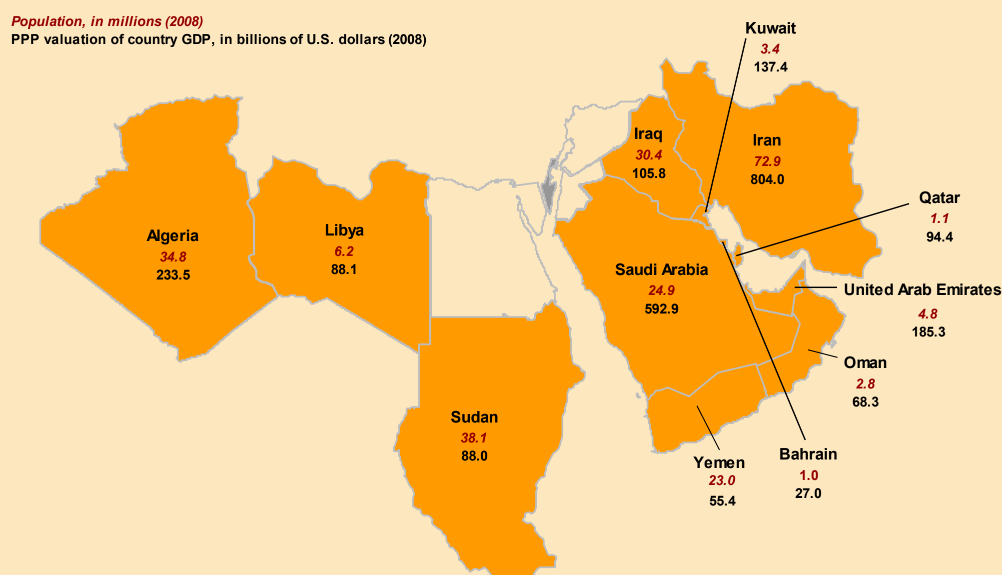
1. MENAP Oil Exporters: Weathering the Global Storm

The MENAP oil exporters were directly affected by the global financial crisis through a sharp drop in oil prices, a contraction in the global economy, and a sudden drying up of capital inflows. Although activity in the oil sector will likely drop by 3.5 percent in 2009, strong countercyclical macroeconomic policies have helped mitigate the impact of the crisis on the non-oil sector, which is projected to grow by 3.2 percent. Looking ahead, higher oil prices, a revival of global demand, and continued government spending will provide the basis for stronger growth in 2010. The crisis also revealed some vulnerabilities in the banking and corporate sectors, requiring countries to undertake exceptional stabilization measures and highlighting the need to strengthen financial sector supervision, enhance corporate governance, foster resource mobilization, and diversify risks.

MENAP Oil-Exporting Countries

The oil exporters comprise 12 countries: the six countries of the Gulf Cooperation Council (GCC—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) and Algeria, Iran, Iraq, Libya, Sudan, and Yemen. Together, they account for 65 percent of global oil reserves and 45 percent of natural gas reserves. The countries are mainly exporters of oil, gas, and refined products, with oil and gas contributing about 50 percent to GDP and 80 percent to government revenue. They are diverse and differ substantially in terms of per capita GDP, which in 2009 is estimated to range from US$1,108 in Yemen to more than US$76,000 in Qatar. The GCC subgroup is relatively homogeneous, however, with similar economic and political institutions and relatively less diverse per capita incomes.



Sources: IMF, *Regional Economic Outlook* database; and Microsoft MapLand.

Note: The country names and borders on this map do not necessarily reflect the IMF's official position.

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Domestic Policy Actions Mitigate Spillovers from Global Crisis

The impact of the crisis in MENAP oil exporters is most visible in the oil sector, where output is projected to contract by 3.5 percent in 2009 (Figure 1.1)—sharper than the drop in the global economy. With the large decline in oil prices—from a peak of US$147 per barrel in the summer of 2008 to about US$30 per barrel at the beginning of 2009—and subsequent cuts in oil production, the Gulf Cooperation Council (GCC) countries have been hardest hit (Table 1.1). Particularly pronounced drops in oil GDP growth are expected for Iraq (almost 8 percentage points) and Saudi Arabia (15 percentage points) this year.

Buttressed by strong international reserve and fiscal positions prior to the crisis, most countries have responded by pursuing expansionary fiscal policies, notably in Saudi Arabia and the United Arab Emirates (Figure 1.2). As a result, non-oil GDP for the MENAP oil exporters is projected to grow by 3.2 percent in 2009, with GDP growth, in the aggregate, decelerating to 1.4 percent. These policies are helping to maintain relatively high levels of imports during the crisis—at just over US$700 billion in 2009—which, in turn, will help mitigate the global downturn.

