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Commercial banking in the Middle East and GCC countries: A snapshot

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Abstract

In the Middle East & GCC region, capital markets are weak or almost non-existent, and banks are the main suppliers of credit to private and public investment projects. Banking sectors in the region, however, have traditionally been highly concentrated markets and large banks are also consolidating their domestic position before expanding in the region. Further, portfolio and liability composition differ considerably across banks in the region, as well as profitability conditions. All banks remain adequately capitalized, on average.

The research presented in this issue was conducted by Ms. Rima Turk Ariss of the Economic Analysis Section within the context of the work of EDGD on financial linkage and economic development. It is a preliminary paper, disseminating the findings of work in progress, and has not been subjected to the usual review process for ESCWA publications. Feedback and comments from readers are therefore welcome and may be made at http://www.escwa.un.org/main/contact.asp.

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Note: The opinions expressed are those of the author and do not necessarily reflect the views of ESCWA.

Commercial banking in the Middle East and GCC countries: A snapshot

Recent advances in information technology, financial innovations, globalization and deregulation have reduced margins in traditional banking activities worldwide, and banks have sought innovative (and sometimes self-destructive) means of increasing profits. In the Middle East &GCC region, capital markets are weak or almost non-existent, and banks are the main suppliers of credit to private and public investment projects. Banking sectors in the region, however, have traditionally been highly concentrated markets. In some countries where a large number of banks operate, like Lebanon, Turkey and the U.A.E, large banks have sought to consolidate their position domestically before expanding in the region. In other countries like Jordan and Kuwait, leading banks are strategically investing across borders in order to enhance their growth potential. The ongoing consolidation of financial institutions within each country and cross-border intensifies public policy debates on issues of concentration and competition in local retail markets. In parallel to the wave of mergers, the governance structure of banks in the region is evolving. Banking institutions have traditionally been either family-owned firms managed by majority shareholders who cater for their own personal interests, or dominated by state authorities, thus making it more difficult for new entrants to compete in the industry. Following accession to the World Trade Organization (WTO) and greater commitment to financial liberalization, however, the ownership of large shares of the banks was altered from government to private and from domestic to foreign control. Such changes occur as governments privatize some of their state-owned banks and reduce barriers to foreign entry, in line with the WTO accession requirements. Leading international financial intermediaries such as Citigroup, HSBC, BNP Paribas, ABN Amro and Standard Chartered have generally set up a wide presence in the MENA region through subsidiaries and are competing with domestic banks in different segments of the industry. Foreign investors bring in state-of-the-art technology, sophisticated risk management techniques and qualified human capital, forcing domestic banks to undergo major structural reforms in order to compete on an equal platform with their peers. Attracting foreign banks also correlates with better disclosure requirements which, together with a better regulatory environment, ultimately have a positive effect on a country's growth performance. In addition to intense competition from foreign banks, commercial banks in region are also facing increased competition from Islamic banks. Recently, banks operating in accordance with the Islamic legal code have proliferated and are now established as viable modes of financial intermediation, thereby increasing competitive pressures in the industry.

What follows is a brief analysis of banking structures in the region, using data from Bankscope.

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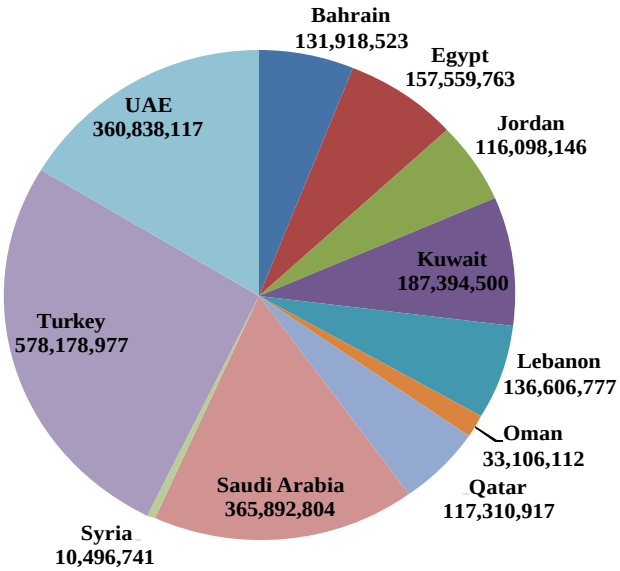
Figures for 2009 indicate that the largest three banking sectors in the region are for Turkey, Saudi Arabia, and the UAE.

