GCC Banking Sector: A Long Climb To Recovery

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S&P Global Ratings

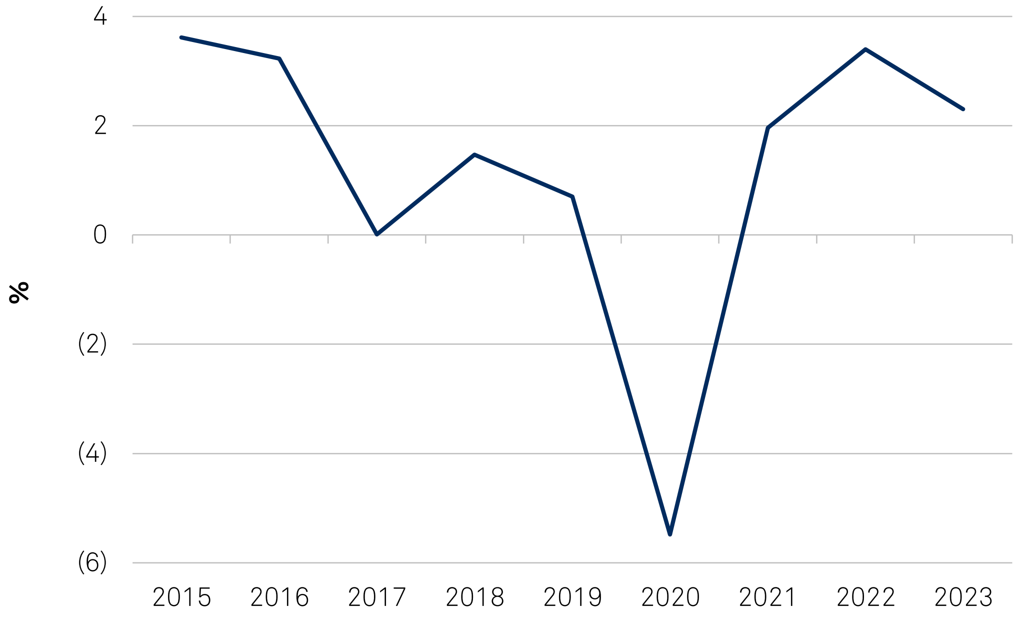
Key Takeaways

- S&P Global Ratings expects GDP growth in the Gulf Cooperation Council (GCC) countries to slowly recover from last year's sharp recession triggered by the COVID-19 pandemic and low oil prices.
- However, we see long-lasting adverse effects from the 2020 shock on GCC economies and banking sectors. Saudi and Qatar's banking sectors will be less impacted than those in the United Arab Emirates (UAE), Oman, and Bahrain, while in Kuwait the story will depend on the evolution of the fiscal impasse.
- Although vaccination programs are progressing, recovery of the aviation and hospitality sectors will take time, with likely significant downside risks from further waves and mutations of the virus.
- We expect banks' asset-quality indicators will continue to deteriorate and cost of risk to remain high as they start recognizing the true impact of 2020 and forbearance measures are lifted in second-half 2021.
- Given continued low interest rates, banks' profitability will remain low in 2021 and beyond, with some potentially showing losses in 2021.
- Strong and stable capital buffers, good funding profiles, and expected government support should continue to support banks' creditworthiness in 2021.

Recovery | A Protracted Return To Normalcy

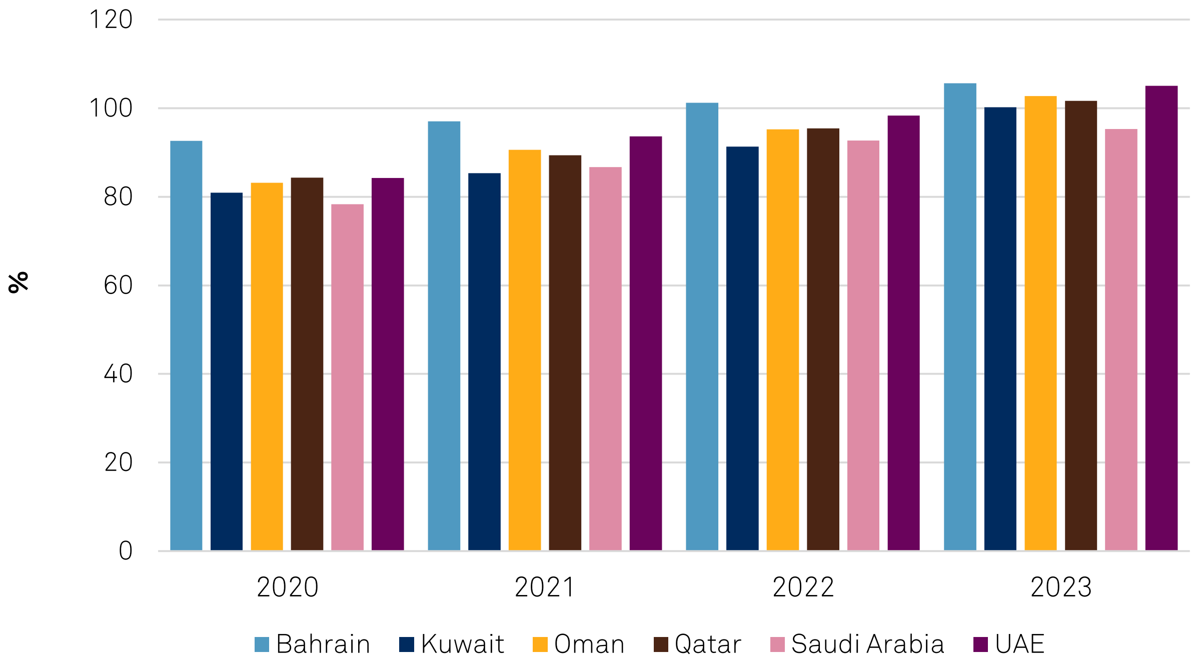
- Real GDP contracted sharply in 2020 because of low oil prices and a significant COVID-19-related slump in the hospitality, commerce, and real estate sectors. We expect oil prices will average $60 for 2021 and 2022 and continued progress on vaccine rollouts but see downside risks from further virus waves.
- Dubai Expo 2020 and the football World Cup in Doha in 2022, as well as hydrocarbon sector recovery, will boost economic growth but it will remain below historical levels. Indeed, most countries will not return to 2019 nominal GDP before 2023, with an even longer road for Saudi Arabia.