The decline in oil prices, combined with an expansionary fiscal stance, is leading to a substantial drop in current account surpluses for the MENAP oil exporters, from more than US$380 billion in 2008 to just over US$50 billion projected for 2009 (Figure 1.3). Combined with the sharp outflows of capital and given the authorities' commitment to maintaining fixed exchange rate regimes, this also led to a significant drawdown of the large stocks of international

Table 1.1

Basic Economic Indicators

(Percent change, unless otherwise indicated)

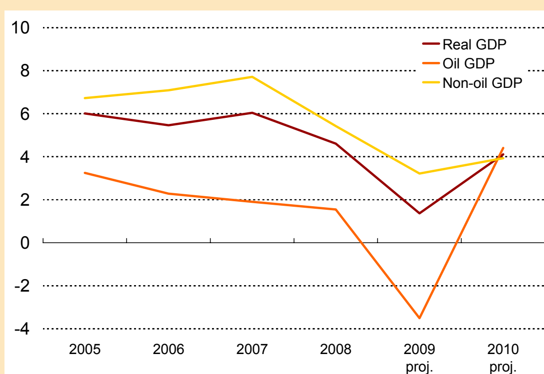
	GCC			MENAP Oil Exporters		
	2008	Proj. 2009	Proj. 2010	2008	Proj. 2009	Proj. 2010
Real GDP growth	6.4	0.7	5.2	4.6	1.4	4.1
Oil	5.8	-5.2	5.5	1.5	-3.5	4.4
Non-oil	6.6	3.2	4.4	5.4	3.2	3.9
Inflation	10.8	3.7	3.8	15.4	5.3	6.2
Imports						
In billions of U.S. dollars	513.8	478.2	516.3	745.1	700.1	751.9
Imports						
In percent of total world imports	2.7	3.2	3.2	3.9	4.7	4.7
Fiscal balance, in percent of GDP	27.4	5.3	10.4	14.2	2.0	5.2
Government expenditure and net lending, in billions of U.S. dollars	305.6	316.6	332.9	581.7	577.2	610.8

Sources: National authorities; and IMF staff estimates and projections.

Figure 1.1

Global Crisis Strikes the Oil Sector

(Real GDP growth; percent)

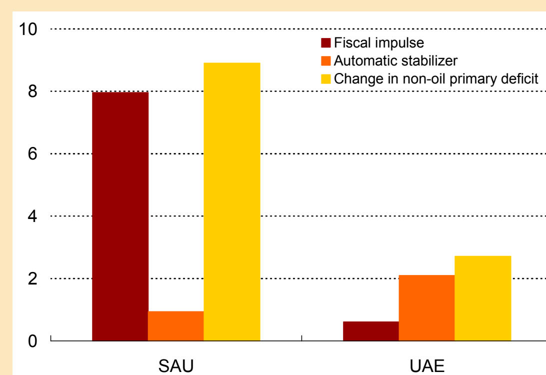


Sources: National authorities; and IMF staff estimates and projections.

Figure 1.2

Large Stimulus in Two Countries

(Change in the non-oil primary fiscal deficit, 2009; percent of non-oil GDP)



Sources: National authorities; and IMF staff estimates and projections.

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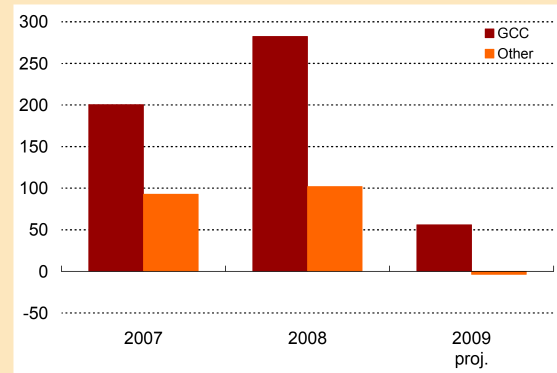
reserves built during the oil boom years[1] (Figure 1.4). From a peak of US$807 billion in September 2008, total reserves of MENAP oil exporters fell by nearly US$40 billion in six months.[2] These numbers exclude movements in sovereign wealth funds, for which only limited function is available. Sudan and Algeria—the two countries that allowed some degree of exchange rate flexibility—experienced downward pressures on their currencies as well.

The sudden drying-up of foreign funds and the decline in domestic asset prices also put severe strains on the balance sheets of banks that had both borrowed externally and were heavily exposed to real estate and equity markets. This led to a striking slowdown of credit expansion in most countries (Figure 1.5); the deceleration ranged from more than 40 percentage points in Qatar to about 5 percentage points in Algeria.

