ECONOMIC REVIEW OF THE GCC COUNTRIES

2008 – 2009

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Oil and gas account for almost a half of GCC economic output and more than three quarters of budget revenues and export earnings. The decline in oil prices during 2009 had a significant impact on growth, inflation, trade, fiscal and current account balances.

As a result fiscal deficit spending was implemented to support economic activity. Although the extent of the stimulus was much larger than in industrialized nations, inflationary consequences were modest given the global recession. However, there are still a large number of private investment projects either put on hold or cancelled due to the drying up of the debt financing. UAE has nearly 80% of the delayed projects.

On the political front, the GCC secretariat announced in March that the introduction of the single currency would be delayed beyond 2010. Oman had earlier announced that it could not satisfy the economic criteria and decided not to join. UAE opted out of the union in May. Nevertheless, Saudi Arabia, Kuwait, Qatar, and Bahrain signed a pact in June to create a joint monetary council, which is the forerunner to a Central Bank for the region. In early September, the Saudi cabinet gave its approval for the planned monetary union and reiterated its hope that the UAE and Oman would eventually re-join the planned monetary union. Final approval by each country is needed to formally adopt the union.

Global developments and implications for GCC

In late October 2009, the IMF predicted the global activity would first contract by around 1% in 2009 and then expand by 3% in 2010.

Further, the OECD gave a sobering forecast: “growth is likely to fluctuate around a modest underlying rate for some time to come. It is being held back by still substantial headwinds as households, financial institutions, non-financial enterprises and, eventually governments have to repair their balance sheets. This also means that unemployment is set to move higher and already low inflation will be under further downward pressure”. Hence, the GCC economies must look to emerging markets to maintain demand for hydrocarbons.

Although some sovereign as well as quasi-sovereign enterprises in Qatar, Bahrain and Abu Dhabi have taken advantage of the slightly improved appetite for bonds in 2009 any attempt by GCC economies to raise funds through the securities market is likely to be met by strong international competition in the future. Through the first ten months of 2009 US bond funds attracted $315 billion of new inflows as compared with $49 billion a year earlier, while there were virtually no inflows into equity markets. US equity funds posted $14.8 billion of net redemptions in October which followed withdrawals of $11.3 billion in the previous month. The US Treasury issued a record amount of new bonds in November and announced the introduction of a new 30-year inflation bond to replace its 20-year Tips. The latter reflects a trend in demand from pension funds and large, long-term institutional investors for relatively safe investment opportunity.
Monetary Developments in the GCC in 2009

Inflation

The inflation rates in GCC countries were modest in 2009 and forecasts were progressively revised downwards over the year. For example, the IMF forecast in May of 5.3% inflation for GCC countries as a whole was revised down to 3.7% in October.

The largest fall in inflation from 2008 to 2009 was in Qatar. For Bahrain inflation was relatively insignificant throughout. However, the inflation remained generally higher than earlier in the decade, the exceptions being Qatar and UAE.

The most likely reasons for the substantial fall in inflation in 2009 are the reduced prices of food and housing, the tightening of credit conditions during the year, and the lack of domestic consumer demand. The former two combined account for from 51.8% in Oman’s consumer basket to 38.8% in Qatar. However, these CPI baskets are confined to the nationals, who make up only a small part of the population and enjoy more from subsidies than the large expatriate population (e.g. ECB reports the employees spend about one third of their income on rents in Qatar). Taking advantage of the GCC region’s employer friendly labour laws and a largely expatriate workforce, many companies cut staff numbers, some on a massive scale. According to the Middle East’s leading online recruitment portal GulfTalent.com the redundancies were 16% in UAE, 12% in Bahrain, 10% in Kuwait, 9% in Qatar, 7% in Saudi Arabia and 6% in Oman. Against the background from the outright ban on terminating employment of the nationals (UAE) to significant administrative as well as financial pressures of not to fire the nationals (e.g. Kuwait and Saudi Arabia), the outflow of the expatriate labour contributed to the fall in rental prices as much as 30-50% in Dubai and Doha.
Other factors were the global economic slowdown and the appreciation of the US dollar against major currencies including the euro, the pound sterling and the yen, in the early part of 2009, which reduced import prices, given that GCC currencies are pegged to the dollar.

Inflation in all GCC countries is predicted to rise in 2010 except in Bahrain. A significant depreciation of the dollar in 2010 together with higher global commodity prices could soon feed into substantial inflation in GCC countries.

Money growth decelerated significantly in most GCC countries in 2009, especially in UAE where it decreased 6-fold from the previous 9-year average and much more compared to 2008. This abrupt correction can be seen as a result of the drying up of the debt financing that was fuelling its property boom. Only country that kept its rapid monetary expansion was Kuwait, where although its broad money decreased in 2009 compared to a year earlier, it’s still higher relative to a longer period average. Because of the worldwide economic downturn that started in the second half of 2008 and continued to 2009 many planned projects in GCC countries were either cancelled or put on hold in 2009 and private investment shrank which tend to go hand in hand with oil prices.