Average GDP Growth Of GCC Countries



Source: S&P Global Ratings.

Projected Nominal GDP Versus 2019 Nominal GDP



Source: S&P Global Ratings.

Key Sectors | A Slower Recovery In Aviation, Tourism, And Property

- A full recovery in the global aviation and tourism industries will take time. We expect a weak recovery of global air travel in 2021-2022.
- Given continued negative investment sentiment, we expect demand for GCC real estate will remain subdued. Although we have seen a significant decline in new launches in Dubai, we still expect the supply overhang to limit any short-to-medium-term recovery.

GCC Country And Sector Sensitivity Matrix

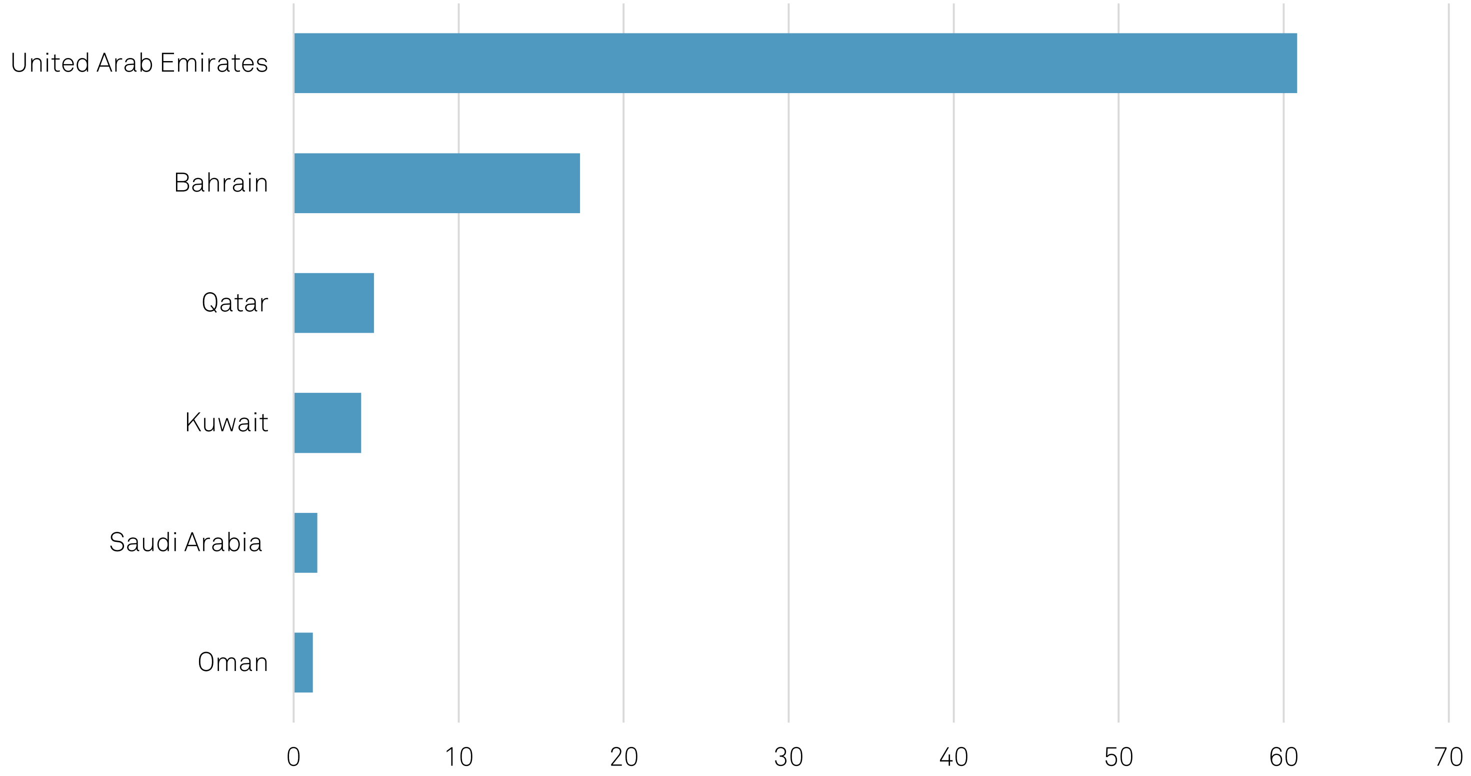
	Saudi Arabia	Qatar	Kuwait	Oman	Bahrain	Dubai	Abu Dhabi
Aviation	VH	VH	VH	VH	VH	VH	VH
Tourism & hospitality	VH	VH	VH	VH	VH	VH	VH
Oil & gas	VH	VH	VH	VH	VH	VH	VH
Telcos	L	L	L	L	L	L	L
Utilities	L	L	N.A.	H	N.A.	M	M
Real estate	H	H	N.A.	N.A.	N.A.	VH	VH
Nonfood retail	VH	H	N.A.	N.A.	VH	VH	VH
Consumer staples	M	L	L	L	L	M	L
Health care services	M	M	N.A.	M	M	M	M
Education	L	L	N.A.	L	L	M	L

Very high	VH	Medium	M
High	H	Limited	L

Data as of Jan. 31, 2021. N.A.--Not available. Source: S&P Global Ratings.