Figure 1.3

Current Account Balance Shrinks

(Billions of U.S. dollars)

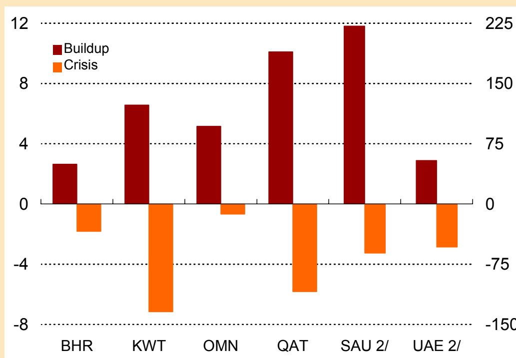


Sources: National authorities; and IMF staff estimates and projections.

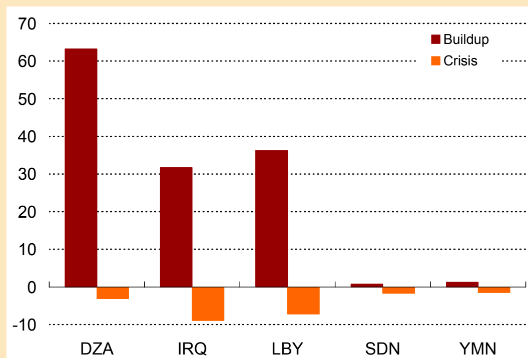
Figure 1.4

Buildup of External Reserves, Drawn Down During Crisis; Changes in International Reserves[1]

(GCC: billions of U.S. dollars)



(Non-GCC: billions of U.S. dollars)



Sources: IMF, *International Financial Statistics*; national authorities; and IMF staff calculations.

[1] Sovereign wealth fund assets are not included. The buildup phase corresponds to the period between January 2007 and the month in which international reserves peaked in each country; and the crisis phase corresponds to the period between the reserve peak and each country's reserve trough, or its most recent figure, if no recovery is visible. Figures generally refer to the IMF *International Financial Statistics* line "total reserves minus gold," except in the case of Bahrain, Oman, and Saudi Arabia, where they refer to central bank foreign assets. The decline in reserves in Libya during the crisis phase is explained by a transfer to its sovereign wealth fund.

[2] Right axis.

[1] With the exception of Sudan and Algeria, all MENAP oil exporters maintain some form of a fixed or managed exchange rate arrangement, mostly vis-à-vis the U.S. dollar. Algeria has a floating exchange rate regime, and Sudan has a managed float with a monetary aggregate target.

[2] Excluding Iran, owing to lack of data.

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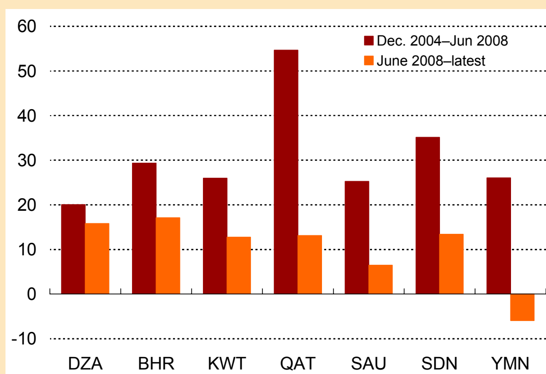
Figure 1.5

Private Sector Credit Decelerated

(Credit to the private sector; annualized growth rate)



Source: IMF, *International Financial Statistics.*

A decomposition of the changes in the sources and uses of funds in the banks' balance sheet helps shed light on factors that have likely contributed to the marked deceleration in bank credit in individual countries.[1] The main factors were the sharp decline in the growth of deposits, banks' limited ability to raise capital, and a withdrawal of foreign financing (Table 1.2). Particularly notable were the decelerations in deposits in Algeria, Bahrain, Qatar, and the United Arab Emirates, as well as reduced foreign financing in Kuwait.

