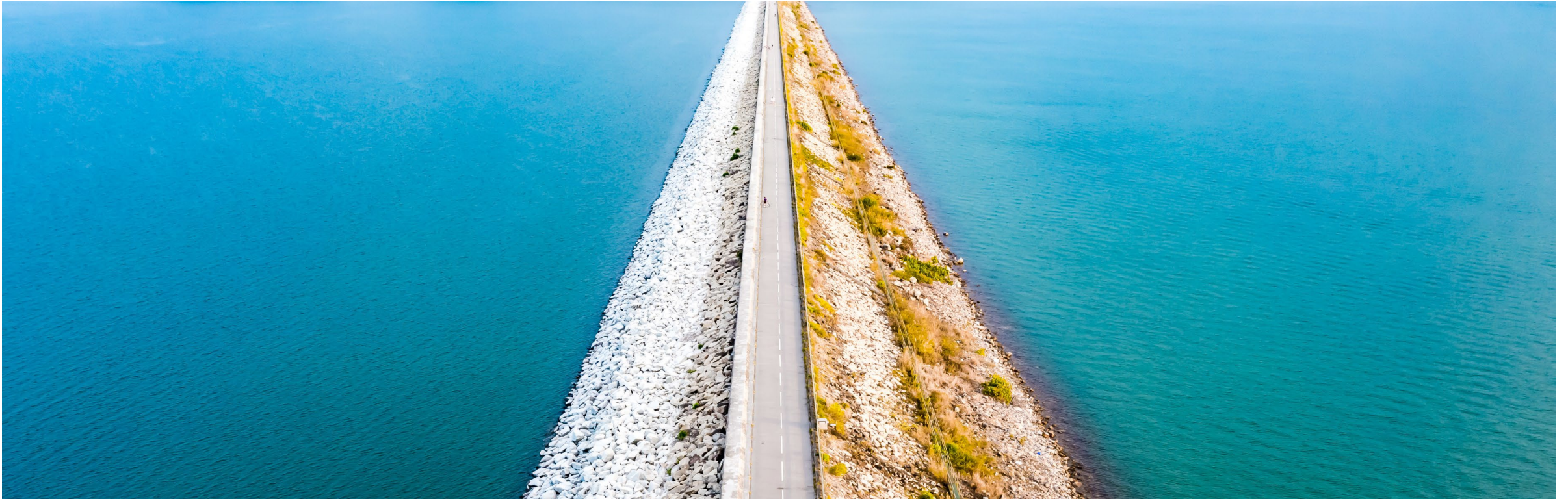


GCC Banking Sector Outlook: **On The Recovery Path In 2022**

Mohamed Damak
Senior Director, Global Head of Islamic Finance
Financial Services

Jan. 11, 2022



S&P Global
Ratings

This report does not constitute a rating action

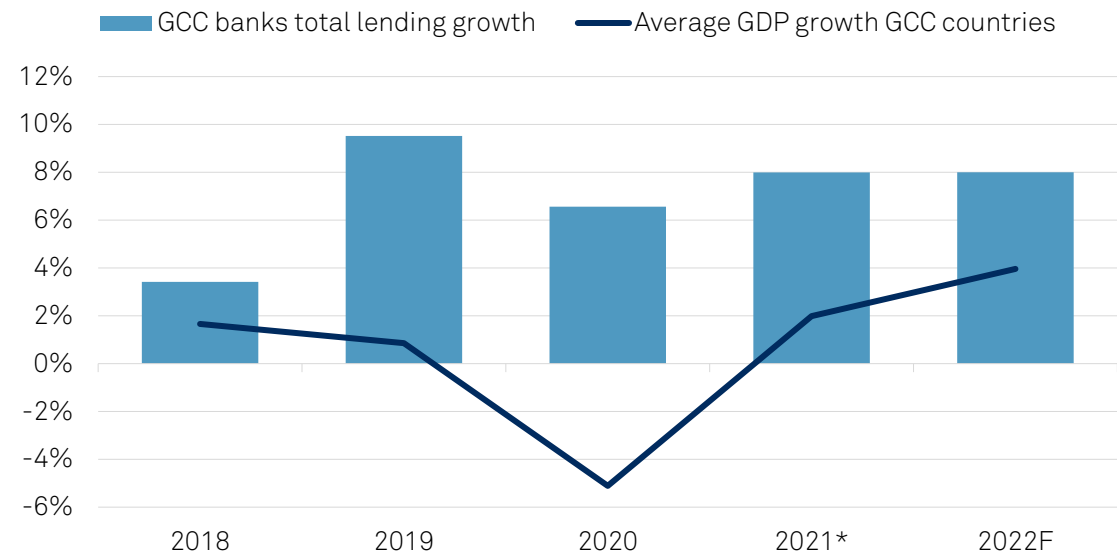
Key Takeaways

- Gulf Cooperation Council (GCC) economies are recovering from the COVID-19 pandemic thanks to higher oil prices, still supportive government spending, and normalizing non-oil activity.
- We expect banks' asset quality indicators to deteriorate only slightly as regulatory forbearance measures have helped the corporate sector to deal with the negative effects of the pandemic. In our view, the nonperforming loan (NPL) ratio will rise in the next 12-24 months without exceeding 5%, compared with 3.7% at Sept 30, 2021.
- Corporates in general are seeing a gradual recovery but certain sectors remain under pressure such as aviation and hospitality. The rise in Dubai real estate prices may be short-lived as the structural oversupply of residential property could challenge the market over the long term, making the recovery fragile.
- Amid a tight job market, accelerated inflation readings over the past few months, and increasingly hawkish forward guidance from the U.S. Federal Reserve, we now expect three rate hikes in 2022, with the first hike expected in May. This will prompt a similar reaction from GCC central banks given their currency pegs. Banks will benefit from such an increase assuming no material impact on asset quality.
- Lower global liquidity is likely to have a limited impact on GCC banks thanks to their strong net external asset positions or limited net external debt positions. Qatar is more vulnerable than other countries due to its large and expanding net external debt position but there are some mitigants.
- Strong capitalization and government support will continue to reinforce banks' creditworthiness.