Vaccine Rollout | Some GCC Countries Are Leading The Way

COVID-19 Vaccine Doses Per 100 people

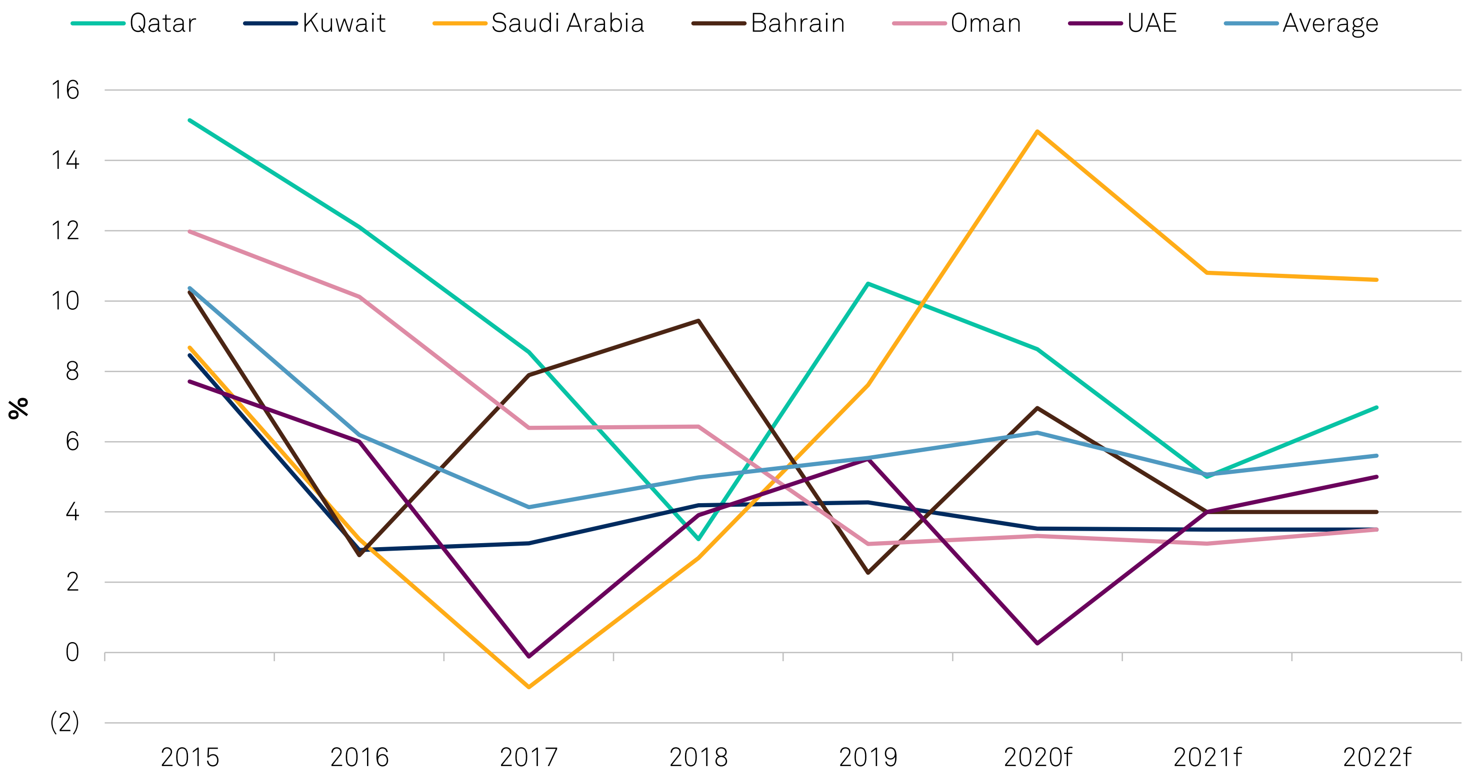


- The UAE plans to vaccinate 50% of its population by March 31, 2021, and the entire population by year end.
- Other GCC countries are also progressing well with their programs.
- COVID-19 mutations and further waves pose downside risks.

Data as of Feb. 27, 2020, for the UAE and Bahrain; Feb. 18, 2020 for Qatar, Saudi Arabia, and Oman; and Feb. 15, 2020 for Kuwait. Source: ourworldindata.org,