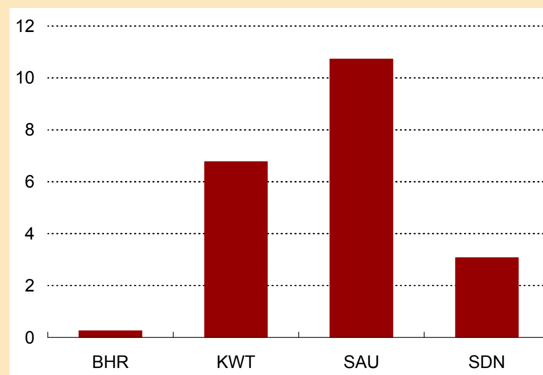
Most authorities responded swiftly to the deteriorating conditions in the financial sector, undertaking a variety of extraordinary steps to mitigate the credit crunch and the impairment of capital by injecting funds in stressed financial institutions. Part of this policy move took the form of expanding central bank credit to the banking system, particularly in Kuwait, Saudi Arabia, and Sudan (Figure 1.6). All of the GCC governments injected funds directly into the banking system. In addition, central banks in some countries (Libya, Yemen, and most GCC countries) lowered policy interest rates. A summary of the wide-ranging policy actions is presented in Table 1.3.

The banking systems have so far absorbed the stress, buffered by the authorities' actions and strong profitability in the precrisis years. By and large, banks have remained solvent and profitable at end-2008, albeit at a lower level (Table 1.4). Capital adequacy ratios have continued to be well above the required regulatory norm, and in many countries, the ratio of nonperforming loans has remained low, with more than 100 percent provision coverage (Oman, Saudi Arabia, and the United Arab Emirates). Within the banking system of the GCC, Islamic banks, having grown at very high rates in previous years, seem to be in a better position to withstand this shock, as a result of their larger capital and liquidity buffers (Box 1.1).

Figure 1.6

Central Banks Extend Credit

(Central banks' net claim on banks; change in percentage of base money)[1]



Source: IMF, *International Financial Statistics.*

[1] Corresponds to the crisis period as defined in Figure 1.4, except in the case of Saudi Arabia, where the increase in credit to banks occurred between August and October 2008, a few months prior to the peak in reserves.

---

[1] Increases in credit to the private sector are defined as the result of increases in the sources of funds minus those in alternative uses of funds. Based on *IFS* data, sources of funds are defined as (a) deposits and other liabilities; (b) credit from the central bank; (c) net foreign liabilities; and (d) capital and others, while alternative uses are defined as (a) net claims on the nonfinancial public sector; and (b) claims on the central bank.

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Table 1.2

Drivers of Change in Credit Growth to the Private Sector During the Crisis[1]

	Factors Contributing to the Fall in Growth Rate of Credit[2,3]					
	Sources of Funds				Alternative Uses of Funds	
	Deposits and Other Liabilities	Credit From the Central Bank	Net Foreign Financing	Capital and Others	Net Claims on the Government	Bank Reserves
Algeria	-		+	+	+	-
Bahrain	-		+	-		-
Kuwait	+		-			-
Qatar	-		+	-	-	-
Saudi Arabia	-	+	-	-	-	+
Sudan	-	+	+		+	+
United Arab Emirates	-	+	-	-	-	-
Yemen	-		-	+		+

Sources: IMF, *International Financial Statistics* (IFS), and IMF staff calculations.

[1] Measures the absolute change in the annualized growth rate of credit, between two periods: 2004:12–2008:6 and 2008:6 to most recent data available.
[2] IFS categories: net foreign financing: foreign liabilities minus foreign assets; bank reserves: claims on the central bank; capital and others: capital plus the residual once all other sources and alternative uses of funds have been identified; net claims on the government: claims on the government and public enterprises minus government deposits.
[3] A + sign indicates that a given factor has accelerated, and a - sign indicates that it has decelerated. A blank cell indicates a negligible effect of a given factor on credit growth. Note that an acceleration in a source (alternative use) of funds will have an accelerating (decelerating) effect on credit.

Table 1.3

MENAP Oil Exporters: Policy Responses to the Crisis

	Financial Sector				Macroeconomic	
Country	Deposit Guarantees	Liquidity Support	Capital Injections	Equity Purchases	Monetary Easing	Fiscal Stimulus
GCC						
Bahrain		✓			✓	
Kuwait	✓	✓	✓	✓	✓	
Oman		✓		✓	✓	
Qatar		✓	✓	✓		
Saudi Arabia	✓	✓			✓	✓
United Arab Emirates	✓	✓	✓		✓	✓
Other						
Algeria					✓	✓
Iran		✓				
Libya	✓			✓	✓	✓
Yemen					✓	

Sources: National authorities; and IMF staff assessments.

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Box 1.1

Islamic Banks and Conventional Banks in the GCC: How Did They Fare?

Islamic banks have grown substantially in recent years. Reflecting a strong increase in the demand for Shariah-compliant products, both in the region and globally, the Islamic banking industry has witnessed significant growth (Table 1), with their assets currently estimated at close to US$850 billion.

Did Islamic banks face different risks going into the global crisis?

