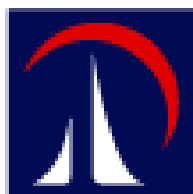


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# **Impact of the Global Financial Crisis on GCC- UAE's Banking Sector**

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## **Abstract**

The rationale behind this paper is to inspect the impact of the global financial crisis on GCC countries, UAE in particular & its banking sector. To assess the extent of that effect, this paper provides some comparison before & after the crises. Additionally, it examines the challenges & recommendations.

Whilst for various GCC the effects of the crisis have been considered to be mild compared to the rest of the world, its impact had been ruthless in some countries, including UAE. A lot of GCC countries have made an gigantic effort in strengthening their policy frameworks and sturdiness, thought-provoking a healthy economic growth, improving the sovereign wealth fund, foreign reserve, financial systems, and the account balance. But a lot are still considered being highly susceptible to a deep global downturn that is so very well linked to oil prices. This paper provides policy advice on how best to address the impact of the crisis on GCC countries, UAE banking sector specifically, and describes suitable measures & policies that should be adopted. It is crucial to set up managed financing facilities to help out sms's, the real-estate sector, the bank operations and industrial sectors, while making efforts to maintain and catalyze additional resources , if needed , from sovereign wealth fund and government bond issues.

## **Methodology**

This paper is a review of the published materials focusing on three distinct areas: the Impact of the global financial crisis on GCC, causes behind Dubai crisis and sub-prime lending, and its impacts on the economy of the UAE banking sector. Research was based on published articles, journals, UAE central bank data, in addition, other data were collected from formal authorities like IMF, BIS, & GCC central banks.

The findings divulge that the Dubai Crisis had a momentous responsibility on the UAE mortgage market and had impacts on the international stock markets. The findings also clarify the reasons and latent solutions to Dubai's debt and Global financial crisis connotation and implications.

## **The Global Financial Crisis**

The subprime mortgage crisis which started in the US in 2007 has developed into a packed international financial crisis which had harsh consequences on the GCC countries and their growth. All of the GCC countries have considerable assets in the US but most prominently, they have been hit by the increased costs of funding and liquidity problems in the middle of the crisis. After showing pliability in 2007 and remaining moderately unaffected by the global subprime turmoil in 2007, the GCC equity markets have endured much more than the markets in the US and other developed markets. Saudi Arabia and the UAE (Dubai), indices have declined more than 40 percent since the beginning of 2008.

Fuelled by admittance to very cheap credit, a housing bubble developed in the US from early 2001. Outstanding credit quantities increased profoundly. The Fed followed a low interest rate policy, whereas the banks marketed risky mortgage products forcefully and had increased the lending to subprime customers at reduced risk premiums. Home owners in turn got used to rising house prices and increased borrowing against their house values without any regard for the obscure risks. Finally, a growing securitization industry and the practice of putting assets in off balance Special Investment Vehicles (SIV) had led to the bubble, as rating agencies were contented and gave unrealistic ratings based on impractical model calculations. The first fractures appeared in 2006, with home prices declining in some segments and foreclosures increasing. The real eruption of the crisis began in March 2007 when more than 25 subprime lenders in the US declared bankruptcy, announced momentous losses, erupted themselves up for sale.

The major cause or the driving factor that had started the global financial crisis is the incapability of homeowners to make their mortgage payments, due chiefly to adjustable-rate mortgages resetting, borrowers overextending, greedy lending, speculation and overbuilding during the boom period, risky mortgage products, high personal and corporate debt levels, financial products that dispersed and possibly concealed the risk of mortgage default, monetary policy, international trade imbalances, and government regulation (Emmons 2008).

The origins of the 2007 financial crisis, which was the sub-prime crisis in the US, be related to the development of financial products such as residential Mortgage Backed Securities, Collateralized Mortgage/Debt Obligations and Credit Default Swaps (CDS) which were subjected to modest or no regulatory inspection for their systemic risk impact. So the financial crisis erupted in high-risk loans because numerous banks which are specialized in real estate sector gave a lot of loans to hundreds of thousands of citizens with limited income, with complete ignorance to the risk.

One of the strong causes of the global crisis was the collapse of the Lehman Brothers, one of the biggest financial institutions in the US, and its filing for bankruptcy on September 15, 2008 made an enormous loss of confidence in the credit and stock markets. In fact, these directed to an absolute blackout of the credit markets. However, the housing bubble was not defiantly not accidental, and it was accompanied by a credit mortgage bang, unwarranted leverage in the financial sector which is one of the main causes of global financial crisis, an era of low interest rates and easy money, multifaceted securitization of mortgage backed securities fuelled up by credit ratings boom, and many other derived factors.

## **The Impact of the Crisis on GCC Countries**

Subsequent September 2008, stock prices in the GCC have decreased hurriedly, so was the case with other developing countries. GCC total stock market capitalization chop down by about \$320 billion from September 10 to October 15, 2008 which is almost 38% of the joint GCC GDP for 2007. With rising dearth of global liquidity, the international financial institutions and the banks became more risk averse and the cost of borrowing at GCC augmented piercingly. Also, de-leveraging by foreign banks raised the cost and condensed the accessibility of liquidity dipping the demand for GCC assets.

GCC banks in general were moderately less impacted by the crisis than other banks of other countries, with the exception to a few banks in typically the UAE & Qatar. The profusion of financial resources for GCC, in addition to the preliminary macro intervention policies taken by their governments, ought to aid to mitigate the adverse impact of the current global financial crisis.

In addition, GCC banks were not as a great deal directly exposed to the securitized and structured financial products and thus were generally less impacted by the global financial crisis. Some of the mainly perceptible effects of the global financial crisis so far have not been caused so a great deal by direct exposure to structured noxious assets but in indirect form, as the GCC countries and their infrastructure and real-estate project finance markets have been affected by the growing costs of borrowing and the diminishing number of large credit finance banks. Hardly any GCC banks only have admitted in public their true exposure to Lehman Brother and the AIG fallout.

These types of exposures might have been in the form of bank bonds, structured investment products and derivative CDS guaranteed by companies like AIG or a bankrupt US investment bank. Nevertheless, bulky percentage of GCC assets is not managed by banks but is managed by Sovereign Wealth Funds, such as Abu Dhabi Investment Authority (ADIA) or Kuwait Investment Authority (KIA). The kind of investment in SWFs comprise a broad range of securities, however published data

about the type and compositions of the assets is not accessible and most sources report estimates only. While the direct subprime exposure of GCC banks has been narrowed, the genuine nuisance for the GCC banks lies in the indirect exposure to enlarged costs of funding amidst maturity disparities and credit exposure to local consumer, project and real-estate financing.

Earlier to the financial crisis, inflation was considered high and interest rates were low which led to huge negative real interest rates in the GCC countries and did not offer an enticement to save. There was a big deterioration in Dubai issued bonds which comprised a big share of the GCC bond market, as Dubai had borrowed expansively to finance its infrastructure and its development projects. There was also a very high value of credit default swap, in which Nakheel for instance, traded at nearly 2000 as of October 10, 2008 whilst the CDS for Saudi Arabia traded at 125. It is quite palpable that the CDS market in Dubai showed an amplified rollover risk, because the bulk of long term project funding have been financed with short-term funds, this maturity disparity placed further pressures in the existing tight capital markets.

The bond market for the GCC countries started to degenerate starting in 2007 with major projects in UAE and Bahrain had to be postponed because of critical market situations. The loan market in the GCC countries was harshly stressed just before the end of 2008 and began to ease a little in March 2009 as of several GCC government interventions and the issuance of SWF Bonds and liquidity injections. On the other hand, most foreign banks are still indisposed to expand their commitments as they face liquidity constraints in their home countries. Project cancelations, postponements and amendments had amplified in the fourth quarter of 2008 and first quarter of 2009. An expected \$39 billion in debt for the GCC had to be repaid or refinanced in 2009, and half of which came from the UAE single-handedly. UAE central bank was one of the first banks in the GCC to grant guarantee for bank deposits similarly to western banks in the US and Europe. In addition, GCC central banks, in the efforts to ease the credit crunch, injected liquidity as in the case of UAE, which provided Dh50 billion short-term facility to banks followed by a supplementary injection of Dh 70 billion on October 15 2008, ( UAE Central Bank, 2008).



## **Exposure of GCC Banks**

With an anticipated \$1.8-2 trillion in foreign assets by the end of 2008, of which about 60 percent were held in US dollar, the GCC countries must evidently be troubled about the asset depreciation.

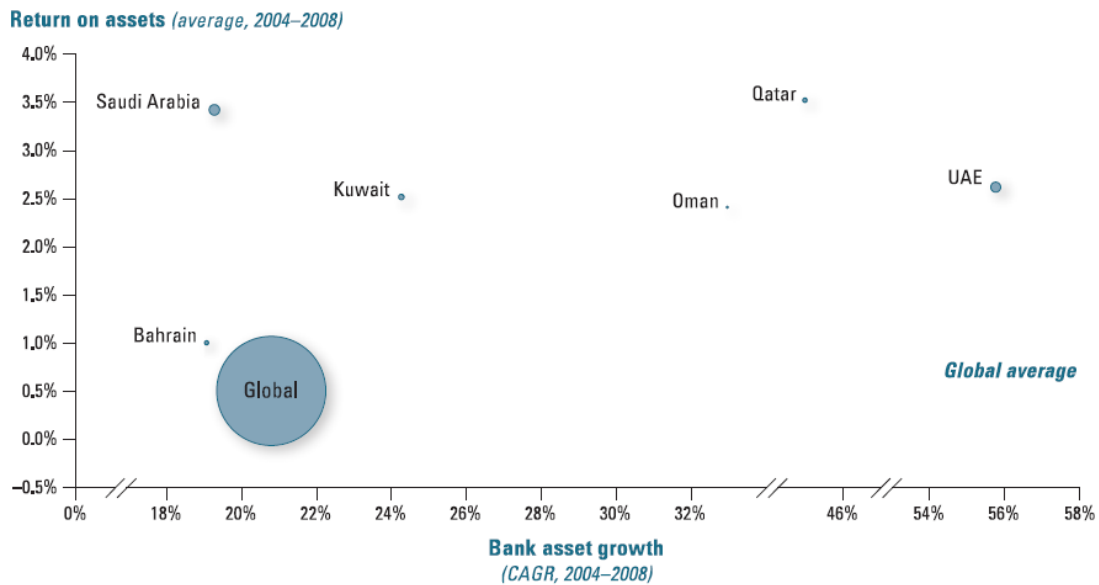
Abu Dhabi Commercial Bank has announced an exposure of \$272 million and has sued Morgan Stanley and other banks for erroneous recommendation in the case of an inopportune SIV deal. Bahrain's Arab Banking Corporation had to handle write-downs of \$1.2 billion; Kuwait-based Gulf Investment Corporation has announced write-downs of \$246 million at the end of 2007 and was expected to add an additional \$200 million; also Bahrain's Gulf International Bank was downgraded by Moody's because of the bank's holdings of US mortgage-backed securities. Although S&P believed that fundamentally Gulf subprime exposures are limited, it considered that banks may be hiding related losses. Among others, Qatar Insurance Company has also been connected with possible subprime losses.

The UAE Central Bank has asked UAE banks to declare their exposure to Lehman in the middle of the bankruptcy of the US banks, but not surprisingly, no public announcement by banks about auxiliary exposures has resulted from this measure. In mid September 2008, the UAE's Central Bank Governor Nasser Al-Suwaidi ruled out a systematic risk exposure of the UAE in the framework of the financial crisis in the US. The Saudi Arabian Monetary Authority (SAMA) was fast to proclaim that no solemn Lehman exposure of Saudi banks subsist, amidst somber doubts that with time passing, such exposure may well surface or in fact may be already there but is not being acknowledged. On the other hand, the Central Bank of Bahrain approved on September 17, 2008 in an interview with MEED that banks in Bahrain might be hauling exposure to Lehman Brothers but did not give any further details. Tawuniyya, the leading Saudi insurance company, has lost about two thirds of its worth since January 2008, sternly underperforming in an already shabby Saudi stock market.

All in all till now the announced subprime exposure of GCC banks of about \$2.7 billion seems to be minute compared to over than \$500 billion in Europe and the US. Fraction of this may be attributable to a lack of transparency with more exposure expected to surface over time, for sure; on the other hand, subjective evidence

suggests that GCC banks have been moderately conservative compared to their American and European peers. In many cases, the investment criterion of banks did not permit the purchase of non-investment grade bonds or complex structured products and infrequent lack of sophistication may have proven to be valuable for some banks, now that such products are considered factually discredited.