Economic Recovery | Ongoing Across The Region

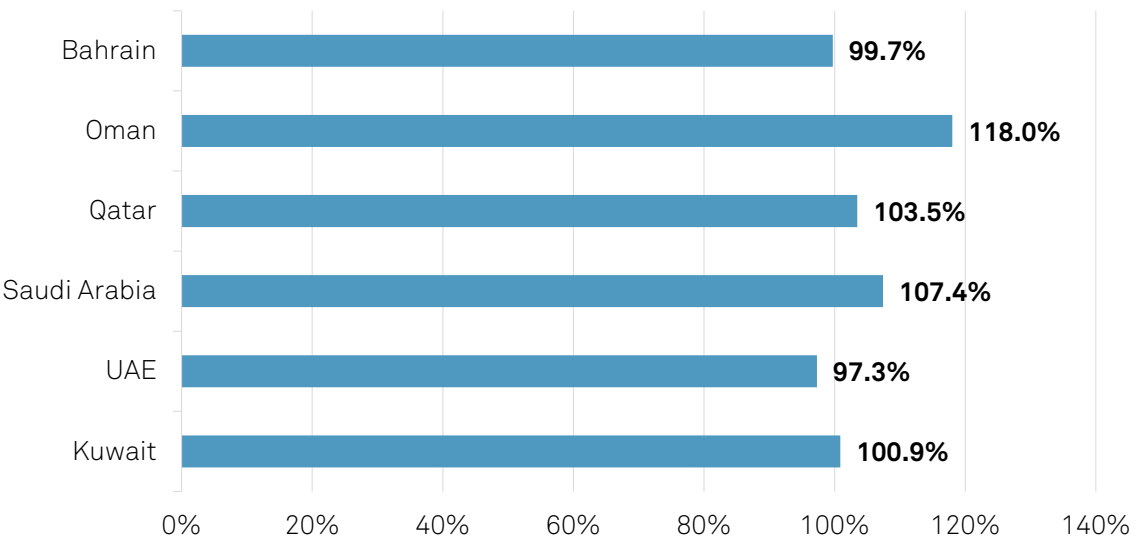
- We expect the Brent oil price to average \$65 per barrel in 2022. Improving economic sentiment and higher hydrocarbon production should lead to accelerated economic growth in the region. However, an uncontrolled resurgence in the pandemic that reduces mobility could hamper the global and regional economic recovery.
- Bahrain and the United Arab Emirates (UAE) are the only two countries where nominal GDP at year-end 2022 will remain slightly lower than 2019. This is because of the weight of the hospitality and real estate sectors in their economies.

A Mild Recovery After A Major Shock



*Annualized. F--Forecast. Source: S&P Global Ratings, banks' financials.

Nominal GDP In 2022 Versus 2019



Source: S&P Global Ratings.

Lending Growth | Accelerating In Some Countries More Than Others

Lending Growth In The GCC 2018-2021

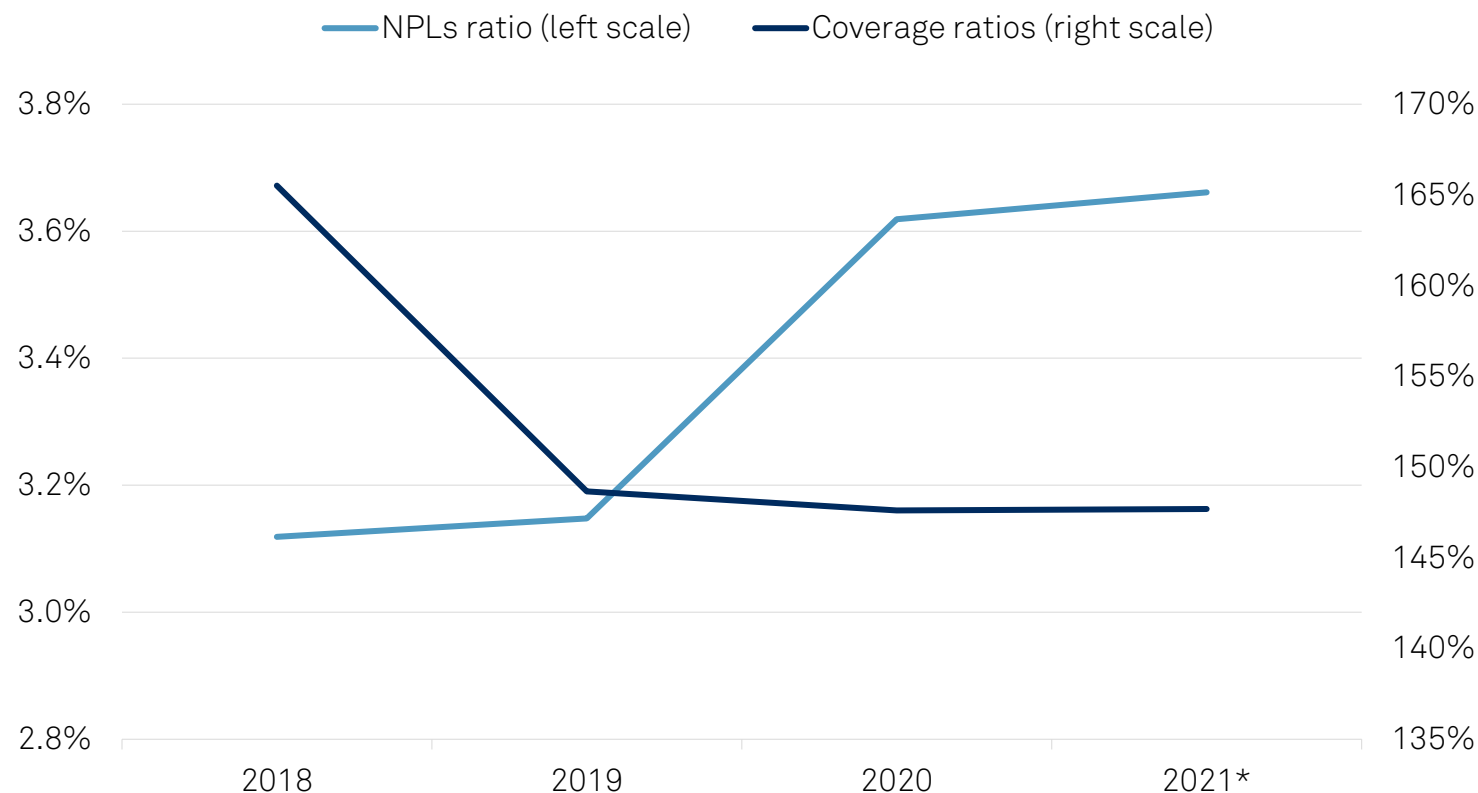
(Mil \$)	2018	2019	2020	2021*
Bahrain	55,051	58,885	60,960	65,756
Annual growth rate (%)	(1)	7	4	10
Relative weight in sample (%)	4	4	4	4
Kuwait	150,988	159,971	171,030	183,006
Annual growth rate (%)	3	6	7	9
Relative weight in sample (%)	12	12	12	12
Oman	38,728	38,291	39,195	40,494
Annual growth rate (%)	5	(1)	2	4
Relative weight in sample (%)	3	3	3	3
Qatar	272,112	299,294	320,018	334,909
Annual growth rate (%)	2	10	7	6
Relative weight in sample (%)	22	22	22	22
Saudi Arabia	375,503	401,921	452,434	501,983
Annual growth rate (%)	2	7	13	15
Relative weight in sample (%)	30	29	31	32
UAE	362,927	416,360	421,297	426,600
Annual growth rate (%)	6	15	1	2
Relative weight in sample (%)	29	30	29	27
Total	1,255,308	1,374,722	1,464,934	1,552,748

*Annualized. Source: S&P Global Ratings, S&P Market Intelligence.