Islamic banks and conventional banks faced similar risks in that (a) the risk profile of Shariah-compliant and conventional contracts are comparable; and (b) credit risk is the main risk for both types of banks. Unlike conventional banks, however, Islamic banks are not permitted to have any direct exposure to financial derivatives or conventional financial institutions' securities—which were hit hardest during the global crisis. Interestingly, an analysis of the GCC's top 50 banks[1] indicates that conventional banks also had this advantage going into the crisis—direct exposure to equity investments (and derivatives in the case of conventional banks) were very low in both types of banks (a mere 1 percent of total assets in conventional banks and 2 percent for Islamic banks in 2008).

The main difference in risk exposures appears to be related to concentration risk of Islamic banks in certain countries. While Islamic banks' exposure to the risky real estate and construpction sectors is lower in Saudi Arabia, Kuwait, and Bahrain, it is significantly higher than the system average in the United Arab Emirates and Qatar (Table 2).

Table 1

Market Share and Average Annual Asset Growth of Islamic and Conventional Banks in Selected Countries

(Percent)

	Islamic Banks' Assets in Total Assets in 2008	Growth Rate of Assets (Islamic Banks)	Growth Rate of Assets (Banking System)[1]	Period
Saudi Arabia[2]	35.0	33.4	19.0	2003–08
Bahrain[3]	29.9	37.6	9.6	2000–08
Kuwait	29.0	23.2	14.3	2002–08
U.A.E.	13.5	59.8	38.1	2001–08
Qatar	11.5	65.8	31.9	2002–08
GCC average	23.8	44.0	22.6	
Jordan	10.3	20.6	11.2	2001–08
Yemen	30.2	26.5	22.7	2004–08

Sources: Central banks; and Islamic banks' annual reports.

[1] Including Islamic banks.
[2] Including Islamic windows.
[3] Growth rate is calculated for the total of wholesale and retail while market share is for retail only.

How did banks fare during the crisis?

GCC banks' profitability fell substantially in 2008 and the first half of 2009 (Table 2), with a largely similar overall impact on Islamic and conventional banks. Islamic banks were less affected by the initial impact of the global crisis, potentially reflecting a stronger first-round effect on conventional banks through mark-to-market valuations on securities in 2008. For the first half of 2009, data indicate slightly larger declines in profitability for Islamic banks compared to conventional banks, which could be linked to the second-round effect of the crisis on the real economy, especially real estate. There are, however, differences in the relative impact on

[1] Based on Bankscope data. The sample for the sector includes the top 49 banks (conventional and Islamic). The Islamic banks' sample includes the top 18 Islamic banks.

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Box 1.1 *(concluded)*

Islamic banks within GCC countries, reflecting variations in relative exposures to risky assets. In particular, the weaker performance of Islamic banks in 2009 was largely driven by the United Arab Emirates and Qatar, where they had a considerably higher exposure to the real estate and construction sectors. Banks are expected to post additional provisions in 2009. A more complete view of the impact of the crisis on the two groups of banks will become available next year.

Table 2

GCC: Selected Indicators for GCC Islamic Banks and the Banking System

(Percent; 2008)

	Saudi Arabia[1]		Kuwait		United Arab Emirates		Bahrain		Qatar		GCC Average[2]	
	Islamic	All	Islamic	All	Islamic	All	Islamic	All	Islamic	All	Islamic	All
Capital adequacy ratio	22.1	16.0	21.7	16.0	12.8	13.3	24.5	18.1	17.9	15.6	19.8	15.7
Change in profitability (2007–08)	2.0	-11.8	-42.7	-70.1	0.7	7.9	18.8	-4.6	4.5	21.7	-6.6	-13.9
Change in profitability (H1 2009–H1 2008)	2.9	-11.9	-71.9	-65.3	-34.2	-19.5	-46.5	-33.7	0.0	5.1	-29.0	-23.5
Change in profitability (2008 and H1 2009 compared with 2007)[3]	4.3	-7.2	-49.7	-65.8	-0.8	10.0	8.2	-3.2	2.8	25.4	-8.8	-10.2
Return on assets	3.7	2.1	1.6	3.2	1.7	2.2	2.6	1.3	6.6	2.6	3.2	2.3
Exposure to real estate and construction[4] (as percent of total loans)	5.6	7.3	22.1	31.4	25.7	12.9	11.3	26.2	38.3	18.4	20.6	19.2

Sources: National authorities; banks' financial statements; Zawya; and IMF staff estimates.