In the long run, there is a positive relationship between the money growth and inflation (First chart, Figure 3A). This relationship is well documented and rather stable over time. Notwithstanding the high inflation, particularly that of 2008, in almost all GCC countries and the lack of long term data for the region, this relationship seems to be rather subdued in GCC economies (all GCC countries lay below the line). Despite the massive liquidity injection in the economy over the last decade in Qatar and UAE, averaging at more than 20% a year, the inflation is about a half of what one would predict from the world trend. For Bahrain, although the monetary expansion over the last decade was the next fastest, the inflation was never a big problem. This could perhaps reflect a unique feature of this most hydrocarbon-centred region, in particular,
the composition of their population and labour force.

Because of the mismatch between the skills and qualifications of the nationals on the one hand and the requirements from the private sector on the other, these economies rely heavily on expatriate labour in the private sector. The problem is particularly severe in UAE and Qatar where expatriate labour make up of 90% of the labour force and more than half of the population. According to the World Bank estimates remittance payments of as high as 8.6% of GDP in Oman.

**Real Developments in the GCC in 2009**

Growth rates in GCC economies in 2009 were either low or negative reflecting the global economic condition (World economy is estimated to have shrunk by 1.3%). According to IMF the GCC economies are expected to have grown by 0.7%, the worst performer being Kuwait. Thanks to the huge production increases in its North Field’s gas project, in the context of somewhat stable price in Natural gas market, Qatar outperforms in the region with an exceptional growth rate of 11.5%. All GCC countries experienced substantial declines compared to 2008, ranging from 3.1 percentage points in Bahrain to 7.9 percentage points in Kuwait lower than a year ago. Decade average performance is also undermined with an exception of Qatar where it was stronger than the first half of the decade because of the continued investments and major projects coming into stream in 2009. The growth is expected to accelerate in 2010 in most GCC economies.

To put things in a context of a long run trend Figure 4A compares the weighted average growth rates of GCC countries with world average, manufacturing oriented and fuel exporter economies (data on non-GCC economies span until 2008). Fuel (Oil and Gas) exporting countries, among them the GCC economies have been growing at an incredibly fast rate since 2000. Growth rates had been higher than any other type of economies since early 2000 and it was unprecedented with only an exception of 1973-1974.
However, the global recession hit hardest these economies. In 2009 GCC economies just broke even and grew 5.2 percentage points less than the average growth rate they enjoyed since the beginning of the decade. Compared to the previous major world recession of early 1990’s GCC economies look much more synchronised with the rest of the world suggesting that the long of period of underperformance in GCC economies won’t be repeated this time.

Figure 5A compares the world economies in terms of their real GDP growth per capita. The rapid population growth, as a result of both higher birth rates and inflow of expatriate labour, in GCC economies and Non-Hydrocarbon Sector

Non-hydrocarbon sectors employ more than 95% of labour force and as such developments in this sector have important implications for GCC economies.

IMF predicts this sector has grown by 3.2% in contrast to more modest prediction made by Institute of International Finance. The main reason behind this apparent escape from a downfall is substantial stimulus packages implemented by the governments in the region and their significant attempts to diversify their economies.

Although dynamics of the non-oil sector remain largely driven by government expenditure, which in turn depends on hydrocarbon revenues, the general business environment is improving as result of the governments attempts. According to the World Bank’s Doing Business indictors the GCC economies rank at the top of Middle Eastern and North African countries, with substantial improvements in UAE and Saudi Arabia in 2009 in terms of the global ranking and the former overtaking Qatar in the GCC region.

There are indications that business sentiment in the GCC also rose during the second quarter of 2009. HSBC’s Gulf Business Confidence Index gained 4.6 points to 79.4 in the second quarter.

Headline developments in 2009

The GCC countries attempt to diversify their economies into 3 main activities away from hydrocarbon: Tourism, Finance and Manufacturing.

Tourism industries in individual GCC economies faced strong competition from within in 2009. Bahrain and Dubai vie to be the tourism hub of the region with the former facing increasing resistance from Muslims who...
oppose the sale of alcohol. Dubai’s Department of Tourism and Commerce Marketing (DTCM) reports the number of guests at hotels and hotel apartments rising 5% to 3.85 million in the first half of 2009. Oman has also experienced a surge in visitors from Asia, Africa and the Gulf region.

The global financial crisis affected Bahrain most whose financial service industry accounts for most non-oil activity. Significant part of the industry is occupied by the wholesale banks which rely on deposits and funding from the global interbank market. UAE joined the race with Bahrain to host the financial industry hub of the region. The IHS, a US based business information service company, reports that Bahrain’s financial centre is the best regulated and most transparent and enjoy a relatively effective legal system in Middle East. The country also started to shift additional focus into health, and construction.

