

# Cercle des Economistes Arabes

## Tour d'horizon des systèmes bancaires au Moyen-Orient

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Moody's Investors Service



Paris  
28 septembre 2009

**Moody's Investors Service**

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# Agenda

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1. Liquidity, credit growth and asset quality in the Gulf
2. Banking reforms going unabated in North Africa
3. Banking opportunities in the Levant
4. Islamic banking: resilient to crisis... but how far?





# 1. Liquidity, credit growth and asset quality in the Gulf



# A paradox?

## Managing past credit growth, current credit crunch?

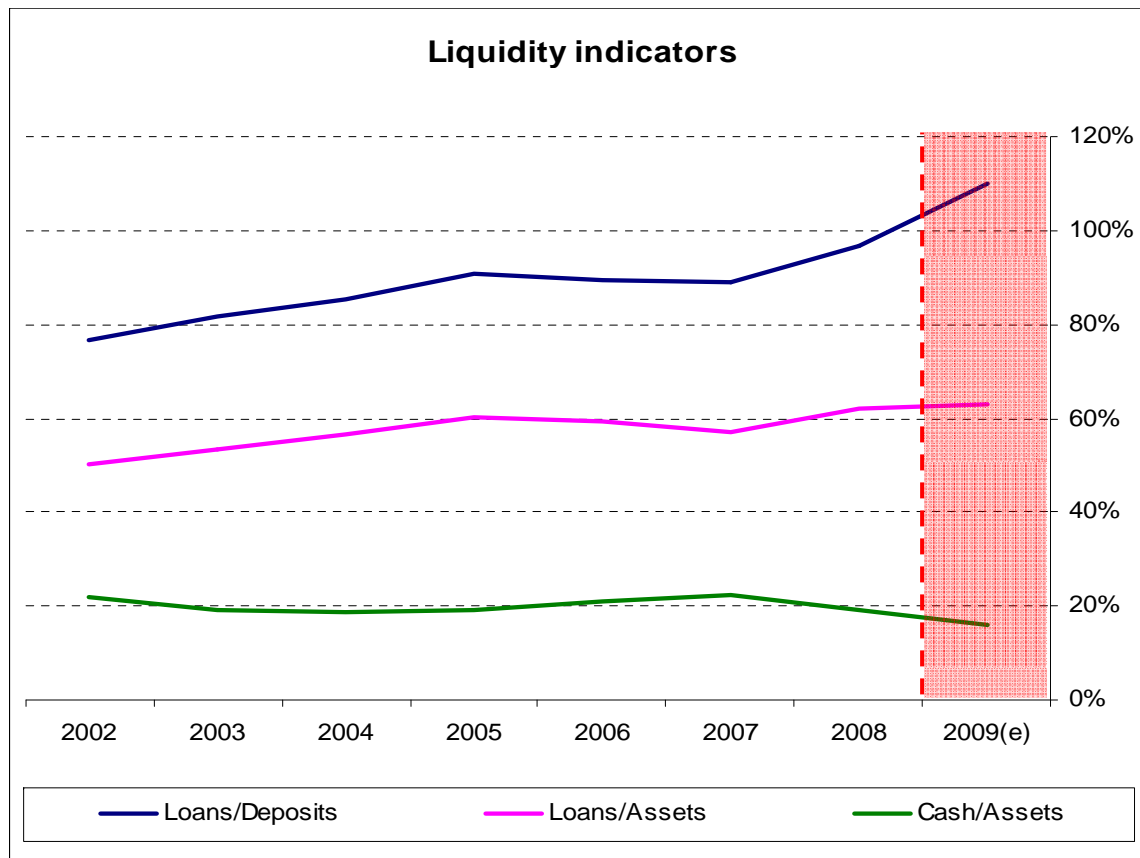
### GCC Banks balance sheets 2002-2008

US million

ASSETS	2008	2007	2006	2005	2004	2003	2002
Cash and equivalent	207,316	199,181	137,552	98,734	78,362	67,910	70,008
Investments	160,665	150,038	107,594	93,541	89,806	86,981	80,671
Loans	673,119	511,996	386,323	311,149	235,738	188,951	162,213
Others	46,487	34,416	19,720	14,488	12,176	11,333	10,066
<b>Total assets</b>	<b>1,087,586</b>	<b>895,630</b>	<b>651,189</b>	<b>517,912</b>	<b>416,081</b>	<b>355,176</b>	<b>322,958</b>
LIABILITIES	2008	2007	2006	2005	2004	2003	2002
Customer deposits	696,348	576,527	432,141	342,947	276,785	231,390	212,238
Interbank	178,766	149,615	78,621	54,493	45,027	41,160	36,983
Other liabilities	89,833	70,103	59,285	56,344	47,322	42,931	37,461
Equity	122,640	99,385	81,141	64,128	46,946	39,695	36,275
<b>Total liabilities</b>	<b>1,087,587</b>	<b>895,630</b>	<b>651,189</b>	<b>517,911</b>	<b>416,081</b>	<b>355,176</b>	<b>322,958</b>
Ratios	2008	2007	2006	2005	2004	2003	2002
Credit growth	31.5%	32.5%	24.2%	32.0%	24.8%	16.5%	15.6%
Growth rate of equity	23.4%	22.5%	26.5%	36.6%	18.3%	9.4%	8.2%
Loans/Deposits	96.7%	88.8%	89.4%	90.7%	85.2%	81.7%	76.4%
Loans/Assets	61.9%	57.2%	59.3%	60.1%	56.7%	53.2%	50.2%
Loans/Equity	5.5	5.2	4.8	4.9	5.0	4.8	4.5
Equity/Assets	11.3%	11.1%	12.5%	12.4%	11.3%	11.2%	11.2%
Cash/Assets	19.1%	22.2%	21.1%	19.1%	18.8%	19.1%	21.7%
Cash/Deposits	29.8%	34.5%	31.8%	28.8%	28.3%	29.3%	33.0%

# Liquidity: deteriorating... but how much?

## How far will liquidity ratios further deteriorate?

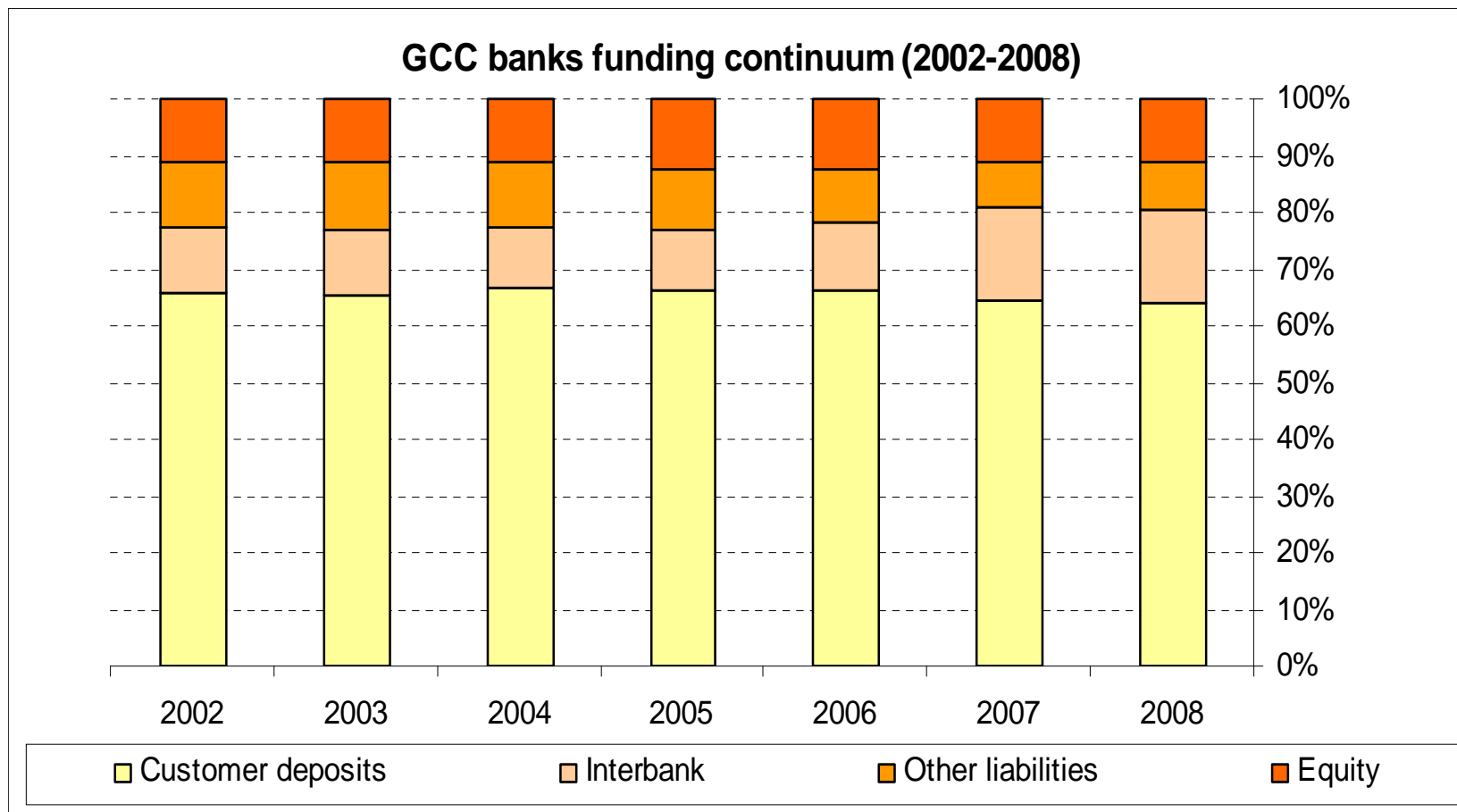


- In the trade-off between liquidity and profitability, what's banks' preference?
- Does it mean banks lend shorter term?
- Does it mean credit is more expensive?
- What are banks' funding strategies at this stage?



# Funding strategies

Is it good time to lengthen the maturity profile of banks' liabilities?