[1] The analysis for Saudi Islamic banks does not include Islamic windows in conventional banks.
[2] Simple average except for change in profitability.
[3] Based on average monthly profitability.
[4] It is not clear from published data whether exposures to real estate and construction include household mortgages. Exceptions Islamic bank data for Qatar, where it is clear that household mortgages are included, and banking sector data for Kuwait, which do not include household mortgages. This renders the comparability of exposures difficult.

Which group of banks is better-positioned to withstand adverse shocks?

With larger capital and liquidity buffers, Islamic banks are better-positioned to withstand adverse market or credit shocks. On average, Islamic banks' capital adequacy ratio (CAR) in the GCC is higher than that for conventional banks (except in the United Arab Emirates). The risk-sharing aspect of Shariah-compliant contracts adds to this buffer as banks are able to pass on losses to investors.

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Table 1.4

Financial Soundness Indicators in Selected Countries, end–2008[1]

	Capital Adequacy Ratio	Ratio of Nonperforming Loans to Total Gross Loans	Ratio of Provisions to Nonperforming Loans	Return on Equity
Algeria	12.9	35.5	...	...
Bahrain	18.1	2.3	84.0	16.9
Kuwait	16.0	3.1	84.7	27.8
Libya	16.2	20.2	...	32.9
Oman	14.7	2.4 [2]	119.3	14.1 [2]
Qatar	15.6	1.2	83.2	21.5
Saudi Arabia	16.0	1.4	153.3	35.1
Sudan	10.5	23.5	...	...
United Arab Emirates	13.3	2.5	101.5	21.1
Yemen	14.6	18.0	62.3	11.4
Average Emerging Europe	15.8	6.5	58.5	6.5

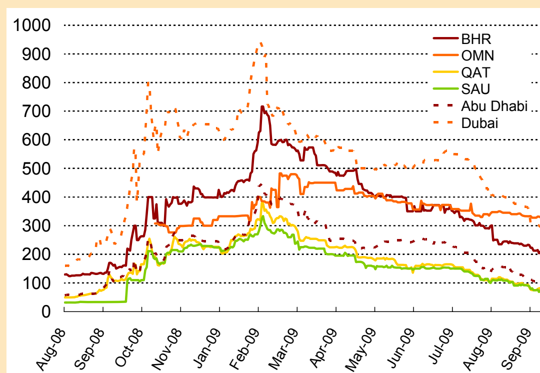
Sources: IMF, *Global Financial Stability Report;* national authorities, and IMF staff estimates.

[1] Except for: Sudan (February 2009) and Kuwait (September 2008).
[2] IMF staff estimates.

Figure 1.7

Financing Conditions Are Improving

(Credit default swap spreads; basis points: Aug. 1, 2008 –Sept. 20, 2009)



Sources: Bloomberg; Markit.

Recovery Taking Hold

The external environment is gradually improving: oil prices are rising, external financing conditions are easing, and an incipient global recovery is under way. After fluctuating between US$30 and US$40 per barrel in early 2009, oil prices rose to about US$70 per barrel in August and, based on futures markets, are projected to remain over US$75 per barrel in 2010. Spreads on sovereign credit default swaps in the region have fallen continuously since their peak in the first quarter of 2009—by more than 650 basis points in the case of Dubai, from a high of 944 basis points on February 13 (Figure 1.7). Despite uncertainties surrounding the strength of the global recovery, oil demand is expected to rebound, with OPEC well positioned to meet a near-term rise in demand (Box 1.2).

On the domestic front, housing markets in a number of hard-hit GCC countries are starting to stabilize, and financial markets have begun to turn around, with the Qatari stock market gaining as much as 72 percent from their trough (Figures 1.8 and 1.9).[2] Price-earnings ratios are increasing, reflecting a sign of renewed optimism over the region's economic outlook. For instance, price-earnings ratios in Abu Dhabi, Dubai, and Saudi Arabia have more than doubled since the beginning of the year and are approaching, or have already surpassed, their early-2008 levels (Figure 1.10).

International reserves are also rising, partially reversing previous losses—recent gains in Kuwait, Oman, and Qatar have been particularly large at 35 percent, 14 percent, and 63 percent, respectively (Figure 1.11). With deposit growth and capital inflows regaining strength, funding conditions in the banking systems are also improving (Figure 1.12). Private sector credit, however, has remained sluggish in some countries, reflecting increased risk aversion, difficulties in raising sufficient capital, and increased supervisory scrutiny. It could also reflect concerns about the recent credit problems faced by large family businesses in the GCC, and an expected deterioration in asset quality.

[2] See Beidas-Strom, Lian, and Maseeh (2009), and J.P. Morgan, "MENA Equity Research."