Figure 1: Regional Bank Assets, 2009



Source: Author's calculations from Bankscope

Banking sectors in the region are highly concentrated, with Oman, Jordan, and Qatar showing the highest 5-bank concentration ratios in terms of total assets.

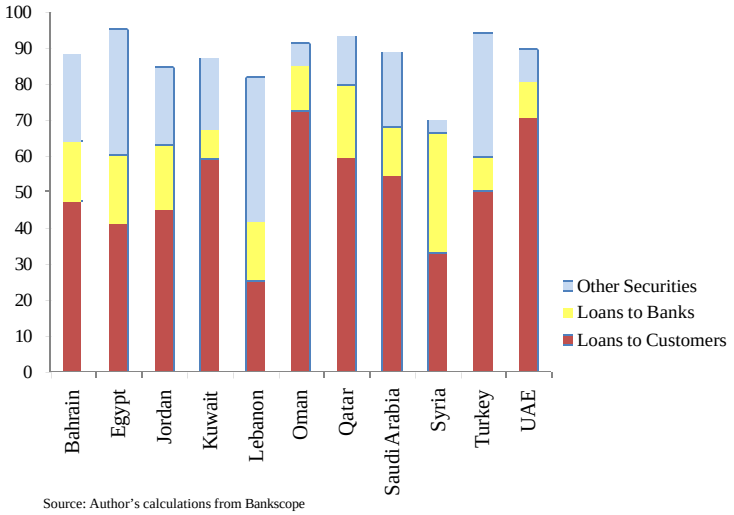
Table 1: Bank concentration, 2009

	3-Bank Concentration	5-Bank Concentration
Bahrain	49.84	64.41
Egypt	54.31	65.72
Jordan	79.00	84.38
Kuwait	54.95	71.39
Lebanon	44.48	60.14
Oman	71.77	87.63
Qatar	66.19	81.04
Saudi Arabia	45.14	66.83
Syria	52.15	79.73
Turkey	42.90	63.07
UAE	48.19	64.80

Source: Author's calculations from Bankscope

Oman and the UAE have the highest ratio of loans to assets, whereas Lebanon has the least exposure to loan portfolio risk. Lebanon has also the highest share of securities in bank portfolios.

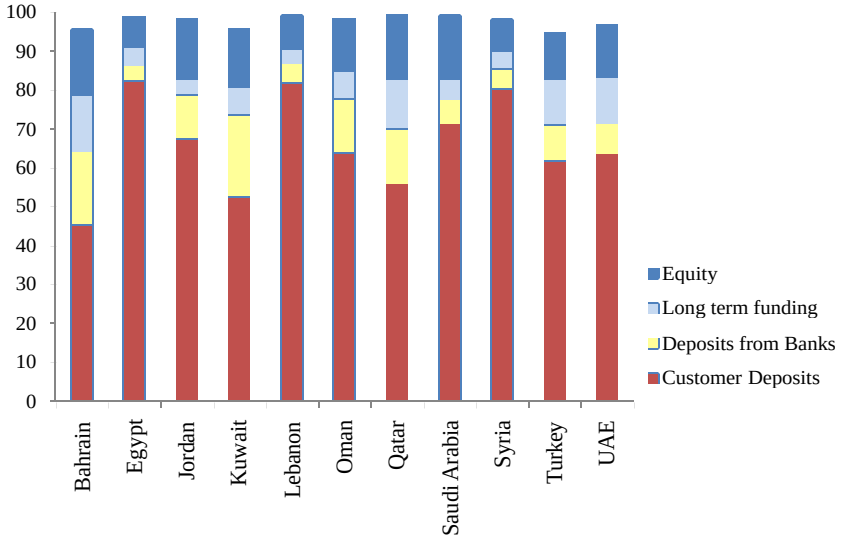
Figure 2: Bank Portfolio Composition (% of Assets), 2009



Source: Author's calculations from Bankscope

Banks in Bahrain, Kuwait, and Qatar rely the least on core funding in the form of customer deposits, and UAE banks rely the most on long-term sources of funds. Interestingly, these four countries were more severely affected by the crisis relative to other countries. The most immune country, Lebanon, has the greatest reliance on stable deposit funding.