### Profitability & Asset Growth: Top 10 GCC vs. Global banks



Source: GCC Banks: On the Road to Maturity, AT Kearney, 2010

Foreign claims on GCC as of June.2011 by nationality of reporting banks, USD billion

	Japan	USA	Europe	World
Bahrain	1.0	3.1	13.6	19.0
Kuwait	0.8	5.8	9.2	16.5
Oman	1.1	0.2	7.1	8.6
Qatar	6.7	2.8	37.9	49.0
Saudi Arabia	3.8	4.1	56.0	64.8
UAE	8.7	15.6	94.9	127.3
Total	22.0	31.7	218.7	285.1

*Source: Dubai Chamber Economic Research based on data from the Bank of International Settlements (BIS)*

## **Brief History of the UAE Banking Sector**

The UAE banking sector started to witness valid expansion when the exploration of oil reserves started in the early 1960s. At the time, new banks were entering the country. The rulers of the UAE stepped in as the regulators in 1975 and banned the opening of any new foreign banks in the UAE for a two-year period. In 1980 the Federal Currency Board had changed and became the Central Bank of the UAE and put a new law in place which empowered the Central Bank's functions. In 1981, the licensing of new banks was allowed again and a lot of banks throughout that period were entering the market. However, in the mid-1980s, several banks failed due to disregard and fraud, as a result of collapsing oil prices and a real estate collapse resulted in high non-performing loan levels. In 1984, the Central Bank of the UAE decided, for the second time, that it would not bestow new branch licenses, and already operating foreign bank branches were limited to only eight branches each. The Central Bank also took quite a lot of actions in the 1980s to strengthen the banking formation through expanding audits and inspections, rising bank-reporting requirements, creating a computerized loan risk subdivision, and setting minimum capital requirements. In 1998, the Central Bank established a particular unit to just monitor the money-laundering activities and inspect any suspicious deals. Till date, the UAE central bank is doing its best to control UAE's banking sector, specially after the crisis.

In 2006, UAE outperformed most among its peers in the MENA region in terms of loan and deposit growth. The UAE's banking sector entirety assets reached AED860 million (US\$234.3 billion) in 2006, creating the leading asset base in the region, exceeding Saudi Arabia (which was beforehand the largest asset base) having SAR861.1 billion (US\$230 billion) in banking assets in 2006. In addition, the UAE had a higher than MENA average loan/deposit, loan/asset and loan/GDP ratios in 2006.

The key ruling families in the UAE, namely the Al Nahyan and Al Maktoum families, and the governments of Dubai or Abu Dhabi do hold the larger part stakes in approximately all of the UAE's most important local banks. For example, the Abu

Dhabi Investment Authority owns 73% of the National Bank of Abu Dhabi and 64% of the Abu Dhabi Commercial Bank. Also, Dubai Islamic Bank is 30% owned by the government of Dubai. Union National Bank is partially-owned by both the governments of Abu Dhabi and the government of Dubai. Mashreqbank is owned by the AlGhurair family, which is as well considered one of the biggest family businesses in the UAE. I believe that this type of focused ownership raises corporate governance concerns. A lucid concern is that it promotes high levels of interbank transactions, explicit name lending and credit attentiveness. It is also considered to be an unfair ground for competition, where these banks get hold of easier access to government projects & many other facilities than other banks just because of their big name.

## **Dubai's Debt Structure**

The government of Dubai's outstanding direct debt is at present put at \$31.4 billion corresponding to 38% of the Emirates GDP. Over half of this (\$18.5 billion) is debt taken on to finance the Dubai Financial Support Fund (DFSF) which has used the money to provide finance to Dubai's stressed government enterprises (GREs), specifically Dubai World & Nakheel. In theory these GRE's have until 2014 to repay the DFSF through sales of assets and their own revenues. This should permit the government to meet the \$20 billion spear in debt repayments in 2014 when its borrowings to fund the DFSF mature.

Another \$6 billion of the outstanding full amount represents holding company level debt of the Investment Corporation of Dubai (ICD) Of the \$6 billion owed by the government, \$4 billion was due this year. On the other hand, agreement has just been reached to refinance \$2.8 billion over 5 years, having ICD repaying the remaining \$1.2 billion. The original loan was taken out in 2008 and had been earmarked for acquisitions, but as an alternative has been drawn down to offer emergency liquidity to the government as the financial crisis struck.

The government of Dubai also has direct contingent liabilities estimated at \$7.6 billion related to guarantees for DEWA (\$3.6 billion) and RTA (\$1.8 billion), as well as \$2.2 billion under a deficit guarantee relating to the restructuring of DW. Including these guarantees, Dubai government debt is advanced at \$39 billion equal to more than 47 percent of the GDP, though the expectation is that the government will not require covering these contingencies.

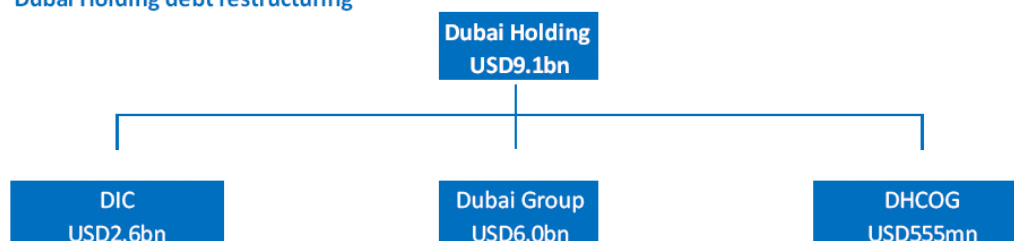
The government's present debt level appears to be manageable with respect to usual indicators of debt to GDP, and the sovereign should be a hard credit risk. However, the debt repayment burden is great given the government's limited fiscal revenues of around \$8 billion a year, and that the budget is running a deficit of \$1-1.6 billion a year. Interest payments have risen from zero in 2007 to \$2.4 billion in 2010 according to the IMF data.

It is therefore serious that the government continues to have access to capital markets at sensible rates and takes measures to strengthen its fiscal accounts. In addition, improvements in GRE finances will be the key to the long term financial health of the emirate, and their repayment of the DFSF as planned is essential to steer clear of the

otherwise unaffordable spear in government repayments in 2014. Nevertheless, it seems more probable that the government will extend repayments due and seek out to roll over the \$10 billion notes held by the central bank, and perhaps the financing from Abu Dhabi through its banks.

In the middle of a challenging operating environment, two major groups have announced having their debt restructured. The first being Dubai Holding (DH) with circa USD9.1bn (AED33bn) of bank debt and the other was the Al Jaber Group (AJG) of Abu Dhabi with approximately USD1.6bn (AED6bn) worth of debt that needed to be renegotiated.

#### Dubai Holding debt restructuring



Source: Bloomberg, Various newspapers

	Dubai Holding	Al Jaber Group
ADCB	<ul style="list-style-type: none"> <li>Likely to have large exposure.</li> <li>Likely to be less than exposure to DW (AED6.7bn).</li> </ul>	<ul style="list-style-type: none"> <li>Has exposure since it is present on restructuring board.</li> <li>Bank is very active in corporate segment.</li> <li>Extent of exposure is not known.</li> </ul>
ENBD	<ul style="list-style-type: none"> <li>Has exposure to 2 out of 3 groups.</li> <li>Likely to be large; present on restructuring committee.</li> <li>Likely to be smaller than exposure to DW (AED9bn).</li> <li>Bank has already included at least AED3bn to its NPLs related to DH in 4Q10.</li> <li>Bank has taken general provisions to the tune of AED600mn in anticipation to this exposure</li> </ul>	<ul style="list-style-type: none"> <li>Likely to have less exposure, if any since Al Jaber is Abu Dhabi based.</li> <li>Exposure is not disclosed as yet.</li> </ul>
FGB	<ul style="list-style-type: none"> <li>Very likely to have exposure.</li> <li>Likely to be less than exposure to DW (AED880mn).</li> </ul>	<ul style="list-style-type: none"> <li>Very likely to have exposure since it is amongst the large banks of Abu Dhabi.</li> </ul>
NBAD	<ul style="list-style-type: none"> <li>Likely to have some exposure.</li> <li>Likely to be less than exposure to DW/related entities (AED1.3bn).</li> </ul>	<ul style="list-style-type: none"> <li>Exposure confirmed by fact that it is chairing the restructuring committee.</li> <li>Participated in financing purchase of jets by Al Jaber Aviation amounting to USD42mn</li> </ul>
UNB	<ul style="list-style-type: none"> <li>Presence on restructuring board means large exposure can be expected.</li> <li>UNB has so far not disclosed its exposure to DW, let alone DH.</li> <li>Market rumours point at an exposure of AED1 – 1.5bn to DW.</li> <li>Likely to have similar or less exposure to DH.</li> </ul>	<ul style="list-style-type: none"> <li>Also present on this restructuring committee therefore significant exposure cannot be ruled out.</li> <li>Market rumours point at exposure of AED700mn to AED900mn.</li> </ul>

As per Mr. Mohammed Al Shaibani (Vice Chairman of Dubai’s top fiscal body and the director of the Dubai Ruler’s Court), 70% of the banks involved in the restructuring of DH are the ones that were originally involved in Dubai World. It can thus be concluded to a level of confidence that most banks will have various

exposures to this group. While none of the UAE banks have disclosed the extent of loans given to DH, at least ENBD has been impending to some extent about its exposure. Remarkable, the prime mass of restructuring belongs to Dubai Group (USD6bn out of USD9bn equals around 67%). Al Jaber Group is a well-known conglomerate belonging to Abu Dhabi that is seeking restructuring of loans worth of AED6bn. Given the size of the group and its diversification through businesses, it is highly probable to have noteworthy exposure to at least all of Abu Dhabi based banks. The CBUAE issued a thorough circular related to retail banking lately, placing certain restrictions on lending quantity and the fee generated from this sector. These regulations are expected to hit all banks in broad and banks with larger retail exposure in specific, case in point being FGB. The impact will be three fold; initially and keeping in mind that retail loans are high yielding, it will limit loan expansion in the sector which will in turn signify smaller interest income generation on incremental business. Secondly loans which were by now exceeding the new defined limits will not be topped up once they mature or are paid off; the impact of which might offset or go beyond the impact of new business creation. This basically means, retail loans might in fact see a decline. Thirdly, and most significantly in the short term, banks will lose a fraction of their fee income coming from this sector; the occurrence of which will be on outstanding as well as incremental loans. The extent of the impact can be gauged from the reality that banks on an average earn fees in the range 2 – 4% on their retail portfolio yearly.

Transparency is absent when it comes to Dubai's debt condition. Official data about the consolidated gross debt of the government and the companies it owns is not officially published.

In November 2009, Moody's gauged this debt load to be between \$80 billion and \$100 billion, the IMF put this number somewhat higher in February 2010 at \$109 billion.

These numbers have been in doubt, especially the estimate of up to \$24 billion possible exposure of Emirates Bank NBD to Dubai Inc. entities, which appears barely reconcilable with publicly available data about the bank's general outstanding loans and liabilities.

The broad variety of the estimates reveals substantial uncertainty, especially with regards to bilateral loans of local banks. In February 2010, Moody's estimated the



general exposure of local UAE banks to Dubai World alone to be \$15 billion. Given Dubai's GDP of \$82 billion, debt load estimates symbolize between 100 and nearly 200 percent of the GDP.

The restructuring of Dubai World will relate only to a portion of this debt and only to the holding company and two of its real estate subsidiaries, Nakheel and Limitless. Dubai Ports World (DPW) and Jebel Ali Free Zone (JAFZ) have been exempted from the restructuring.

Dubai World's liabilities amount to an extensively \$59 billion. However, this number refers to liabilities, not debt instruments alone but also unpaid contractor bills or land grants, according to Deutsche Bank. The amount of debt proper has been estimated to be \$22 billion-\$24 billion, and on the eve of further announcements, Barclay's assumed that \$18 billion of this amount would be part of the restructuring course. After a nerve-wracking weekend without detailed information, Dubai World lastly specified that a higher amount of \$26 billion of debt will be restructured.

With regard to the overall debt load of Dubai, two main factors are troublesome: First, the maturity of outstanding debts is very short term. From 2010 to 2012, \$50 billion of debts are due, \$12-\$13 billion in 2010 and a staggering \$25 billion in 2011 alone. Dubai needed to refinance this debt at considerably higher costs, as markets have dropped their supposition of an understood government guarantee. Secondly, there is an extensive amount of bad debt, which is not backed any longer by viable assets or any kind of business models. As per Moody's estimates this bad debt may perhaps amount to \$25 billion. Eventually someone will need to take this loss in a bailout or a restructuring & this is what happened. Banks received tradable securities with maturities of five and eight years for their outstanding principal, with sub-commercial levels of interest payments that are still under concession.

Suppliers received a cash payment of Dh500 (\$135), which satisfied a lot of the smaller contractors. The larger companies received only 40 percent of their receivables and will get paid the remaining 60 percent in the form of a "tradable security" with a maturity of five years, whose specifications are still under concession as well. The Dubai World owner, Dubai government, injected \$9.5 billion into the company; \$5.7 billion have been from the earlier \$10 billion bailout bond of Abu

Dhabi and another \$3.8 billion came out of the pockets of the Dubai government itself.