- Residential mortgage lending continues to drive strong growth in Saudi Arabia.
- Kuwait is also seeing expansion, mainly spurred by retail lending and the oil sector.
- In Qatar, the government remains the main impetus for higher lending growth.
- UAE lending growth remains sluggish but we expect an acceleration as economic sentiment improves.
- Bahrain's double-digit growth is explained by acquisitions and expansion outside the country.
- Oman is recovering slowly.

Asset Quality | Deterioration Will Continue

Top 45 Banks' Asset Quality Indicators



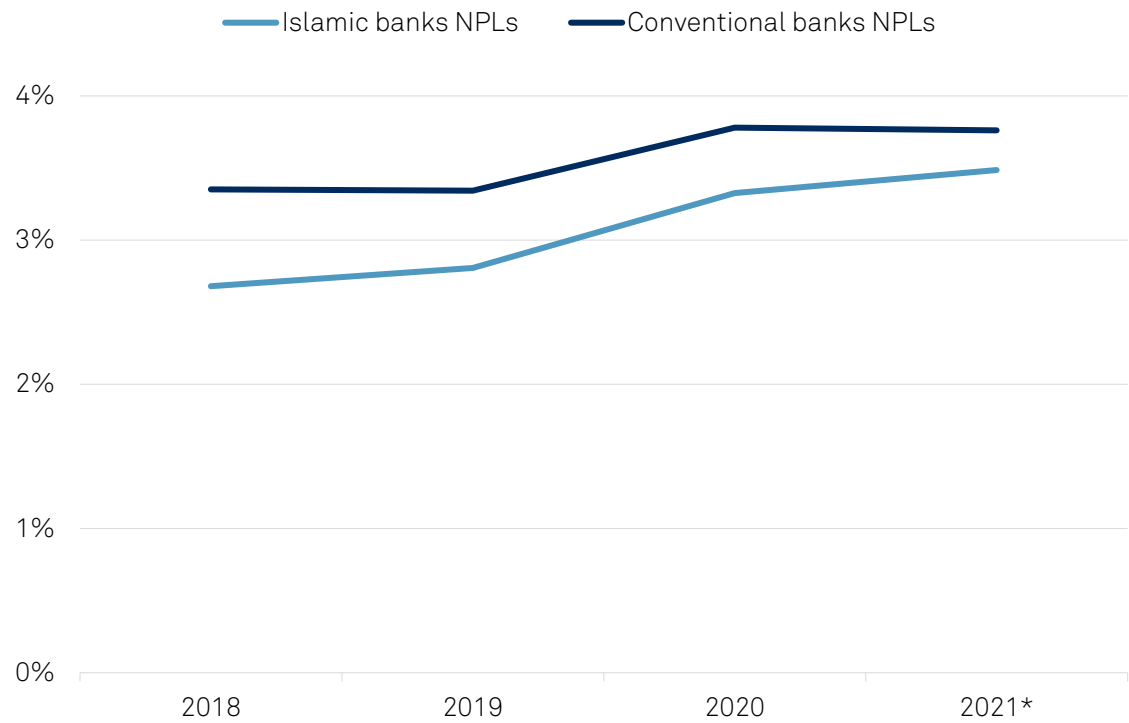
- The NPL ratio continued to increase, reaching 3.7% on average for our sample of banks at Sept. 30, 2021, compared with 3.1% at year-end 2019.
- Regulatory forbearance helped to avert a more significant increase and gave corporates the necessary time to recover.
- Although cash flows are still below historical levels for many corporates, most have managed to generate enough revenue to remain current on their bank financings.
- We have observed a reduction in deferred exposures in most GCC countries.
- We expect NPLs to continue increasing but not exceed 5% on average.

*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

Asset Quality | Islamic Banks Are Seeing Similar Trends

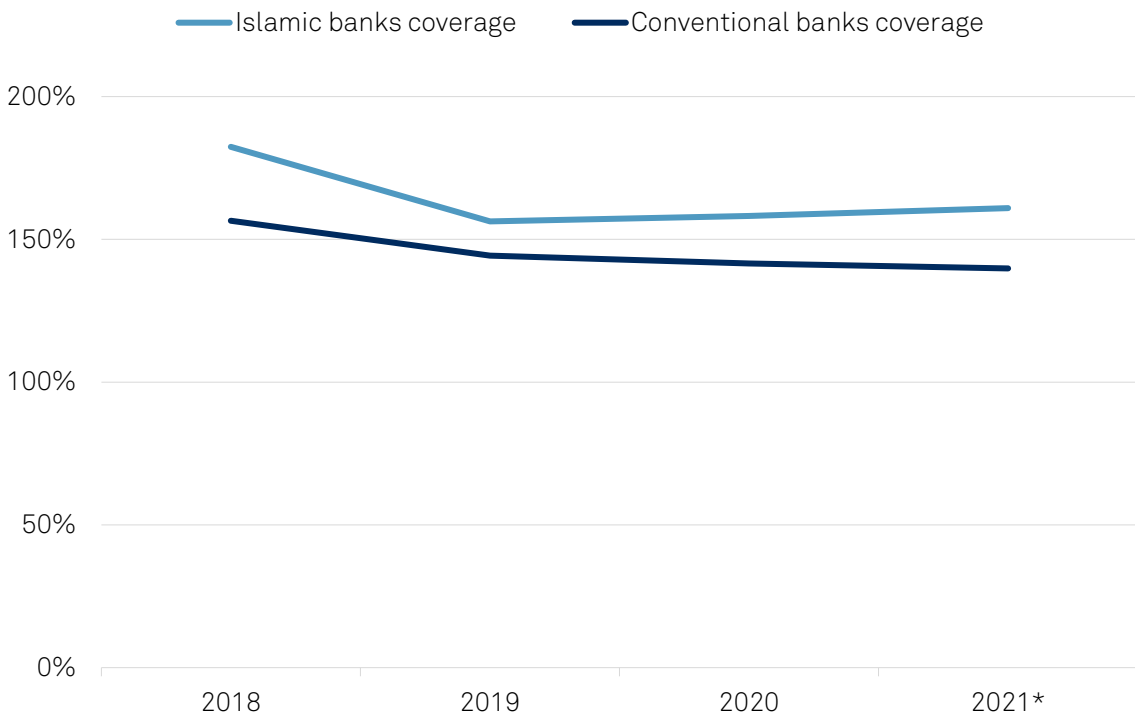
- There is no major difference between the two models as banking in the GCC remains focused on the real economy.

