The Brexit could impact the Fed's decision to reconsider rate hikes and this could impact monetary tightening in the GCC. – *Reuters*

GCC banking sector is alert to Brexit dynamics

Fed's monetary tightening may reduce liquidity pressure

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THE GULF COOPERATION Council (GCC) economies witnessed a slowdown in economic growth and tightening of liquidity due to the slump in oil prices in the first half of this year. The recent revival in oil prices marginally improved liquidity. However, the pressure on liquidity may result in a decline in private sector credit growth due to the higher cost of funds, lower credit demand and increased debt financing by governments.

Policy makers have adopted diverse responses to tightening liquidity, such as easing their loan-to-deposit ratios and reducing reserve requirements. There is a need in the GCC to ensure coherence in fiscal and monetary operations to avoid amplifying liquidity shocks, ensure effective liquidity assistance frameworks and ensure appropriate loan classification and provisioning. Fund raising to manage fiscal deficit can be utilised within the region. Sovereign wealth fund reserves can also be used to ease liquidity.

Banking sector lending growth in Saudi Arabia was above five per cent in the first quarter of 2016. Lending growth to the private sector was three per cent. Lending growth to government and quasi-government entities was 29 per cent. Demand deposit had surged by one per cent in the first quarter of 2016. However, time and savings deposit fell five per cent in the first quarter of 2016 due to a decline in oil prices.

Demand deposits are mostly sourced from businesses and individuals, while time and savings deposits are sourced from government entities. According to the International Monetary Fund (IMF)'s April 2016 outlook, the Saudi economy is expected to grow 1.2 per cent in 2016.

The UAE banking sector witnessed a loan growth of 1.4 per cent year-to-date in the first four months of 2016, with the private sector being a major contributor to growth of more than one per cent. Deposit growth was close to 1.9 per cent. The growth in non-residents' deposits has been much stronger at 3.8 per cent than residents' deposits, which grew 2.2 per cent. This year, the lack of liquidity could result in higher rates, increase cost of funding and create pressure on net interest margin. According to the IMF April 2016 outlook, the UAE economy is expected to grow 2.4 per cent this year.

In the Oman banking sector, lending growth was close to four per cent in the first quarter of 2016. Deposit growth was close to two per cent. This year, higher borrowing costs and rising expenses could impact Omani banks. According to the IMF April 2016 outlook, the Oman economy is expected to grow by 1.8 per cent this year.

The lending growth in Qatar was more than seven per cent in the first five months of 2016. The government sector witnessed a growth of more than 18 per cent, real estate close to five per cent and services sector more than 13 per cent during the same period. Consumption and contracting sectors witnessed sluggish lending. Deposit growth was close to five per cent year-to-date in the first five months of 2016. According to the IMF April 2016 outlook, the Qatar economy may grow at 3.4 per cent.

After the recent Brexit vote, near-term volatility in stock prices and currency volatility in the GCC could be driven by "subdued" sentiment and lower oil prices, which could impact the banking sector. The Brexit could also impact the US Fed's decision to reconsider further rate hikes and thereby the monetary tightening in the GCC due to rate hikes will also be deferred.

Given the currency peg in most of the GCC economies, such an event would be more positive for the GCC as lower oil prices have resulted in slower growth and a lower interest rate would be conducive in this scenario. The revival in oil prices since February 2016 and the possible deferment of Fed's monetary tightening could reduce the liquidity pressure on GCC economies.

The recent European summit at Brussels had negotiations on how to implement Brexit, encompassing various segments such as access to the single market of the European Union, open migration from EU and clearance of euro transactions from the city of London. However, we need to watch the progress of exit negotiations as that will determine financial market volatility, oil prices and even Fed action. The GCC banking sector is alert to the dynamics of Brexit.

The writer is the group CEO of Doha Bank. Views expressed are his own and do not reflect the newspaper's policy.