ANNUAL SUPPLEMENT 2012
MIDDLE EAST

GLOBAL FINANCE

Change Is In The Air

As one drives into Riyadh, the Saudi Arabian capital, on King Khalid International Airport Road, a symbol of change appears suddenly through the window after miles of desert. It is the enormous campus of the world's largest university for women, Princess Nora bint Abdulrahman University. A monorail with 33 trains links its 800 buildings on 2,000 acres of University City, built at a cost of more than $10 billion.

The new city, which will be fully functioning later this year, will have a capacity of 40,000 students and 12,000 employees. Its 15 colleges will offer such courses as business administration, information technology, English language and science.

The campus, which includes a 700-bed student hospital, research centers, academic and administration buildings, as well as housing for students and staff, a museum, a theater and sports complex, was constructed by local contractors: Saudi Oger, Saudi Binladin and El Seif Engineering and Contracting. US firm Johnson Controls provided the cooling systems.

Women comprise 58% of college students in Saudi Arabia, but they make up only 14% of the kingdom's labor force. Some 85% of Saudi women who are employed work in the education field. The new Princess Nora bint Abdulrahman University aims to provide skills to expand Saudi women's role in the workforce. Plus, women will be able to vote and run in the 2015 local elections and be appointed to the country's consultative assembly, the advisory Shura Council. Change is coming in some areas, yet Saudi remains the only country in the world that prohibits women from driving.

Elsewhere, Islamist parties are gaining power in a number of the countries that faced political upheaval and revolt over the past year and three months—during the Arab Spring. In Egypt, the Muslim Brotherhood is seeking to rescue an economy in crisis and to convince investors that Islamic law will be friendly to the market economy and free trade.

In the UAE once free-spending Dubai is wrestling with debt and Abu Dhabi is becoming a big spender on cultural projects. Yemen has a new president. Everywhere you look, the region is changing. A baby boom and volatile oil prices will drive further change. The Middle East remains one of the fastest-growing regions in the world, thanks largely to its hydrocarbon wealth, but increasingly due to its human capital.

The median age in the countries of the Middle East and North Africa is 25 years, which is below the average of other emerging regions and well below that of developed countries, according to the Arab World Competitiveness Report 2011–2012, published by the World Economic Forum and the OECD. "These young populations represent a tremendous opportunity, both as a market and as a labor force," the report notes. The youth bulge provides a window of opportunity, it adds, but not a guarantee of economic and social development. Governments and civil society will need to create the institutions and policies to make that happen.

Gordon Platt
Contributing Writer
Global Finance

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Shifting Sands

Extraordinary changes are occurring in the Middle East in the aftermath of the Arab Spring uprisings. New economic models—and new opportunities for foreign investors—are developing. But the potential for great reward comes with great risk. **By Gordon Platt**

The Arab Spring uprisings and the withdrawal of US troops from Iraq have left behind a volatile mix of factions vying for power in the Middle East and North Africa. Until the violence subsides and political stability returns, it will be difficult for those countries affected to attract long-term investment. But Egypt, the most populous country in the Arab world, and Iraq, with its huge oil resources, could offer some of the most promising opportunities for investors willing to make long-term commitments.

Egypt's Muslim Brotherhood, the country's oldest and long-outlawed Islamist group, has, over the years, created a social welfare organization that helps the most needy members of society. Now that the Brotherhood's Freedom and Justice Party has won control of

Bourland, Jadwa Investment: The emergence of Iraqi production and the shift to new sources—including the US, Brazil and Canada—will be increasingly important to oil prices

the Egyptian parliament, the question is whether it can rescue an economy in crisis and avoid steep devaluation of the Egyptian pound by limiting subsidies and promoting growth. The party says it will accept aid from the International Monetary Fund, as long as it comes with no strings attached.

Another unknown is whether—or perhaps how quickly—the Brotherhood will move to create an Islamic economy and replace interest-paying institutions. Any change is expected to be gradual and cautious, analysts say. The party has, for example, announced that it will not interfere with the industrial zones jointly managed by Egypt and Israel. What happens in Egypt could influence economies and policies in Libya, Tunisia, Iraq and elsewhere in the region.