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# Concentration risks

**Sector concentration: a curse?**

**Geographic concentration: a blessing?**

**Sector concentration in credit (yearend 2008)**

%	KUWAIT	QATAR	KSA	OMAN	UAE	BAHRAIN	GCC
Real estate and construction	30.1%	18.8%	7.1%	11.1%	13.5%	21.3%	14.4%
Retail and personal loans	31.8%	23.8%	37.8%	39.5%	26.4%	33.4%	31.0%
Trade and commerce	9.2%	12.8%	23.1%	12.2%	17.1%	18.2%	17.4%
Industry	5.9%	5.1%	12.3%	16.8%	7.9%	9.5%	9.1%
Non-bank financial institutions	11.1%	13.8%	2.2%	4.9%	6.4%	6.2%	6.4%
All other lending	11.9%	25.7%	17.5%	15.4%	28.7%	11.4%	21.8%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100%</b>	<b>100%</b>	<b>100.0%</b>

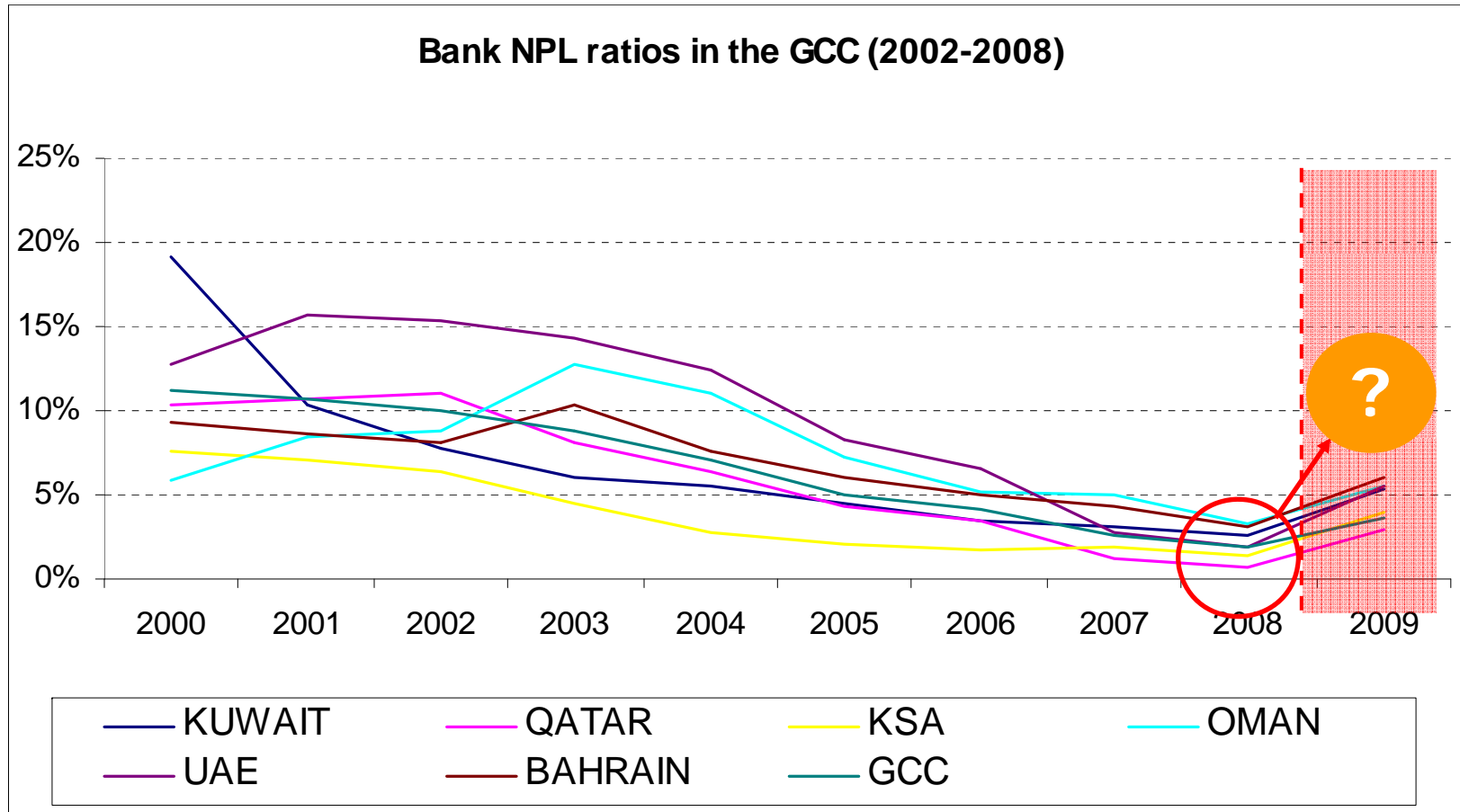
**Geographic concentration of assets (YE2008)**

%	KUWAIT	QATAR	KSA	OMAN	UAE	BAHRAIN
<b>Domestic</b>	81%	73%	88%	85%	71%	42%
<b>Foreign assets</b>	19%	27%	12%	15%	29%	58%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>



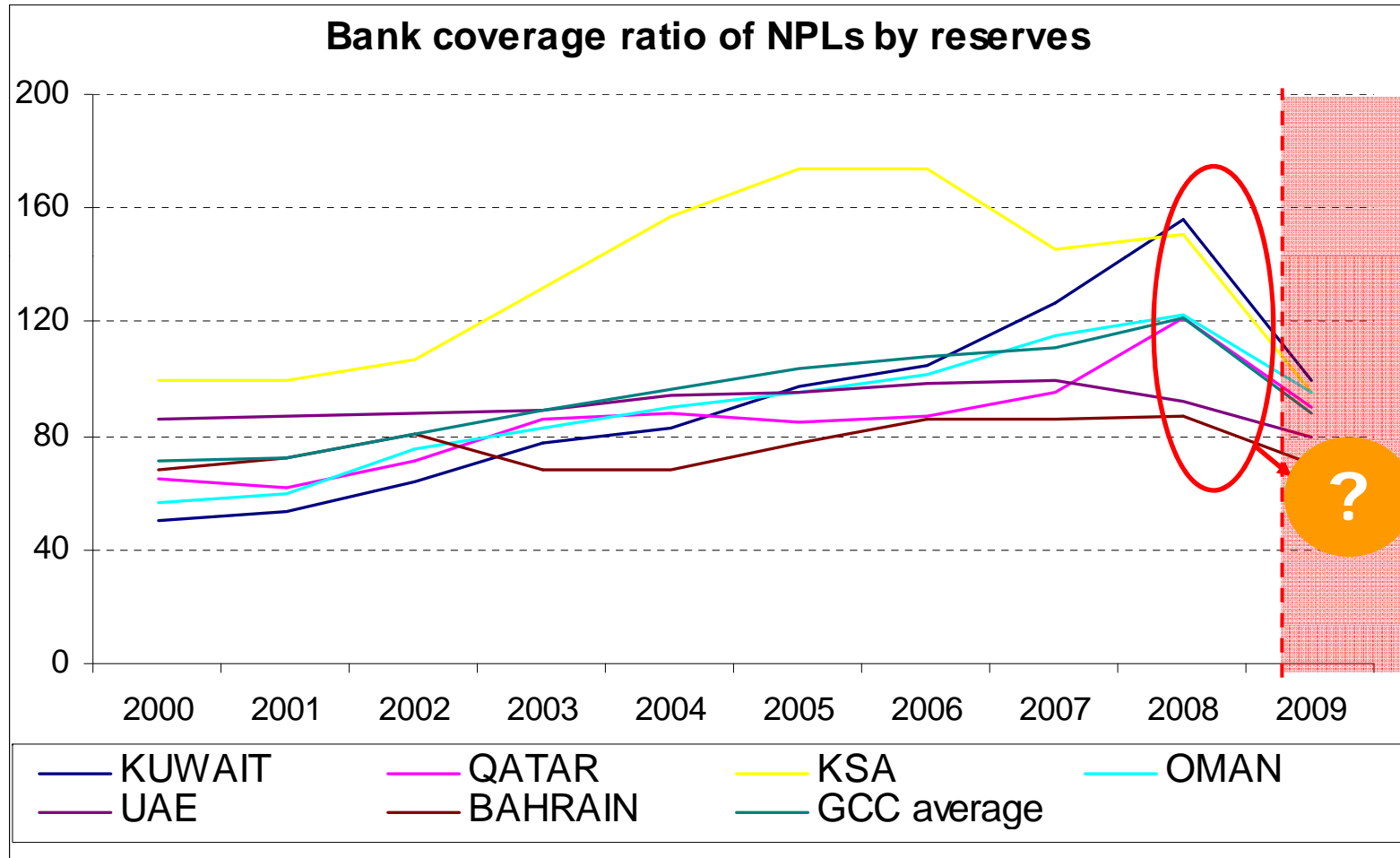
# Asset quality (1)

## How credible are asset quality statistics?



# Asset quality (2)

## Why such high provisioning levels?



## Strategy & tactics

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### What should we expect?

Will GCC banks...

- ... grow more slowly?
- ... continue to curb lending?
- ... focus on the short term only?
- ... reduce their risk appetite?
- ... explore new asset classes?
- ... activate new business lines?





## 2. Banking reform going unabated in North Africa



# Morocco: sustained growth despite crisis

## MOROCCAN BANKING SYSTEM: KEY ROW DATA

Million dirhams

	VOLUMES				GROWTH		
	2005	2006	2007	2008(f)	2006	2007	2008(f)
<b>Total assets</b>							
Private-sector banks	395,666	467,561	563,557	651,702	18.2%	20.5%	15.6%
Public-sector banks	60,091	70,671	91,109	105,359	17.6%	28.9%	15.6%
All banks	455,757	538,232	654,666	757,061	18.1%	21.6%	15.6%
<b>Loan book</b>							
Private-sector banks	219,248	270,537	354,566	405,793	23.4%	31.1%	14.4%
Public-sector banks	58,884	56,820	68,066	77,900	-3.5%	19.8%	14.4%
All banks	278,132	327,357	422,632	483,693	17.7%	29.1%	14.4%
<b>Customer deposits</b>							
Private-sector banks	332,754	389,040	461,091	489,982	16.9%	18.5%	6.3%
Public-sector banks	38,142	46,997	54,080	57,469	23.2%	15.1%	6.3%
All banks	370,896	436,037	515,171	547,451	17.6%	18.1%	6.3%
<b>NPLs</b>							
Private-sector banks	21,073	20,253	19,055	20,290	-3.9%	-5.9%	6.5%
Public-sector banks	22,532	15,553	14,256	6,313	-31.0%	-8.3%	-55.7%
All banks	43,605	35,806	33,311	26,603	-17.9%	-7.0%	-20.1%
<b>Loan loss reserves (LLRs)</b>							
Private-sector banks	15,601	15,587	16,104	17,246	-0.1%	3.3%	7.1%
Public-sector banks	13,679	9,781	8,949	4,800	-28.5%	-8.5%	-46.4%
All banks	29,280	25,368	25,053	22,046	-13.4%	-1.2%	-12.0%
<b>NPL%</b>							
Private-sector banks	9.6%	7.5%	5.4%	5.0%	-2.1	-2.1	-0.4
Public-sector banks	38.3%	27.4%	20.9%	8.1%	-10.9	-6.4	-12.8
All banks	15.7%	10.9%	7.9%	5.5%	-4.7	-3.1	-2.4
<b>NPL coverage by LLRs</b>							
Private-sector banks	74.0%	77.0%	84.5%	85.0%	2.9	7.6	0.5
Public-sector banks	60.7%	62.9%	62.8%	76.0%	2.2	-0.1	13.3
All banks	67.1%	70.8%	75.2%	82.9%	3.7	4.4	7.7