Construction and real estate is recovering in the GCC region. By the end of the 3rd quarter the volume of residential real estate transactions fell 40% from the 4th quarter of 2008 and 52% from the 3rd quarter a year earlier in Bahrain. In contrast, real estate sales and the number of transactions during June saw their highest levels since December 2008 in Kuwait due to robust apartment property activity. Dubai has been hardest hit because of the most pronounced the property boom. Real estate consultant Asteco and Collier International show steep drops in rent and housing prices through the first half of 2009, ranging from 20% to 50%.

On November 25 Dubai World, one of Dubai’s three main state-owned business groups, requested a six month debt standstill. The event and the lack of clarity in the restructuring undermined investor confidence and made investors revisit their assumptions concerning quasi-sovereign risk and its pricing. Partly because of such market sentiment, Emirates NBD delayed a bond issue. The announcement could have been arranged better as later statements from Dubai World indicated that debt restructuring was only being sought on $26 billion, originating from its holding company ($5.5 billion), and two of its subsidiaries: Nakheel ($8.5 billion) and Limitless ($1.2 billion). There is no publically available information on the remaining $10 billion. Available estimates put Dubai’s total external debt in the region of $ 85-90 billion, that is over 100% of GDP, while Dubai World’s total liabilities were reported to be $59 billion at the end 2008, against assets of $99.6 billion. Fortunately, the event was perceived by the market sufficiently localised to this company. Tadawul All Share Index (TASI) lost just 1% of its value on the first day of trading following Dubai’s announcement (Dubai DFM dropped 12.5% in the first two days). By December 7, TASI had fallen by around 4% in the aftermath of the Dubai World announcement.
Hydrocarbon Sector

Hydrocarbon sector in GCC is severely affected by the global recession in 2009, the magnitude of which depending on how much individual countries rely on this sector. The exception is Qatar, whose North field gas projects were planned well before the recession and the fact that they started their operations in 2009 at already agreed upon price terms. The other two countries that recorded non-negative growth rates were Bahrain (0.1%) and Oman (5.5%) who have the most dividing hydrocarbon resources and were not subject to production cut agreements. The hydrocarbon sector of the region is estimated to have shrunk on average by 5.2% in 2009.

According to IMF oil revenue of oil exporting countries is estimated to have been less than half of what they were compared to 2008, reflecting lower global demand for oil. The sector was negatively affected by both lower price and production cutbacks agreed at OPEC.

Since the collapse in the second half of 2008, the oil prices have not been able to recover to anywhere near the average of 2008. OPEC basket oil price reached US$61.1 in 2009 loosing over one third of its value from a year earlier. Individual oil prices all declined ranging from US$38.1 barrel for WTI to US$30.4 for Kuwait export.

In response to the falling oil prices OPEC cut output quotas by a record 4.2 mb/d. Although the compliance slipped from 80% in March to around 60% in December, OPEC was not unduly concerned given that the prices are on the rise and right in their range of “low enough to stimulate demand and high enough to encourage new investments”. Consequently, in OPEC meeting in Angola on December 22, 2009 OPEC decided to maintain the production level.

The most reductions occurred in Saudi Arabia with 12% cut and other OPEC member GCC countries (Kuwait, Qatar and UAE) also cutting more than the rest of the OPEC (minimum of 8% cut in Qatar compared to 5% cut in the rest of the OPEC).
Non-OPEC production levels substantially increased in 2009 and OPEC called for cooperation from Non OPEC countries to maintain price stability. Russian output surged to 10mb/d in 2009 (The former Soviet Union increasing production from 12.6 m/b to 12.9 m/b), considerably exceeding that of Saudi Arabia which fell to 8.1 mb/d from a high of 9.1 mb/d in 2008. The number of oil rigs shot up by 23 in Asia Pacific followed by 15 in North America to benefit from the improved prices compared to 2008 year end. Latin America and non GCC Middle eastern countries operated substantially lower number of oil rigs, reflecting the higher extraction costs of the region.

At the end of 2009 the most hydrocarbon rich 5 GCC countries had 113 oil rigs and 38 gas rigs in operation, with 6 oil and 4 gas rigs out of operation from 2008 level. All GCC countries closed some oil and gas rigs or kept the number constant with an exception of Kuwait which opened 6 more oil rigs.

OPEC prefers to keep the price in the range of $75-80/barrel in 2010 that would fend off substantial investments in other sources of energy, including substitutes for crude oil, such as oil sand, synthetic oil and bio-fuels. The IMF predicts the price to be $76/barrel for the year and there is no sign of downward pressure coming from the futures market, where the Brent December 2017 contract started to hit three digit prices in November 2009, the first time over a year. Any substantial price recovery beyond the current level is unlikely given the relatively weak world economy and the estimated 150 million barrels of both crude and products in floating storage and on-shore inventories around the world.
Hydrocarbon potential for the future

GCC Countries possess 39% of the world’s proven oil reserves and 23% of proven gas reserves.