Investors from the Arab Gulf will take their time exploring opportunities in Egypt, says Brad Bourland, chief economist and MD of proprietary investment at Jadwa Investment in Riyadh. There has been a strong anti-private-sector backlash since the revolution, and there are lingering effects from the unrest, he says.

"It will take time for a strong, welcoming environment to emerge in Egypt," Bourland says. "After all, the stock market was closed for three months [last year], and it will take years to restore confidence." Egypt's main stock market index fell by nearly half last year, making it one of the worst-performing markets in the world.

Egypt's first presidential election since the resignation of Hosni Mubarak will begin in May, according to the electoral commission. The first round will be held May 23–24, with a run-off June 16–17. The ruling military council has said it will turn over power to a civilian government following the election.

OIL & GAS GIANTS

In neighboring Libya, the militias that helped topple Muammar al-Qadhafi are now engaged in rivalries that are dividing the country and challenging central authority. The oil-rich country is restoring hydrocarbon production, but the threat of a civil war looms ahead of planned elections in May or June.

Iraq, meanwhile, has improved the terms under which it will auction off 12 oil and gas exploration blocks on May 30–31. The oil ministry had postponed the auction several times to encourage more firms to participate. The country is sitting on an estimated 143 billion barrels of proven oil reserves, according to the World Bank.

The introduction of new sanctions against Iran has added further uncertainty to oil-market prospects, according to a report by the economics department at Samba Financial Group, in Riyadh. "Prices have continued to firm in response, despite weakening demand, as markets worry about supply disruptions," the report notes.

The Iranian economy has come under pressure, and domestic politics have become strained, making responses hard to predict, the bank says. "That said, closing the Strait [of Hormuz] seems unlikely and, for now at least, both Teheran and Washington seem eager to avoid precipitating a military conflict," according to the report. The key question, it adds, is whether Iran will be able to find alternative buyers for its crude.

Fundamental factors will be much more important to the course of oil prices this year than will speculation about the effect of Western sanctions on Iran's oil revenues, says Bourland of Jadwa Investment. "The emergence of Iraqi production and the shift to sources in the Western Hemisphere, including the US, Brazil and Canada, as well as Russia, will be more significant," he says.

Saudi Arabia has been producing crude at the high rate of nearly 10 million barrels per day and likely will cut back this year, Bourland says. Non-oil growth in the kingdom will accelerate, centered on housing and construction. The transportation, telecom and retail sectors of the economy are all strong, Bourland says. In addition, the Saudi ministry of commerce has banned cement exports to make more of the product available to the domestic market and asked factories to produce at full capacity to meet local demand.

"Transitions can be derailed and detoured to new autocracies"

— Hillary Clinton, US secretary of state

DIVERSIFYING FOREIGN INVESTMENT

Foreign investment in the MENA region needs to diversify away from the oil and gas industries and toward areas that have a greater impact on boosting jobs, according to a joint study by the World Economic Forum and the Organization for Economic Cooperation and Development (OECD). Despite a decade-long surge of foreign direct investment to the region, high and persistent unemployment is endemic, especially among the young, whose jobless rate exceeds 40% in some countries, the report says.

An underdeveloped private sector and a widespread mismatch between workforce skills and business needs are two key reasons for the high unemployment rate, it adds. "Economic reform must accompany political transition if the root causes of the Arab Spring protests are to be addressed and jobs created for the 2.8 million young people who enter the labor market every year," the study notes.

In addition, private sector growth is stifled by an unwelcoming business environment, according to the World Economic Forum and OECD. Foreign direct investment flows have fallen recently as a result of the ongoing global economic crisis and the impact of the Arab Spring on investors' confidence. "The Arab Spring has led to significant turbulence in the region, which has had negative effects on the economic performance of countries in the short term," the report says. "This is likely to persist in the medium term as well, depending on the success and direction of political reform. However, the political changes under way and the recognition of the key role of the private sector in generating jobs and growth may drive the needed political momentum to enhance competitiveness over the medium to longer term," it adds.

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>
> ***—Brad Bourland, Jadwa Investment***

BRINGING ARAB SPRING REVOLTS TO FRUITION

Hillary Clinton, US secretary of state, during a speech in Tunisia in late February, warned: "Transitions can be derailed and detoured to new autocracies." She urged young people who fought in the uprisings to keep up the pressure on their leaders to stay on the path of liberalization and openness and fulfill the promise of the Arab Spring. Tunisia was the first Arab nation to topple a long-term dictator in the uprisings, with the ousting of Zine El Abidine Ben Ali in January 2011.