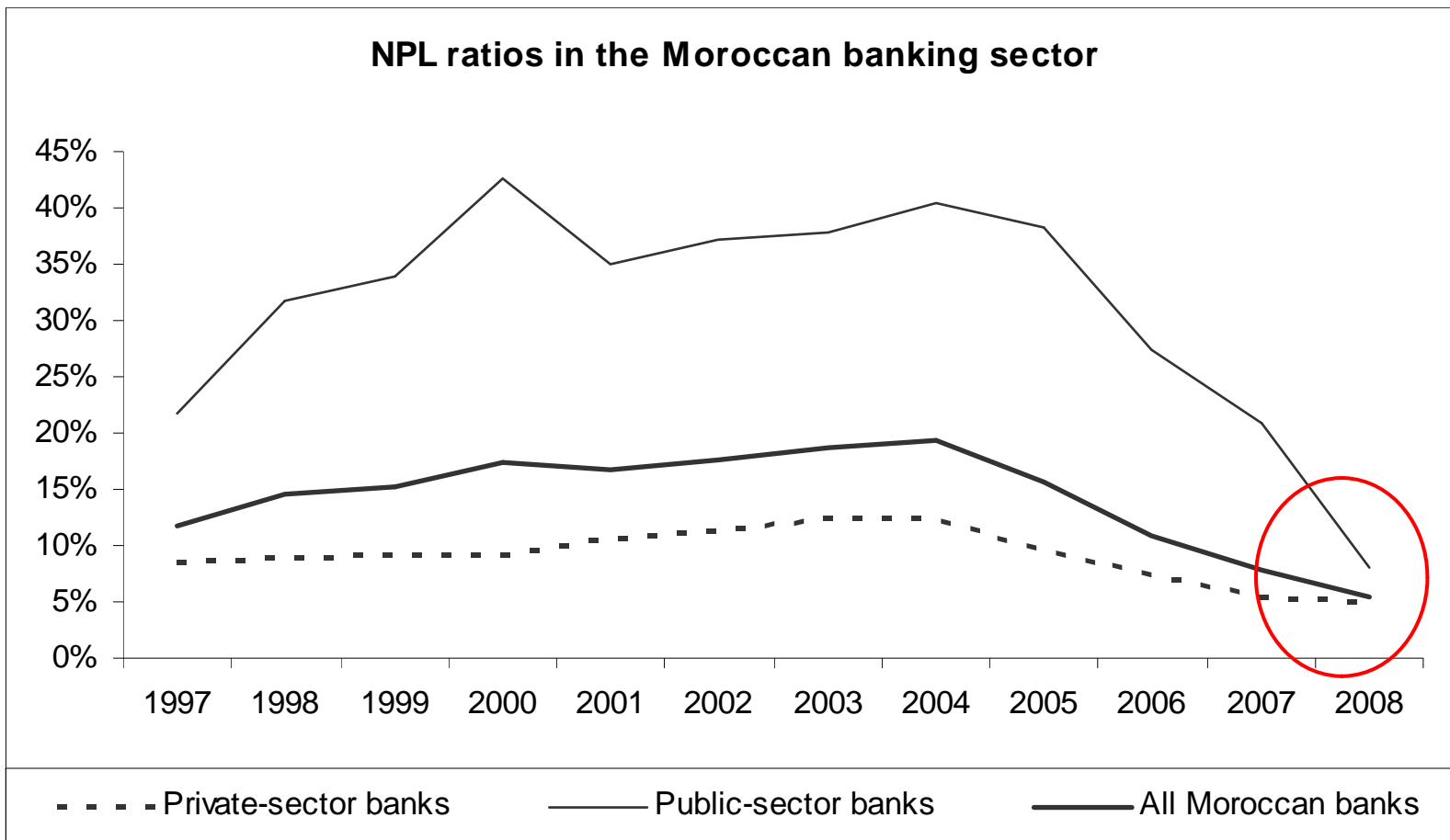
# Morocco: good performance; capital under pressure

## MOROCCAN BANKING SYSTEM: KEY RATIOS

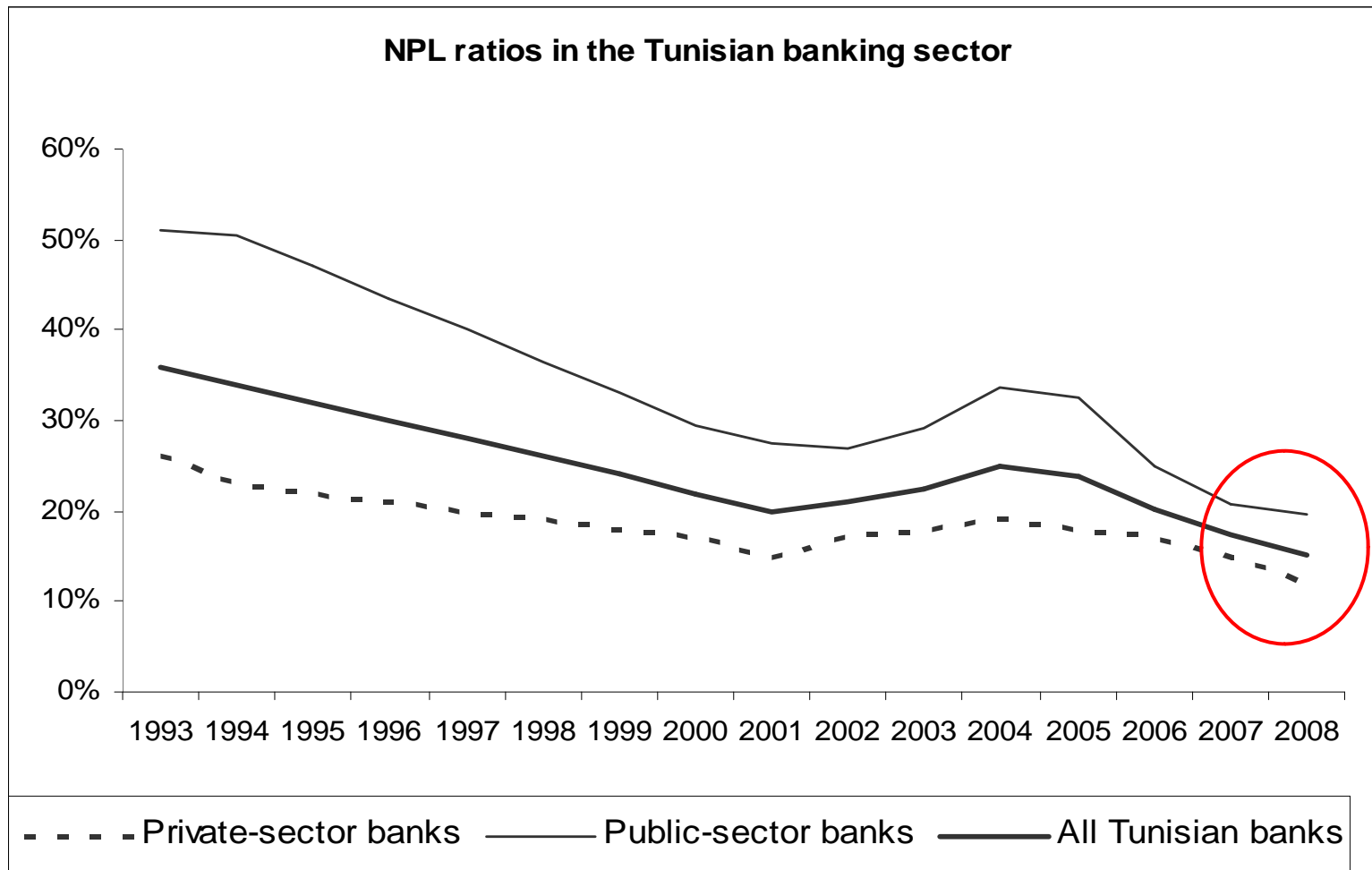
	Commercial banks (excluding public-sector banks)						All banks					
	2003	2004	2005	2006	2007	2008(f)	2003	2004	2005	2006	2007	2008(f)
<b>Regulatory Capital</b>												
Regulatory capital to risk-weighted assets (Basel II since 2007)	13.0	13.9	14.2	13.2	10.1	10.0	9.6	10.5	11.5	12.3	10.6	10.4
Tier 1 capital to risk weighted assets	12.5	13.1	12.5	11.8	8.8	8.6	11.1	11.5	10.0	11.0	9.2	9.0
Capital to assets	8.5	8.8	8.7	7.8	7.4	7.2	7.6	7.6	7.7	7.4	6.9	6.8
<b>Asset Quality</b>												
Non Performing Loans (NPLs) to total loans	12.3	12.4	9.6	7.4	5.3	5.0	18.7	19.4	15.7	10.9	7.9	5.5
Specific provisions to NPLs	71.5	72.2	74.0	77.7	84.3	85.0	54.9	59.3	67.1	71.2	75.2	82.9
NPLs, net of provisions, to Tier 1 capital	27.5	26.8	21.0	14.4	8.3	7.5	81.8	75.3	57.2	30.3	20.1	12
Interest rate average spread (b/w loans and deposits)	5.5	5.3	4.9	4.6	4.3	4.2	5.4	5.0	4.8	4.7	4.4	4.3
Specific provisions to total loans	8.8	8.9	7.1	5.8	4.5	4.1	10.3	11.5	10.5	7.8	5.9	5
General provisions to total loans	1.9	1.4	1.3	0.9	0.8	1.0	1.7	1.4	1.2	0.9	0.9	1
<b>Profitability</b>												
Return on Assets (ROA)	0.5	1.0	1.2	1.4	1.3	1.4	-0.2	0.8	0.5	1.3	1.5	1.5
Return on Equity (ROE)	6.4	10.8	14.1	16.2	17.4	16.8	-2.0	10.9	6.3	17.4	20.6	18.5
Net interest margin to net banking product (PNB)	81.4	78.6	78.8	74.9	74.1	75	82.4	79.8	80.1	75.8	75.9	76
Operating expenses to PNB	51.8	50.4	49.8	48.8	46.8	45	53.4	94.7	50.0	48.4	46.5	45
Operating expenses to total assets	2.5	2.4	2.3	2.2	1.9	1.8	2.4	2.4	2.3	2.2	2.0	1.9
Personnel expenses to non-interest expenses	52.9	51.7	52.2	49.9	52.2	53	53.7	52.5	53.1	50.7	52.3	53
Trading and other non-interest income to PNB	19.3	22.1	21.0	24.8	25.9	25	18.2	20.8	19.6	23.9	24.1	24.5
<b>Liquidity</b>												
Liquid assets to total assets	31.2	32.9	32.0	29.0	21.8	20	28.1	29.6	29.0	27.0	23.6	21.5
Liquid assets to short-term liabilities	40.0	42.3	39.5	36.2	29.3	27	42.6	42.4	40.2	36.8	30.7	28.5
Deposits to loans	172.0	173.2	169.1	160.5	147.2	135	138.5	142.9	144.9	146.0	135.2	129
Deposits of state-owned enterprises to total deposits	2.5	2.2	2.6	3.4	2.6	2.8	2.6	2.2	3.7	4.6	3.9	4