Lending Growth | Saudi And Qatar Are Ahead Of The Pack

Higher Growth In Saudi And Qatar

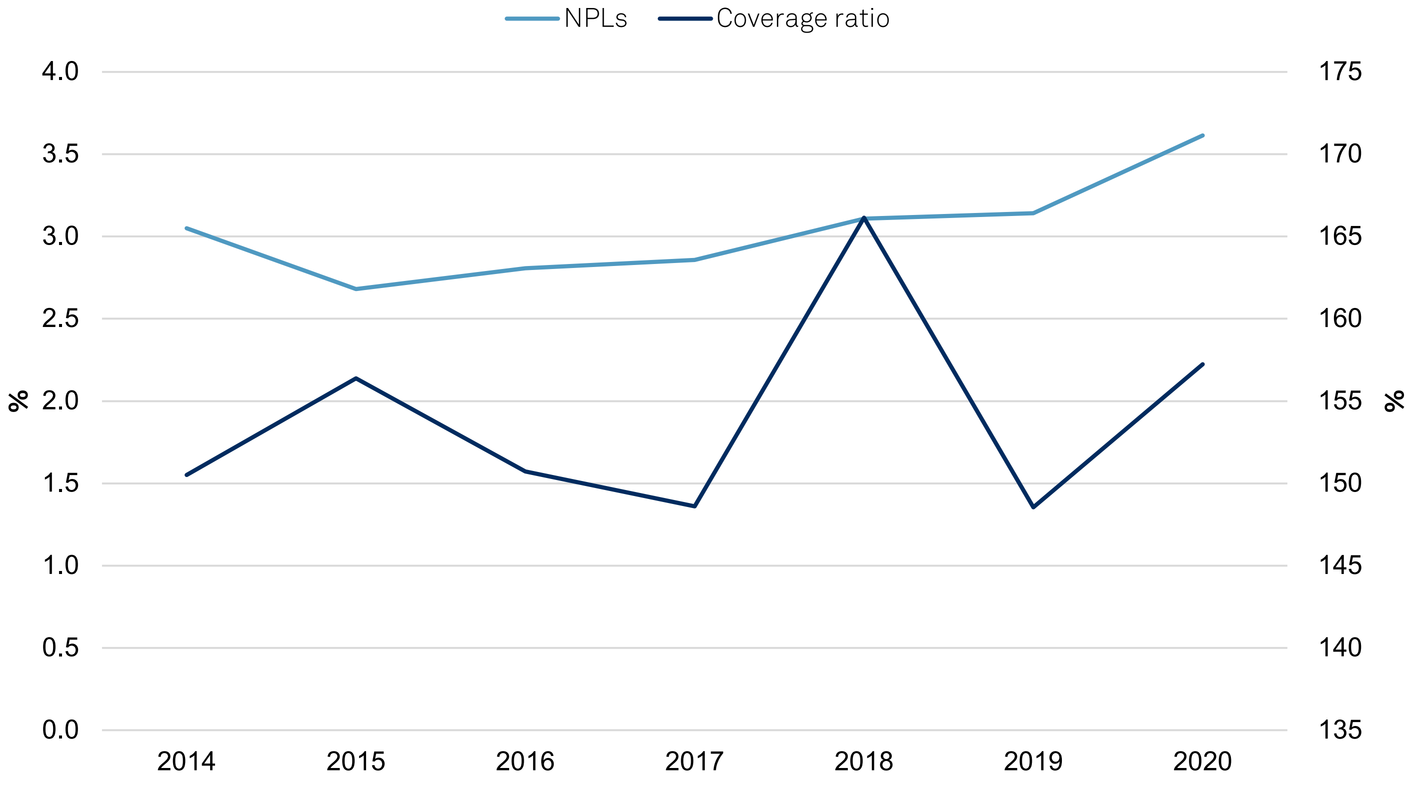


f--Forecast. Source: S&P Global Ratings, GCC Central banks

- We expect muted lending growth in all GCC countries except Qatar and Saudi Arabia.
- In Saudi, mortgage lending continues to expand due to the authorities' objective of increasing home ownership, while in Qatar government projects are boosting growth.
- Demand from corporates will likely improve only slightly, with some deferred 2020 capital expenditure and debt refinancing potentially occurring this year.

Asset Quality | Deterioration Will Continue As Forbearance Is Lifted

Top 45 GCC Banks' Nonperforming Loan And Coverage Ratios



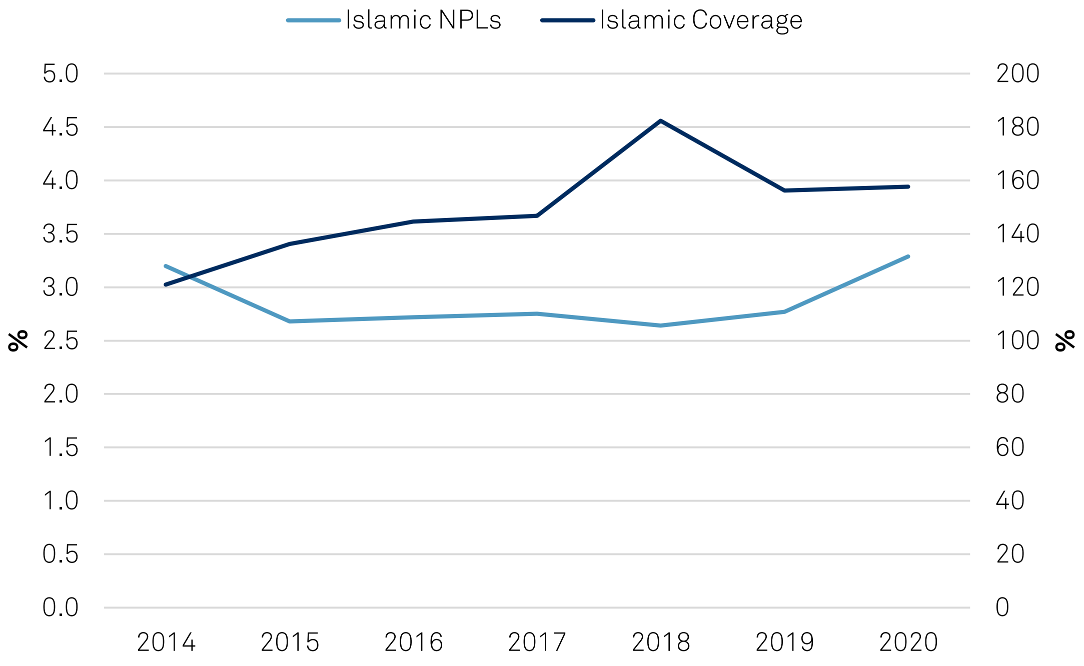
NPLs--Nonperforming loans. Source: S&P Global Market Intelligence.

- We expect a deterioration of asset quality across the board, with nonperforming loans increasing. This will not be helped by the lifting of regulatory forbearance measures, although we expect it to be progressive.
- We think that the measures implemented by most central banks in the region are supportive of liquidity but do not remove or reduce credit risk from the balance sheet of banks (yet).

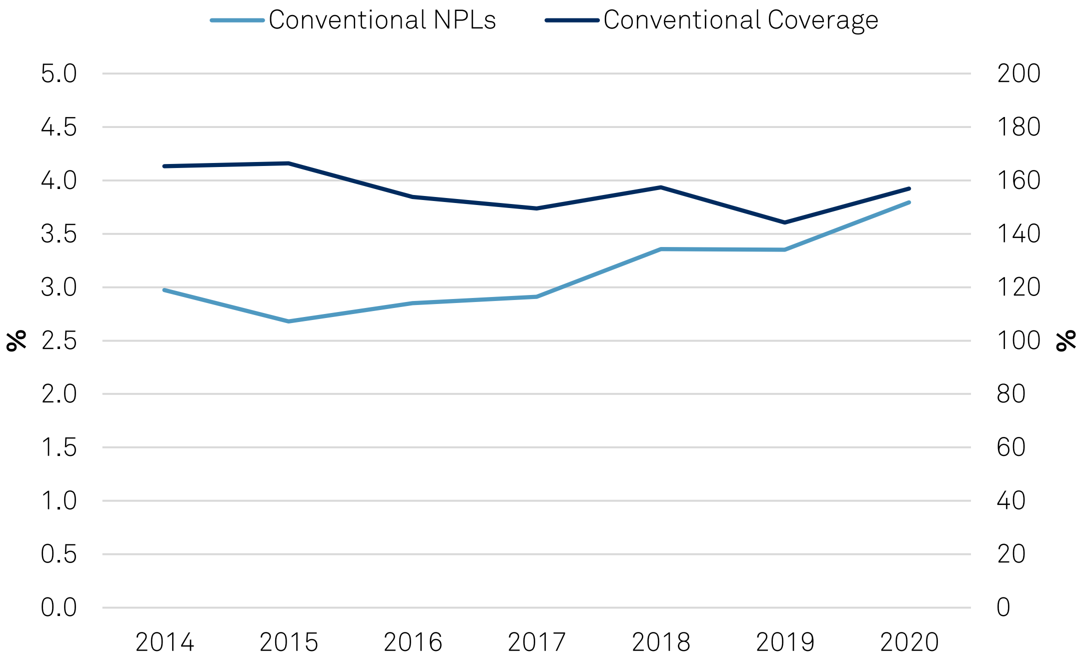
Asset Quality | Islamic Banks Are Comparable To Conventional Peers