"There are those who question whether Islamist politics can really be compatible with democracy," Clinton said. "Well, Tunisia has a chance to answer that question affirmatively and to demonstrate that there is no contradiction."

Clinton said the Islamists and other parties must learn to govern together and uphold respect for the rule of law. The Islamists seek to create societies based on shariah law. Clinton was in Tunisia to attend a meeting of countries supporting the opposition to Syrian president Bashar al-Assad. Meanwhile, the fighting between Syrian regulars and the Free Syrian Army continues.

Earlier this year in Kuwait—a member of the Gulf Cooperation Council (GCC)—opposition groups including Islamists and tribal leaders gained control of the country's parliament, in the process taking the seats of all four then-sitting female parliamentarians.

The country now faces heightened political gridlock that threatens to stall its development program. Kuwait's emir, sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, called the election after opposition lawmakers demanded to question the prime minister about an alleged payoff scandal.

Hillary Clinton, US secretary of state: Tunisia has a chance to demonstrate to the world that Islamist politics can be compatible with democracy

TRINACRIA PHOTO / SHUTTERSTOCK.COM

Although GCC countries have used oil money to buy stability, they have not been immune to the uprisings. In Bahrain pro-democracy demonstrations were put down last year by a Saudi-backed crackdown. The economy has suffered amid a lack of political progress. Tourism has declined sharply, and several banks have relocated operations to Dubai. ■

PAUL COWAN / SHUTTERSTOCK.COM

Abundant Flows

The oil and gas sector is leading an investment explosion in the region, particularly in Saudi Arabia and Qatar. By Gordon Platt

Led by Saudi Arabia and Qatar, the countries of the Gulf Cooperation Council (GCC) are experiencing strong economic growth. Oil and gas exports are fueling an investment boom. Increased bank lending and higher consumer spending are adding to the forward momentum. The Middle East economy thrives on high oil prices, but other sectors are becoming increasingly important as diversification and job creation get top billing.

It was a strong start to the year for the non-oil private sectors of the main oil-exporting countries in the Arab Gulf. Output and new orders rose in January, and business confidence was bolstered by strong government spending.

GCC countries plan to invest up to $2 trillion in infrastructure projects alone in the next decade. In Saudi Arabia, the largest economy in the Arab world, and Qatar, the region's fastest-growing economy, infrastructure

Al-Sowailim, Falcom: Infrastructure investment and the growing economic role of women will help build sustained growth

spending is exceptionally strong. This is having spillover effects on other sectors, such as the construction industry and building supplies.

Government spending in Saudi Arabia is budgeted at an all-time high for 2012. At the same time, global demand for oil is expected to rise in 2012 on continued strong growth in emerging markets, according to the International Energy Agency.

"With the implementation of an unprecedented number of major projects, as well as enhancement of the role of women in the Saudi economy, the kingdom is moving to a new level of sustained growth and prosperity," says Adeeb Al-Sowailim, CEO of Falcom Financial Services in Riyadh. Women will be allowed to vote in the 2015 local elections and to be appointed to the Shura Council, the formal advisory body of Saudi Arabia.

The kingdom has a strong competitive advantage in the production of fertilizer, aluminum, steel and, of course, petroleum-based products, Al-Sowailim says.

The Saudi economy grew by 6.8% in real terms in 2011. However, the dominant oil and gas sector grew by only 4.3%. Manufacturing, which is primarily focused on petrochemicals, saw a 12% gain, its sharpest rise for well over a decade, according to the Central Department of Statistics.

Private consumption has become an important driver of economic growth, according to Samba Financial Group in Riyadh. The most recent census puts population growth at 3.4%, making Saudi Arabia one of the fastest-growing countries in the world. The global average is 1.2%.

"Growth [in the population] over the past decade has been spurred by expatriates, who tend to save more and consume less, but the Saudi national population is still growing at a brisk 2.1%," says Keith Savard, director of economics research at Samba.

"The pool of savings in the country is exceptionally large, with a savings rate of about 15%," Savard says. "We believe that optimism goes hand in hand with income growth, which will be uniformly positive in the next 12 months."