# Morocco: good news is asset quality trends



# Tunisia: following the same path



## Tunisia: key issues

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- Banking reform taken seriously
- Banking system clean-up higher on government agenda
- Privatization of « development banks »
- Public-sector banks back on track
- Private-sector banks improving financial performance
- Emergence of a sustainable retail platform
- More foreign entrants allowed in



## Egypt: Moody's Ratings

- Moody's rates five Egyptian banks (National bank of Egypt, Banque Misr, Banque du Caire, Bank of Alexandria and Commercial International Bank) which account for around of 50% of total banking system assets.
- Their BFSR vary from D- to C- (all with stable outlook) while their Local Currency (LC) deposit ratings are in the **Baa** category (RUR) and their Foreign Currency (FC) deposit ratings are at **Ba2** (all stable outlook).
- In July 2009, the five Egyptian banks LC deposit ratings were **placed under review for possible downgrade** in light of Moody's global review of systemic support indicators for banking systems.
- In August 2009, the FC deposit ratings' **outlook of the five Egyptian banks was changed to stable from negative** following Moody's sovereign team recent change in Egypt FC deposit ceilings outlook to stable from negative. This action came in response to the easing of inflation levels and the banking sector resiliency in the face of the global financial crisis.
- Egypt's banking system **outlook for the coming 12 months is stable**. All sovereign ratings carry also a stable outlook.



# Egyptian Banking System: Main Rating Drivers

- Funding remains largely **deposit-based** with minimal exposures to capital market funding.
- **Underbanked market** with significant opportunities in retail, mortgage and SME sectors.
- **Strong systemic support** factored in the banks' deposit ratings.
- **High level of NPLs** remains a major issue facing the Egyptian banking system, in particular at the state-owned banks.
- Significant single-name borrower **concentration** levels constraint the banks' risk profile.
- **Enhanced regulatory and supervisory practices**, though in need of further development.
- Limited geographical and business **diversification**.
- Challenging operating environment, characterised by a low GDP per capita level, high unemployment rate and weakening macro-economic conditions due to the global economic turmoil.



## Egypt and the global financial crisis...

- GDP growth is expected to **drop** to 4% in 2009 from 7.4% in 2008.
- **Revenues** from tourism, the Suez Canal, oil & gaz exports as well as remittances of Egyptian working abroad are likely to come under pressure in 2009.
- **Inflation** has decreased to 10% in June 2009 from a peak of 24% recorded in august 2008.
- The Egyptian government's **stimulus** package of 1.5% of GDP has mainly targeted infrastructure projects. Other stimulus measures include full tariff exemptions on some infrastructure goods.
- The banking system has exhibited **strong resiliency** in the face of the global financial turmoil; the main reasons for that are largely attributed to the banking system nil exposures to the sophisticated structured products, its **abundant liquidity** and the positive achievements of the banking sector reform.
- **FX reserves**, which have been on the rise over the last few years, would help Egypt overcome a potential deterioration in current account balances resulting from lower FDIs as well as tourism, Suez Canal and oil-exports receipts.



# Egypt Banking Sector: Recent developments

- **Considerable progress** has been achieved in the CBE banking sector reform plan launched in 2004. This is reflected by the sector consolidation and privatisation drive, the improving asset quality trend and the ongoing restructuring of the state-owned banks.
- **Phase 2 of the banking system reform has now started**, this will aim at enhancing access to finance, implementing Basel II, enforcing implementation of corporate governance rules in the banking sector and improving the financial fundamental of state-owned banks.
- NPL ratio has been on the decline thanks to the large cleaning-up process taking place, loan restructuring and re-negotiation with clients. **As of June 2009, banking system NPL ratio reached 15% while provisioning coverage ratio exceeded 90%.**
- A credit bureau was set-up in 2007. This will help banks assess their clients' leverage potential, hence improve their risk profile.

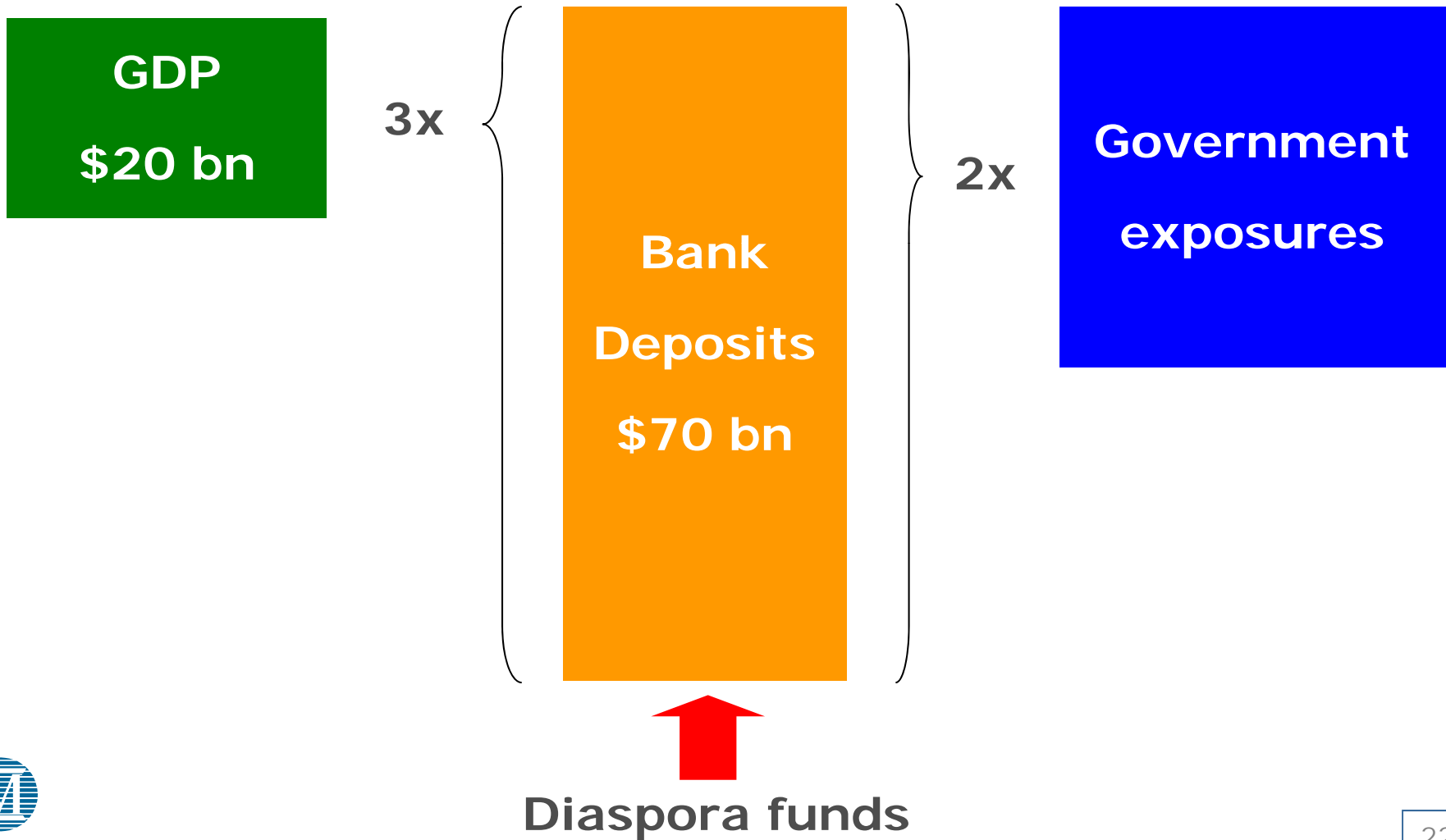




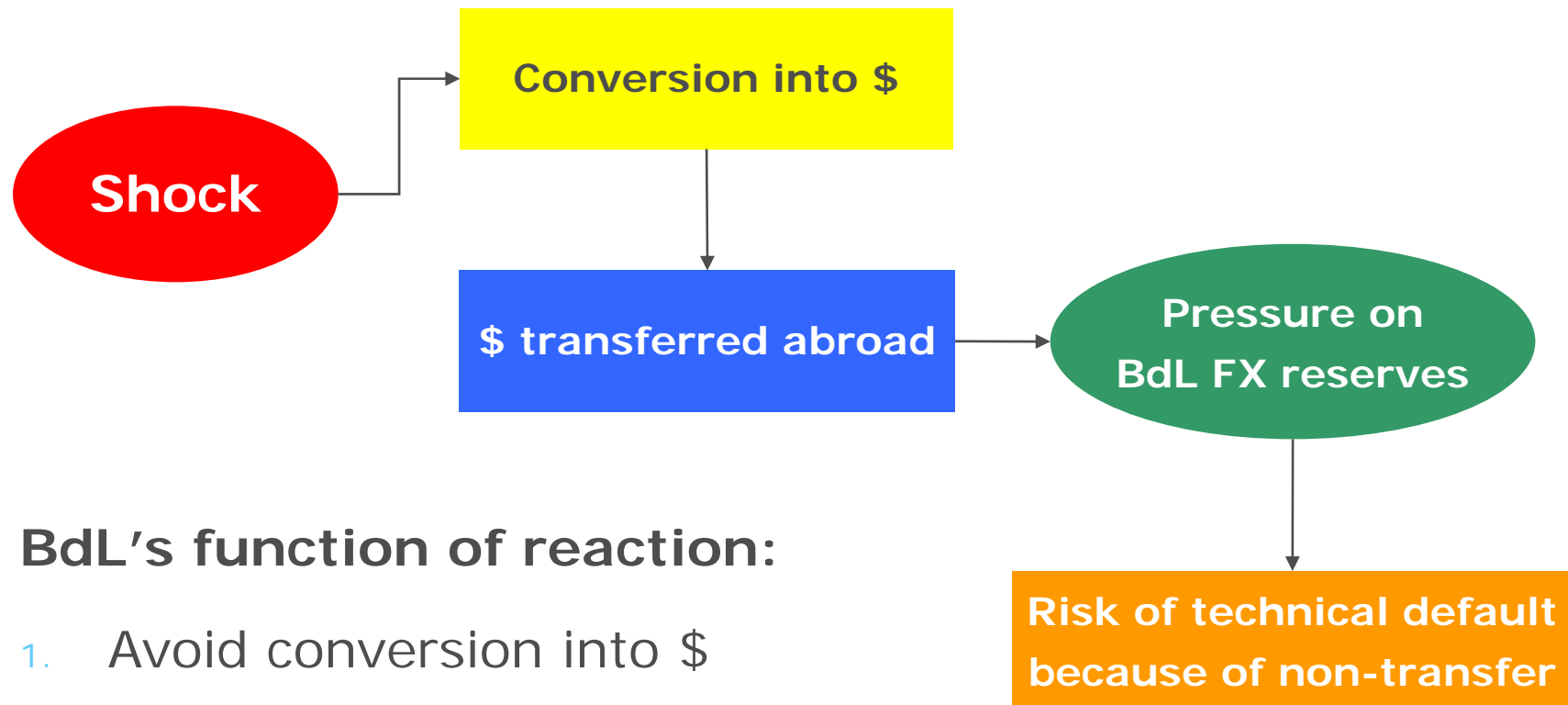
### 3. Banking opportunities in the Levant



# Lebanon's very specific in the Middle East



## Lebanon: experts in managing crises



### BdL's function of reaction:

1. Avoid conversion into \$
2. If LBP converted into \$, keep them in Lebanon



## Lebanon: for banks, few ways out...

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### What can Lebanese banks do in such a context?