Islamic Banks Versus Conventional Banks--NPLs



*September 2021. NPL--Nonperforming loan. Source: S&P Global Ratings, S&P Market Intelligence.

Islamic Banks Versus Conventional Banks--Coverage

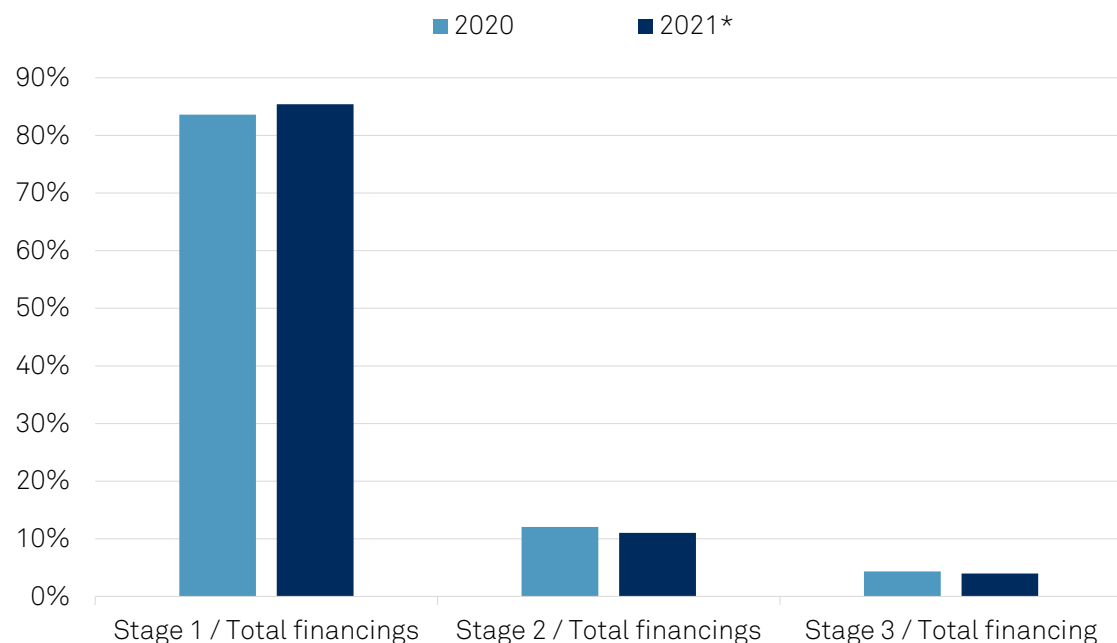


*September 2021. Coverage: Provision / NPLs. Source: S&P Global Ratings, S&P Market Intelligence.

Asset Quality | Regulatory Forbearance Has Helped

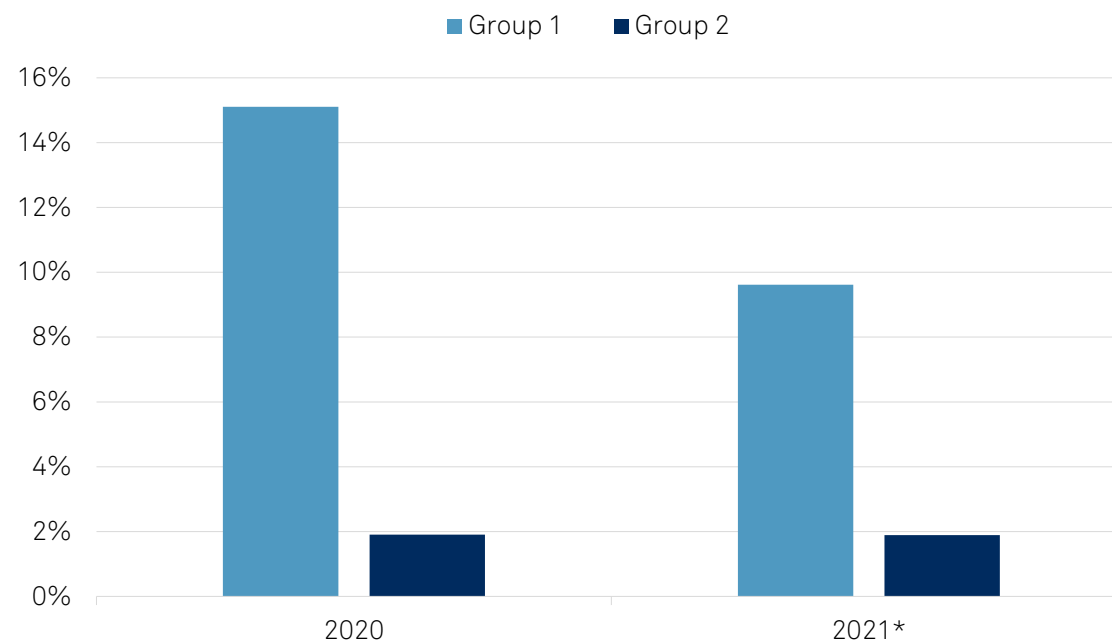
- We have not observed a major deterioration in asset quality indicators thanks to regulatory forbearance measures that gave corporates some breathing space and helped banks to align their loans to new cash flows realities.
- We expect to see some migration of loans to Stage 3 from Stage 2 as forbearance measures are lifted.

IFRS 9 Data Show No Major Deterioration In Asset Quality



*September 2021. IFRS--International Financial Reporting Standard. Source: S&P Global Ratings, S&P Market Intelligence.