OIL & GAS EXPORTS GROW IN QATAR

Bank lending is on the rise in Qatar, one of the fastest-growing economies in the world. Private sector credit growth rose 19.2% last year, while public sector credit growth remained high at 44.7%.

A large part of the lending to the private sector went to contractors and real estate, which saw a gain of 33%, according to Samba. "We expect that credit growth will remain healthy this year as salary increases and sustained high levels of public spending promote increased activity and investment," the bank says.

Qatar's hydrocarbon exports surpassed $100 billion in 2011 and are expected to remain high this year and next, Samba says. This reflects a surge in production capacity in liquefied natural gas (LNG) and refined petroleum products, as well as recent strength in oil prices, it says.

"Qatar has been a success story in the energy sector for the past 10 to 15 years," says Mohamad Moabi, assistant general manager for economics, financial analysis and research, at Qatar National Bank.

The country is enjoying increasing demand for LNG from China, India and Japan. Meanwhile, Qatar is the world's leading country by far in GTL (gas-to-liquids), with major plants by Sasol of South Africa and Shell that convert natural gas into low-sulphur diesel, naptha and liquid petroleum gas.

In addition, Qatar is sending gas by pipeline to neighboring countries. Qatar Petroleum completed a $10.4 billion financing last December of its Barzan gas project, which will help meet growing domestic and regional energy demand.

Over the next decade, Qatar will focus on development and infrastructure, adding capacity to its existing transportation network and building a new airport, as it prepares to host the FIFA World Cup in 2022, Moabi says. More than $180 billion of projects are planned in the region over the next 10 years, with Qatar making up a significant chunk of that investment.

STRONG BANKS

Qatar National Bank led the country's banking market in terms of assets, with $82.9 billion on December 31, 2011. QNB accounts for nearly half of the assets of all Qatari banks.

The country's banking sector is working on a new regulatory framework, as the Qatar Financial Centre Regulatory Authority—the state financial regulator—is restructuring to create three niche service hubs: reinsurance, captive insurance and asset management. "We have been working hard to put

> **"We believe that optimism goes hand in hand with income growth, which will be uniformly positive in the next 12 months"**
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> *— Keith Savard, Samba Financial Group*

in place the best regulatory environment for all three of our core hubs," says Shashank Srivastava, acting CEO of the QFC Authority.

The QFC Authority officially enacted a new tax and regulatory regime in 2010—including a 10% corporation tax on locally sourced profits, zero personal income tax, no restrictions on dealing in any currency and special provisions for Islamic finance.

GOOD BUSINESS ENVIRONMENT

"The low rate of tax is attractive for local firms with international ambitions and multinational firms thinking of establishing a presence in the region," Srivastava says.

Qatar and the QFC have been largely unaffected by the regional political unrest, Srivastava adds. The most recent global competitiveness report from the World Economic Forum ranked Qatar as the world's 14th most business-friendly country and the highest rated in the Middle East and North Africa.

Srivastava, QFC Authority: Qatar's low tax rate is attractive for local firms with international ambitions and multinational firms entering the region

Last July the QFC Regulatory Authority issued new business rules for captive insurers, captive managers and insurance intermediaries. The changes include a new and more flexible "class 4" captive, a risk-based model for capital requirements, and streamlining of the approval process.

QFC-licensed companies are allowed to operate outside the two QFC Towers, as long as the premises are designated as QFC locations. There are about 40 such locations around Doha and new ones being considered.

"One of the factors limiting the growth of Qatar's financial services sector is the shortage of skilled and experienced people," Srivastava says. With this in mind the QFC Authority and the Qatar Foundation have jointly created the Qatar Finance and Business Academy to train financial services professionals and provide certifications. ■

Liberalization And Growth Fuel Capital Markets

Saudi Arabia's stock market recently hit a 40-month high, and with global markets showing signs of growing confidence, Falcom Financial Services of Riyadh predicts the Saudi market will continue to rise. The stock market is expected to open to foreign investment, which will increase trading and pave the way for more exchange-traded funds to develop.

Saudi Arabia's banks remains largely insulated from dislocations in the eurozone and enjoy plentiful liquidity and solid capitalization ratios, according to a report by Samba Financial Group in Riyadh. "This liquidity is being put to good use in the local project market, which is largely untroubled by the exiting of many European banks from the region," says Keith Savard, director of economics research at Samba.