1. Keep on receiving Diaspora's deposits
2. Keep on funding the public sector's needs
3. Use balance sheet size to expand in neighboring countries
4. Syria: Islamic banking
5. Jordan, Egypt, Turkey: retail and corporate banking
6. GCC: investment and merchant banking



# Jordan: crowded but still developing

## Strengths

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- Strong asset growth funded by sufficient liquidity in the system
- Enhanced supervision and regulation by the Central Bank of Jordan
- High probability of systemic support to banks in case of need
- Improving core operating profits on the back of still wide margins
- Healthy capitalisation levels provide a cushion for growth and for absorption of possible losses

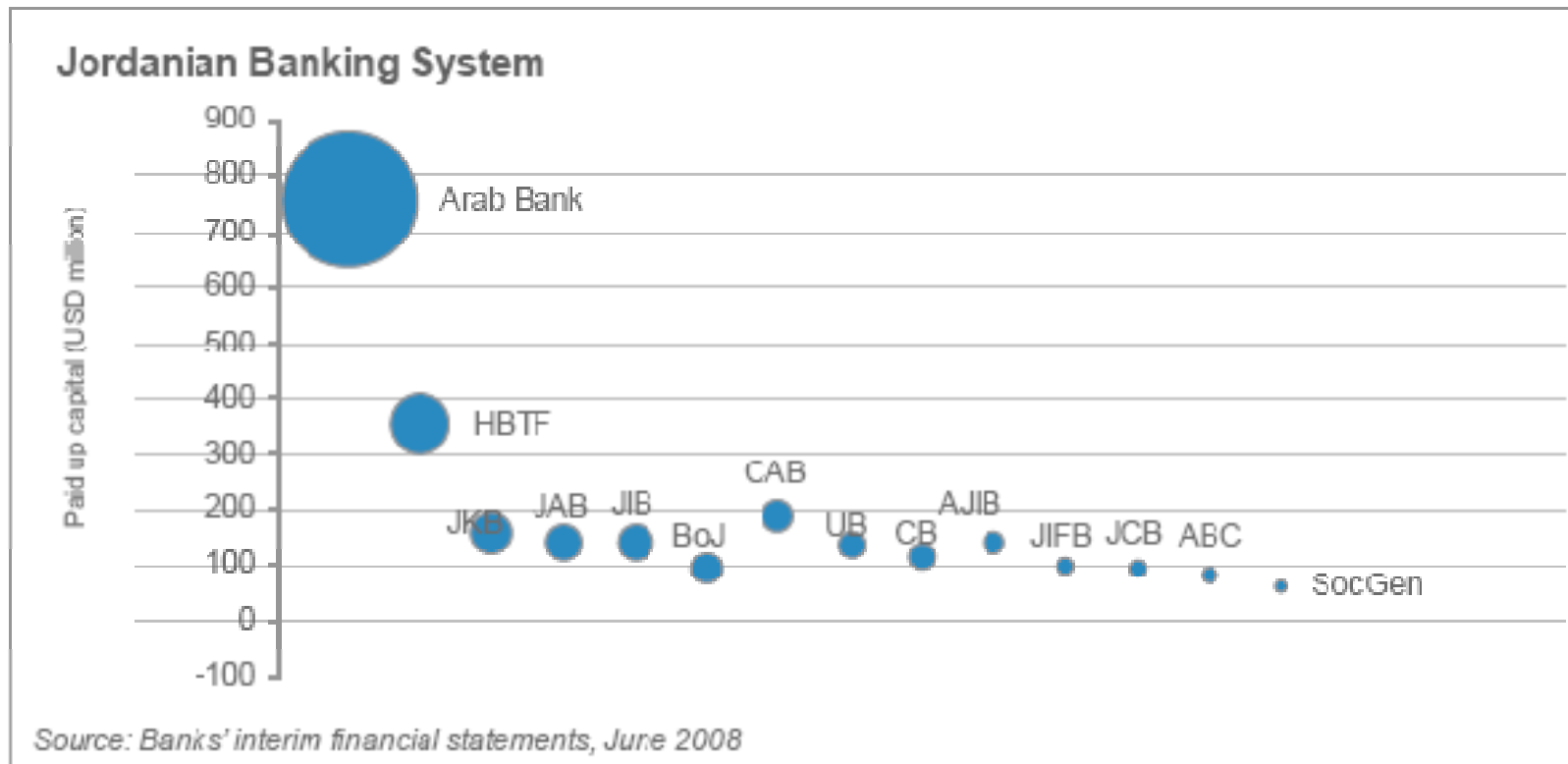
## Challenges

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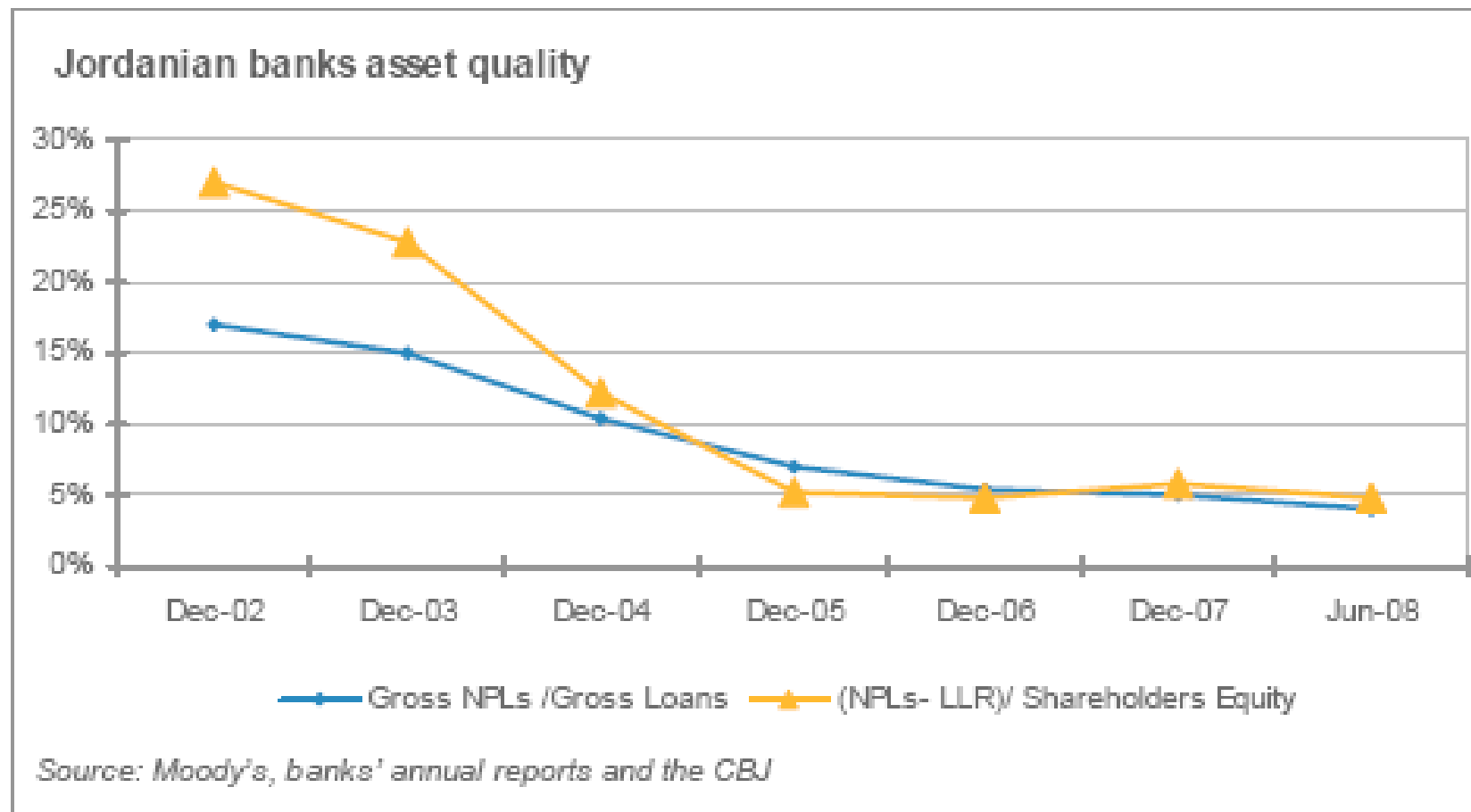
- A small and challenging operating environment combined with regional political instability
- Fierce competition within the market may have resulted in banks taking increased risks
- Delinquencies could increase as loan portfolios begin to season
- Exposures to the Palestinian territories carry significant risks
- Maturity gaps caused by the short-term maturity profile of deposits
- Corrections in the equity market and in real estate prices could have an impact on loan quality
- FDI withdrawals could have an impact on liquidity