Overall, the suggestion has been received positively by stock markets. In May 2010, a deal was cut with a foundation group of seven primary creditor banks which held 60 per cent of the \$14.4 billion debt of the Dubai World holding company. Lastly, on September 10, an official agreement with 99 percent of the creditors was reached thus avoiding costly lawsuits and arbitration procedures. Only one US fund continued to oppose the agreement which commits to restructuring a total of \$24.9 billion, including \$10 billion that are owed to the government of the UAE. Property developer Nakheel would negotiate its \$10.5 billion of bank loans and unpaid bills separately and would be split from the conglomerate as part of the restructuring proposal.

Dubai Holding, a large conglomerate owned by the Dubai ruler personally, is also at the beginning of negotiating a restructuring of its debt. Its non-financial arm asked for a deferring of loan payments for a second time in September 2010.

## **The Impact of the Crisis on Dubai & it's Banking Sector**

Flanking the Global financial crisis, Dubai's debt exists as an essentially important facet of modern economy. Set against a huge backdrop of fluctuating stock prices, an unbalanced real estate market and a vague world economy, assumptions about the future of Dubai is prevalent, despite Dubai originally appearing to tolerate the global financial crisis. Foreign banks had beforehand pumped noteworthy amounts of money into Dubai as loans and investments, knowing that they would undergo huge losses if Dubai defaulted on its debt.

The main root grounds of the recent financial crisis lies with the granting of extreme expensive loans and a deficiency of conformity to regulations connected with that facility. It is a basic rule that loans boost the cost of capital, which inexorably increases both load and company financial commitments. Thus putting an implausible risk and have proved active in the case of Dubai world (DW) unwarranted facilities and the recent global subprime mortgage crisis.

Moreover, lending banks and financial institutions surrendering these facilities risk bankruptcy in those cases where borrowing companies are themselves made bankrupt. In this case, lending banks are left not capable to recover their money from heavily indebted companies.

It seems apparent that the Dubai's debt and mortgage crisis is a development of the US/European financial crisis of 2007 and 2008. As a result of this global financial crisis, most of the region's financial markets have drastically declined. This is due to mass surplus liquidity in the GCC countries that are born out of the 'oil boom' of recent years, yet this 'surplus liquidity' is not enjoyed crossways the UAE. It is quite noticeable now that Dubai had become greatly indebted alongside a backdrop of regional economic growth carried by revenue from oil, investment in real estate, housing and tourism rather than by any other productive activity.

Towards the end of 2008, the global financial crisis had reached its crest in the developed countries and started to spill over to emerging countries like Dubai. During 2009, the crisis overwhelmed Dubai economy and its horrid impact was felt in most sectors of Dubai economy such in construction, real estate, trade, hotels and restaurants. All those sectors witnessed a negative real growth in the first quarter, the

first half, the third quarter and the whole of year of 2009 compared to the same times period in 2008. Towards the end of 2009, 10,500 employees were made unneeded as part of a restructuring plan carried out with the help of Deloitte consultants (Twin, 2009). At that time, Dubai World had debts totaling to \$59 billion, including a US\$3.5 billion loan which the company had been obligated to default (Nasser, 2009). Research showed that this figure (US\$3.5 billion) in fact accounted for almost three-quarters of the UAE's total debt of US\$80-billion debt (Smith and Kiwan, 2009).

Originally, the government of Dubai had refused to guarantee the debt of Dubai World (DW) due to the spiky plunge in the stock market of both Abu Dhabi (8.3%) and Dubai (7.3%) to the lowest levels in over 12 months amid the fake belief, on the part of creditors, that Dubai World (DW) exists as part of the government (Guillén, 2009). With this snub, a global panic started as it had confirmed the fake belief and that the company would now be not capable to immediately pay its creditors.

In order to lend a hand to Dubai to manage its debt, Abu Dhabi had stepped in by offering US \$10bn to the Dubai government from which it took US \$4.1bn to bail out government-owned Dubai World (DW). Similarly, Nakheel received US \$8 Billion from the Dubai Government, mounting total financial support to about US \$9.5 billion and enabling it to pay contractors and guarantee project completion. The Dubai government has pledged to employ this money to help the owners of Nakheel and Dubai World to restructure their debt. The company has made it clear that support for Nakheel is conditional on a recapitalization plan settled with its creditors, within which Nakheel will receive an initial \$1.5 billion to pay contractors to prolong building near-term projects.

The demand by Dubai World (DW) to extend its creditor repayment deadline (\$59 billion to be paid by the end of May 2010), besides the abruptness of the announcement, resulted in an adverse reaction within global financial markets. The mode of which the announcement was made in such speed had resulted in a breakdown to distinguish delay from default.

The reason for this dread although it is beyond doubt that the Dubai real estate market has been enjoying a boom supported by the steady demand in the oil industry and international trade relationships; the primary problem is the lack of buyers within the market and the succeeding risk evading displayed by investors. However, due to the crisis affecting other countries as well, both in real estate and tourism, for Dubai to face this major reduction in real estate investment that had incurred its own industrial

debt is not a peculiar default. Debt particularly in this industry was expected due to the reality that most of the projects have been funded by banks and institutional loans. The Dubai economy weakened even more by its decision to go after non-oil producing countries, such as Japan, as role models for the management of their own with other resources including tourism, trade and real estate now existing as high-risk sectors following the global financial crisis. Abu Dhabi relied profoundly on its oil and gas reserves as Abu Dhabi's oil resource constitutes more than 90% of the UAE's total oil reserves and almost 8% of the global reserves (IMF, 2005, Abdelal, 2009). The Abu Dhabi Investment Authority, is the world's largest sovereign wealth fund. The ADIA wealth is fundamental to Abu Dhabi's economy in regards to financing as a range of economic activities in the industrial, commercial and real estate sectors are reliant on it.

Though, special attention was paid to the real estate sector because of its close relation to the economic development and population growth.

Dubai has attempted to branch out its resources by establishing a number of construction companies and a variety of produce companies by encouraging those businesses to be mainly contingent on foreign currencies and support.

It is a fact that the UAE is the largest country dependant on real estate and construction in the GCC and for the reason that Dubai depends on real estate and construction for investment more than any other; it became a gradually more high risk area.

UAE Banks have enjoyed complete backing of the central bank and federal government during the global financial crisis. More lately, the central bank has introduced an extra liquidity facility, even though banks have not seen strange deposit outflows in the after effects of the announcement. Banks' liabilities (deposits and interbank loans) have been under a 3-year federal government guarantee from the time of September 2008. Depending on the terms of the debt restructuring and individual bank exposure to DW, some banks might necessitate an additional capital injections, perhaps from the government. The federal government still has \$5.5 billion left for bank capital support under a program of \$19 billion introduced post-Lehman.

After the November 25th announcement from Dubai World (DW), the NASDAQ Dubai fell by 10.29 %, while the Abu Dhabi Securities Exchange fell by 11.68 %.

Dubai's debt resulted in falls in the FTSE of 1.4 %, the Nikkei of 1.44 %, the Dow Jones of 2.14 %, the DAX of 1.59 % and the CAC 40 of 0.51 %, while the markets of the UAE have continued to be affected by Dubai World's debt issues.

The Islamic banking sector in Saudi Arab and UAE has not been affected that much by the global financial crisis as it sticks to the rulings of Islamic Shariah.

In 2009, Moody's had downgraded ratings of DP World, DIFC Investments DIFC Investments, DEWA Dubai Electricity and Water Authority, JAFZ Jebel Ali Free Zone, Dubai Holding Commercial Operations Group (DHCOG) and DIFC.

The downgrade includes the following rating changes:

- 1 - DP World issuer and debt ratings were downgraded to Baa2 from A3.
- 2 - Dubai Electricity & Water Authority issuer and debt ratings were downgraded to Baa2 from A3.
- 3 - DIFC Investments issuer and debt ratings were downgraded to Ba1 from A3
- 4 - Jebel Ali Free Zone (JAFZA) issuer and debt ratings were downgraded to Ba1 from Baa1.
- 5 - Dubai Holding Commercial Operations Group (DHCOG) issuer and debt ratings were downgraded to Ba2 from Baa1.
- 6 - Emaar Properties issuer ratings were downgraded to Ba2 from Baa1. (Sambidge, 2009, DIFC, 2009).

The rating action reflects the announcement by the Dubai government of a restructuring approach for Dubai World, including a requested halt on all financing to Dubai World and its subsidiary Nakheel (DIFC, 2009).

The effects of the financial crisis will surely continue to be felt in Dubai, but not as brutally as in Europe and America. The main reason for this lies in the position of gulf as a developing economic hub and, for its sizeable oil resource and the guaranteed global demand for its provision, which allows the government to continue to fund multiple organizations and development of projects.

Stock market indices crossways Arab countries suffered a jump down of more than 50% between their peak in mid-2008 and their trough in early 2009, incurring a loss of between US \$200 billion and US \$600 billion; these losses were chiefly high in oil producing countries, with Dubai the worst hit. In a parallel decline, the stock market

suffered drops in the majority of Arab countries in mid-2008 as a result of the Global Financial crisis.

During Dubai financial crisis no bankruptcy happened as a result of the debt problem in the two big companies in Dubai (Dubai World and Nakeel), & no bankruptcy happened in the banking sector in Dubai, unlike the many bankruptcies that happened in the US during the financial crisis.

The crisis in Dubai had resulted in the loss of jobs, and a loss of foreign business to the emirates, as well as a loss of investment into the real estate sector where the impact of low real estate prices is most.

Dubai-based companies & banks will avoid bankruptcy for the following reasons:

- State-linked Dubai World's property and investment assets exceeded \$120bn at the end of 2009; a figure which would serve to cover its debt (Walid, 2010)
- The UAE has more than US \$ 500bn monetary reserves, according to IMF.
- The UAE own budget-backed oil revenues
- Dubai has the financial support of the wider UAE, which has a vested interest in preserving those companies owned by Dubai's government and the assets of Dubai World (DW).
- The UAE has one of the highest GDP per capita in the world.
- The UAE economically has a good advantaged in its oil revenue, as well as the investment and trade sectors.

As noted above, the United Arab Emirates holds the seventh largest oil reserve in the world and possesses one of the most developed economies in the Middle East(CIA, 2010) (C.I.A, 2010).

The declaration of Dubai World's debt restructuring scheme in March 2010 was handled much more efficiently. A pending question was whether employees at many Dubai Inc. entities were experienced enough to handle a crisis of such extent.

It would be deceptive to reduce the Dubai debt crisis to the ethical failures of individuals. Crises of this scale are not brought about by individual failures but by the

instability of capitalist development and infectious exuberance that is dissonantly evocative of earlier boom-bust scenarios.

Dubai's economy is conquered by Dubai Inc., a web of commercial corporations, financial institutions, and investment arms owned directly by the GD or the ruling family under the umbrella of three major holding companies (Dubai Holding, DW, and the Investment Corporation of Dubai). Each of these holding companies includes numerous property developers and is involved in various property ventures in Dubai and around the globe. They also have momentous operations in trade and services (for example in ports, logistics, transportation, and tourism), which maintain to do quite well.

Dubai Inc. borrowed lengthily in 2004–08 to fund a main push into the commercial and the residential property. A major increase in leverage happened, followed by a real-estate bubble.

Between 2004 and 2008, liabilities to global banks as a ratio to non-oil GDP more than doubled as did the local credit to nonoil GDP. Credit growth was amongst the fastest in emerging markets, with U.A.E. banks extending almost \$100 billion of credit in surplus of the historical trend. Banks remained highly rated right through the period, shimmering government ownership or implied government backing.

The implications of the Dubai crisis are still unfolding, as it will take some time for the GD to extend a strategy to reform its corporate sector. The investigation is complex due to the lack of information on DW's and many Dubai GREs' financials. A full-fledged restructuring may perhaps engage operational restructuring, asset sales, debt relief, or equity injections. It possibly will also need further financial support from Abu Dhabi or the federal government, on a case-by-case basis, as external funding for Dubai is probable to become more expensive and limited. Almost about \$50 billion of bonds and syndicated loans to Dubai-based non-bank entities are likely to descend over the next three years.

The mainly observable effects of the global meltdown have not been caused by direct exposure to distressed assets, but in fact on an indirect form, as the UAE and regional project financing market have been affected due to the credit clutch and rising costs of borrowing. Dubai, being the heart of plentiful projects and totally reliant on international financing, has been hit the hardest. Nevertheless, a small



number of commercial banks in the UAE have openly declared their exposure to the sub-prime crisis.

In mid-September 2008, UAE Central Bank Governor Nasser Al-Suwaidi ruled out a systematic risk exposure of the UAE in the framework of the financial crisis in the US.