The average capital adequacy ratio of Saudi banks is 17%. Their foreign liabilities have fallen steadily in recent years, Savard says. "In addition, the Islamic nature of banking in Saudi Arabia means that a good deal of deposits are non-interest-bearing, which keeps the cost of funds comparatively low," he says.

STRONG ISLAMIC MARKET

Islamic bond sales also got off to a strong start this year, highlighted by the Saudi Arabian government's first Islamic note issue. The 15 billion riyal ($4 billion), 10-year instrument was issued by the General Authority of Civil Aviation. The proceeds will be used to finance the King Abdulaziz International Airport redevelopment in Jeddah.

In Qatar, the development of a market for Islamic issuance is strongly supported by the state financial regulator, the Qatar Financial Centre Regulatory Authority. The QFC Authority gives the same support to Islamic finance as it does to conventional finance, according to Shashank Srivastava, acting CEO of the QFC Authority. "For example, the QFC supports the development of retakaful [Islamic reinsurance] products and the issuance of sukuk as an asset class in response to increasing investor demand," he says.

Faith In The Dollar Peg

Global Finance sits down with Qatar's central bank governor, sheikh Abdullah Bin Saud Al-Thani. The pegged-exchange-rate regime is working well, according to Al-Thani, and the resilient financial sector will help Doha to develop as a financial hub. By Gordon Platt

Global Finance: **Monetary union in the Gulf Cooperation Council, if achieved, would deprive the Qatar central bank of independence and policy tools to guide the economy. Is it worth it to continue the riyal's peg to the dollar until GCC monetary union?**

Al-Thani: Qatar's decision to keep its exchange rate pegged to the dollar is based on key considerations that encompass the economic realities of the country, the state of development of the financial markets, and several other factors. There are several advantages in maintaining the dollar peg, which is preferred by most oil exporters. First, the fixed exchange rate [to the dollar] provides a credible anchor for monetary policy, as almost all of Qatar's export contracts and invoicing are done in dollars. Thus, a stable exchange rate renders stability to our foreign export earnings, the main component of government revenue. Second, for most of the period for which the peg has been maintained, the Qatari economy has benefited from the stable economic environment in the US. Third, fixed exchange rates are much easier to monitor in the absence of exchange-rate risk. The absence of developed and robust financial markets precludes the development of adequate risk-hedging instruments needed in a floating exchange-rate regime.

Despite these obvious benefits, there are some challenges while operating under fixed exchange rates. With the fixed anchor, we have to maintain policy [relatively] consistent with that of the US. [But this] may not always be justified based on our own domestic considerations, [so] we have demonstrated some independence of policy in light of our own economic imperatives.

For instance, we changed our policy stance to further easing in 2010 and 2011, while the US continued with the pause on policy rates. We continue [to have] faith in the pegged exchange rate regime after carefully weighing the benefits against the costs. Nevertheless, we will continue to review the situation in light of evolving international and domestic macroeconomic developments.

"Qatar's decision to keep its exchange rate pegged to the dollar is based on key considerations that encompass the economic realities of the country, the state of development of the financial markets, and several other factors"

-Sheikh Abdullah Bin Saud Al-Thani

GF: Bank lending to the real estate sector in Qatar rose sharply last year. Will we continue to see such fast rates of growth in lending to the property market ahead of the 2022 FIFA World Cup?

Al-Thani: Overall credit growth during 2011 was 28.2%, driven primarily by public-sector credit expansion. The two major drivers of private credit—real estate (including contractors) and consumption—recorded growth rates of around 33% and 20%, respectively.

In future, a significant amount of private participation will be required in the run-up to the World Cup. Therefore, with project financing opportunities coming up, along with infrastructure investment, credit demand is likely to improve over the medium term. Under these circumstances the role of the government would be to provide an enabling economic environment for the private sector to grow and prosper, in line with our National Vision (a long-term national economic blueprint, framed in 2008, for an advanced, self-sustaining society).

GF: According to the IMF, Qatar's projected GDP growth for 2012 is 6%. That will feel like a sharp deceleration from nearly 20% growth last year. Are you planning a smoothing policy?