UAE Banks Have Benefitted From Regulatory Forbearance

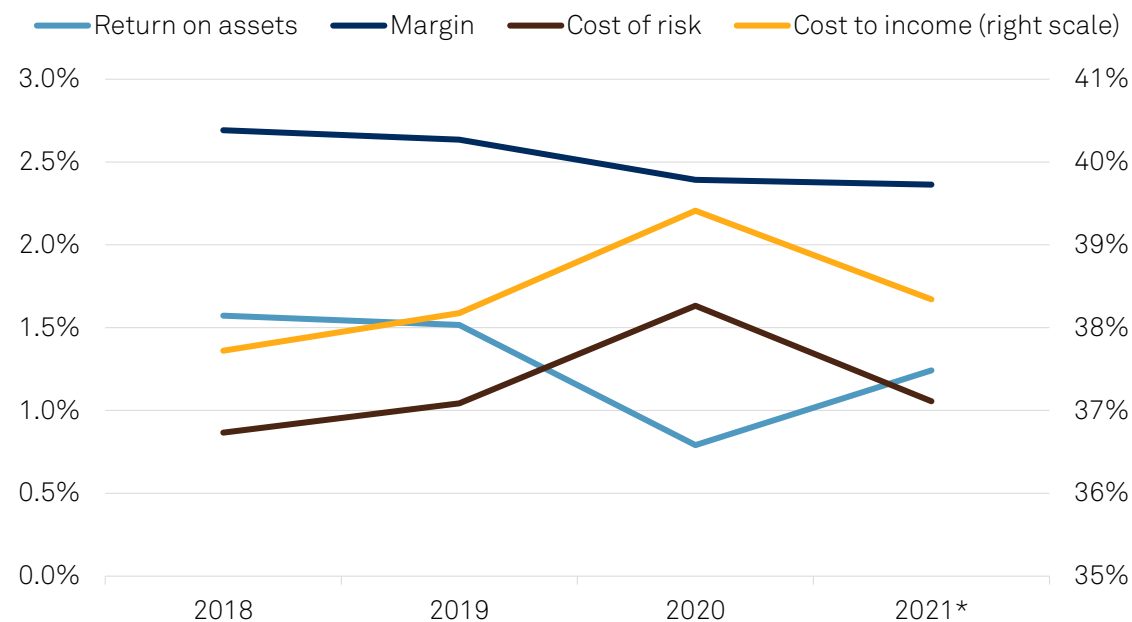


* September 2021. Group 1 (minimal impact) and Group 2 (material impact) deferred lending under the UAE Central Bank's Targeted Economic Support Scheme. Source: S&P Global Ratings, S&P Market Intelligence.

Profitability | Improving And Could Benefit From Higher Rates

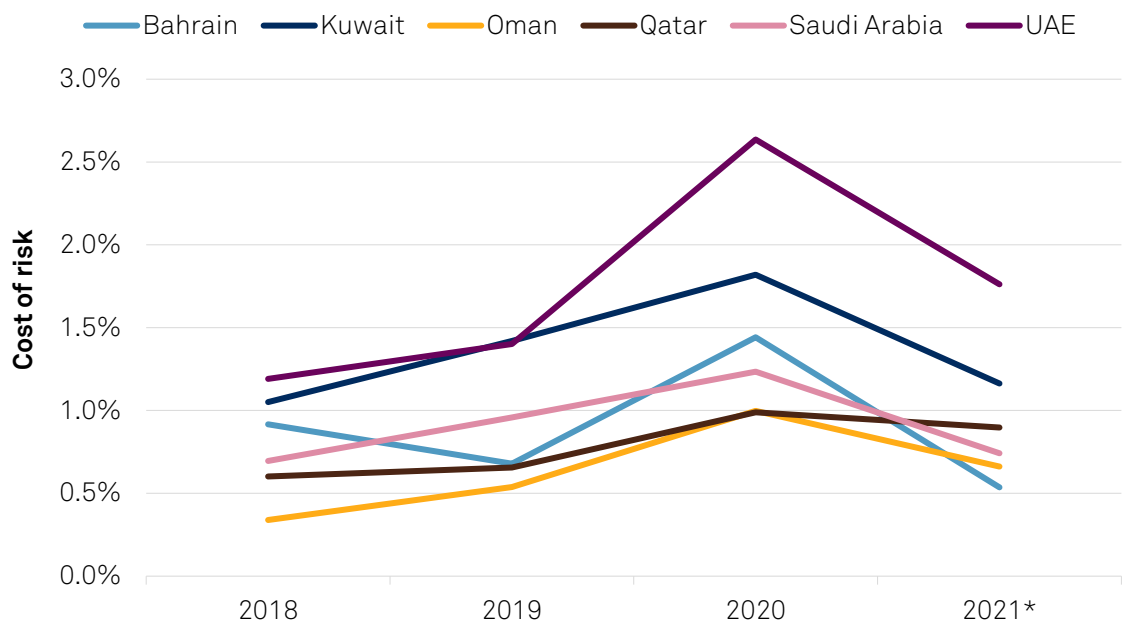
- Margins have stabilized for now and cost of risk has dropped compared with last year. We expect cost of risk to normalize over the next couple of years and margins to benefit from the expected increase in interest rates.
- Banks’ efficiency continues to support profitability, helped by low cost of labor and limited taxation.