They have the single biggest oil reserve (496.3 t.m.b.) in the world, a position they have held for 3 decades. Marginal additions to the world reserves are mainly coming from other Middle Eastern countries (which have 257.8 t.m.b.), Europe and EuroAsia (with 142.2 t.m.b). Saudi Arabia owns more than half of the oil reserves in the region (264.1 t.m.b), followed by Kuwait (101.5 t.m.b.), UAE (97.8 t.m.b.), Qatar (27.3 t.m.b) and Oman (5.6 t.m.b). There’s virtually nothing left in Bahrain.

GCC’s current gas reserve estimate is 42.31 t.c.m. and it’s greatly enhanced by the recent additions made by Qatar (now holds 25.5 t.c.m). The region’s reserve is only rivalled by that of Europe (62.9 t.c.m); Other Middle Eastern countries (33.6), Asia Pacific (15.4), Africa (14.6), North America (8.9) and South and Central America (7.3) has less reserves. Saudi Arabia, UAE, Kuwait, Oman and Bahrain has 7.6, 6.4, 1.8, 1, and 0.1 t.c.m. gas reserves respectively. countries possess, as a region, the second largest gas reserves in the world its future potential is greatly enhanced with the advent of gas discoveries in Qatar.

However, despite the biggest oil reserves in the world the region’s extraction rates are overtaking the rate at which new reserves are added in. For example in Kuwait, the reserve to production ratio reached 122.7 years in 2009 from 183.9 years of 1989, a fall of 60 years worth of reserves in just 20 years. Saudi Arabia’s production also outpaces the new discoveries and R/P ratio reaches 89.9 years in 2009 from 124 in 1989. In contrast, Qatar extended its R/P ratio by 3 decades over the last 2 decades. As of 2009 Oman has the least oil and Kuwait still possesses the largest reserve in terms of its GDP.
Middle Eastern Oil Exporting countries’ external current account is estimated to have been in deficit by $10 billion in 2009 compared to a surplus of $400 billion in 2008 (REO Oct 2009, IMF)

All GCC states except Saudi Arabia manage the bulk of their reserves through sovereign wealth funds which hold combined assets conservatively estimated at around $750 billion, with the Abu Dhabi Investment Authority and KIA holding assets between $250-400 billion each.

Bahrain. Authorities are set to scrap the visa sponsorship system to allow expats (basically ending the black market for employer visa trading) to look for jobs freely, demand higher wages and increasing the cost of employing an expat (possibly 10 Bahrain Dinar monthly tax- $26.65) thus decreasing the wage gap between expatriates and nationals.

Kuwait. Emir dissolved the Parliament in March and temporarily abated the long running political discord between the ruling family and members of parliament. With Kuwait sinking deeper into political crisis, it’s clear that the government will not be able to push the al-Zour refinery or any other mega-venture through Parliament in the near term.

Kuwaiti Ministry of Electricity and Water awarded GE with a contract to supply and build 2000 mega-watt power plant, worth $2.7 billion in the north of the country to be completed in 2011. Other bidders were Japanese compatriots Mitsui and Co, and Marubeni Corporation, Germany’s Siemens, Spain’s Iberdrola, and Canada’s SNC-Lavalin.

Kuwait Investment Authority (KIA) repatriated part of its foreign assets and deposited them in domestic banks to provide liquidity (REO, IMF). In September, KIA expressed its intention not to sell its investments in Merrill Lynch and Citigroup in the short term as the authority relies in its investment policies on a long term view. The investment of $5 billion fell at one point to $2.2 billion before picking up.

Oman. The main state-owned oil company Petroleum Development Oman (PDO) recently announced the successful arrest and reversal of the sultanate’s oil production as well as three new discoveries, which will provide additional oil revenues in the future.

Qatar. In the coming years three new 7.8 million tonnes a year (mt/y) LNG trains are expected to come on stream while those started operations in late 2009 should be producing at full capacity. Overall LNG output is expected to rise from about 40mt/y in 2009 to over 75 mt/y by 2012.

Through a dedicated attempt to be placed on the sporting map of excellence, Qatar has put itself forward for the 2020 Olympic Games and the 2022 World Cup. In order to meet international regulatory standards, Qatar has developed a multibillion-dollar programme to expand the country's transport infrastructure.

Saudi Arabia. Saudi government moved forward with the major pledged upstream increments to meet target of 12 million b/d capacity through 2012 and Saudi Aramco announced in July that it reached it with start-up of Shyabah, Khurais, and the delayed Nuayyim fields. With a margin of nearly 4 million b/d Saudi Arubis has effectively created a new Iran from the capacity increments.