- There is no major difference between Islamic and conventional banking in the GCC because both models remain focused on the real economy.
- That said, the absence of late payment fees and higher exposure to the real estate sector could put Islamic banks at a disadvantage.

Islamic Banks' Asset Quality



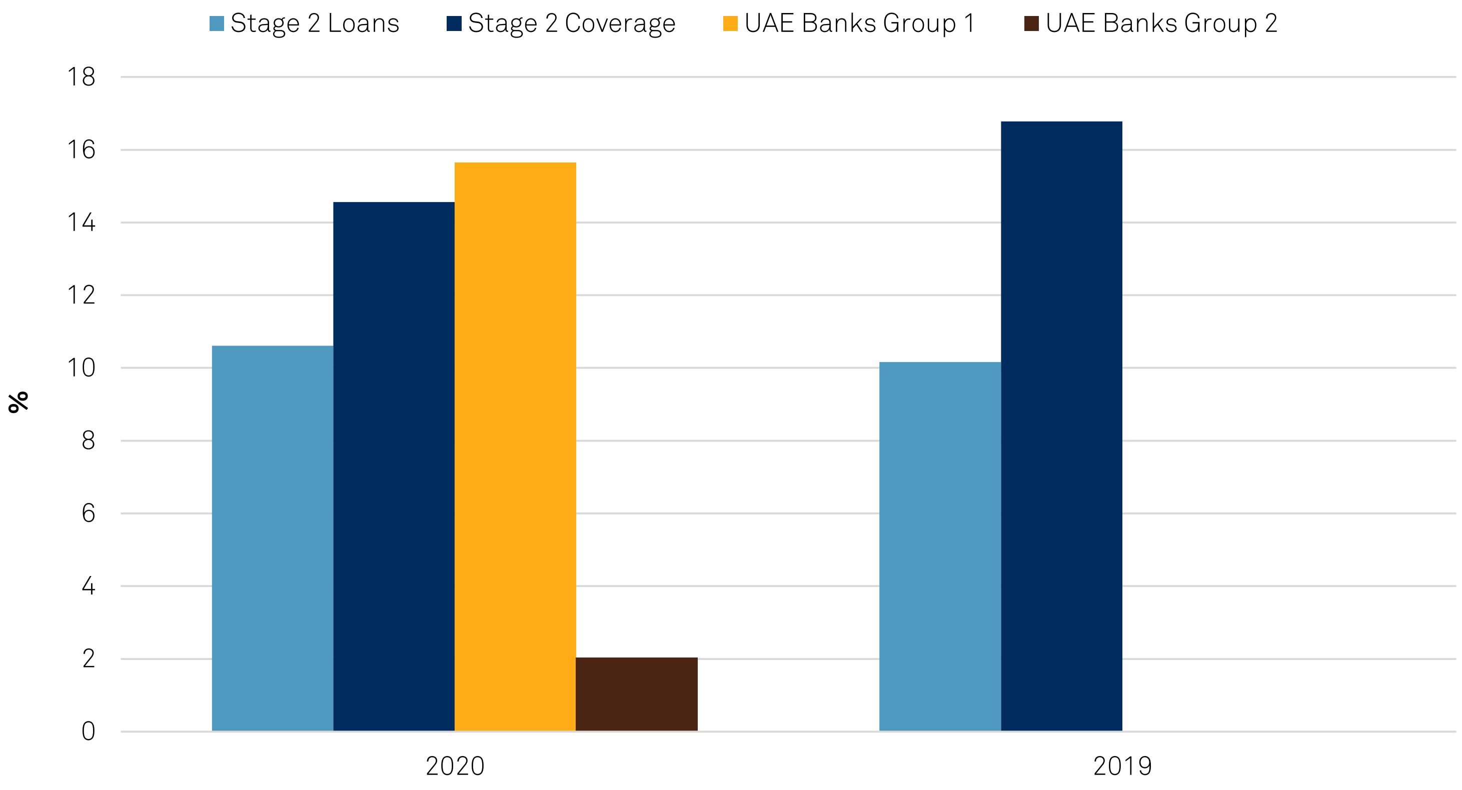
Conventional Banks' Asset Quality



NPLs--Nonperforming loans. Source: S&P Global Market Intelligence.