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Box 1.2

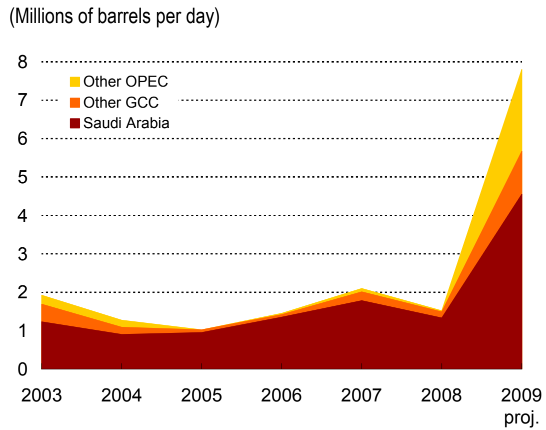
Oil Sector Prospects: Global Implications

Excess capacity in crude oil in OPEC countries is sufficient to ensure a smooth supply response to the global recovery in the near term. In particular, GCC countries have accounted for more than 90 percent of OPEC's spare capacity during 2003–09 (Figure 1). This was the result of investment in capacity expansion during the boom years, most notably in Saudi Arabia, which contributed 78 percent on average to OPEC's excess capacity. OPEC's excess capacity surged in 2009 to about 7.5 million barrels per day (mbd) compared with a global consumption of 86.3 mbd in 2008, in part owing to the cut back in supply in response to the contraction in global demand. OPEC members' compliance with revised quotas in January 2009 was initially higher than in earlier episodes of quota reductions, but has weakened in recent months.

Figure 1

OPEC Spare Production Capacity

(Millions of barrels per day)



Source: Energy Information Administration.

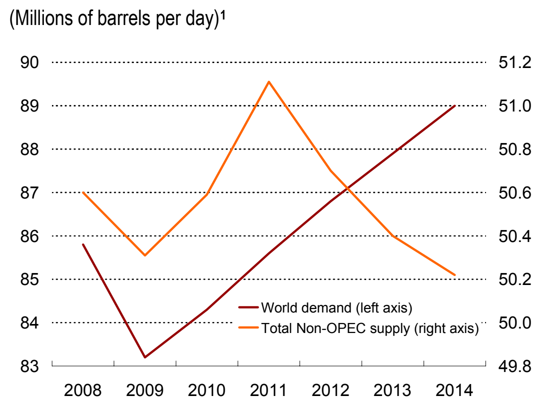
The pace of the global recovery will influence demand and supply developments in the medium term. Global demand and supply are projected to reach 89 mbd and 93.4 mbd by 2014, respectively (Figure 2). Transportation fuels will be the main driver of oil demand growth, which will emanate largely from non-OECD countries. Non-OECD demand is projected to grow by 2.6 percent on average per year through 2014 (from 38.3 mbd in 2008 to 44.6 mbd in 2014) with growth concentrated in Asia, the Middle East, and Latin America. This would represent roughly 50 percent of global demand, compared with about 45 percent in 2008.

Looking ahead, about 90 percent of the increase in supply is expected to come from OPEC. The potential for increasing oil production is much more limited in non-OPEC countries, reflecting the impact of tight liquidity conditions on both upstream and downstream investments and aging fields. In contrast, OPEC supply response is predicated on stronger fiscal and external positions that have permitted continued capacity expansion despite delays in the implementation of some projects. Crude production capacity in OPEC countries is projected to increase from 34.2 mbd in 2008 to 35.8 mbd by 2014. This would be supplemented by natural gas liquids (NGLs) and condensates, which are projected to more than double to 7.3 mbd. About 90 percent of the increase in NGLs and condensates would originate in the GCC.

Figure 2

Global Oil Medium-Term Prospects

(Millions of barrels per day)[1]



Source: International Energy Agency.

[1] Projections.

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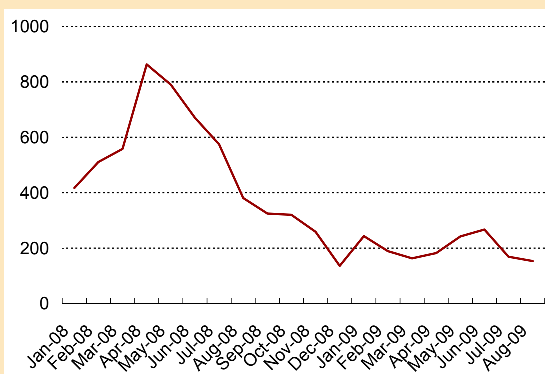
Figure 1.8

Signs of Bottoming Out

(Dubai Land Transactions: number of transactions)



Source: Dubai Land Department.

