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PRESS RELEASE

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GCC banks urged to fine-tune liquidity management in order to address new economic cycle - Coface Economic Report

- **Weak energy prices and lower government spending across the GCC region put pressure on lending opportunities**
- **Despite current business conditions, GCC to register solid loan growth of 4.9% in 2017**
- **Banks more selective in granting loans in 2017 and 2018**
- **Alternative financing options due to tight market conditions**

Stagnation of oil prices: a differentiated impact on business financing

The stagnation of low oil prices is weighing on liquidity conditions across Gulf Cooperation Council (GCC) countries. This is slowing down government fiscal revenues, tightening liquidity in the banking sector, inflating the costs of funding and dragging down economic growth (2.1% in 2017 according to Coface's forecast). The report analyses that further restrictions on government subsidies would exacerbate the slowdown in deposit growth.

Interbank rates have increased and money supply has slowed across the region. This situation has been particularly a concern for Oman and Bahrain, as they have the lowest fiscal and external buffers in the region. This means that tightening liquidity conditions have had a deeper impact for corporate financing in these two countries compared to others, such as the UAE and Saudi Arabia, which benefit from stronger financial buffers.

Overall, loan growth is expected to register a solid growth of 4.9% in 2017. This is, however, far lower than the average annual growth of 9.2% recorded between 2012 and 2016.

Seltem Iyigun, Coface economist, said: "*Restricted resources would make banks more selective on granting loans in 2017 and 2018. This would also limit access to funding for corporates, especially for small and medium-sized companies, as they represent higher risks*."

Capital markets to play bigger role in fundraising

Oil prices declined by over 75% between mid-2014 and January 2016 and since then, have risen back by about 85%. The fall resulted in deteriorated financial and business conditions in many countries, leading some governments to adopt austerity measures - such as cancelling low priority projects, raising administrative fees and curbing some subsidies.

Massimo Falcioni, CEO for Middle East Countries at Coface, said: "*The banking system in Gulf Countries is facing new challenges following the decline in oil prices. Funding costs have increased due to US interest hikes - which invariably affects the UAE dirham as it is pegged to the greenback - and capital adjustments are necessary, due to the recently implementation of Basel III requirements, which will require banks to hold a significant amount of high quality liquid assets in 2018-2019.*"

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The Coface report highlights how heavy dependence on oil has dragged down government fiscal revenues in many countries across the region. This has, in turn, had a bearing on liquidity in the banking sector and the results of corporates. The region's budgets for 2017 showed reductions in public spending which will lead to the postponement of some important projects. This will make cash flow management more difficult for companies and reduce the opportunities for banks to finance mega-projects, which are among their main sources of profitability.

"*GCC banks need to fine-tune their liquidity management in order to face the economic cycle ahead. Current account surpluses have declined and countries' fiscal surpluses have turned into deficits. The capacity of the public sector to accumulate liquidity in the banking system has subsequently lowered as well*", added Falcioni.

Low oil prices have led some of the GCC countries to use their own resources to finance budget deficits. Capital markets could play a larger role in fundraising in the present business environment. Tapping into international bond markets would help GCC governments to ease liquidity pressures and find additional sources that could be used for the private sector. In 2016, GCC governments raised $38.9 billion through international bond issues and despite the recovery in oil prices, they are expected to continue tapping into the bond markets in 2017. According to the report, a total of over $38.9 billion was raised by GCC governments in 2016 through international bond markets and the trend is expected to continue in 2017.

"*Liquidity squeezes do not only put pressure on corporate and SME financing, they also increase the trade risks associated with solvency and non-payments. Within this environment, protection of the trade system is highly recommended as a stabiliser, as well as an accelerator, for the ongoing strategic expansion in non-oil sectors*", concluded Falcioni.

Tightened liquidity conditions are also leading companies to implement financing solutions, such as Initial Public Offerings and turning to private equity funds to meet their capital needs.

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About Coface

Coface, a world-leading credit insurer, offers 50,000 companies around the globe solutions to protect them against the risk of financial default of their clients, both on their domestic and export markets. The Group, which aims to be the most agile global credit insurer in the industry, is present in 100 countries, employs 4,300 people, and posted consolidated turnover of €1.411 billion in 2016. Coface publishes quarterly country and sector risk assessments based on its unique knowledge of companies' payment behavior and on the expertise of its 660 underwriters and credit analysts located close to clients and their debtors.

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