Pedestrians pass by financial institutions on Bank Street in Dubai. The funding of GCC banks remains anchored by low-cost deposits. — *Photo by Dhes Handumon*

GCC banks set for hectic fund-raising

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MARKET INSIGHT

ACCORDING TO the International Monetary Fund's October 2016 outlook, in 2017, the economy of Saudi Arabia is expected to grow by 1.98 per cent, the UAE by 2.5 per cent, Qatar by 3.4 per cent, Oman by 2.6 per cent and Bahrain by 1.76 per cent.

2016 had begun amid a sharp cut in fuel subsidies in Saudi Arabia, Qatar, Bahrain and Oman, following a lead set by the UAE in 2015, accompanied by a series of rises in the price of water and electricity throughout the region. Such subsidy cuts, due to continue throughout the region in 2017, will see business costs rise. Lower oil revenues have resulted in a decline in government deposits in banks.

Interbank rates have increased. Bahrain, Oman, Qatar, Saudi Arabia and the UAE have issued bonds and obtained syndicated loans in international markets in 2016 and can continue this further in 2017 to address the fiscal deficit and mitigate funding pressures. In the banking sector, more rate hikes are likely in the GCC in 2017 as the GCC Central Bank mirrors action by the US Federal Reserve.

Liquidity pressure is expected to remain in 2017. The funding of GCC banks remains anchored by low-cost deposits, but it is under pressure because of decelerating deposit growth. On average, deposits provide 70 to 85 per cent of non-equity funding. Deposit growth is expected to slow further in 2017. This will increase banks' reliance on more costly deposits and market funding, increasing loan-to-deposit ratios and driving higher funding costs.

Lending growth to the government sector in Qatar and Saudi Arabia is expected to pick up. However, deposit mobilisation from the government sector will be more challenging.

Deposit growth

In the UAE, non-resident deposits growth will continue to be higher than resident deposits. The private sector will be a major contributor to lending growth. The services sector is also an area to watch out for in Qatar after phenomenal lending growth in 2016. The contract sector will face challenges.

The IFRS 9 Financial instruments are going to be mandatory for all accounting periods beginning on or after January 1, 2018 and needs to be complied by all banks operating in the GCC. Most GCC banks have already started discussions with their risk, informational technology and finance departments along with their respective auditors and central banks. 2017 will continue to witness intense preparations by the banking sector to ensure compliance with this new standard.

As a result of tighter liquidity, banks have issued more debt in 2016 and this trend could continue in 2017. Another option used by many banks has been to tap the international syndicated loan market to refinance maturing debt. Many investors, mainly in Asia, but also in the US and Europe where interest rates are low, are willing to increase their exposure to GCC sovereigns and banks due to their high credit ratings and good yields.

85%
of a bank's non-equity funding are usually provided by deposits

With an improved outlook for oil prices after the Opec's move to curtail oil output, borrowers in the region are likely to use the opportunity to fill their coffers. Coupled with the region's growing financial markets and the use of financing arrangements, this will drive further fund-raising activities.

Rising yields on loans are expected to offset increasing funding costs in a phased manner. However, pricing competition remains intense in some of the GCC markets. The major challenge for GCC banks in 2017 is to keep funding costs under control, aim to improve loan yields and, thereby, contribute better to the net interest margin. The stress on net interest margin is expected to prevail amid monetary tightening in the GCC.

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