6 A New Era for Gulf Banking

INTRODUCTION

A combination of declining lending activities, rising number of non-performing loans, more competition and government regulation, squeezed margins and greater lending risks are pulling down earnings of Gulf banks. Meanwhile, international banking is becoming more competitive as financial institutions link up to provide round the clock service in the new globalized deregulated market. A new era for Gulf banking is dawning that requires long term structural adjustment to cope with the challenging economic and business environment.

During the 1974–83 boom, Gulf banks expanded rapidly and generated good profits, servicing economies growing at double digits growth rates. Governments were the main propellors of growth and banks thrived on huge public sector expenditures. However, in the first half of this decade, the GCC countries witnessed a dramatic transition from surpluses in the balance of payments and government budgets into corresponding deficits. Oil revenues are estimated to have dropped to less than 40% of the $150 billion recorded in 1980. It has become evident that the region is experiencing an extended period of consolidation and retrenchment. The GCC countries are preparing themselves to cope with lower oil revenues for sometime to come.

The ongoing period of retrenchment mirrors a new economic realism in the region. The fall in oil revenues coincided with the end of the first development cycle. Much of the necessary infrastructure has been completed and emphasis is now being shifted towards the industrial and services sectors and towards operating the economies more efficiently. The private sector is being induced to participate more actively in the overall development process.

Gulf central banks are also signalling the end of an era for free banking and lax financial reporting habits in the region. Regulators are determined to introduce reforms leading to better disclosure norms and to drive banks to reconsider their lending practices before the recent decline in the quality of loan portfolio becomes alarming. The increased supervisory role of the central banks are expected to be accompanied by new and more effective tools of monetary policy.

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The changing business opportunities in the Gulf and abroad are creating a more sophisticated financial services market to which banks in the region are expected to contribute. What is the outlook for Gulf banking? Can Gulf banks cope with the challenge? and What changes they need to implement in order to evolve into full service financial institutions?

CHANGING BANKING CONDITIONS IN THE GULF

The reduction in the pace of regional growth and development has led to an overall slackening of demand for finance. Guarantee business, contract financing and import financing, previously Gulf banks’ core business, accounting for more than 70% of their loan commitments have fallen off sharply last year. A good portion of the loan demand for these sectors now takes the form of rollovers of existing credit. Banking environment in the region has become more testing and competition among banks all chasing fewer first-tier clients is leading to tighter profit margins.

Good commercial banking business is less easy to come by, running costs are being looked at more critically, and some loans which one to two years ago seemed sound enough now look more suspect. Depressed property and stock market have undermined even the best of the collaterals that banks hold.

Gulf Bankers, preoccupied mainly by asset growth in the 70s and early 80s, are now re-evaluating assets, insisting on quality, looking for opportunities abroad and specializing either in traditional trade financing, investment banking, financial serves or in portfolio management.

The economic slowdown in the region is bound to create cash flow problems especially among inefficient companies that have been mismanaged for sometime. Many Gulf companies expanded so rapidly in the boom period that they did not have time to build up an organizational structure to keep with the volume of work at hand. Provided they were technically competent, money kept flowing in and everyone made a profit. Cash and liability management did not seem important in the 70s and early 80s. Some companies took loans for construction purposes and ‘downstreamed’ them into property and financial transactions. Others tied up some of their own resources in investments at home and abroad which were not necessarily bad, but were too illiquid to be of use in a crisis.