Asset Quality | Regulatory Forbearance Is Delaying NPL Recognition

Stage 2 Loans Have Barely Increased



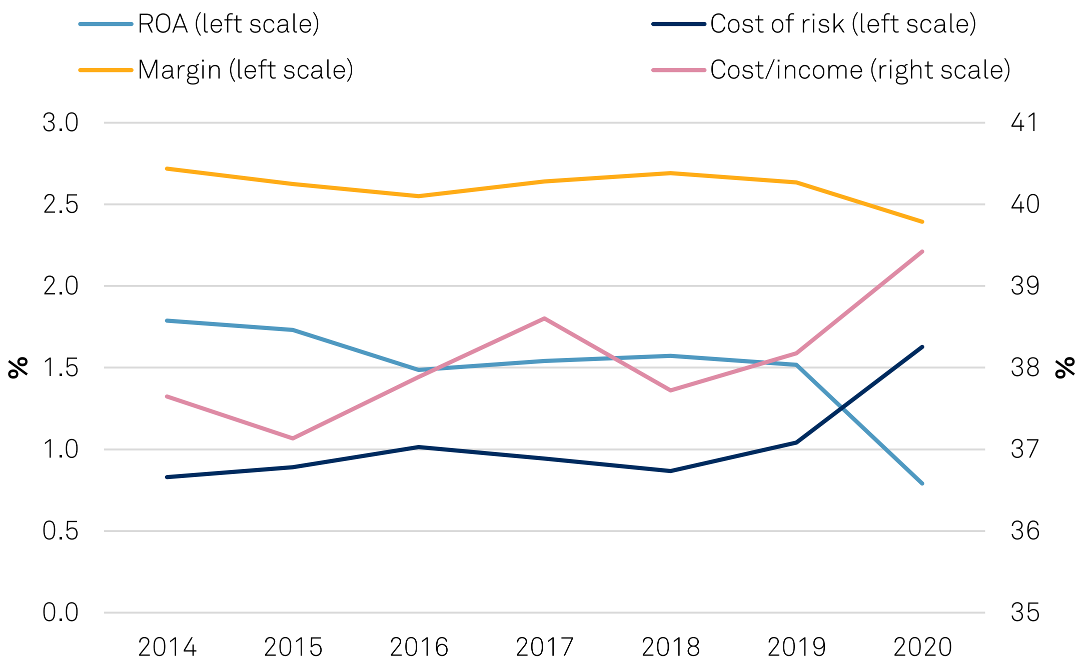
Source: S&P Global Market Intelligence, banks' financials.

- Stage 2 loans have increased slightly because regulators asked banks not to reclassify loans unless there are evident viability issues.
- A significant number of loans were classified as Group 1 and 2 in the UAE, which means that some migration may happen in the next 12 months.

Profitability | Some Banks Will Post Losses In 2021

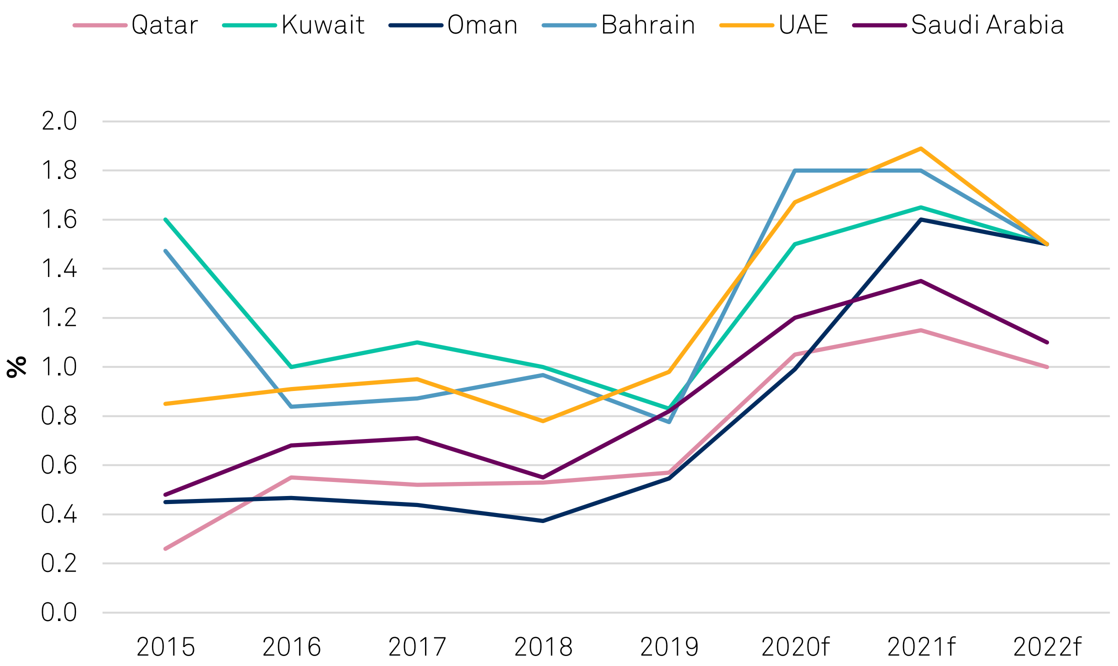
- Banks suffered a triple shock to profitability in 2020 from lower lending growth, lower-for-longer interest rates, and higher cost of risk.
- Cost of risk will remain elevated following a jump of 60% in 2020 as banks set aside provisions in preparation for more stress.

The Top 45 GCC Banks' Profitability Took A Hit



ROA--Return on assets. Source: S&P Global Market Intelligence.

Credit Losses Will Remain Elevated



f--Forecast. Source: S&P Global Market Intelligence.