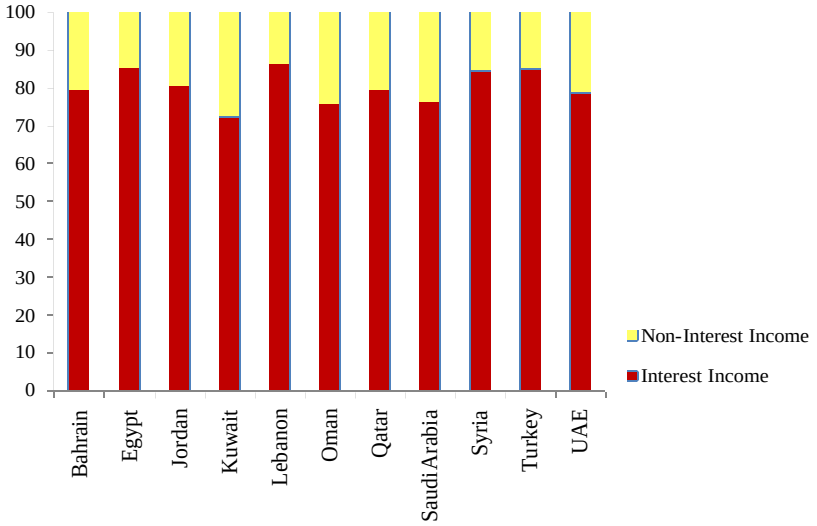
Figure 3: Bank Sources of Funding (% of Assets), 2009



Source: Author's calculations from Bankscope

Banks in Oman, Kuwait, and Saudi Arabia seem to have more diversified revenues relative to banks in other countries whose main source of income stems from interest income.

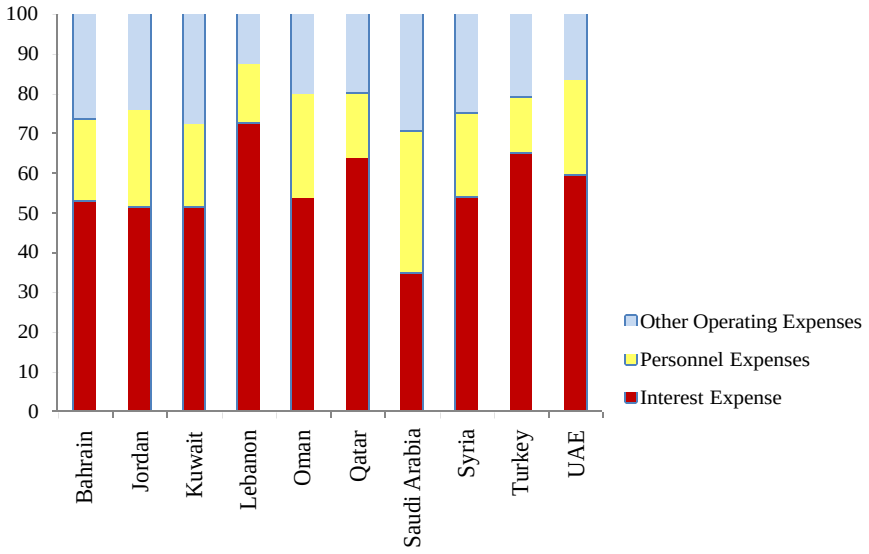
Figure 4: Bank Revenue Composition (% of total), 2009



Source: Author's calculations from Bankscope

In all countries except Saudi Arabia, interest expense dominates the cost structure of banks. Personnel expenses represent the least fraction of costs in Lebanon, whereas in Saudi Arabia both personnel and other administrative and operating costs are the most.