GCC Banks’ Profitability Is Improving



*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

Cost Of Risk Has Increased In Some Countries More than Others

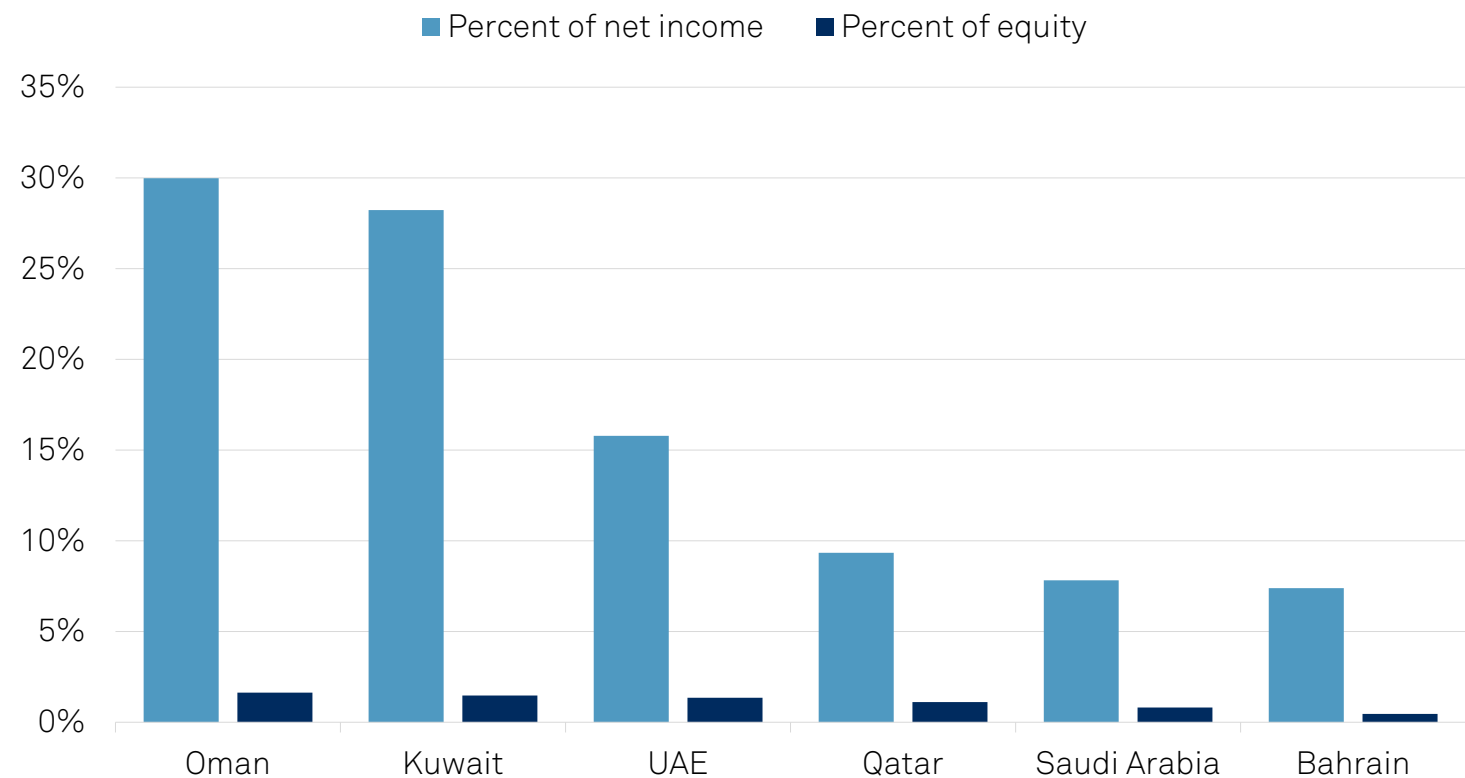


*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

Interest Rates | Potential Hikes Will Support Banks' Earnings

- GCC banks are positively geared to rising interest rates.
 - On average, a 100-basis-point (bps) increase in rates would result in a 14% increase in earnings and 1% capital accretion*.
 - We do not expect a major slowdown in lending growth following a rate increase as this is more dependent on government spending and oil prices.
 - However, external funding might become scarce and more expensive and asset quality indicators could be impacted in case of a faster than expected increase in rates.
- *Calculation based on banks' reported impact of a parallel shift in yield curve at year-end 2020.*

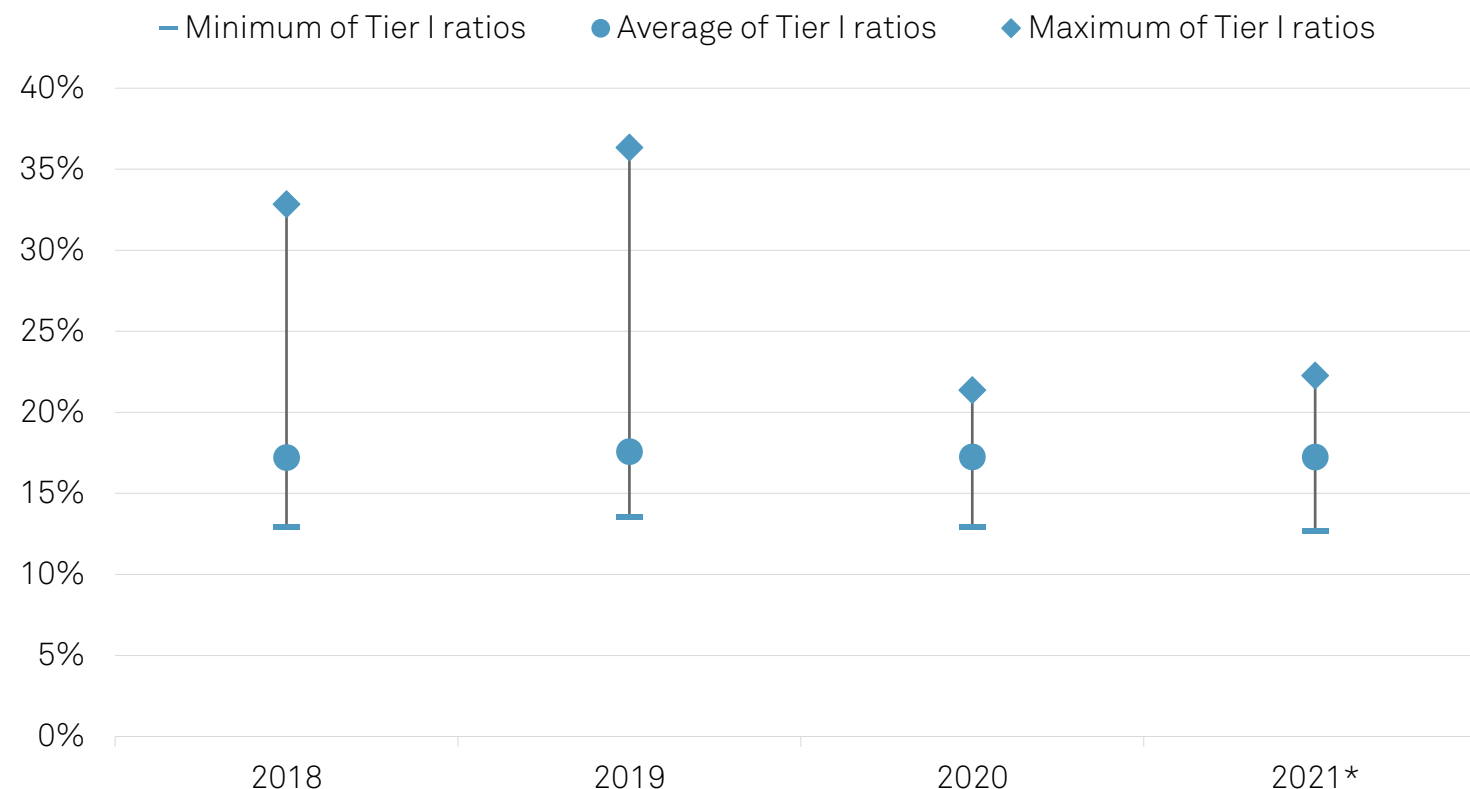
Impact Of A 100-Basis-Point Increase In Interest Rates



Source: S&P Global Ratings.