The genuine trouble for the banking sector was due to their indirect exposure to augmented costs of funding amidst maturity disparity and credit exposure to local consumer, project and real estate financing. A key reason for this distraught scenario is the corrosion of Dubai related credit that constitutes a large part of the GCC bond market. The Emirate borrowed expansively to finance its development projects, and “Dubai, Inc.” companies were amongst the majority well-known issuers in the GCC. While on October 10, credit default swaps for Saudi Arabia traded at 125, for the UAE at 174, for Samba at 265 and for Abu Dhabi National Bank at 216, Emirates Bank and Dubai Ports World traded at 580 and Nakheel signaled harsh concern on the part of investors as it traded close to a astounding 2000 amid qualms about its sukuk, which was to expire in December 2009. According to JP Morgan Dubai had to refinance \$16 billion of total debt in 2009. The CDS market evidently shows increased anxiety about debt funding of local projects and the real estate market. As a huge quantity of long-term projects have been financed with short-term funds, this maturity divergence put extra pressures in existing tight capital markets.

The UAE banking sector profits witnessed two consecutive years of profitability turn down in both 2008 and 2009. Since the crisis had struck in the closing quarter of 2008, banking profits fared better off with a trivial decline. The year 2009 however felt the actual impact spilling over from the previous year, with profits descending 21% YoY. Facing one problem after another, starting from a distressed economy, liquidity tightening worsened by upcoming debt maturities, investment impairments, the Sa’ad & Al-gosaibi default, abrupt & extreme retail defaults, the banking sector felt the final shake in the ending months of the year, when the Dubai World (DW) announcement was made. Despite the challenging environment, the banks’ top-line (net interest income) still grew by a superb 26% YoY, indicating that troubles were mainly asset quality related.

The NPLs ratio for UAE banks were at 3.0% in 2009, up 150bps from 2008; ADIB, ADCB and DIB were worst-off. UAE banks were harshly affected by the default of Sa'ad & Al-gosaibi leading them to take serious provisions from the corporate sector. Moreover, major fall in property prices impacted the banks' loans exposure to the real-estate sector, intensely scarring banks that had loans portfolios skewed towards this sector. Additionally, due to the broad economic conditions and crosswise the board lay-offs, the delinquency rate in the retail sector as well shot up.

Toward the inside the new decade, UAE banks bear the baggage of a threatening emanating from the probable default of Dubai World (DW) and other related entities. Ever since the news came at the end of 2009 that DW has not in fact defaulted as yet, banks were technically not requisite to take provisions in 2009. Furthermore as per bankers, the CBUAE had requested banks not to take provisions over DW, mentioning that a number of banks took general voluntary provisions in 2009.

As per the CBUAE, banks were requisite to take 50% provisioning for the non-performing loans to Sa'ad and Al-Qosaibi and 100% against Awal bank and TIBC. The banks exposed to the Saudi groups might consequently take the residual fraction of the provisions in 2010, which might account for high provisions in 2010.

The retail exposure to banks took a large hit in terms of defaults, whereby retail default rates (retail impairments as percentage of retail loans) ranged between 3 – 10% for different banks. While delinquencies in the retail sector came in powerfully in 2009, I believe that the worst is not over for them but perhaps more to come. The retail sector forms one-quarter of the whole loans disbursed in the UAE and might thus effect in aggregation to NPLs and ultimately provisions of sizeable proportions.

Exposure to real estate makes one of the big portions of banking loans in the UAE, forming 13% of the whole loans of the UAE banking sector. With a more decrease in property prices in 2010, the secured lending similar to mortgage can be the next in line for defaults after a high delinquency rate forming from unsecured lending.

The UAE banking sector is as well vulnerable to expected changes in regulations pertaining to non-performing loans and general provisions, implemented by the CBUAE. There is a high possibility of the following changes being implemented by the CBUAE:

1. Banks will be obligated to preserve a collective provisioning of 1.25% of RWAs (Risk Weighted Assets). Discussion with bankers leads to deem that it might moreover be 1.25% of gross loans or 1.25% of gross loans (less sovereign loans).

2. Banks will be obligated to deem loans that have repayment or interest pending for more than 90 days, as non-performing, as against 180 days previously. At present a number of banks have voluntarily adhered to this standard, whilst others have only implemented this merely on corporate loan.

Big banks such as ENBD, ADCB and DIB have or are assumed to have still a huge exposure to DW. Dubai based banks are further vulnerable since DW is one of the biggest conglomerates in Dubai having the same sponsors. ENBD being the largest bank in the UAE, is rumored to encompass an exposure of US\$3bn (AED11bn) to DW. The bank's exposure to UAE related GREs is approximately 20% or AED40bn and an exposure of AED10-11bn to DW are not profound. Furthermore, newspapers have quoted the CEO of ADCB as having mentioned that the bank's exposure to DW and related entities, both affected and unaffected by restructuring, to be US\$2.7bn (approx. AED10bn) whilst NBAD has disclosed its exposure to DW as being US\$345mn (AED1.3bn). Provisioning arising from exposure to DW was predictable to weigh in on the earnings of the banking sector as a whole and ENBD, DIB and ADCB in specific, in 2010 /2011.

The UAE banking sector is not utterly safe now after the crisis, actually some main concerns hang about due to the following reasons:

- The high financial penetration, with the loan-to-GDP & the deposit-to-GDP is being still high & was above 100% in 2009.
- The tight liquidity circumstances, hitherto improved as a result of a variety of government support & interventions, having the loan-to-deposit ratio at 97% for the intact banking system in UAE as of September 2010, increased banks' management center of awareness on balance sheet optimization, rather than anything else.
- The retail credit penetration in the UAE is amid the maximum in the region (28% as of September 2010)
- The High real estate exposure of banks.

- The Central Bank issued a circular in November 2010 requesting all UAE banks to convert the NPL categorization to 90 days overdue, instead of 180 days over due, for both corporate and retail loans, effective right away. Additionally, the circular requested all banks to build up general provisions corresponding to 1.5% of risk weighted assets, over a period of four years. Moreover, the Central Bank requested all banks to elevate the provisions coverage for the Saad and Al Ghosaibi exposure from 50% to 80% by the end of 2010.

On November 25, 2009, the world was stunned when Dubai World requested a restructuring of \$26 billion (USD) in total debts. This debt caused much tumult in capital markets and became officially known as the "Dubai Debt Crisis". The main distress was the impediment in the repayment of the \$4 billion sukuk/Islamic bond, of Dubai World's developer Nakheel, which was predominantly known for the construction of the Dubai Palm Islands. The "Nakheel Sukuk" maturity date was on December 14, 2009. This restructuring request caused anguish among the sukuk holders. This raised questions about the financial structure of the Nakheel Sukuk and their financial soundness.

Succeeding to the federal finance ministry's fragmentary cash injection program in October 2008, Abu Dhabi injected \$4 billion of tier 1 capital into its own banks in early February 2009. The UAE central bank then bought \$10 billion bonds from the government of Dubai later on that same month.

Banks in the UAE, have long suffered from awkward maturity mismatches, with commonly medium-term loan books supported by overpoweringly short-term deposit funding base.

But the actuality is that UAE banks find it very hard to compete with global lenders. The global financial crisis had by now exacerbated this, before the latest political situations made it even much worse. Over the past years, global banks in New York, London and in other places have enjoyed far superior admittance to reasonably priced term funding, which is mostly unavailable in UAE dirhams.

The banking sector in the UAE is quite patchy, with the market currently being served by 23 domestic banks and 28 foreign banks. Banks incorporated in Abu Dhabi and Dubai hold the biggest share of total local assets.

The Funding and liquidity pressures in the banking system are the main issues. The increasing cost of local deposits in a competitive market and abridged access to the international debt capital market are as well main contributors to the tackling in fueling of the banking sector with resources to match the ruthless development plans & projects of the country. Federal liquidity support measures & practices had to a great scope helped to steady the banking system in 2009. The Abu Dhabi-based banks had received Tier 1 capital funding totaling to AED 16 billion, which was circulated among the biggest four major banks, eventually contributing to liquidity in the banking sector. Capital adequacy ratios of UAE banks strengthened in 2009 following government measures and better preservations of net income by the banks and also lower risk-weighted assets. The average regulatory Tier 1 and total capital ratios were maintained at considerably above the regulatory requirements, sometimes exceeding 20%, which will ultimately strengthen the ability of banks to absorb higher non-performing loans (NPL) over the next years. Asset quality deteriorated drastically in 2009 and the trend continued like that in 2010 with average NPL to gross loans ratio of banks growing to 4.3% in 2009 from 1.7% at the end of 2008. These figures do not even comprise the anxious debt of Dubai World, which have been reported in the 2010 financial statements. It is worth mentioning that these ratios may not mirror the genuine quality of the loans portfolio given the high levels of restructured and rescheduled loans and those past due reported by banks in harmony with the International Financial Reporting Standards. These same ratios, reported by foreign banks operating in the UAE, were elevated in 2009, which gives an enhanced indication given the strict provisioning requirements of those banks. As loan languished in 2010 and into 2011, the ratio of NPL to gross loans is expected to increase for all banks as challenging assets facade in the banking system. The deterioration in the asset quality of banks will augment the impairment charge and will put pressure on the profitability of banks, which might cause a boost in the cost of funding on debtors as a compensation instrument to maintain profitability. That, in return, will have a direct impact on the profitability of debtors and their ability to meet their obligations as per the agreed terms and conditions.

Provisions averaged 0.58 percent of total loans during 2003-2007, it reached 1.15 percent during 2008 and 1.67 percent during 2009 almost three times the long-term average. In utter terms, provisions increased from \$1.6 billion in 2003 to almost \$10 billion by 2009.

UAE provisions amplified from \$44 million in 2007 to \$1.5 billion in 2008 and to \$4 billion in 2009. In the case of Kuwait, the majority of the increase happened during 2008 when provisions increased from \$371 million in 2007 to \$2.8 billion in 2008 implying a growth of 666 percent and stayed at that high level at \$2.4 billion during 2009. All in total 2008 proved to be the retribution with provisions being at an increase to \$6.8 billion from \$1.8 billion in 2007. In general when economic growth slows and prices crumple, it takes time for these losses to appear on bank's balance sheets. However, in the case of GCC countries they had appeared right away leading to very high levels of provisioning and recapitalization.

The loan growth mentioned earlier is fuelled by the deposit growth averaging 18 percent for the GCC during 2003-2009. However, UAE and Qatar witnessed a 30 percent growth while Oman registered an annual growth of 22 percent.

While at the aggregate level, net income grew by an annualized 18 percent during the period 2003-2009, there is wide disparity noticed amongst countries. Kuwait, for example, registered a 0 percent growth, the UAE recorded an annualized growth of 24 percent and Qatar 41 percent. After witnessing successive growth up to 2007, the following two years witnessed a fall in aggregate profits. From a high of \$19 billion in 2007, aggregate net income declined to \$15 billion in 2009.

UAE's banking profits will decrease by 11% YoY on un-adjusted basis due to one-off gains made by ENBD and ADCB in 2011 but jumps by 12% YoY on adjusted basis. Top-line growth will be slow, growing by 5% YoY mimicking loans growth expectations of 5% YoY while the spreads stay comparatively unchanged from levels seen in the previous year. Non-interest income is not expected to charge any better with fee and commission income which is the chief contributor, increasing by just 2% YoY due to the fresh retail regulations from the CBUAE. Decline in provisions, will thus be the next largest contributor to income after NII; provision expense declines by only 7% YoY. The NPLs ratio will touch peak (addition of 66bps to arrive at 8.8%) during the year, with NPLs raising by 14% YoY (totaling of

AED7.7bn); a substantial slow-down from the preceding years. The rise in NPLs will be fueled mainly by acknowledgment of exposure to Dubai Group, merger of Dubai Bank into ENBD and possibly Al Jaber Group.

The UAE banking sector ought to feel one more tough year in 2012 particularly since asset quality anguish for the country are still not over. With small visibility on operating conditions it is hard to rule out the incidence of additional corporate defaults and restructurings. NPL ratio for UAE banking sector is still anticipated to touch peak, in spite of having the highest NPL ratio among its peers and that supposition is drawn from direction received from leading banks in the UAE themselves. The UAE banking sector is still vigorous and safe with a collective CAR of over 20%. It is also very able of handling any new NPL formation, present sufficiently for the same and still demonstrate a decent set of profits. Moreover, it is still the cheapest within the GCC peer group, as per relative valuations and individual banks present sizeable returns that are just too attractive to miss.

In such a competitive market, it is crucial for banks to comprehend how customers and market sectors have a say towards profitability, and to what degree relationships with particular customers are profitable. More focus on client satisfaction, quality of the service and innovation in products offered, will show the way to the creation of new categories of interest income, charges, commissions and possibly FX-related profits.

The credit facilities extended to the private sector followed a descending trend in 2010 after plummeting to AED 720.6 billion compared to AED 723.9 billion in 2009, a 0.4% decrease. As a result, due to the pervasiveness of challenging market circumstances within the private sector in 2009 & 2010, banks began lending to government & public sector. This was reflected in UAE's government main goals for mounting its fiscal policies & promoting infrastructure projects to maintain the economy in a whole.