Following distortions to the WTI benchmark oil price during this year, Saudi Arabia has decided to start pricing its crude oil for customers in the US against the Argus sour crude benchmark starting in Jan 2010. The Qatar-Bahrain Friendship Causeway, a 40 km long marine causeway featuring a 22 km bridge and 18 km embankments connecting the west coast of Qatar to the east coast of Bahrain, is scheduled to begin construction in 2010. The project is worth $US 3 billion.

UAE. Red Line of Dubai Metro was officially opened on 9 Sep 2009. Green, Blue and Purple lines are expected to come into service in 2010, 2011 and 2012 respectively, covering a total track of 170.5 km. The cost of the Red and Green Lines has risen from the original budget of AED15.5 billion to more than AED28 (US$7.6 billion) as a result of additions and extensions to the project. Modernizing infrastructure has been an important part of the country’s diversification policy toward the non-oil sector.
In mid 2008 the global crisis hit the entire GCC region driving stock markets down (falling by 46.5% on average). UAE experienced the greatest fall (by an average of 61%) while Bahrain experienced the least (23%). These values were close to those of the more liquid financial centres of Europe and US. (Tables 1B-2B, Figures 1B-2B)

By 2009 Q1 the crisis was in its final stages with losses averaging 15% in the GCC, very close to the 12.4% experienced by the S&P 500 and the 15% of the DJ Euro Stoxx.

After 2009 Q1 stock markets recovered, with average returns reaching 18.5% and 11.8% in Q2 and Q3 respectively. The best performer was UAE with an average return of 28.4%; the worst performer was Bahrain with a fall of 1.3% (average performance 2009Q2-2009Q3).

2009 Q4 was dominated by the Dubai Financial crisis, which had a big impact upon the GCC markets, while the rest of the world remained unscathed. UAE losses were 26.5% on average in Q4 (the worst performance) while Saudi Arabia showed positive returns of only 0.53% on average.

Quite remarkable was the performance of the two Islamic indexes which outperformed many conventional indexes. The full impact of the financial crisis came slightly later (in 2008 Q2 there were positive returns) and recovery was sooner (2008 Q4 had similar losses to 2008 Q3, when S&P500 and most other indexes were plummeting). In 2009 Islamic indexes performed better than the S&P 500, the FTSE 100 and many other indexes showing that the momentum of Islamic finance continued despite the crisis.
Risk—Conventional Indices

- The riskiness of markets is reflected in volatility and ‘Value at Risk’ (Figure 3B). A period of increased volatility is usually associated with a crisis and turmoil. VAR is another measure of risk. It stipulates how much could be lost within the next day with a certain confidence level (usually 95% or 99%).
- The second half of 2008 was characterised by high volatility in the GCC region, as the financial crisis shifted from the US and UK to the rest of the world. VARs also increase dramatically verifying the potential losses that investments in stock markets could yield during the period. (Figure 3Bi) Bahrain maintained the lowest volatility (less than 1%) and VAR (2.3%) a superior performance not only among the other Gulf members but also among more diversified economies like US, UK and Europe. (comparing Figures 3Bi and 4Bi) The performance of the UAE (average volatility 2.55%, average VAR 8.51% - not shown in the graphs but the quarterly values reflect our point) was the worst: clearly affected by the reluctance of foreign investors to continue investing in huge projects (Palm tree islands, Burj Dubai—now known as Burj Khalifa in recognition of the help from Abu Dhabi leader to overcome debt problems that arose a year later) amidst the financial crisis.
- In 2009 Q1 turmoil in the financial markets settled down. This was more evident in the US and UK where volatility and VAR were halved. (For example, volatility and VAR for S&P respectively fell from 4.18% and 9.47% in 2008 Q4 to 2.57% and 5.43 %.). In the GCC, although the drop was less pronounced; signs were that the peak of the crisis had passed.
- From 2009 Q2 onwards, stock market confidence was restored, with risks back to normal levels. Bahrain remains the safest place for the investor with lower risk than the US and UK, which is partly accredited to the Bahrain Central Bank for promoting sound regulation, transparency and an effective legal system.
- We observe that the S&P 500 is highly correlated between UK and European stock markets as well as the FTSE Shariah index. However, the correlation with GCC markets is very low. This provides evidence that GCC markets are not affected by stock market movements in New York or London. (Table 3B)
- Correlations within the GCC are lower than expected given that these countries share the same macro-economic conditions and most of their revenues come from oil exports.
- In 2009, after the peak of the financial crisis, correlations decreased especially within the GCC showing that in times of distress investors prefer companies within their country as lack of trust builds up.