Capital | A Positive Rating Factor

Tier 1 Capital Ratios Show Strong Regional Capitalization



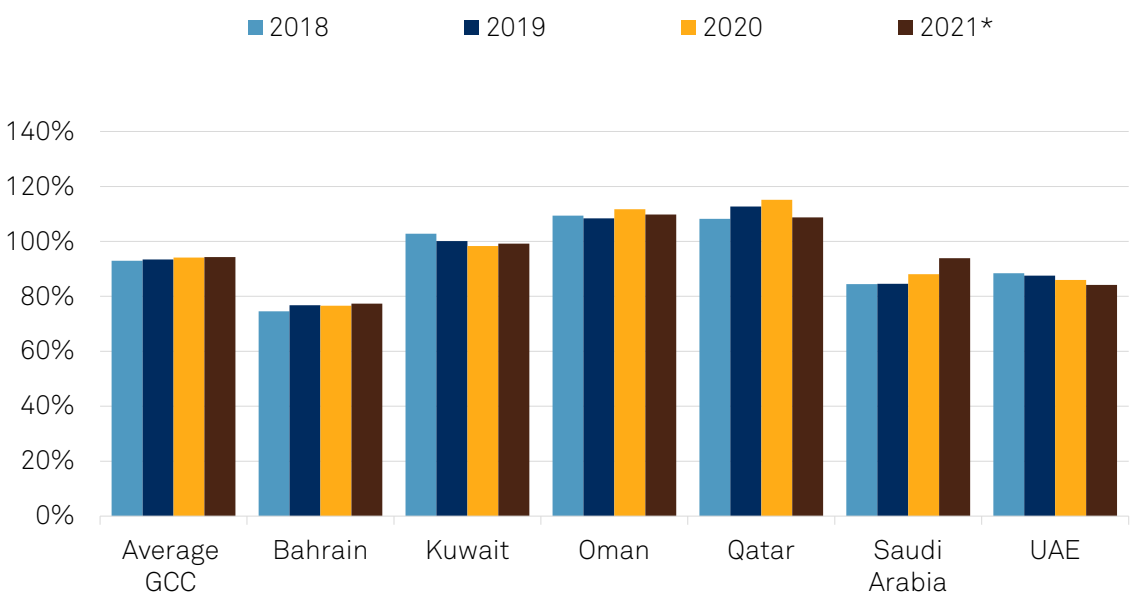
*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

- GCC banks' capitalization will continue to support their creditworthiness in 2022.
- Banks stepped up their additional Tier 1 (AT1) issuances (both conventional and Islamic) in 2020-2021 to benefit from supportive market conditions.
- As interest rates are expected to increase, we might see lower issuance volumes in 2022.

Funding Profile | Dominated By Core Deposits

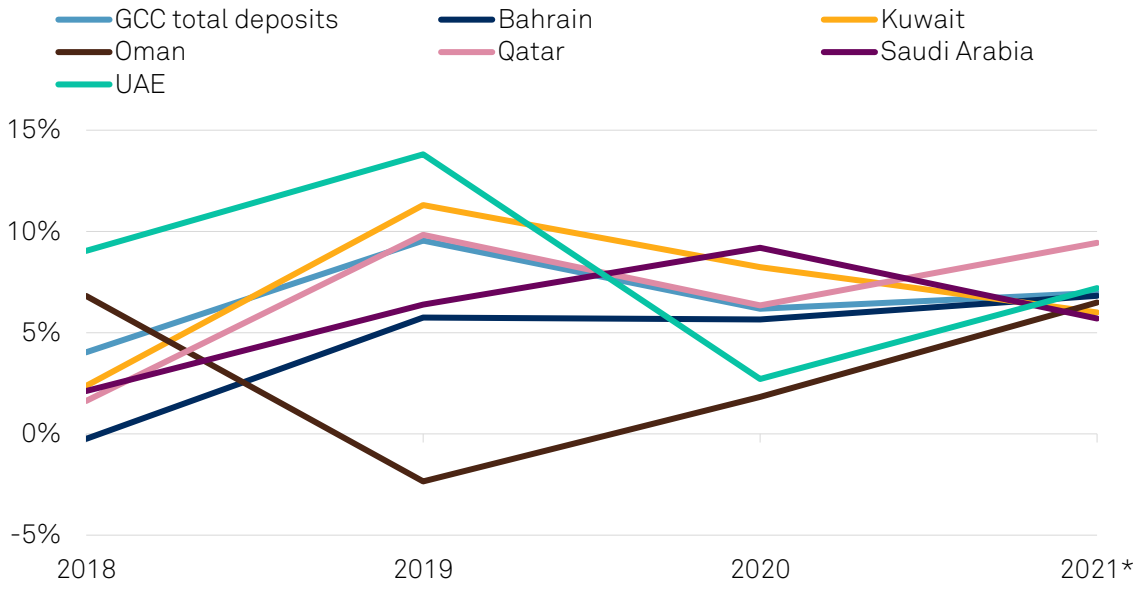
- GCC banks are mainly funded by domestic deposits, which have proved stable through periods of economic stress. These balances reflect the working balances and savings of residents, with expatriate populations remitting regularly.
- Public sector deposits typically account for 15%-30% of the deposit base (except in Bahrain, where it is much less) , which supports banks' funding profiles.