# Jordan: imbalanced banking system

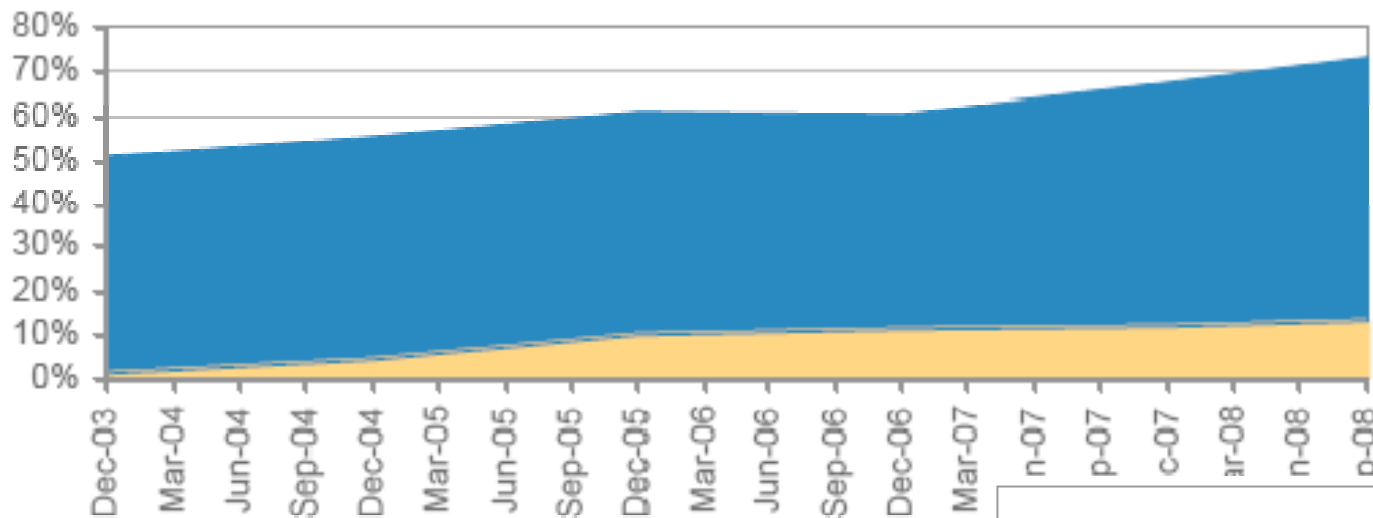


## Jordan: better asset quality...



# ... mitigated by increasing exposures to « hot » sectors

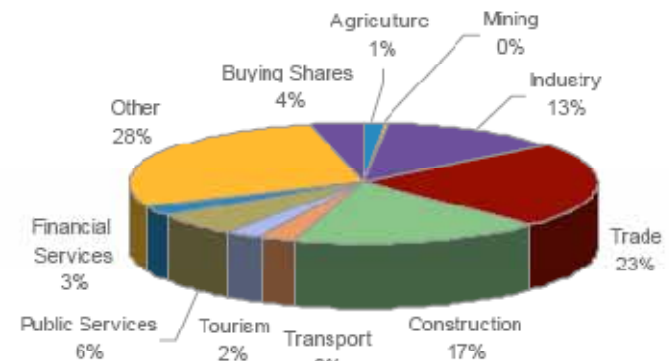
Jordanian banks exposures in "hot" sectors relative to aggregate equity



■ Construction and Real Estate loans % of Bank's  
 ■ Loans for investing in equities % of Banks' Total

Source: CBJ, Monthly Statistical Bulletin and Moody's calculations

Credit by sector (data as of Sept 08)



Source: CBJ, Monthly Statistical Bulletin



Moody's Investors Service



## 4. Islamic finance resilient to crisis... but how far?



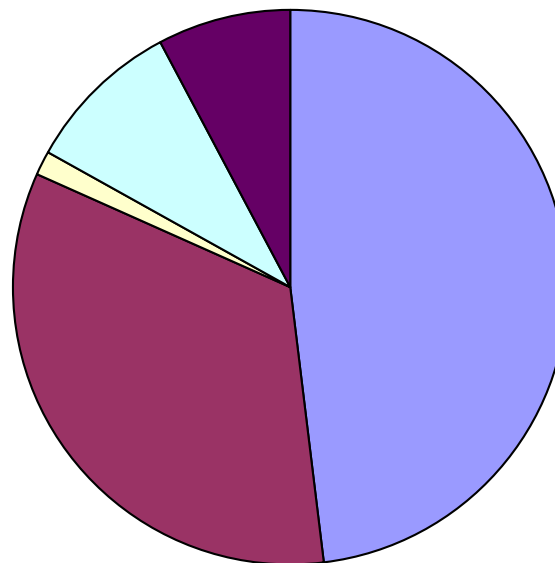
# Islamic finance: some key numbers

**First commercial Islamic bank**  
**Size of the market at YE2008**  
**CAGR**  
**Geographic distribution**  
**Sukuk market at YE2008**  
**Listed sukuk**  
**Issuance of global sukuk in 2006**  
**Issuance of global sukuk in 2007**  
**Issuance of global sukuk in 2008**

1975  
 \$840 bn  
 10% to 20% depending on asset classes  
 60% in the Persian Gulf, 20% South Asia  
 \$106 bn\*  
 c\$40 bn  
 +\$17 bn out of +\$27 bn  
 +\$14 bn out of +\$33 bn  
 +\$5 bn out of +\$15 bn

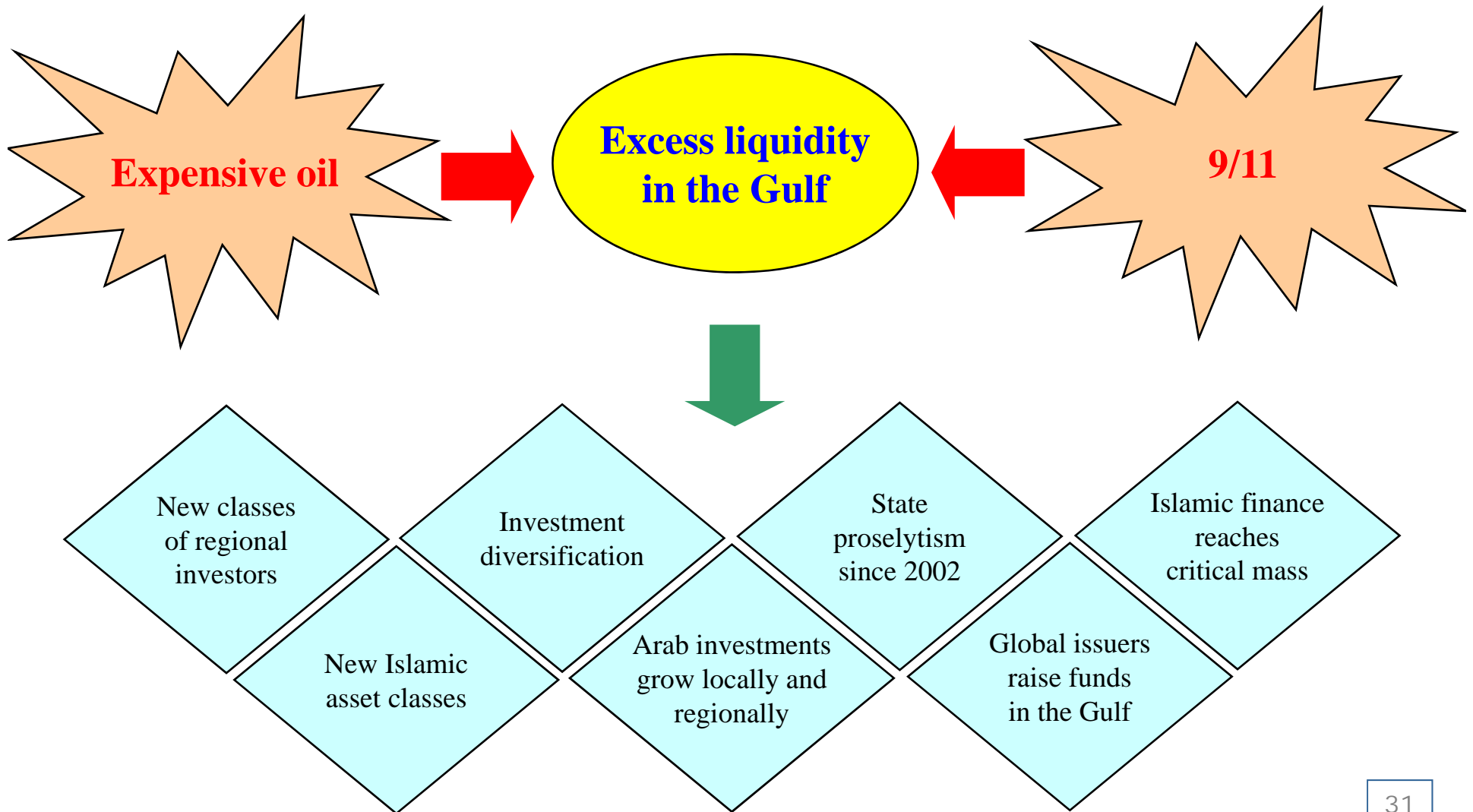
\* Two thirds in Malaysia

Breakdown of Islamic financial assets at YE2008



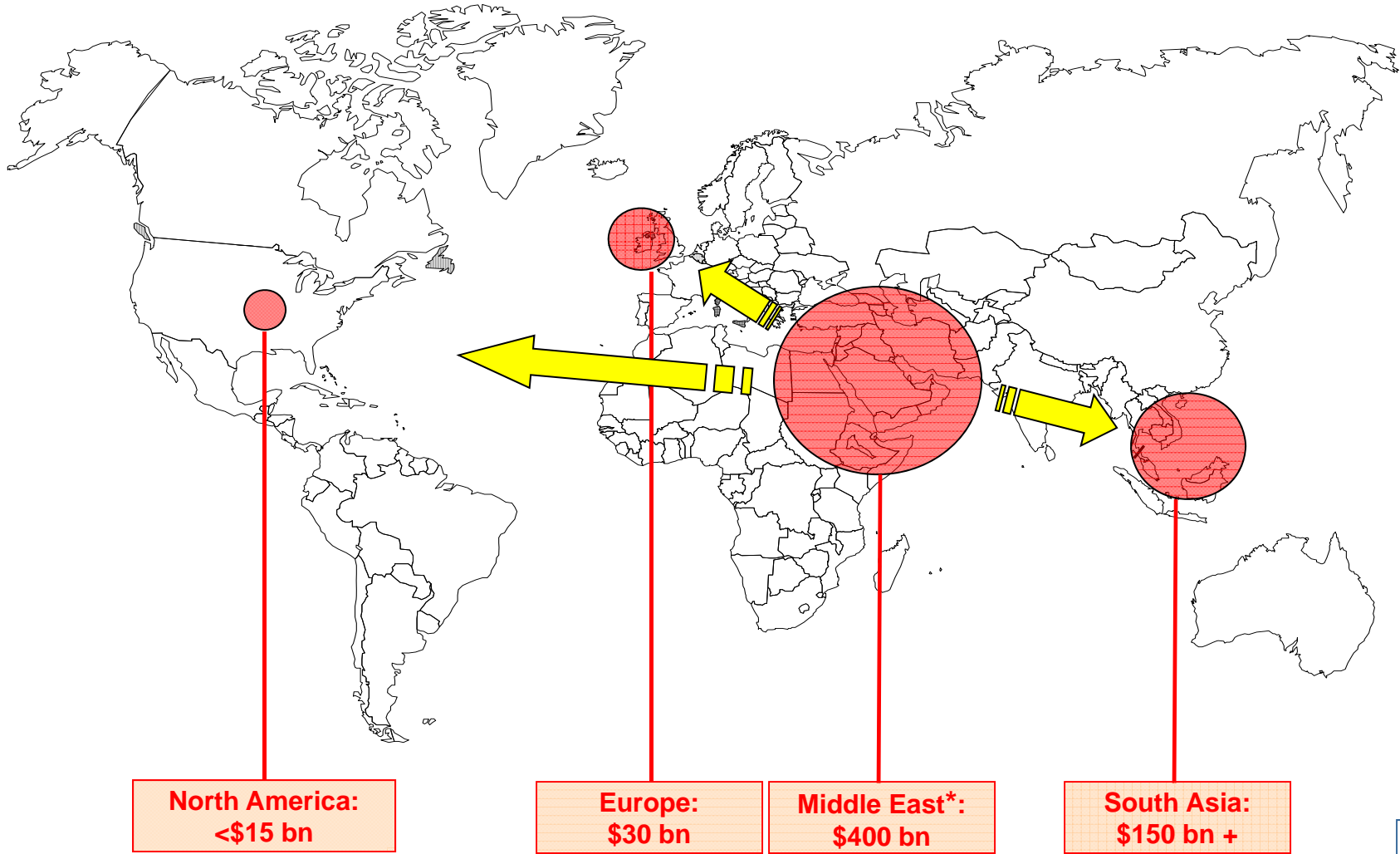
- IFIs' on-balance sheet assets
- Assets booked on conventional banks' Islamic windows
- Takaful companies' assets
- Off-balance sheet Islamic assets
- Islamic funds