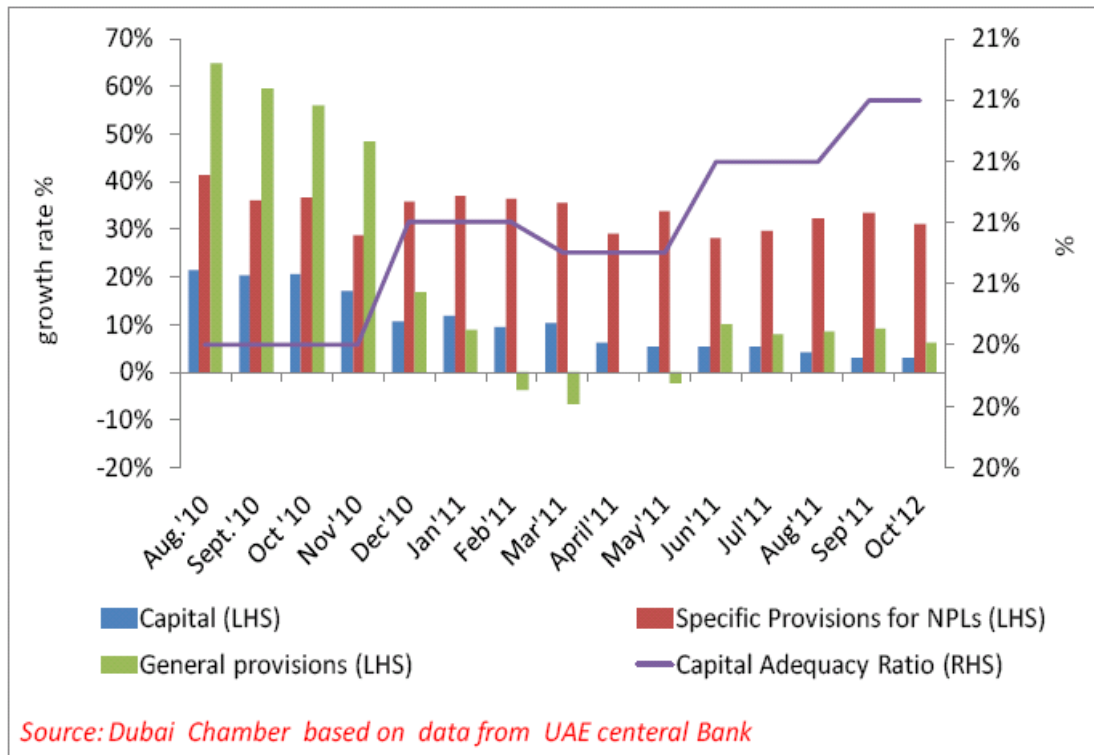
The UAE's banking sector's capitalization remains sound & is considered adequate to suck up debt troubles faced by Dubai Government Related Entities (GRE). The financial chaos has put the banking sector in the UAE on a test as local banks are

facing difficulties principally with rising retail & corporate impairments, debt restructuring associated to Dubai GRE, sprawl in the real estate market along with funding & liquidity pressures triggered by a condensed lending appetite & a high loan-to- deposit ratio ensuing in a stagnation in the banking sector of the UAE.

UAE banks managed to spread their deposit base as deposits with foreign banks grew by 38% in 2010 to AED 76.4 billion compared to AED 55.5 billion in 2009. On a whole, the UAE’s banking sector finances look recovered today as deposits have recorded significant growth since 2008. Loans & advances on the other hand as of Dec 2010 have remained stretched with total credit increasing to AED 972.1 billion compared to AED 958.6 billion as of Dec 2009.

Due to the boost in deposits, UAE banks’ loan-to-deposit ratio has improved from 101.3% in 2008 to 92.6% as of Dec-2010. Hence banks have been victorious in dropping their loan to deposit ratio below the UAE central bank’s upper limit of 100%.

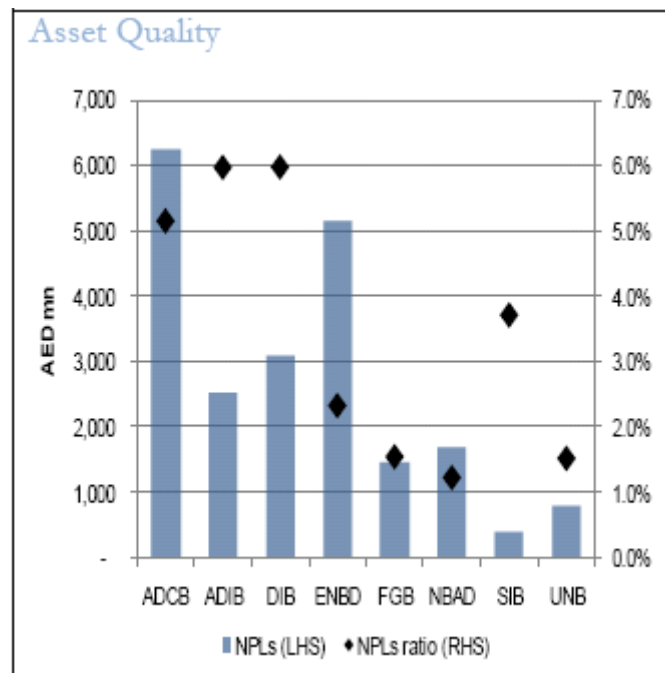
Development's in UAE bank's Capital & Provisions

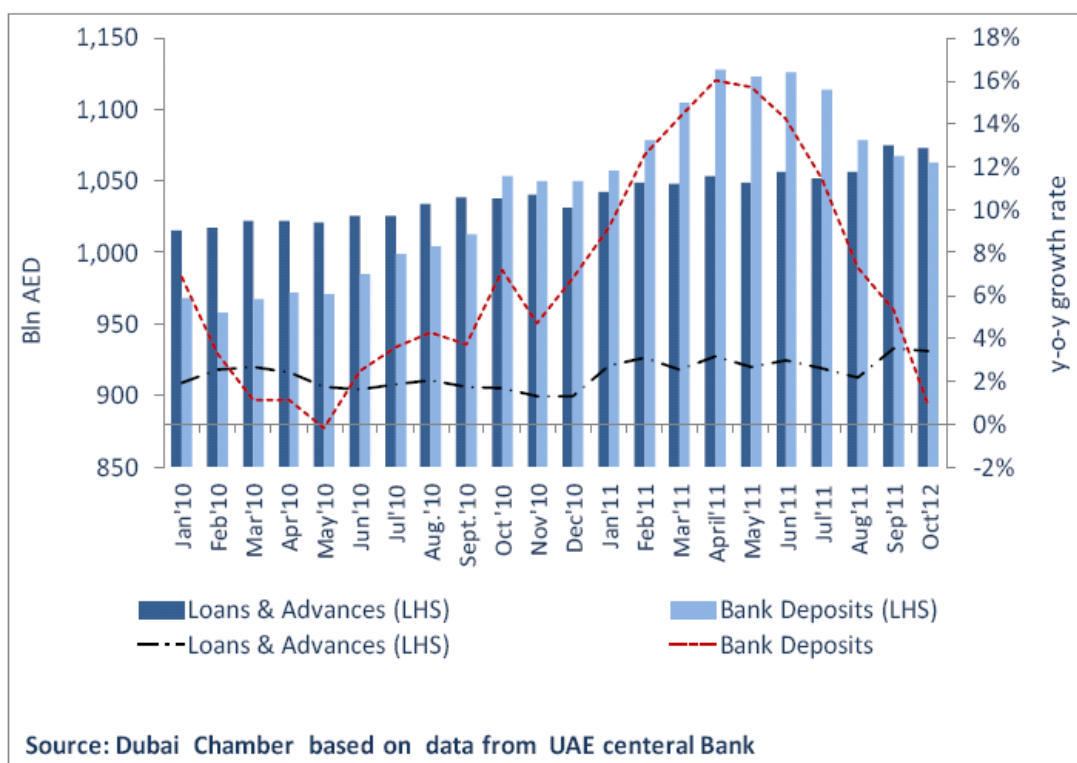


The above chart gives an idea about the annual growth rate of the UAE banks’ capital, detailed provisions for bad loans and banks broad provisions and capital in addition to the capital adequacy ratio. The growth rate of specific provisions for bad loans has been growing at high levels nearly all through 2011. In October 2011, the rate of



growth in specific provisions for bad loans decreased to 31% as compared to 33% in Sept. 2011. For the duration of the third quarter of 2010, bank's capital growth rate was elevated, averaged during the last four months of 2010 about 20%, and then started to decline afterwards. On the other hand, the capital adequacy ratio has amplified from 13 % in Dec. 2008 to 21.2% in Sept. 2011. Increased regulatory capital requirement hold back banks lending appetite.



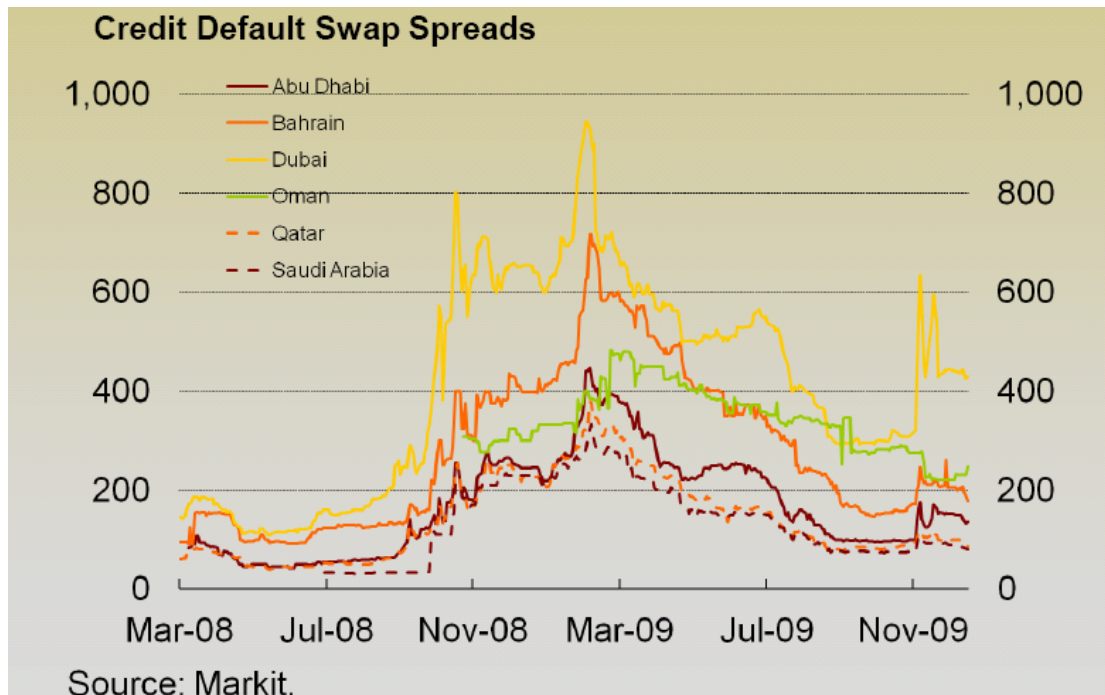
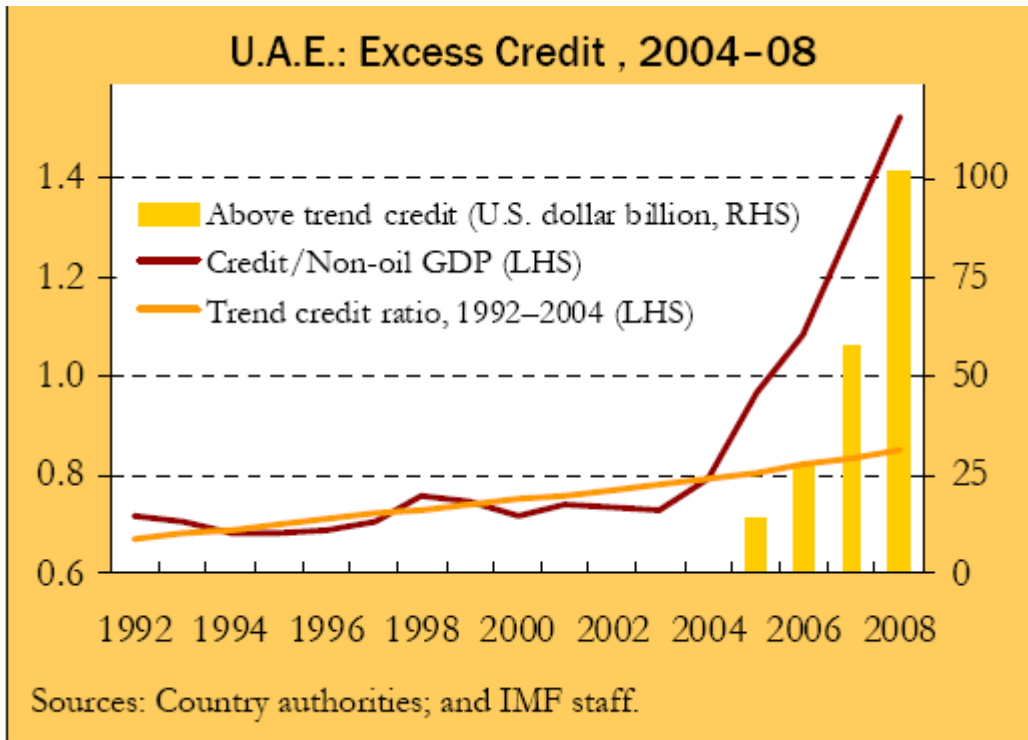