Core Deposits Dominate GCC Banks' Funding Profiles
Loan-to-deposit ratio



*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

Deposits Have Continued To Increase
Deposits growth rate

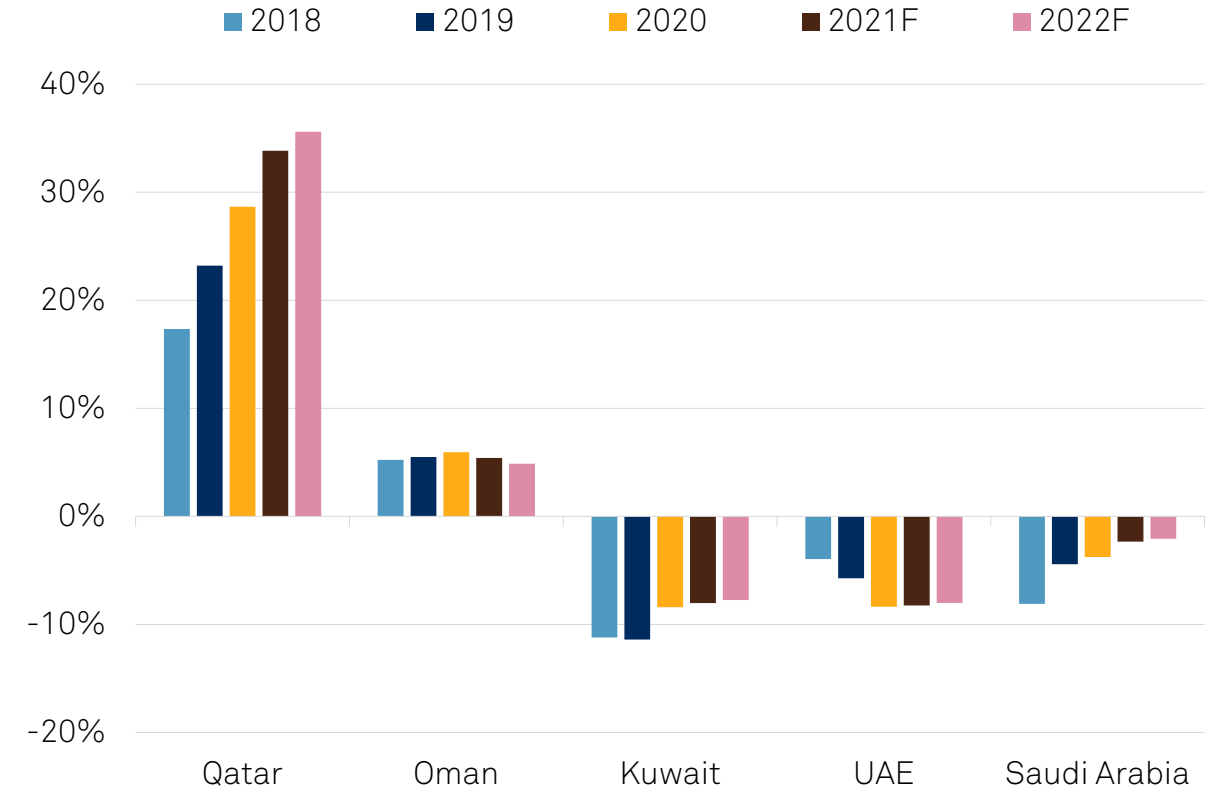


*September 2021. Source: S&P Global Ratings, S&P Market Intelligence.

External Funding | A Source Of Risk For Qatar

- Slower domestic funding growth and low oil prices prompted an increase in external debt from 2015, facilitated by ample global liquidity and low interest rates.
- Regionally, external funding mostly increased in Qatar, but also in the UAE. This has helped to diversify banks' funding, and, in absolute terms, we expect the trend will continue gradually, but slower than the pace of loan growth.
- Qatar is the only GCC system with a large net external debt position, which does increase its vulnerability to investor sentiment and higher interest rates.
- However, a proportion of these deposits relate to parties with long-term economic interests in Qatar and they continued to increase through the 2017-2021 boycott. We also remain of the view that the government would support the system if needed.

External Funding Is High In Qatar But Limited Elsewhere
Net external debt to domestic loans



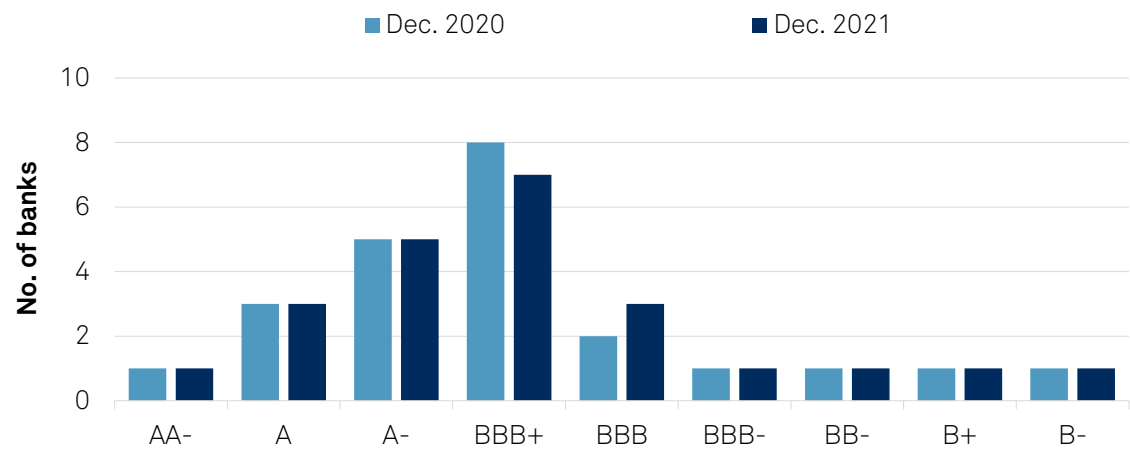
F--Forecast. Source: S&P Global Ratings.

Ratings | Negative Outlook Bias Has Reduced...

- Negative outlooks are mainly concentrated in Kuwait (due to the negative sovereign rating outlook) and Bahrain (due to bank-specific idiosyncratic factors).

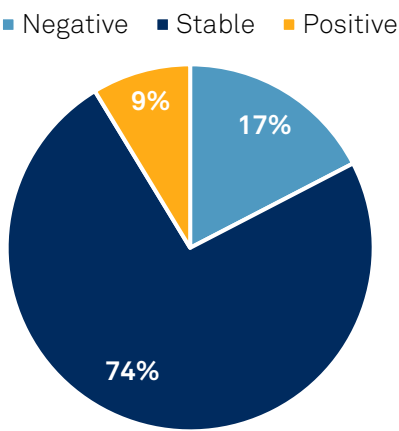
	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Government Support Assessment	Uncertain	Highly Supportive	Uncertain	Highly Supportive	Highly Supportive	Highly Supportive
Anchor	bb	bbb	bb	bbb-	bbb	bbb-
BICRA	7	4	7	5	4	5
Economic Risk / Trend	7 / Stable	5 / Stable	7 / Stable	5 / Stable	5 / Stable	6 / Stable
Industry Risk / Trend	6 / Stable	4 / Stable	6 / Stable	6 / Stable	3 / Stable	5 / Stable

GCC Banks Rating Distribution At Year-End 2021



Source: S&P Global Ratings.

GCC Banks Outlook Distribution At Year-End 2021



Source: S&P Global Ratings.

Related research

- [Credit Conditions Emerging Markets: Inflation, The Unwelcome Guest](#), Dec. 1, 2021
- [EMEA Financial Institutions Monitor 4Q2021: Rebounding Economies Bolster Banks' Recovery](#), Nov. 5, 2021
- [Government Support And Improving Economic Sentiment Help Mitigate Sector Vulnerabilities For GCC Banks](#), Sept. 26, 2021
- [GCC Banks Hope The Worst Is Over As The Recovery Begins](#), Oct. 5, 2021

Analytical Contacts



Mohamed Damak

Senior Director

+971-4-372-7153

mohamed.damak@spglobal.com



Benjamin Young

Director

+971-4-372-7191

benjamin.young@spglobal.com



Zeina Nasreddine

Associate

+971-4-372-7169

zeina.nasreddine@spglobal.com



Puneet Tuli

Associate

+971-4-372-7157

puneet.tuli@spglobal.com

Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com (free of charge), and www.ratingsdirect.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Australia: S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

spglobal.com/ratings

S&P Global
Ratings