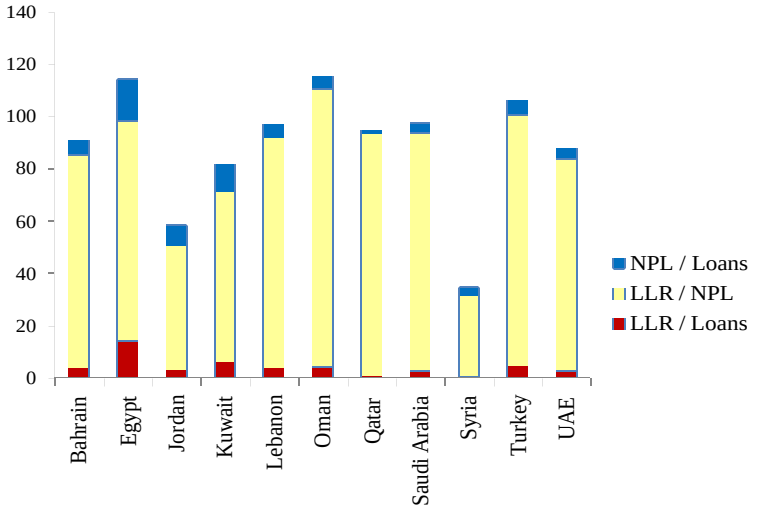
Figure 5: Bank Expense Composition (% of total), 2009



Source: Author's calculations from Bankscope

In terms of asset quality, banks in Qatar have the lowest ratio of nonperforming loans to total loans, and banks in Oman seem to be the best provisioned relative to other countries.

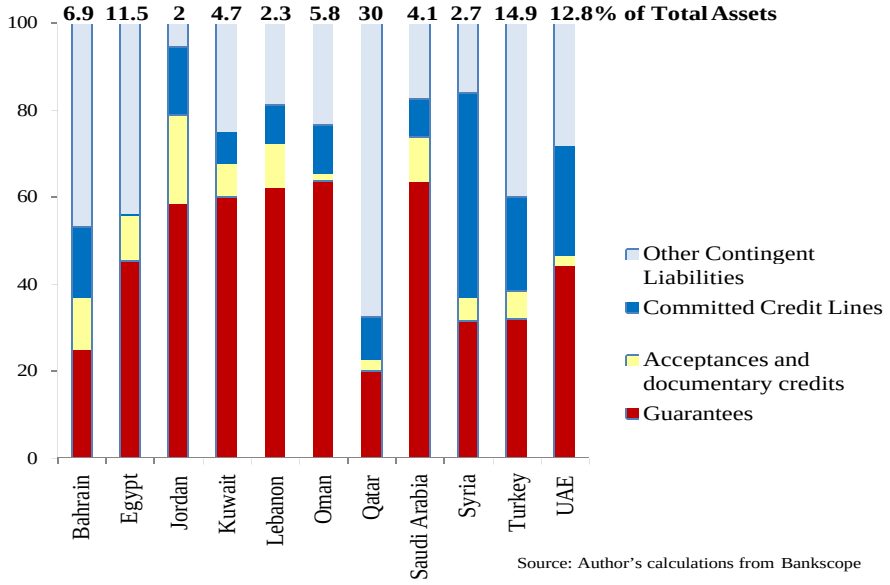
Figure 6: Asset Quality, 2009



Source: Author's calculations from Bankscope

Off balance sheet activities vary greatly for banks in the region, from as low as 2.3% of assets in Lebanon to 30% of assets in Qatar. Lower values suggest a greater risk-aversion attitude by banks.