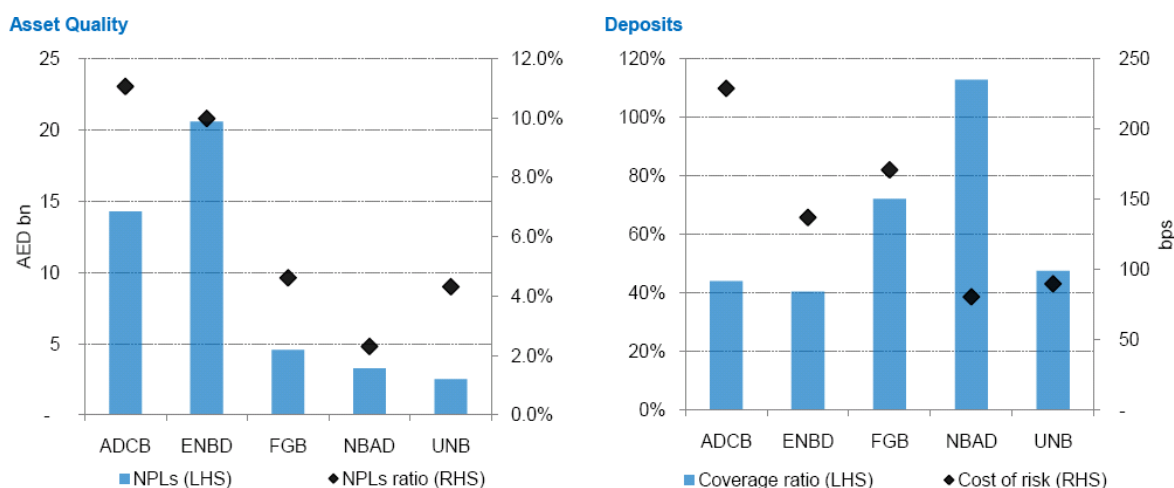
The above chart shows the developments in the UAE banks' loans and advances and deposits. In October 2011, banks deposits declined by 0.4 % on monthly basis, reaching almost AED 1062.3 billion compared to AED 1067.3 billion in September 2011. Tracking annual changes, UAE banks' deposits have recorded a very fragile growth rate of about 0.85%, the lowest growth rate in 16 months. On the other hand, loans and advances have also registered a negative growth rate of about -0.1% on monthly basis to reach about AED 1073.30 billion in October 2011, down from AED 1075.20. On annual basis, loans and advances increased by 2.9%, significantly slower than its growth rate in September 2011. As a result of the fragile hastening in loans and advances growth rate compared to that in deposits growth rate in Oct. 2011, the funding balance between loans and deposits was in shortage for the second successive month by about AED 10 billion in Oct. 2011.

#### UAE Bank's Loans to Deposit Ratios

(AED millions)	2006	2007	2008	2009	2010
Loans & Advances	537,425	626,694	924,383	958,588	972,107
Total Deposits	518,806	716,021	912,170	982,579	1,049,628
<b>Loan to Deposit Ratio</b>	<b>103.6%</b>	<b>87.5%</b>	<b>101.3%</b>	<b>97.6%</b>	<b>92.6%</b>

Source: KAMCO Research & Central Bank of the UAE





## NBAD Case

NBAD's aspire is to be one of largest Arab banks and, as a result, continues to gaze for opportunities in large Arab economies, as well as other international markets.

NBAD is expanding regionally and internationally, with a focus on precise segments within certain countries. For example, the bank has 28 branches in Egypt focusing mainly on trade flow businesses, large Egyptian corporations, government institutions, and very high net worth individuals. Management intends to take the total branches in Egypt to a total of 50.

Also under deliberation is the development into countries with strong business growth latent including Malaysia, Lebanon, Morocco, Singapore, Shanghai, India, Indonesia and Turkey. According to the bank's CEO, the bank prefers to "build rather than buy" in growing its operations, though it will obtain if the right opportunity arises, the CEO noted.

NBAD is the largest bank in Abu Dhabi and the second largest in the UAE, with a loan and deposit market share of 13.4% and 11.9%, respectively, as of September 2010. NBAD is the major bank for the Abu Dhabi government, providing it with an extremely large and secured business, at a lower risk profile, compared to its peers. The bank achieved a 3Q2010 net profit of AED920 million, 8% lower than the AED1 billion reported in 2Q2010 and 1% higher than the AED914 million reported in 3Q2009. Loans and advances reached AED139 billion, recording a strong 5% growth

YTD, accompanied by a YTD fall in deposits of 1% to score AED120.4 billion. There were a lot of optimistic aspects within the results, mostly vigorous margins, high efficiency, vigorous balance sheet growth and the strong expansion in operating income, which covered for the necessary increase in the booked provisions. Nevertheless, the plunge in asset quality continued through out the beginning 2011. Accordingly, booked provisions were approximately unchanged and increased to some extent. NBAD reported vigorous growth in net profit on the back of increased interest income and higher fees and commissions. Performance was affected unconstructively by the fall in investment income and the increase in booked provisions, chiefly on higher NPLs.

NBAD sustained to show high efficiency in spite of the minor increase in costs, largely because of natural expansion. Balance sheet growth continued to be vigorous y-o-y (+15%), because of the medium-term funding raised, and in spite of the fact that the lending growth surpassed deposit growth. NBAD will continued to manage its balance sheet in 2011, & it I believed that the bank will carry on to be an outperformer in contrast to its peers. Excluding provisions, a 2012 - 2015 net income CAGR of 9.5% is expected. NBAD seems able to deliver stable margins over the next five years. The bank witnessed a 9.5% growth in non-interest income in 2011, given the lower base it witnessed in 2010. The cost-to-income ratio for the bank will also rose, & will keep rising gradually, over the next five years, but ought to linger at a very efficient level, below 32%. The bank's NPL ratio peaked to 2.3% by mid 2011, NBAD will continue to face the challenge of balance sheet optimization, whilst focusing on calculated expansion. NBAD may face asset quality difficulties over the next 6 months, depending on the economic developments in the UAE, but the scale of the plunge in asset quality may be a lesser amount of than its peers, given the bank's very conformist strategy.

ADCB has the third highest NPLs ratio in UAE banking sector suggestive of one of the lowest asset qualities. NPLs jumped 4 times in 2009 reaching AED6.2bn whilst NPLs ratio increased from just 1.1% in 2008 to 5.2% in 2009. Being one of the most belligerent banks in the UAE, ADCB was heavily exposed to the Sa'ad and Al-Gosaibi groups and now when that tale is almost over, it is deemed to have a great exposure to DW as well. Moreover, ADCB currently provides 1.09% of RWA from its communal/portfolio provisions. Implementation of provisioning requirements to the adjust of 1.25% (of RWA), could add another AED200 – 250mn to provisions.

This is of course reliant on whether the Central Bank chooses to implement such a regulation.

Furthermore, loans and advances are not the merely assets plaguing ADCB's asset quality. The bank has a gross exposure of over AED700mn to CDO's and FRN's and an additional AED2,400mn to CDS. Collectively, the bank took provisions of AED785mn from CDS and investment securities. .

The impairments from investments (including CDO and FRN) will decreased noticeably during 2010 whereas those from CDS to maintain 2009 levels. The bank increased its coverage ratio to over 100%, as used to be the case prior to 2009.

As per the facts of its short & medium term borrowings, ADCB is anticipated to see profound debt repayment over some period, with maturities of over AED23.7bn scheduled from 2010 – 2013. The bank was scheduled to repay AED8.8bn in 2010 and AED4.9bn in 2011.

ADCB's spreads increased by just 11bps in 2009 as compared to most of its peers which exhibited advanced increase. With higher relative cost of funds and the lowest yield on assets after NBAD, the bank has one of the lowest spreads among peers.

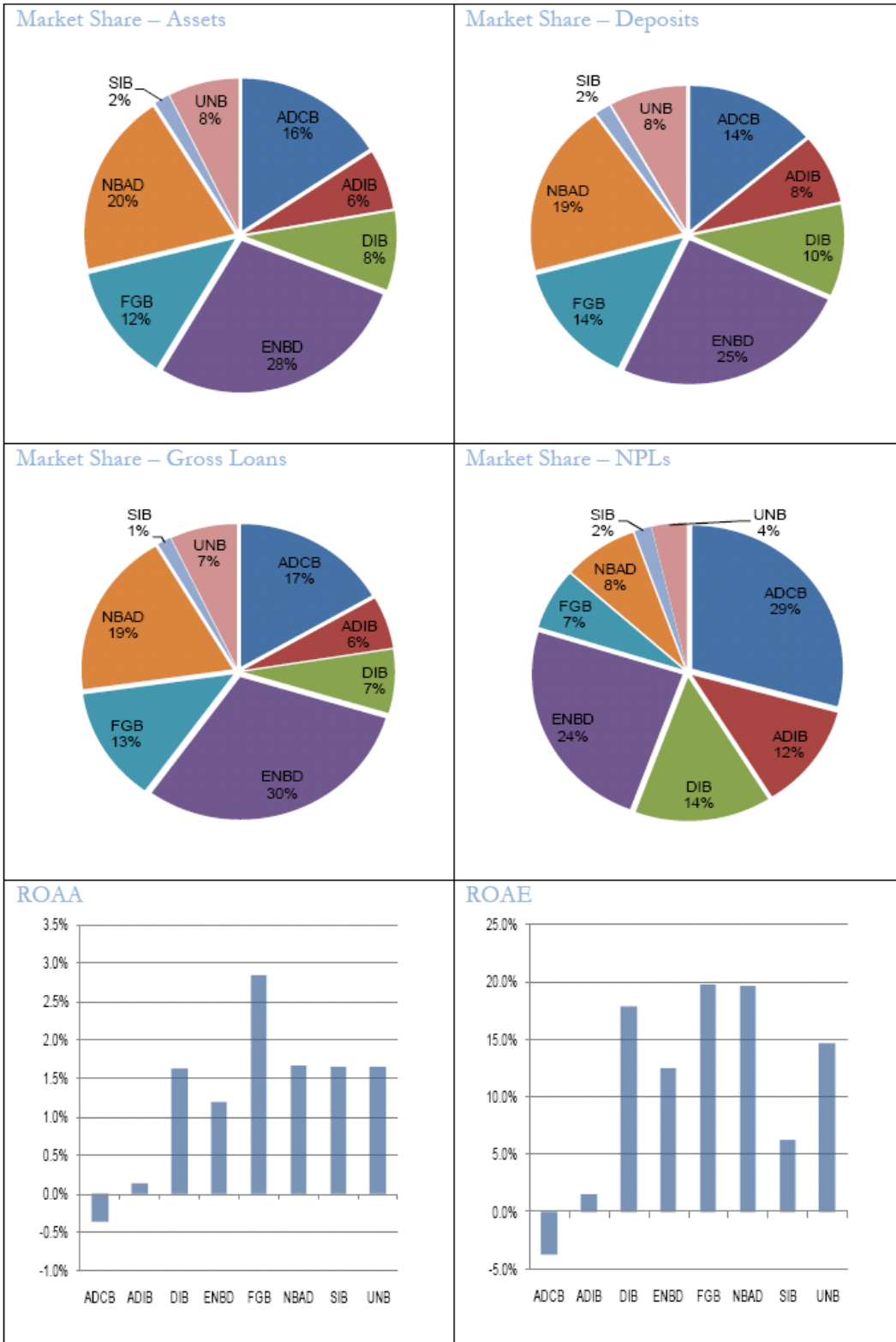
ADCB has been one of the first banks in the UAE to voluntarily adopt the 90+ day non-performing aging schedule. Whereas that mitigates the chances of any increase in NPLs (and provisions) from the change in classification, additional provisioning will yet be required if the Central Bank asks the banks to provide the much-heard-about 1.25% of RWAs. Moreover, a sizeable fraction of the over-due-but-not-impaired loans t to AED4 totaling.2bn (3.8% of total loans) may also drip down into the non-performing status.

Furthermore, as per the Central Bank's guidelines, banks were supposed to supply for 50% of the exposure to the Saudi conglomerates (exclusive of their banking entities to which 100% was to be provided) by year end 2009. ADCB's exposure to risky CDS and CDOs is as well troublesome. Impairments in these products, which are associated to sub-prime mortgage among other things, have windswept a sizeable fraction of the bank's income since 2007. This makes the bank highly disposed to any deterioration in the US markets especially those interrelated to sub-prime securities. Investment exposure to the equity and property markets, even if petite, offers no relief either, further highlighting the riskiness of ADCB's assets. The recent measures taken by the SEC in the US against Goldman Sachs may actually turn out to be constructive

news for ADCB which itself had carried out litigation against certain US-based investment companies as regards to failure of its investments.