![Figure 3B(i,ii): Volatility of Global Stock Markets](image1)

![Figure 4B(i,ii): Value at Risk (VaR) of GCC Stock Markets](image2)

![Figure 3B(iii,iv): Volatility of GCC Stock Markets](image3)

![Figure 4B(iii,iv): Value at Risk (VaR) of GCC Stock Markets](image4)

| Table 3B: Correlation coefficient (ρ) measures the degree of co-movement among stock markets. Higher values of the correlation coefficient (ρ), are typically found in more integrated financial markets. In the table “High”, “Med” and “Low” signify that ρ > 0.7, 0.3 < ρ < 0.7 and ρ < 0.3 respectively. |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                | FTSE Shariah | FTSE 500 | FTSE 100 | DJ EuroStoxx | Bahrain |
| S&P 500   | High         | High      | High      | High           | Low           |
| FTSE 100   | High         | Med       | Low       | Low            | Low           |
| DJ EuroStoxx| High         | High      | High      | Low            | Low           |
| Bahrain   | Low          | Low       | Low       | Low            | Low           |
| Kuwait    | Low          | Low       | Low       | Low Med        | Low Med       |
| Oman      | Low          | Low       | Low       | Low Med        | Low Med       |
| Qatar     | Low          | Low       | Low Med   | Med            | Med           |
| UAE       | Low          | Low       | Low       | Low Med        | Low Med       |

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Performance – Shariah Compliant Indices

- Shariah compliant indexes exclude industries whose lines of businesses include forbidden goods or where their debt/assets ratios exceed 33%. (Table 4B, Figure 5B)
- In the first half of 2008 some of the GCC markets (both conventional and Shariah compliant) were hit by the financial crisis. These were the oil exporting Saudi Arabia and natural gas exporting Qatar which faced an income drop after the oil and gas prices plummeted as the world entered recession. UAE were also affected as many foreign investors curtailed their investments in order to avoid offset liquidity problems.
- In the second half of 2008, the crisis deepened and all stock markets of GCC members faced negative returns. Best performer of 2008 was Bahrain which had positive returns in the first half of 2008 and when the crisis worsened the negative returns were significantly smaller than other GCC members.
- Shariah compliant indices show greater losses than the conventional ones providing evidence for the problems that productive sectors would face. In particular, real estate and manufacturing business in UAE and energy exporters Saudi Arabia and Qatar were the first to have problems.
- Shariah compliant indices in this period recorded higher gains than the conventional indexes for specific markets (e.g. Bahrain in 2009 Q2 6.74% compared with -0.89%) and in general (e.g. UAE in 2009 8.20% compared with 5.25%)
Risk – Shariah Compliant Indices

- 2008, the year of the crisis increased the riskiness of all GCC markets. Bahrain is the safest place as shown both by volatility and Value at risk (0.72% average volatility and 2.33% average VAR). UAE were the most volatile (2.55% average volatility and 8.51% average VAR) (Figure 6B-7B)

- In 2009 volatilities fall, indicating that the peak point of the crisis has passed. Bahrain still is the safest place for investments with average volatility being 0.68% and average VAR at 2.62% followed by Oman. On the other hand the most risky place is UAE (2.52% average volatility and 8.33% average VAR) where the Dubai crisis was reflected in increased volatilities and VARs.

- Shariah compliant indexes tend to be only slightly higher than conventional ones. The significant differences observed between global Islamic indexes (like the DJ Islamic) and worldwide benchmarks (e.g. S&P 500) are not observed here. This might be explained by the narrower range of investment assets in the GCC markets and the higher percentage of Shariah compliant companies.

- Co-movement between stock indices in the GCC region is much lower than expected given the similar macroeconomic conditions of the member countries, and the upcoming monetary union which, theoretically, should increase stock market integration. We believe that investors see every country individually rather that a union. This might be due to the different policies and priorities each country sets (i.e. UAE clearly promote a more liberal development than Saudi Arabia). A convergence in policies however will have to occur as the monetary union progresses.

- In support of the previous statement, correlations between S&P 500, FTSE 100 and DJ Euro Stoxx are all above 65% and even reach 92%. In the GCC, correlations vary between 20% and 58%.

- Shariah compliant indexes show medium correlations with conventional indices for respective markets (e.g. Bahrain-Bahrain Shariah = 0.55) except for Qatar and UAE. One possible explanation is the progressive character of these economies (Dubai has invested greatly in tourism and financial services) as against Saudi Arabia.

![Volatility of Shariah compliant GCC Stock Markets](#)

![Value at Risk of Shariah compliant GCC Stock Markets](#)

*Figure 6B (left):* Volatilities (see figure 2 above for description) of Shariah compliant GCC stock markets. “S” is for a Shariah compliant index.

*Figure 7B (right):* Value at Risk (VAR) estimates (see figure 3 above for description). Shariah compliant indices show greater losses than the corresponding conventional during the financial crisis.

