the financial sector continues to face some challenges more so in 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 was also mixed reactions with the government's decision to draw down deposits and issue local denominated currency notes with the objective to fund deficits. Although this move helped the banking sector remain resilient until 2015, it also drained out liquidity from 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 per cent in 2016 compared to 3.7 per cent during the previous year.

On its part, the CAGR growth stood at 8.3 per cent between 2011 and 2016 and 5.4 per cent 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 utilisation 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 per cent and 3.6 per cent growth respectively.

FOREIGN RESERVES

KSA recorded the highest foreign reserve decline of 27 per cent from $724.3 billion in 2014 to $528.6 billion in 2016. Qatar recorded a 26.5 per cent drop in two years from $42.7 billion 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 per cent and 6.4 per cent 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 utilise 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 per cent and 85 per cent 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.

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