<b>Key Ratios</b>	<b>2008a</b>	<b>2009a</b>	<b>2010e</b>	<b>2011f</b>	<b>2012f</b>
EPS (AED)	1.26	1.21	1.33	1.52	1.93
P/E (x)	9.3	9.7	8.8	7.7	6.1
BVPS (AED)	5.75	8.46	9.78	11.28	13.15
P/BV (x)	2.0	1.4	1.2	1.0	0.9
DPS (AED)	0.40	0.09	0.11	0.12	0.15
Dividend yield (%)	3.4	0.8	0.9	1.0	1.3
<b>Profitability Ratios</b>					
ROAA (%)	2.0	1.6	1.5	1.6	1.9
ROAE (%)	24.2	17.1	16.1	17.1	18.3
Net Interest Margin (%)	2.7	2.8	2.8	2.8	2.8
<b>Efficiency Ratios</b>					
Cost -to- Income (%)	28.2	29.7	29.8	30.3	31.1
<b>Liquidity Ratios</b>					
Avg. G. Loans/Av. Deposits (%)	106.8	111.6	113.2	114.5	114.5
Avg. G. Loans/Av. Funds (%)	72.4	79.1	77.3	76.5	77.6
<b>Asset Quality Ratios</b>					
NPLs/G. Loans (%)	0.9	1.2	2.2	2.3	2.3
Provisions Coverage(%)	144.6	157.5	132.8	150.0	160.0
<b>Capitalisation Ratios</b>					
Capital Adequacy Ratio(%)	13.7	17.6	19.0	19.9	20.7
Dividend Payout Ratio (%)	19.6	7.2	7.5	7.5	7.5

Source: NBAD and Beltone Financial estimates



Source: Company Accounts & Global Research  
 Figures are for 2009



## **GCC Islamic Banks & the Crisis**

Islamic banks were not as much affected than conventional banks by the original impact of the global crisis, probable reflecting a stronger first-round impact on conventional banks through valuations on securities in 2008. For 2009, H1 data indicate somewhat larger declines in profitability for Islamic banks, which might be accredited to second-round effects of the crisis on the real economy and the real estate market. Islamic banks are enhanced to face other shocks due to their bigger capital and liquidity buffers. Actually, the risk-sharing aspect of Shariah-compliant contracts could add to this buffer. Islamic Banks have developed significantly in recent years reflecting a sturdy increase in the demand for Shariah-compliant products, together in the region and globally, the Islamic banking industry has witnessed important growth, with assets presently estimated approximately to \$850 billion.

Islamic banks and conventional banks face comparable risks in that (i) the risk profile of Shariah-compliant and conventional contracts are similar and (ii) credit risk is the chief risk for both types of banks. Contrasting to conventional banks, however, Islamic banks are not permitted to have any direct exposure to financial derivatives or conventional financial institutions' securities—which were hit the majority throughout the global crisis. Fascinatingly, an analysis of the GCC best 50 banks indicates that conventional banks as well had this benefit going into the crisis, direct exposure to equity investments were very small in both types of banks.

The chief disparity in risk exposures appears to be linked to the attentiveness of risk of Islamic banks in certain countries. Whilst Islamic banks' exposure to the risky real estate and construction sectors is inferior in Saudi Arabia, Kuwait, and Bahrain, it is appreciably higher than the system's average in the U.A.E. and Qatar.

	Saudi Arabia <sup>1</sup>		Kuwait		U.A.E.		Bahrain		Qatar		GCC Average <sup>2</sup>	
	Islamic	All	Islamic	All	Islamic	All	Islamic	All	Islamic	All	Islamic	All
Capital adequacy ratio	22.1	16.0	21.7	16.0	12.8	13.3	24.5	18.1	17.9	15.6	19.8	15.7
Change in profitability (2007–08)	2.0	-11.8	-42.7	-70.1	0.7	7.9	14.7	-4.8	4.5	21.7	-7.6	-14.2
Change in profitability (H1 2009–H1 2008)	2.9	-11.9	-71.9	-65.3	-34.2	-19.5	-57.6	-36.8	0.0	5.1	-29.3	-23.3
Change in profitability (2008 and H1 2009 compared to 2007) <sup>3</sup>	4.3	-7.2	-49.7	-65.8	-0.8	10.0	1.4	-3.4	2.8	25.4	-9.7	-10.5
Return on assets	3.7	2.1	1.6	3.2	1.7	2.2	2.6	1.3	6.6	2.6	3.2	2.3
Exposure to real estate and construction* (as percent of total loans)	5.6	7.3	22.1	31.4	25.7	12.9	11.3	26.2	38.3	18.4	20.6	19.2

Sources: Authorities; banks' financial statements; Zawya; and IMF staff estimates.

All GCC banks' profitability fell in 2008 and in the first half of 2009, with a mostly comparable overall impact on Islamic and conventional banks.

There are, though, differences in the relative impact on Islamic banks within the GCC countries, reflecting variations in exposures to risky asset categories. In exacting, the weaker performance of Islamic banks in 2009 was mainly driven by the U.A.E. and Qatar, where they had a significantly elevated exposure to real estate and construction sectors. With bigger capital and liquidity buffers, Islamic banks are better-positioned to endure unfavorable market or credit shocks. On average, Islamic banks' CARs in the GCC are higher than those for conventional banks (except in the U.A.E.). The risk-sharing aspect of Shariah-compliant contracts adjoin to this buffer, as banks are able to partly pay off their losses by providing lesser returns to their investors. However, the higher capital buffers can be fairly counteracted by the quicker credit growth for Islamic banks in the recent years. Islamic banks tend to sustain a high liquidity on their balance sheets in the form of short-term international Mudarabah and central bank deposits. It ought to be noted, however, that this is attributed to the fact that liquidity risk and management is normally further challenging for Islamic banks, as there is still a scarcity of liquid Islamic instruments that Islamic banks can exploit, both in the interbank market and at the a range of central banks.

## **Corporate Governance in the GCC Banking Sector**

Consciousness about corporate governance, particularly in banks, has infinitely increased, predominantly after the financial crises. There is an improved prominence for banks to have strong corporate governance rules and regulations that are implemented sturdily and critically. In fact, the financial crises had brought a constructive impact in terms it gave companies, financial institutions specially, an imminent about the momentous importance of having corporate governance that promotes transparency, operational and financial process competence, and protecting all stakeholders.

Mainly in banks, the big fraction of liabilities comes directly from depositors; that's way regulators such as Central banks, forced more strict regulations on banks, including corporate governance; as any concern that a bank might face could have a ruthless impact on the whole economy which then makes investors loose confidence in the country's economy hence withdrawing their money; this is exactly what Dubai suffered throughout the financial crisis thus affecting the UAE's financial market making it the highest percentage decline in the world.

Corporate governance for banks is considerably important given their financial intermediation role; the need to safeguard depositors' funds, shareholders' funds, and the harmful consequences of vain governance practices.

It is largely important to have lucid and systematic authorities, responsibilities, systems and processes to make sure that decision making in the bank is suitably managed.

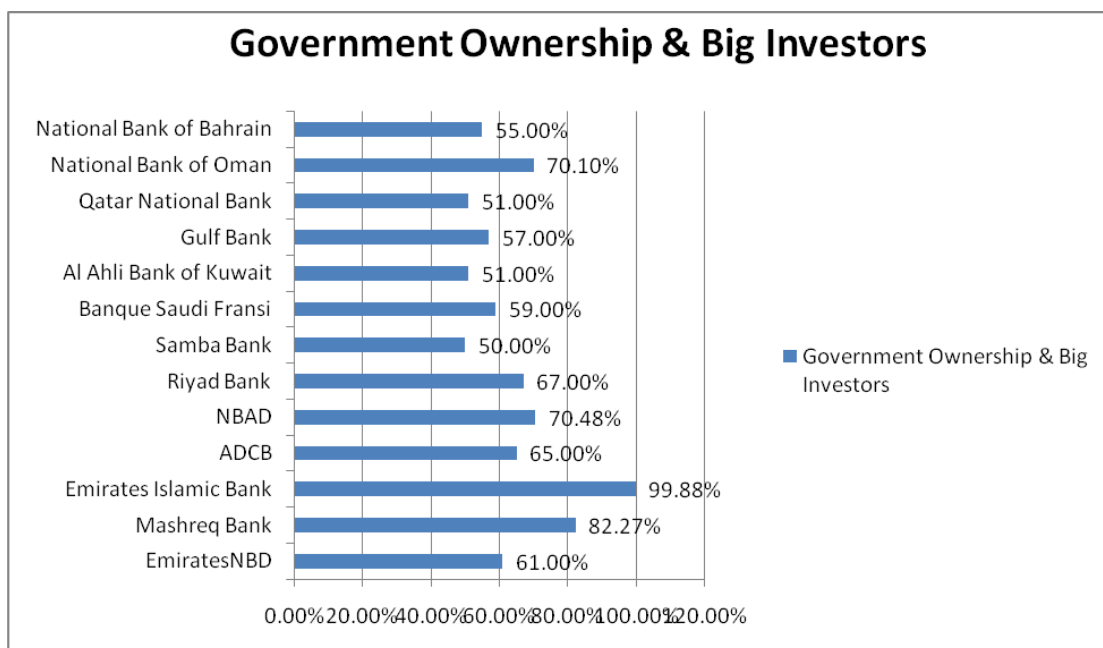
There are quite main challenges that GCC banks face in terms of corporate governance.

A chief challenge is developing faith in the corporate governance itself. The regulations of the corporate governance are theoretical rather than actual. They are broad rules that do not reflect how in reality they could be implanted.

Knowledge of investors is one more challenge of implementing strong corporate governance. Investors are not attentive of their rights, and the only solution to resolve this issue is for authorities to lift awareness about the complete rights of investors, which in actuality they are doing their best in regards to this point. Hawkamah , the corporate governance body of UAE ,was established before the crises and from their

findings they found out that more than 56% of UAE companies do not have a full complete understating of what is corporate governance and its benefits; in addition, almost all UAE companies (95%) agreed that their government practices call for improvement. Another survey conducted by Hawkamah is that from 400 CEO in Middle East that 60% of them believed that the corporate governance is vital, however, when asked in the survey to define what corporate governance is, only 40% got it precisely right.

Another challenge is the continuous pressure from government and big investors to push for not having exact implemented corporate governance. Despite that, lately in UAE for example in 2010, that year witnessed a structural reform in the structure of the Board of Directors as per the rule set by Securities & Commodities Authority indicating that there must be an independent member in the Board of Directors.



As seen in the graph above more than 50 % of chief GCC banks are owned by governments and big investors.

In addition, the voting procedure in the corporate governance must be covered from a practical standpoint rather than a broad one as some banks do not conform to the voting process since most of the shares are owned by the government.

Banks must be compelled to deliver an annual corporate governance report & hand it out to the public & shall enclose full details & not generalized information. A minimum series of corporate governance workshops should be organized for directors, investors, & employees in order to hoist awareness about corporate governance.

The UAE Central Bank issued in 2010 & 2011 guidelines for banks to follow. These Guidelines aim to enhance the quality of directors' leadership and appreciably perk up their board processes. Such improvements will be value-adding and will strengthen the international competitiveness of UAE banks. Banks with good quality governance and that are translucent in their disclosure practices are trusted by their stakeholders: shareholders, clients, employees and regulators.

Some of the issues that UAE banks and their directors need to pay more attention to include:

- To progress disclosure standards and boost transparency
- The call for for directors to be more attentive of their duties and responsibilities to their banks and to all their investors
- The call for for directors to comprehend more undoubtedly what is expected of them
- The significance of managing conflicts of interest
- The call for establishing board committees to handle audit, remuneration and nomination issues and to guarantee there are credit and risk committees in place

The financial crisis has shown:

- Sound corporate governance is not only a fundamental factor at the level of the individual bank but is also a decisive ingredient in promoting and maintaining a sound financial system.
- The wellbeing of any financial system depends on the underlying soundness and the relationship between its diverse components, including regulatory bodies, banks and non-bank financial institutions.

- In turn, the soundness of these institutions mostly depends on their capability to recognize, scrutinize and manage their risks. Fragile institutional structures and poor risk management, as we have witnessed, can have potentially harsh effects not only on the individual banks but also on the system as a whole.

According to the UAE's Central bank, banks are ought to integrate corporate governance criteria into their investment and lending criteria. Banks can participate a vital role in instilling a culture of high-quality corporate governance in the region.