# Historical perspective: the reasons of a rapid success



# Geographic perspective: relative size of submarkets

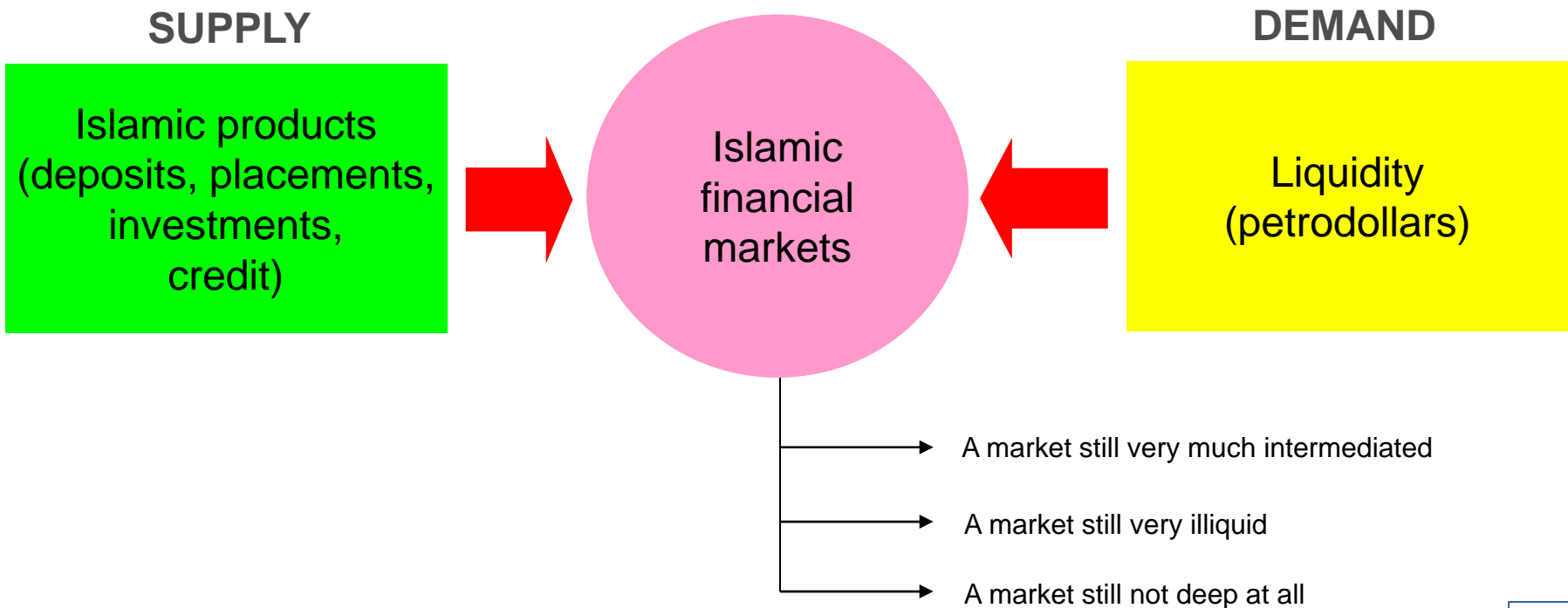
\* Including: Iran, Pakistan, Sudan and Turkey



# A market driven by demand

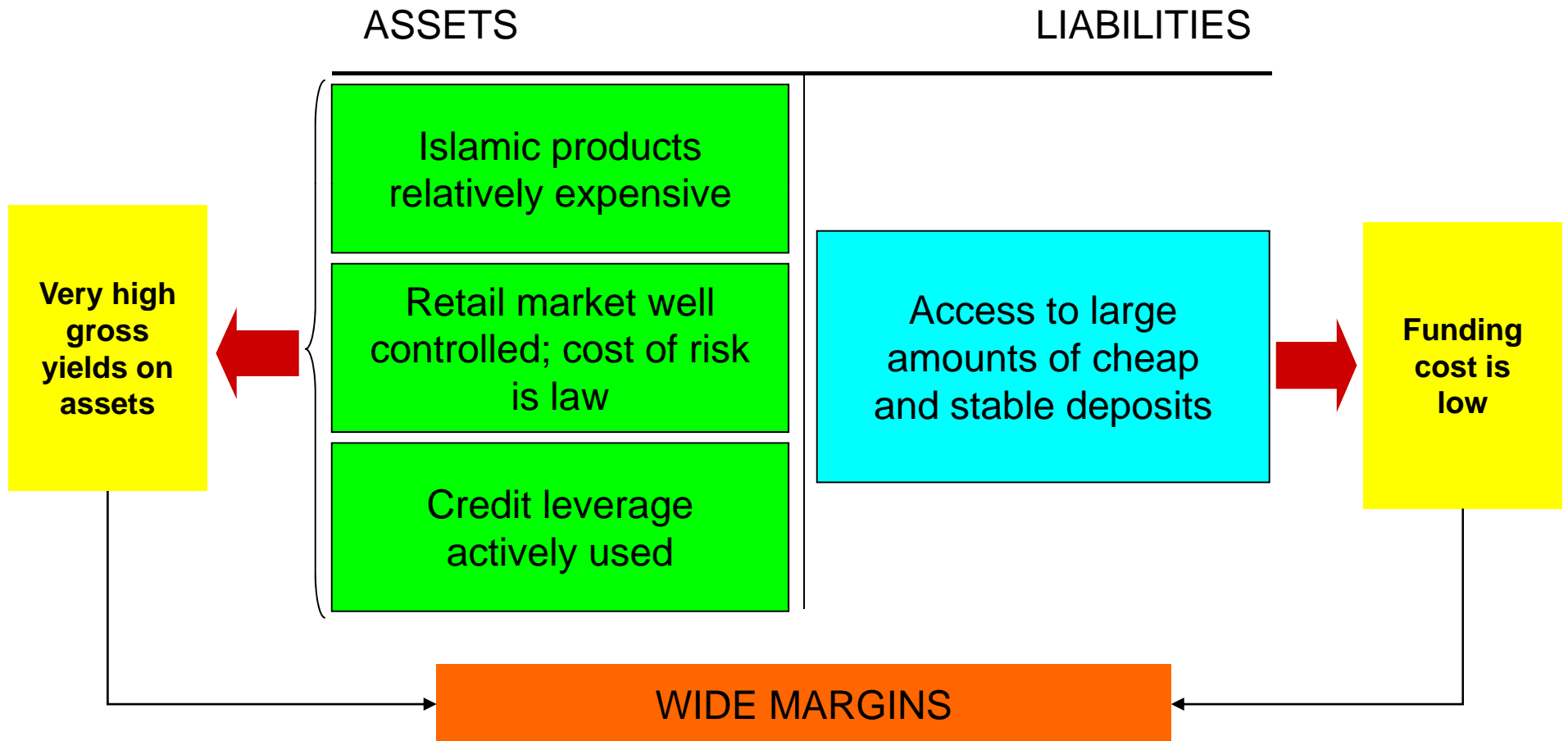
**Today, supply reacts to demand**

In the 70s, the supply of Islamic financial products created a latent demand, not clearly expressed. Today, the reverse is true...