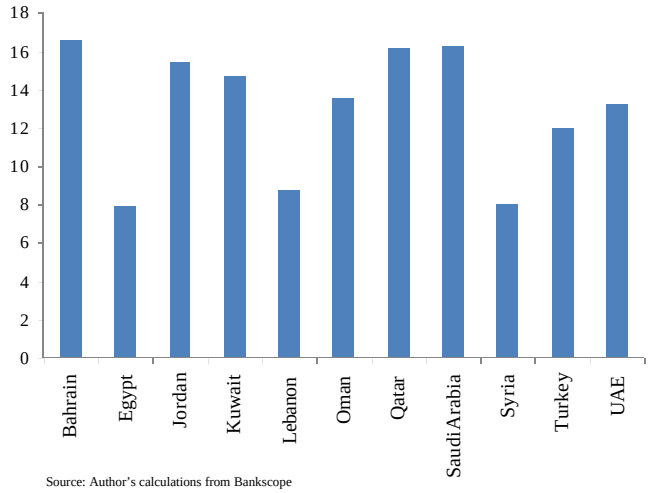
Figure 7: **Off-Balance Sheet Activities, 2009**



Source: Author's calculations from Bankscope

Overall, banks in the region are more than adequately capitalized following international standards. Banks in Bahrain, Saudi Arabia, and Qatar report the highest equity to assets ratios.

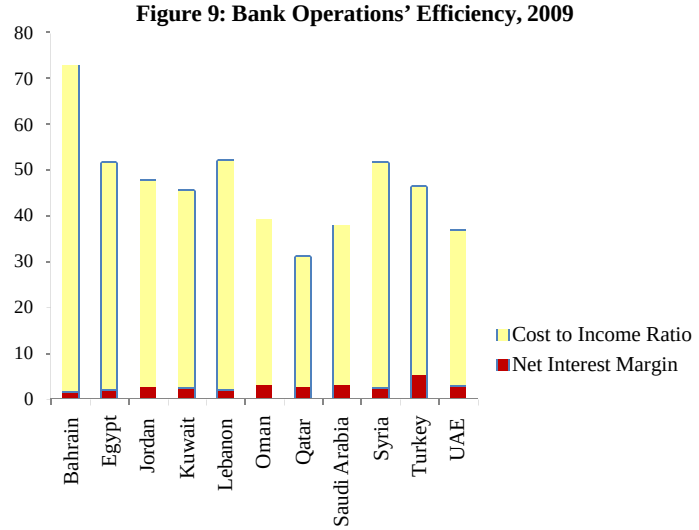
Figure 8: Bank Capital: Equity-to-Assets, 2009



Source: Author's calculations from Bankscope

Banks in Bahrain seem to be the least efficient (followed by Lebanon and Syria) because of their highest cost to income ratio. In contrast, banks in Qatar have the lowest cost-to-income ratio, and banks in Turkey report the highest net interest margin.

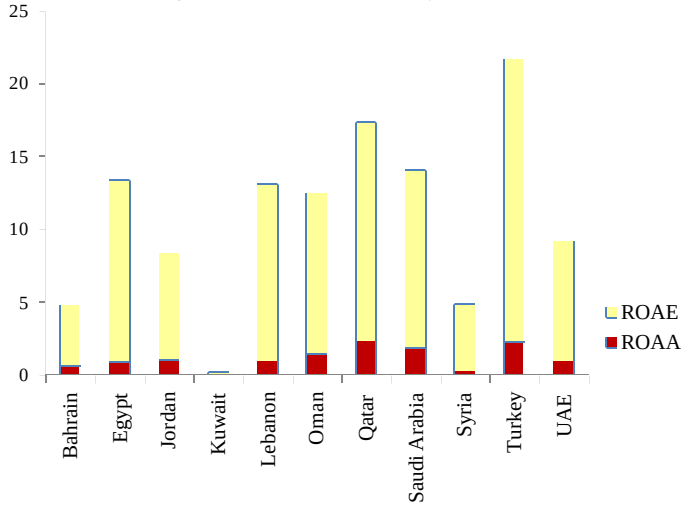
Figure 9: Bank Operations' Efficiency, 2009



Source: Author's calculations from Bankscope

The most profitable banking sector, both in terms of return on average assets and equity, is for Turkey, followed by Qatar and Saudi Arabia.

Figure 10: Bank Profitability, 2009



Source: Author's calculations from Bankscope

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