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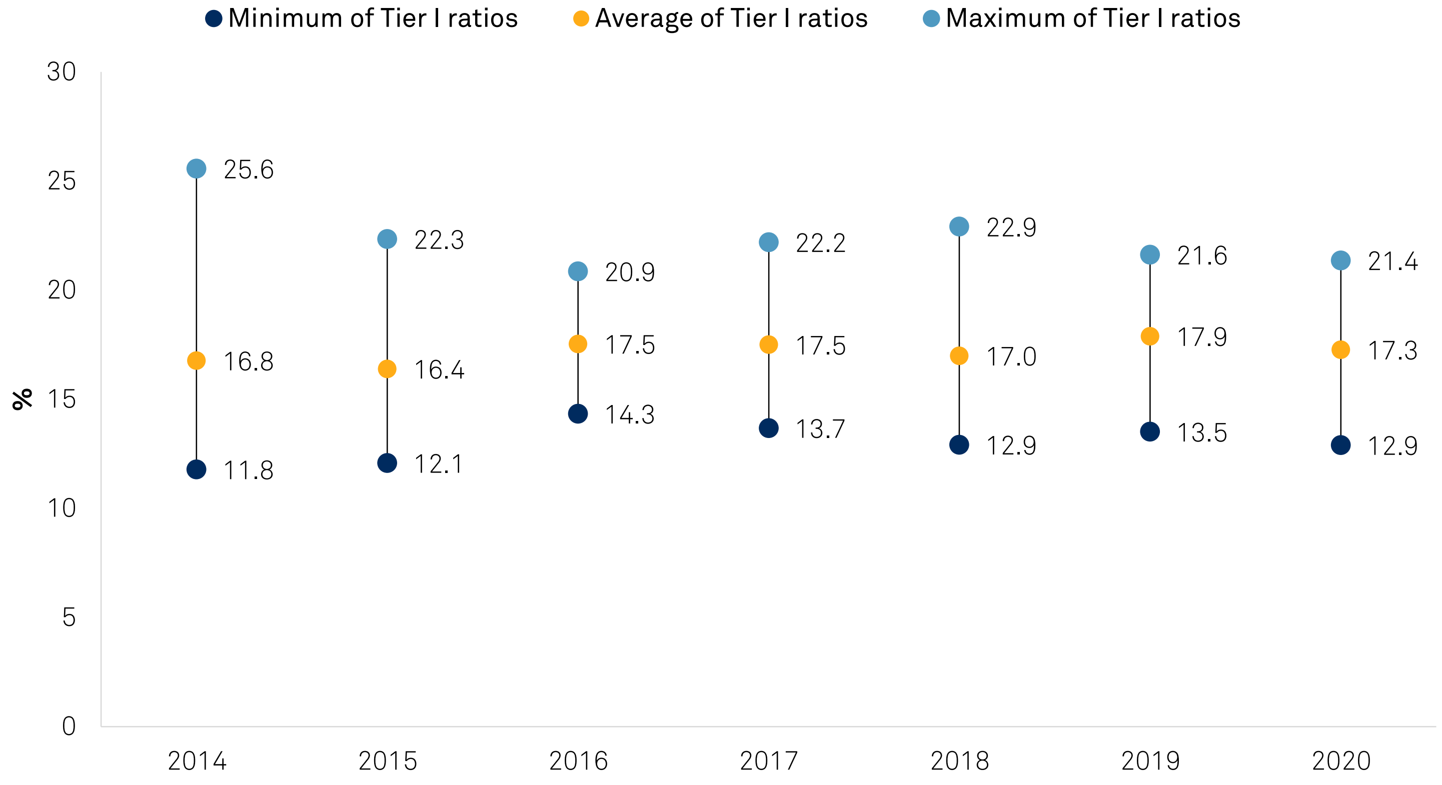
Capital | Strong Buffers Should Support Banks' 2021 Credit Metrics

Top 45 GCC Banks' Tier 1 Ratios



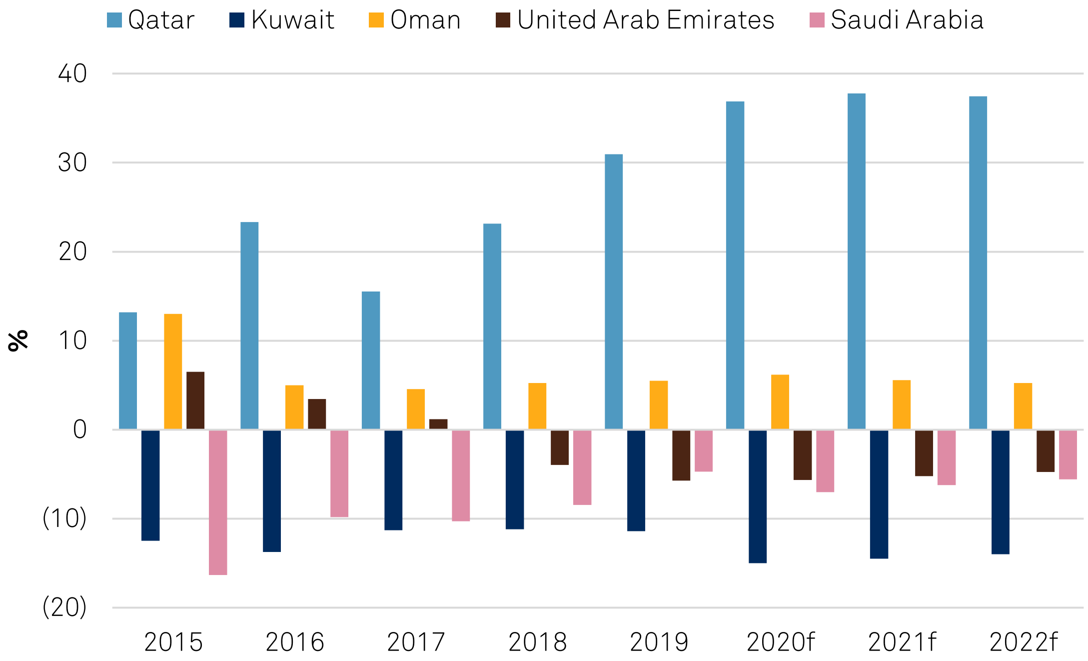
Source: S&P Global Market Intelligence.

- GCC banks' capitalization will continue to support their creditworthiness in 2021.
- Banks stepped up Additional Tier 1 issuances (both conventional and Islamic) in 2020 to benefit from supportive market conditions and this should continue in 2021.