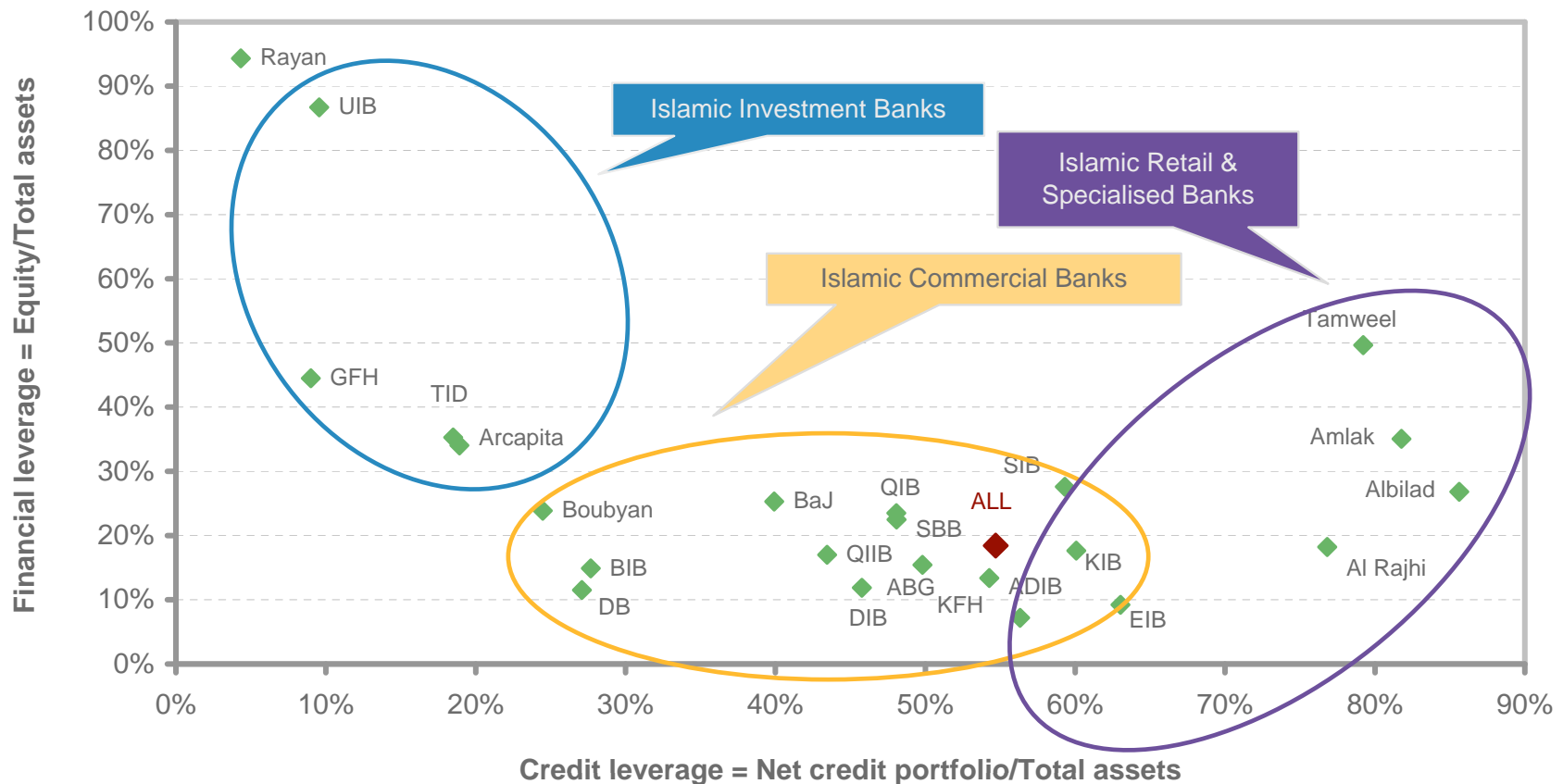
# IFIs are profitable and expected to remain so

## High profit rates: some explanation



# Growing specialization and business diversification of IFIs in the GCC

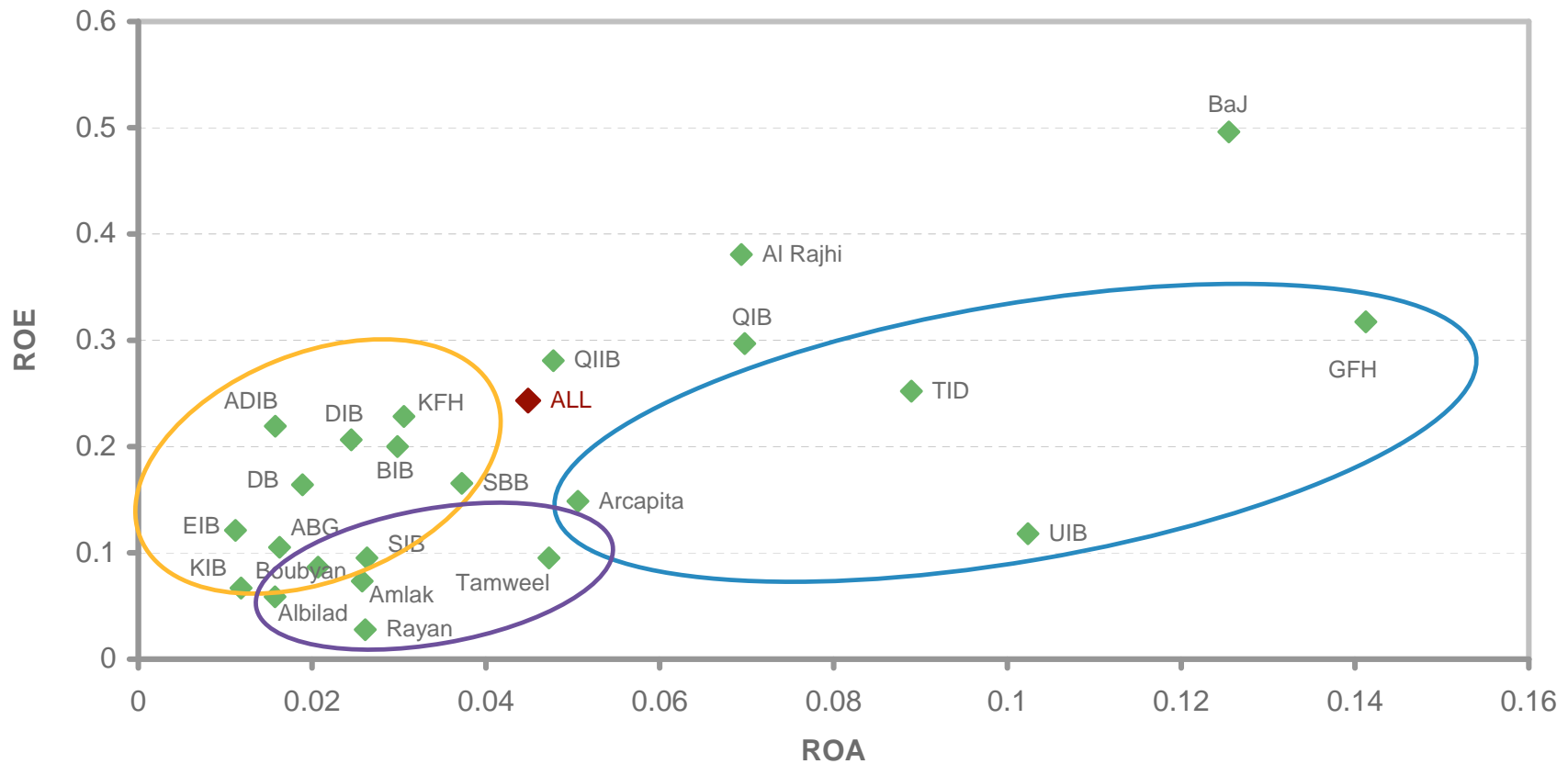
Credit vs. Financial Leverage Ratios for Islamic Banks Under Review (2006)



At Dec. 31, 2006

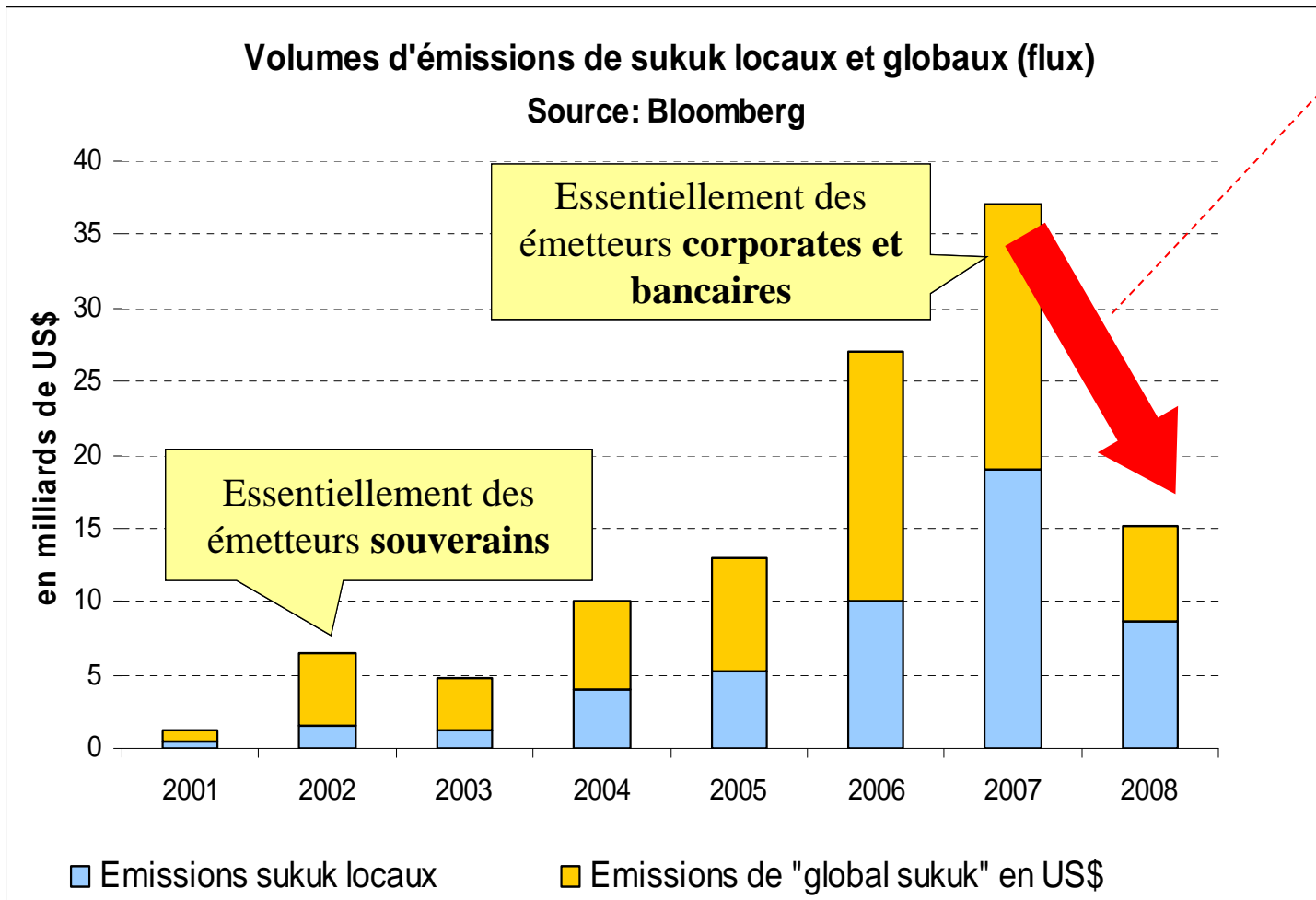
# Growing specialization and business diversification of IFIs in the GCC (2)

ROA vs. ROE for Islamic Banks Under Review (2006)



As at Dec. 31, 2006, excluding extraordinary income

# No man's an island...



**Subprime effect!**

- Volumes hit: \$150 bn by 2012.
- Diversification's key: new issuers; more complex structures; securitization.
- **But in the meantime, liquidity drought is pushing sukuk down**

## Where there any defaults?

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- Yes indeed, although relatively fewer.
- Global Investment House (Kuwait)
- The Investment Dar (Kuwait)
- East Cameron Gas Co. (Canada)
- More to come?
- Shari'ah-compliant investment banking model:  
illiquid and concentrated assets + wholesale,  
concentrated funding base = higher default  
probabilities