Al-Thani: The projected deceleration in GDP growth to 6% in 2012 by the IMF is over the base of 2011, which has experienced high growth. This deceleration is premised on significant moderation of real hydrocarbon GDP growth on account of the self-imposed moratorium on hydrocarbon production, which would keep LNG production capped at 77 million metric tons. Large infrastructure investment and increased production in the manufacturing sector, however, will maintain real non-hydrocarbon growth at 9% in 2012.

In this regard, it has been our endeavor to gradually reduce Qatar's reliance on the hydrocarbon sector by diversification into other sectors and reinforcing competitiveness. This will necessitate raising productivity through greater use of the latest technologies, increasing the efficiency of investments, fostering more openness to foreign competition, and enhancing the quality of labor. This has been articulated in the government's national development strategy for 2011–2016. From the central bank's perspective, we are fully supportive of this process of diversification by ensuring adequate flow of credit to the productive sectors of the economy.

GF: What is your vision of the role of Doha as a regional and international financial center? Will its specialty be in wealth management, insurance or something else?

Al-Thani: Qatar is one of the few Gulf countries able to successfully withstand the global financial crisis. With its vision of becoming a world-class investment destination, Qatar has been improving its economic and financial infrastructure. The Qatar Exchange has entered into a strategic partnership with the New York Stock Exchange in order to become a preferred choice for investors. Efforts are also ongoing to list small and medium enterprises on the stock market. This will further boost the diversification efforts of our economy.

Further, a process of unification of the regulatory bodies is under way, which will enable us to address the regulatory gaps and overlaps. We hope to develop a robust and resilient financial sector that will cater to the diverse requirements of investors across various asset classes.

GF: Is Qatar's banking system capable of financing the $100 billion worth of projects in the country's 2030 Vision?

Al-Thani: The banking system is well capitalized, profitable and has low levels of delinquent loans. The banks have been continuously improving their outreach by expanding beyond national borders. At the same time, banks have been taking proactive steps to improve their risk-management skills in order to cope with the challenges of financing large-scale projects. From our side, we have been continuously fine-tuning our regulatory and supervisory framework with a macro-prudential focus to comprehensively monitor and manage risks. ■

The Levant Banks On Stability

Caution and conservative growth are the key goals of Levantine economies. By Gordon Platt

The resource-poor countries of the Levant have been trying to promote open markets, free trade and labor mobility among themselves to strengthen their economies, but the ongoing hostilities in Syria have complicated the effort.

Banks in the Levant—countries on or near the eastern Mediterranean—have witnessed several political and economic crises in recent years, which has taught them to be cautious and conservative in their operations, says Abdel Hamid Shoman, chairman of Arab Bank, based in Jordan. He says taking a prudent approach during turbulent times is critical to long-term success. "This [stance] has allowed us to be well positioned to capitalize on times of growth," Shoman says.

The unrest in Syria started to take its toll on neighboring countries in 2011. "Tourism in the region has been affected, as well as trade," Shoman says. "Syrian exports are relatively cheap in comparison to other options."

Amid the uprisings, the kingdom of Jordan, which has been invited to join the Gulf Cooperation Council, is working on reform, both politically and economically, Shoman says. "The fiscal challenge is large, and the 2012 draft budget aims to reduce the deficit by controlling spending in areas with little social returns and increasing the revenue effort," he says. "Efforts have also been expanded in supporting small and medium enterprises as well as entrepreneurship, given their potential to drive economic growth." In addition, the country is working to boost the Amman Stock Exchange and revise investment regulations to create a healthier and ultimately more attractive market for investors.

"Despite the challenges that lie ahead for Jordan, there are still positive indicators in the form of a steady flow of foreign remittances, a tourism industry that boasts great potential, and robust exports of phosphate and potash," Shoman adds. The Jordan Free Zone is also playing a major role in attracting investments from the region and globally.

UNDERBANKED IN THE WEST BANK

Hashim Shawa, chairman and general manager of Bank of Palestine, says the West Bank and Gaza economies will remain heavily dependent on foreign aid until Palestine gains sovereignty and creates an efficient state. He says the Palestinian community has been largely unaffected by the revolutions in Syria and Egypt.

Bank of Palestine earned $34 million in 2011, an increase of 13% from a year earlier. The bank's lending increased by more than 32% and could rise another 30% to 40% in 2012, Shawa says. The bank has the widest presence of any financial institution in Gaza and the West Bank, with 47 branches.