Funding And Liquidity | Mostly Remains A Strong Factor In The GCC

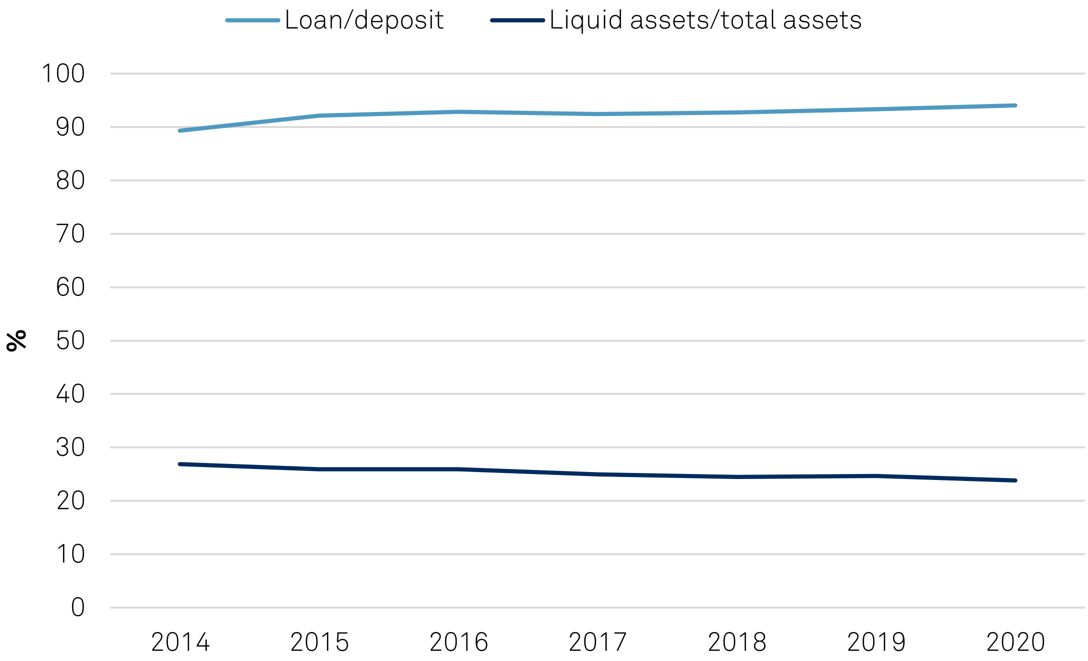
- We see funding as a relative strength for most GCC banking systems. Qatar is an exception, where the banking system still carries significant net external debt. About one-quarter of banks' assets are in liquid forms.

Dependence On External Funding Is High In Qatar



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

Top 45 GCC Banks' Funding And Liquidity Metrics

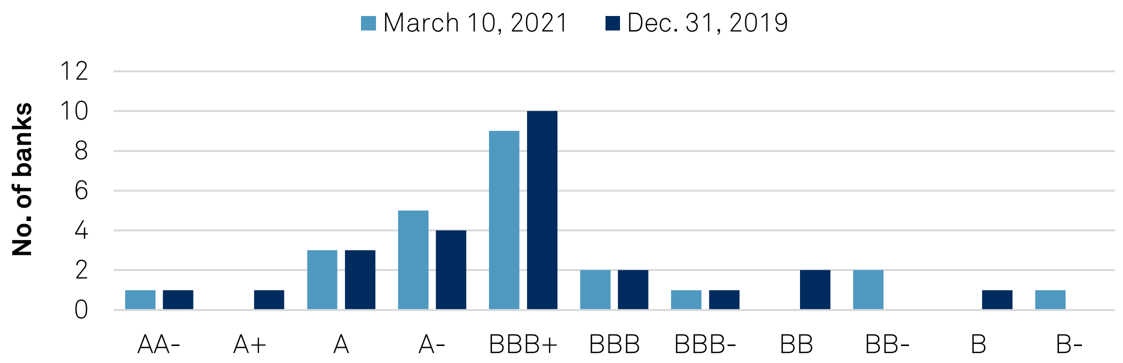


Source: S&P Global Ratings, S&P Global Market Intelligence.

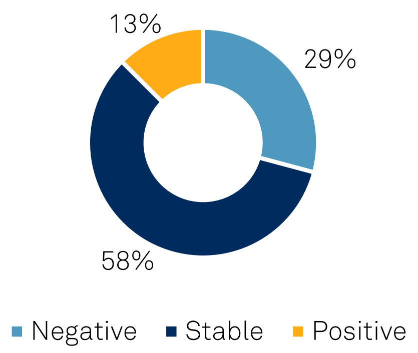
Ratings | Negative Outlook Bias Has Increased…

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
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/Negative	5/Stable	5/Stable	5/Negative
Industry Risk/Trend	6/Stable	4/Stable	6/Stable	6/Stable	3/Stable	5/Negative

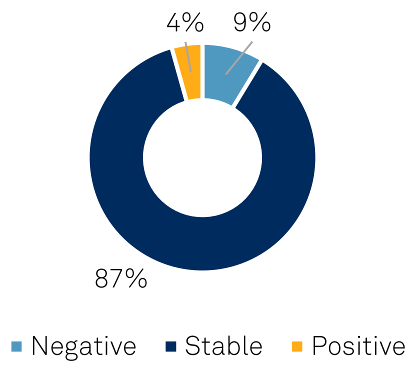
Bank Rating Distribution



Outlook Distribution – March 10, 2021



Outlook Distribution – Dec. 31, 2019



Source: S&P Global Ratings.

M&A | Is A Second Wave Coming?

- A second wave of mergers and acquisitions (M&A) could begin when the full impact of the weaker operating environment on banks becomes visible.
- The first wave of M&A was driven by shareholders' desire to reorganize their assets, including the upcoming merger between The National Commercial Bank and Samba Financial Group.
- The second wave will be more opportunistic and spurred by economic rationale.
- The operating environment might push some banks to find a stronger shareholder or join forces with peers to enhance their resilience.
- This might involve consolidation across the different GCC countries or the different emirates in the UAE, for example.
- However, it would require more aggressive moves by management than seen previously.

Related **Research**

- Dubai's Property Market In 2021 A Tough Year On The Road To Recovery, March 1, 2021
- Saudi Banking Sector 2021 Outlook: Growth Hinges On Mortgage Lending And Public Spending, Feb. 23, 2021
- Good Earning Capacity Gives Rated Banks In Emerging Markets A Buffer From COVID-19's Effects, Feb. 22, 2021
- UAE Banking Sector 2021 Outlook, A Long Recovery Road Ahead, Jan. 26, 2021
- GCC Economic Activity Held Back By Its Hydrocarbon-Heavy Economic Structure And OPEC-Related Production Cuts, Dec. 7, 2020
- GCC Banks: Lower Profitability Is Here To Stay, Oct. 13, 2020
- Credit FAQ: Dubai's Already High Debt Burden Set To Worsen Amid A Deep Pandemic-Related Macroeconomic Shock, Sept. 30, 2020

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