Specific provision percentages based on the number of days past due has to be followed for retail lending categories (including residential mortgages) according to the UAE's central bank as per the below table:

<b>Days past due</b>	<b>Personal Consumer Loan</b>	<b>Car Loans</b>	<b>Credit Card Loans</b>	<b>Residential Mortgages</b>
90 - 120 days(inclusive)	At least 25 %	At least 25 %	At least 25 %	At least 25 %
120 – 180 days (inclusive)	At least 50 %	At least 50 %	At least 50 %	At least 50 %
Over180 days	At least 100 %	At least 100 %	At least 100 %	At least 100 %

Note: the percentages in the table are of the net exposure amount (defined below)

General provisions are calculated as 1.5% multiplied by the ‘normal’ and ‘watch list’ Credit Risk Weighted Assets (CRWA). CRWA should be calculated using the Basel II standardized approach.

By definition all exposures receiving 0% Risk Weight are excluded from General Provisions.

Banks are allowed a period of 4 years to reach the minimum general provisions prescribed as 1.5% of CRWA. Banks are encouraged to attain the minimum requirement of General Provisions in a shorter duration if possible.

No bank is permissible to go down below its current level of General Provisioning during the 4 years evolution period unless its general provisions exceed the least requirement of 1.5% of CRWA.

The Central Bank will be assessing the progress towards building up the general provisions by the banks and will issue individual guidance to banks if required.

Below are the minimum provisions for all loans:

<b>Classification</b>	<b>Criteria</b>	<b>Provision</b>
Normal	All information available assures repayment as agreed	General Provision.
Watch-list	Some weakness in the borrower's financial position and credit	General Provision.
	worthiness that requires more than normal attention.	
Sub -standard loans	Payment of principal is in arrears beyond 90 days or some loss is possible due to adverse factors.	Specific Provision Minimum 25% of the net exposure amount
Doubtful loans	Full recovery seems doubtful based on the available information, leading to a loss or part of these loans.	Specific Provision Minimum 50% of the net exposure amount
Loss loans	Possibility of no recovery at all after the bank has exhausted all available courses of action	Specific Provision Minimum 100% of the net exposure amount

According to UAE's Central Banks shall submit to the Central Bank on monthly basis the following statements:

- Categorization of loans and advances and provisioning and movement in provisions and interest in suspense
- Categorization of loans and advances by economic activity
- Categorization of loans and advances by sectors
- Statement of overdue and rescheduled loans and advances and performing and non-performing loans and advances
- Security wise distribution of loans and advances

GCC countries need to consider/develop:

- a) Macro-prudential actions to tackle systemic risks, economic cyclicity derived from oil prices, instability produced by short-term capital inflows
- b) Enhanced regulatory and supervisory tools
- c) Local currency domestic money & debt markets
- d) Collection & distribution of financial & economic statistics
- e) Liberalize Banking & Financial Services in the GCC

f) Set up a GCC College of Bank Supervisors

While projections for the GCC are favorable, significant challenges remain. The instant challenge is to complete the cleaning up of banks' balance sheets and ease the restructuring of the nonbanking sector in some countries. This must be accompanied by enhancements to regulatory, supervisory, and resolution frameworks, wherever needed. Over the medium-term, these actions should be accompanied by enhanced disclosure; an extended set of macro prudential tools to sustain monetary and fiscal policy; and regulatory and supervisory frameworks that meeting point on the stability of the financial system as a whole.

Instant Measures should be taken such as:

- Addressing the Emerging Financial Sector Challenges
- Enhanced communication possibly will improve policy effectiveness
- Clear communication on policy measures, objectives, and rules and procedures governing authorities' actions would help make certain their success and speed up recovery. Improved communication would as well help alleviate investor uncertainty and lessen speculation and market instability.

The instantaneous challenge for maintaining public confidence in the banking sector and sustaining credit growth is to ensure that the process of cleaning up of the banks' balance sheets is completed slickly, based on continued appreciation of losses and immediate bank recapitalization.

This should be accompanied by enhancements to regulatory, supervisory and resolution frameworks, where needed. Specifically:

- Continue to be forward looking concerning banking sector recapitalization needs. The GCC appears to have adopted a strategy of upfront acknowledgment of losses and instant bank recapitalization. For example, the U.A.E. and Qatar conducted preventative bank recapitalizations using public funds, which were helpful in addressing market concerns. In the period ahead, GCC countries must demeanor episodic reviews of banks' asset quality, in addition to stress testing, to determine whether the intensity of capital support is adequate. To the extent possible, recapitalization should be based on private sector capital injections to minimize moral



hazard. The authorities should preserve a transparent and inclusive fiscal accounting of intervention and should overturn public sector injections as soon as market circumstances permit it. Assessments of the impact of continued and further distress, including a further corrosion in real estate markets, would be important. Stress tests can also be used to direct the authorities' decisions on bank asset purchases, if required. Some GCC countries have already initiated stress testing (Bahrain, Kuwait, Qatar, and Saudi Arabia)

- Improve bank supervision and monitoring and take action on time to address bank infractions of prudential regulations. As the effect of the crisis continues to work through banks' balance sheets, supervisors must observe banks closely, with attention focused on the larger banks and groups of banks that share comparable high risks, such as exposure to real estate.

- Specify regulations for bank intervention triggered by objective criteria and make sure that banks tackle emerging problems quickly. In view of the impact of the crisis in Kuwait and the U.A.E., the two countries have already taken the scheme to reform their regulatory frameworks.

- Develop immediate and efficient restructuring and resolution frameworks. Supervisors must review resolution frameworks with a view to initiate more well-organized, speedier, and cost-effective options that permit for the reorganization of practical firms and the quick exit of non-viable ones. These may well comprise purchase and assumption transactions, & good bank/bad bank legal structure.

On the public sector side, there is a call for for better corporate governance of state-owned/affiliated enterprises, with larger attentiveness given to managing quasi-sovereign balance-sheet risks, transparency, and excessive leverage.

Regarding the banking sector, GCC countries must make FSIs available on a timely basis as delays amplify speculation and complicate the market's ability to conduct timely analysis.

As regards the private sector, the incentive structure for companies to improve disclosure and governance requirements to be strengthened, and impediments for

listing family businesses need to be removed. Banking regulations on large exposures can be amended by linking single-obligor exposure limits to borrowers' listing or rating rank. Forming a second-tier stock market listing with less restrictive requirements could also encourage family businesses to go public.

The international familiarity with the current crisis has underscored the significance of expanding central banks' traditional permission to better incorporate financial constancy as a complementary objective. Central banks need to respond not only to traditional indicators of inflationary pressures, but also to signs of emerging vulnerabilities in banks, and households' balance sheets, which are characteristically linked with high credit increase and asset price bubbles. In view of their pegged exchange rate regimes, it is possible that GCC countries will be faced with renewed exploratory capital inflows as oil prices get well. This could lead to a recommencement of overheating pressures and a resurrection of high credit growth and asset price inflation. Given the very limitations of monetary policy, fiscal policy would require to be supported by an adequate set of macro prudential tools.

The authorities already have in place a number of prudential measures that have helped alleviate the impact of capital inflows and economic booms, such as ceilings on loan-to-deposit ratios and sectoral exposures. These tools would require to be firmly enforced. Reserve requirements must also be actively used, and consideration could be given to widening their base to contain banks' short-term foreign liabilities. Other policy options could also include the introduction of a capital gains tax on property and equity transactions.

In the GCC, financial stability calls for policies that attempt to lag the financial system from the oil cycle—both on the liquidity and solvency fronts—and dampen channels by which the oil cycle is transmitted to the non-oil sector and asset prices. extreme corporate sector leverage, both private and public, should be avoided, and the buildup of balance sheet vulnerabilities should be monitored. Additionally, spillover risks from OFCs should be examined and addressed, cross-border cooperation should be enhanced, and the timeliness and coverage of financial and macroeconomic data should be improved to allow the authorities to demeanor efficient surveillance.

Countries should assess how best to offer incentives for banks to administer liquidity more efficiently and minimize instability associated with the oil cycle. Clearly, the fiscal posture has important implications for liquidity. On the monetary policy side, central banks should avoid persistent excess liquidity circumstances when oil prices are high by actively using reserve requirements to soak up excess structural liquidity. In addition, thought should be given to building larger stocks of central bank certificates of deposit or treasury bills to assist expand local interbank markets to enable banks to run their liquidity more effectively. Developing the corporate bond market would also assist banks reduce their asset/liability maturity discrepancies. Investigating countercyclical approaches to bank capitalization and provisioning practices. The purpose is to make sure that revised regulations encourage prudent provisioning—similar to the case of Saudi Arabia, which has already been implementing countercyclical provisioning policies—and capital buffers over the business cycle. Specially, capital buffers and provisions must be built up during the boom years to be drawn upon throughout economic downturns. Saudi Arabia has been implementing countercyclical provisioning policies since the early 2000s and so banks have already built a stock of provisions that might be used in the current downturn. Amendments to regulations must be based on the Basel Committee’s revisions to the Basel II framework, which are presently under preparation. Revisions would be better completed jointly contained by the GCC to ensure a level playing field, particularly in light of open capital accounts in the region.

Avoiding extreme leverage in the corporate sector, optimistic economic activity and excess liquidity conditions generally associated with high oil prices produce incentives, for both lenders and creditors, to increase leverage. The result is higher corporate sector susceptibility to economic downturns and adverse credit conditions, and large bank exposures to exceedingly leveraged borrowers. The Dubai debt issue is a case in point. Prudential regulations, chiefly large exposure limits, should be adequately set and fully compulsory to mitigate these risks.

The call for to exchange information among cross-border supervisors has not been critical so far given the still inadequate number of GCC banks with cross-border operations.

On the other hand, cross-border cooperation must be strengthened in light of the changing regional financial landscape and increased integration.

Coordination of regulation and supervision within the GCC will also be vital to shun regulatory arbitrage in both offshore and onshore banking activities.

Key elements would be a stricter licensing policy and closer supervision, which as well call for continuous efforts to enhance the number and quality of on- and off-site supervisory staff in charge of OFCs. A high degree of cross-border supervisory cooperation will be vital to ensure that all aspects of foreign activities that affect the reliability of onshore banks, directly or indirectly, are addressed.

Whilst much information exists in the banks' internal data and management systems, the challenge for the authorities is to recover data aggregation, timeliness, and interpretation for purposes of policy action. Financial data collection should spotlight on:

- Improvements in classification of sectoral credit exposures to detect concentration, for instance, in the real estate sector.
- Improvements in credit bureau plan and use to track concentrated exposures to ultimate obligors, taking into consideration the ownership structures of conglomerates.
- Monitoring of funding, particularly from cross-border sources, of core financial institutions to detect its concentration and maturity structure.
- Measurement and monitoring of leverage in financial institutions, the corporate sector, and households.
- Awareness of complex structures (e.g., cross-border structures, hardto- value instruments, off-balance sheet vehicles) that currently render some aspects of risk-taking difficult to supervise.

In addition to the above, the authorities should pace up the management of macro data and enhance its timeliness. Ongoing initiatives to diversify financing channels away from banks should be pursued. Development of local or regional debt markets for large corporates will allow banks to increasingly concentrate on financing small and medium-size enterprises that will create the bulk of future jobs. It will also help corporates improve their debt maturity profile, with a positive impact on their liquidity positions, and could enhance corporate governance as debt issuance will demand more rigorous financial disclosure and transparency. In time, the development of debt markets could also supply new venues for public policy to offset the adverse impact of banking distress on credit provision to the economy. By openly supporting these markets (for example, through asset purchase programs) throughout

periods of crisis, governments may have additional chances to restart the flow of credit than via the sole provision of liquidity and capital to banks.

The experience of emerging markets over the past few years suggests that the development of private bond markets requires government pledge to issue its own debt securities in a complete range of maturities and in a fairly systematic way. Fiscal surpluses in the GCC may have made such course of action difficult to validate. However, other countries with sustained fiscal surpluses, such as Norway, Singapore, and Australia, have found ways to remain a critical mass of government debt outstanding as a public good to make sure a orientation yield curve and sustain interest by investors and a core number of dealers.

On the fiscal side, countercyclical actions must continue to focus on capital spending to facilitate their future turnaround, with the view that private sector demand must replace public sector spending in driving non-oil growth over the medium term. This should be accompanied by structural reforms aimed at promoting the job of the private sector, added reformation of business registration procedures, and reducing administrative barriers to investment.

## Conclusion

There are obvious differences between the Dubai crisis and the Global Financial Crisis. Dubai's total debt amounts to about US \$59bn and the Global debt totals more than ten times of that amount.

The GCC banking sector is an imperative segment of the GCC financial sector. The banking sector is conquered by local players due to regulatory protection. A major change occurred during the fourth quarter of 2008, after which the banking sector continued to witness marvelous challenges.

On an average & according to IMF, banks in GCC held 18 percent of their portfolios in securities as of end-2008 of which exposure to equities/derivatives is only 1 percent.

The assets of the GCC banking sector witnessed an extraordinary growth.

The GCC banking sector loans recorded an average annual growth rate of 23 percent between 2003 and 2009. The years 2007 and 2008 were notable with loan growth averaging 38 percent and 34 percent, correspondingly. However, the growth constricted to -0.67 percent for 2009 as a result of a slowdown.

The Financial crisis affected largely Dubai's economy & its banking sector but it's on its way to recover.

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