Large parts of the West Bank are underbanked, Shawa says. "When we open a branch, we attract a lot of deposits from under the mattress or under the floor." The Bank of Palestine is focusing its lending on microfinance, in addition to large corporations, Shawa says. "We have seen a pickup in entrepreneurial activity, which is the engine of the economy," he says.

There has been a major boom in the construction sector. More than three-quarters of the Palestinian population is under the age of 35, which is one of the reasons there is a huge demand for housing, Shawa says. The Bank of Palestine created the first mortgage program specifically for Palestinian community and is making 25-year home loans in partnership with developers. "We have had good support from the regulatory authorities," Shawa says. In 2010 the Palestine Monetary Authority introduced an electronic credit bureau that is used by utilities and other businesses.

Shoman, Arab Bank: Jordanian policymakers aim to control spending and increase revenue collection

Shawa, Bank of Palestine: Banks in Gaza and the West Bank have good support from regulatory authorities

Ultimately, although advances have been made and banks in the region are hoping for greater stability to aid development, the sector continues to struggle with the ever-present shadow of further hostilities in neighboring nations. Until that shadow is lifted, it will be slow going for banks. ■

Easing The Burden

Dubai has some way to go before its debt profile is viewed as safe and sound, but it has already made great strides. By Gordon Platt

The Dubai debt crisis shocked the world in November 2009. Despite the ongoing generosity of Abu Dhabi, the oil-rich capital of the United Arab Emirates, Dubai's debt issues have still not been solved. The Dubai government and related entities have managed to restructure and refinance billions of dollars of debt, but the rollovers are becoming a habit.

"Dubai's debt is under control, but still worrisome," says Brad Bourland, chief economist and managing director of proprietary investment at Jadwa Investment in Riyadh. The economy of Dubai has bounced back, thanks to tourism and logistics, and the emirate is doing quite well despite its overbuilt real estate market, he says. Abu Dhabi has the capacity to fully help Dubai if necessary, Bourland adds.

"Dubai's fast growth track, which was mainly financed by debt, was put to the test in the past three years," says Abdel Hamid Shoman, chairman of Arab Bank, in Jordan. "Dubai is largely a service-based economy, which still has a lot of potential for growth," he says.

Dubai's status as an international city, with lots of trade and tourism, makes it susceptible to the influence of the global economy, Shoman says. "On the other hand, that also means that Dubai will benefit greatly when the global recovery gets going, signs of which have already started appearing with the recent pickup in real estate pricing," he says.

This is evident in the housing sector, Shoman says, which has been driven by higher demand and the fact that many companies are moving to open offices in Dubai. The emirate has been helped by its safe-haven status amid the Arab Spring uprisings.

Rick Pudner, group CEO of Emirates NBD, the largest lender in the UAE, says rebounding tourism, trade and logistics will boosting Dubai's economy, which grew more than 3% last year, and that retail sales are robust.

"[European] banks are significant participants in existing financing [in Dubai] and may not be eager to participate in refinancing debt that is coming due"

—Christos Papadopoulos, Standard Chartered

REFINANCING DEBT

Christos Papadopoulos, regional CEO for the Middle East, North Africa and Pakistan at Standard Chartered, says he is not particularly worried about the current situation in Dubai with regard to its debt. "We are cognizant of the refinancing coming up and we are watching the space carefully," he says. "The problems are not all behind us."

However, European banks are deleveraging and need to improve their capital ratios, Papadopoulos notes. "[European] banks are significant participants in existing financing [in Dubai] and may not be eager to participate in refinancing debt that is coming due."

Standard Chartered is the leading international bank in the UAE. It is involved in commercial and retail banking as well as capital markets activities in the UAE domestic market. In addition, it has a large trading room in its own facilities at the Dubai International Financial Center.

The bank has positioned some of its global desks at the DIFC, which benefits from being in a time zone between Asia and Europe and offers a favorable tax environment, as well as increasingly deep markets, Papadopoulos says.

EXTERNAL AID

Abu Dhabi made a liquidity injection into Emirates NBD last October of $762 million at a discount to market rates to help it absorb Dubai Bank. Emirates NBD took over the Islamic lender on orders of the ruler of Dubai, according to the Dubai Government Media Office.