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*Table 5B: Correlation coefficient (ρ) (see notes to table 3 above)*
Recent Developments in the GCC sukuk market

- Sukuk Issuances fell to less than 8 per quarter after 2008 Q2 while the amount issued was about 1 billion USD per quarter. For comparison, in 2008Q1 there were 16 issuances of a total of 5 billion USD (Figure 1Ca)

- A breakdown between corporate and sovereign sukuk shows corporate investment activity to have frozen after the intensification of the crisis in 2008 Q4

- On the other hand sovereign issuances increase in 2009 Q2 to reach a record high in 2009 Q3. Clearly the state powers and large companies where the state has a large share (quasi-sovereign) are not threatened by the crisis. We believe that a stance like this could be problematic. Indeed the Dubai case seems to verify the argument that even companies with strong sovereign support could face difficulties.

- The UAE have the lead in sukuk issuances but Saudi Arabia has by far the greatest value of issuances; almost half of the raised funds in 2008 and 2009 were by Saudi Arabia. Bahrain and Qatar raised the least amount in the GCC

Major Commodities

- Oil prices were at record levels (145 $/barrel) in first half of 2008, before they plummeted as the financial crisis turned into a recession.
- In 2009 oil prices rose again to an average of 60 $/barrel. In 2009 Q4 prices reached 80 $/barrel, as the recession was drawing to an end.
- Natural gas followed similar patterns.
- Gold increased in value, as usually happens in a recession and periods of turmoil. From 2008 Q1 to 2009 Q4 the gold price rose by 26%.

Exchange Rates

- GCC currencies are held at a fixed rate to the US dollar. The exception is Kuwait, whose currency is linked to a basket of currencies.
- Compared to the Euro area, the value of GCC currencies fell against the Euro in the first half of 2008. This resulted from the continuing depreciation of the US dollar.
- From 2009 Q1 currencies fell back almost to the levels of 2008 Q1.
- GCC currencies held their value against the GBP in 2008.
- GCC currencies appreciate relatively to the pound between 2008 Q3 and 2009Q1. (a bit earlier than the Euro providing evidence that UK was hit first by the global financial crisis).
Understanding the Objectives of Islamic Banking: A Survey of Stakeholders' Perspectives

Asyraf Wajdi Dusuki (2008) [International Journal of Islamic and ME Finance and Management]

The purpose of this paper is to survey the viewpoints of various stakeholder groups (e.g. customers, local communities, employees etc) on the philosophy and objectives of Islamic banking in a dual banking environment like Malaysia. Using data obtained through questionnaires the study reveals that respondents regard Islamic banking as an institution that should first attend to the social needs of the society (e.g. promote education) rather than emphasizing on profit maximisation. This paper clearly shows that stakeholders of Islamic banks have different priorities than the stakeholders of conventional banks; therefore managers should take that into consideration in order to plan the most appropriate corporate behaviour.

The Relationship between Monetary Policy and Islamic Stock Market

Mohd Yahya Mohd Hussin and Mohd Faisol Ibrahim (2008) [Review of Islamic Economics]

The aim of this paper is to analyse the short and long run dynamics between monetary policy and the Islamic stock market in Malaysia. Specifically it investigates the link between monetary policy variables (e.g. money supply, treasury bill rates etc) and the mean of stock returns using co-integration, causality tests and error correction models. The first result is that Islamic indices respond to the same set of monetary policy variables as the conventional stock market index of Malaysia. Secondly, a comparison between the Malaysian and the US stock markets shows that the latter are affected by a different set of factors than the former. Results of this paper, especially the implications for the Islamic stock markets, should be interpreted with caution because of the different rules and bank structures that apply in Malaysia compared to the GCC region (e.g. debt can be traded, bank holding companies have conventional and Islamic windows).

The Arboon Sale: A Shariah Compliant Alternative to Selling Short with Borrowed Securities

Shaykh Yusuf Talal DeLorenzo (2008) [Shariah Capital]

Modern Islamic finance does not have the ability to benefit from falling markets or even to protect stock market investment from downward trends. It is acknowledged that conventional hedging techniques like the short sale cannot be applied in Islamic banking as they oppose the Shariah Law. However a solution could be found in the Arboon and Salam contracts, the use of which is completely legitimate under the Shariah. These instruments could give investment managers the necessary tools to hedge and manage risks. A difficulty according, to the author, in the application of Salam and Arboon is that the contracts that underlie the exchange of securities must be made to comply with Shariah rules.

Shariah Issues in Liquidity Risk Management: A Survey

Rifki Ismal (2008) [Review of Islamic Economics]

The topic of this paper is the need for Islamic banks to establish sound liquidity management as a standard practise to ensure ongoing operations under regular and irregular liquidity needs. The paper focuses on theoretical aspects of this issue, specifically about the relationship between Islamic banks and the Central bank of every country and how financial aid should be provided. The author concludes that due to the different nature of Islamic banks, liquidity management is embedded within every bank’s operations; therefore additional measures are unnecessary. If however such measures should be taken then these should be specially tailored for the Islamic banks.
Assessing the Globalisation Performance of the Muslim Countries through Convergence Analysis

Sayyed Abdolmajid Jalaie, Alireza Hassanzadeh Jezdani and Hamid Reza Horry (2009) [Review of Islamic Economics]

This paper explores the degree of convergence of Muslim countries to the rest of the world. Using globalisation indices it ranks countries according to their progress so far and their future prospects. Muslim countries are split into six performance groups according to similarities in performance and convergence. Malaysia holds the first place among Islamic countries followed by Saudi Arabia. GCC countries are all in the top 10 giving indications that their economy is open and they have benefited from global economic forces and synergies. On the contrary countries like Nigeria, Sudan and Chad are at the bottom of the list giving evidence that more effort has to be made to converge towards the others. According to the authors, countries should first attempt to converge with their closer peers (same countries within the group) by elimination of trade barriers.

Efficiency in Islamic and Conventional banks: A comparison based on financial ratios and data envelopment analysis

Jill Johnes, Marwan Izzeldin and Vasileios Pappas (2009) [GOLCER Research Paper]

The efficiency of Islamic and conventional banks in the GCC region is the topic of this paper which utilises Financial Ratio Analysis and Data Envelopment Analysis. According to the authors Islamic banks are more profit and revenue efficient but less cost efficient compared to their conventional counterparts. In the latter years of the sample, Islamic banks become more efficient mainly attributed to technological improvements. Contribution of the paper is significant as all countries of the GCC are included in the study and the sample size is larger than previous papers of similar topic. Additionally Islamic banks are only 4%-6% less efficient than conventional banks while previous studies claimed that the difference is around 15%-16%.

Dynamic Relationship between Monetary Policy and Bank Balance Sheet Items in Malaysia: A Comparison between Islamic and Conventional Banks (2009)


This study explores the effect of monetary policy changes on deposits and loans of conventional and Islamic banks in Malaysia. The authors find that Islamic banks’ balance sheet items are more sensitive to monetary policy changes than conventional banks. The authors attribute this to the wider and deeper market base that conventional banks are linked to which gives the ability to offset a decline in liquidity that follows from a tighter monetary policy. On the contrary, the relative newer Islamic banks cannot benefit from such linkages and have to bear the “brunt” of the tighter monetary policy. Additionally the study finds that small banks are more de-stabilising compared to large ones because of their limited financial alternatives.

Introducing Islamic Monetization

Armen V. Papazian (2009) [Cambridge University Working Paper]

In this paper the concept of equity-based monetisation (or Islamic Monetization) is introduced which is basically an alternative to debt-based monetisation. The author clarifies that equity monetisation should be used in the context of cash-flows and commitments, exchanged between the government and the central bank, rather than shared ownership. Public Capitalisation Notes (PCN) would be issued by treasuries and sold to central banks. The payment would be structured in a dividend form (rather than a predetermined interest rate) which governments would pay when they could afford it, satisfying the risk sharing principle that underlies Islamic finance. The author proposes that GCC region could provide an ideal candidate given its dire need for reform, the lack of monetisation power (i.e. central banks buying and selling government securities) and the lack of an individual exchange rate policy.
Forthcoming Conferences


Crude Oil and Condensate Value and Trade, March 1–2; Dubai, UAE, www.econnection.org

Successful Strategies for Handling and Avoiding Bunkering Disputes, March 14 –15; Dubai, UAE, www.econnection.org

156th (Ordinary) Meeting of the OPEC Conference, March 17; Vienna, Austria, http://www.opec.org


Kuwait Quality Summit, May 25-26, Movenpick Hotel, Kuwait, http://www.kuwaitquality.com

The 2010 Gulf Research Meeting, July 7-10, 2010; Robinson College, University of Cambridge, www.grcevent.net/cambridge
The **Gulf One Lancaster Centre for Economic Research (GOLCER)** was established in May 2008 by Lancaster University Management School and Gulf One Investment Bank. The centre is funded by a donation from Gulf One Bank.

The main purpose of the Centre is to conduct empirical research focused on key economic and financial developments in the Middle East and North Africa (MENA) region, with special emphasis on the Gulf region. This region includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates, countries that form the Gulf Cooperation Council.

GOLCER’s research agenda will include, as primary topics, energy economics, Islamic banking and finance, telecommunication and infrastructure economics. Recent developments in these fields will be assessed in the light of their impact on the economy of the Gulf region.

In addition to its research activities, GOLCER will provide tailored training courses in specialised areas, including quantitative methods and applications of state-of-the-art econometric and statistical software packages to economic and financial phenomena. GOLCER will also provide consultancy services.

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