Abu Dhabi gave Dubai $20 billion in 2009 to help restructure debt, but Dubai government officials say they have no intention of seeking more help from its deep-pocketed neighbor this year.

Emirates NBD posted a 62% decline in 2011 fourth-quarter profit to $41 million after it increased provisions for bad loans. Nonperforming loans have risen as the bank deals with exposure to debt restructuring by state-owned companies.

The bank's ratio of NPLs to total loans rose to 13.8% in the fourth quarter from 12.9% in September 2011. The ratio is expected to rise to 14% or 15% this year and may hit 16% in 2013.

"It is a little early to say if the nonperforming loan ratio will peak this year or next year, because one or two restructurings have not been finalized, but it is leveling out," Pudner says.

Nonetheless, the bank's full-year 2011 profits rose 8.2%, due in part to a 7% increase in net interest income. "We have taken a conservative view with our provisioning level, and the bank is in a good position to ride out the next two to three years," Pudner says.

CORPORATE DEBT RESTRUCTURING

Dubai's Jebel Ali Free Zone is trying to refinance a $2 billion sukuk coming due in November. Pudner says he is confident that the restructuring negotiations will be handled smoothly. The industrial free zone, which is part of state-owned conglomerate Dubai World, has hired Citi to advise it on its options for meeting the sukuk maturity. The restructuring is expected to involve a cash payment of about $300 million, as well as a new Islamic bond and a syndicated loan. The free zone houses more than 6,400 companies, including 593 industrial companies, and accounts for more than half of Dubai's exports.

Dubai World reached an agreement on a $25 billion debt restructuring a year ago, but many government-linked enterprises have not. DIFC Investments, the financial arm of the Dubai International Financial Center, has a $1.25 billion sukuk maturing in June.

Dubai Group, an investment company owned by Dubai's ruler, sheikh

Market watchers are anticipating Dubai's upcoming refinancing and evaluating the outcomes carefully

Papadopoulos, Standard Chartered

Mohammed bin Rashid Al Maktoum, has offered to pay creditors over five to 10 years, as it seeks to restructure $6 billion of bank loans. Altogether, Dubai and related companies have more than $10.3 billion in debt maturing this year, according to an estimate by Bank of America Merrill Lynch.

Emirates NBD, which is 55.6% owned by Dubai's government, increased its loans to the government by 10% last year. Pudner says the bank's relationship with the government has always been an arm's-length, commercial relationship.

LEGAL WRANGLING

Meanwhile, bankers and investors seeking to collect on loans coming due are finding little help available in the UAE's courts. The World Bank's Ease of Doing Business survey ranks the UAE 151st out of 183 countries in terms of resolving insolvency.

A draft of the country's first bankruptcy law is expected to be completed by the end of this year. The new law will not apply to government entities or companies licensed to operate in a financial free zone, such as the Dubai International Financial Center.

Government officials say one of the goals of the new law is to dissuade debtors from fleeing the country when they get into financial trouble. It wants them to remain and restructure their businesses.

A unit of Monarch Alternative Capital, a New York investment company, filed a claim of about $45 million in London last October against Drydocks World, a

Drydocks World, a ship-repair subsidiary of Dubai World, is seeking to restructure $2.2 billion of debt

> "Dubai will benefit greatly when the global recovery gets going, signs of which have already started appearing with the recent pickup in real estate pricing"
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> —*Abdel Hamid Shoman, Arab Bank*

ship-repair subsidiary of Dubai World. But lawyers say a judgment by the High Court of London would have no bearing in Dubai, where Drydocks World is seeking to restructure $2.2 billion of debt, including a $1.7 billion syndicated facility issued in 2008 and a $500 million Islamic facility.

Dubai has a $20 billion support fund that was set up in 2009 with Abu Dhabi's money to help bail out its debt-laden companies. However, the Dubai government is encouraging companies and their lenders to reach a restructuring agreement before seeking government support.

In the case of the Jebel Ali Free Zone, J.P. Morgan said in a research note that local banks hold most of the maturing sukuk and that they are likely to roll over their exposure into new debt. "We are now more comfortable with the refinancing risk, as we believe that there is healthy appetite for Jebel Ali Free Zone among local banks (including banks in Abu Dhabi), resulting in lower dependence on foreign capital markets," the bank said. ■