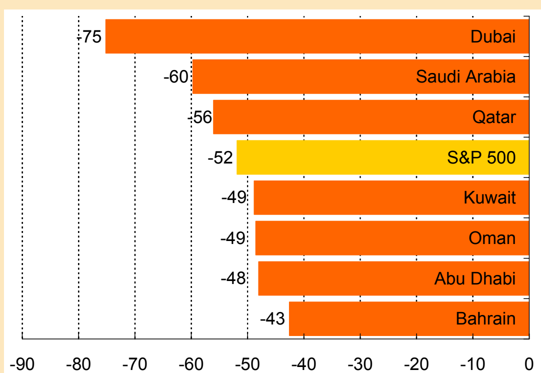
an increase in international commodity prices since the beginning of 2009,[3] inflation rates have continued to fall since August 2008 (Figure 1.13), and are forecast to remain in the 5–10 percent range in most countries.

The current account balance for the MENAP oil exporters as a whole is projected to show a surplus of about US$171 billion or 9.5 percentage points of GDP in 2010 (Figure 1.14). Imports are projected to increase to more than US$750 billion in 2010, lifting the region's share of world imports from 3.9 percent in 2008 to 4.7 percent (Table 1.1). Thus, the MENAP oil exporters will continue to contribute to sustaining global demand.

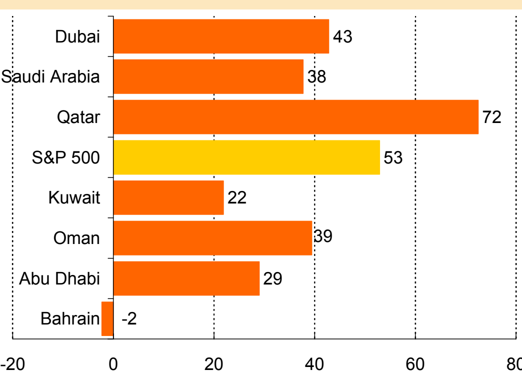
Figure 1.9

Change in Stock Market Indices: Large Drop, Partial Recovery

(Percent change: Jan. 1, 2008–Mar. 3, 2009)



(Percent change: Mar. 3, 2009–Sept. 21, 2009)



Source: Bloomberg.

Outlook for 2010

With the rebound in the global economy in 2010, oil and non-oil GDP are projected to grow at 4.4 percent and 3.9 percent, respectively, on average across the region (Figure 1.1). Given current projections for domestic spending, the pace of non-oil sector activity will remain well below the growth rates reached in 2005–07. Despite expansionary macroeconomic policies and

The countercyclical fiscal policy pursued in several GCC countries in response to the crisis is expected to be maintained (especially in

[3] During the first six months of this year, the WEO world non-fuel commodity price index increased by 15.3 percent, while the food and beverage index rose by 13.0 percent.

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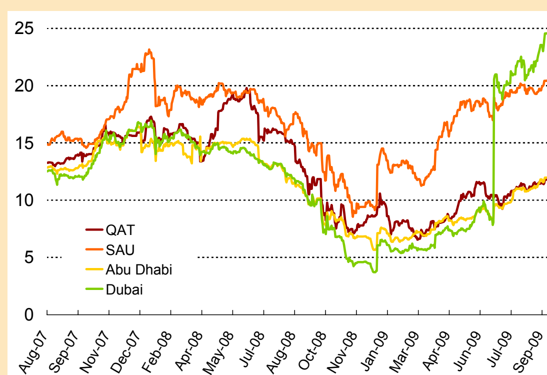
Figure 1.10

Valuation Ratios Signal Optimism Toward a Recovery

(Price-earnings ratios in selected markets)

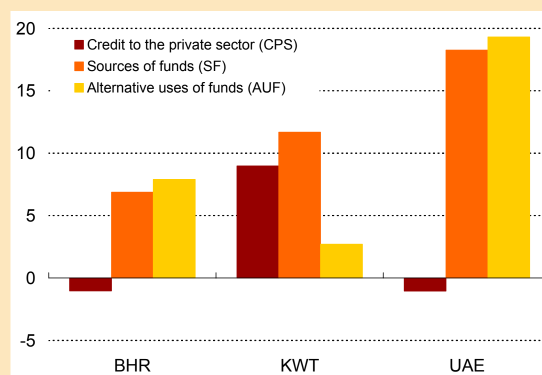


Source: Bloomberg.

Figure 1.12

Banks' Funding Sources Are Recovering, but Not Necessarily Their Lending Activities[1]

(Decomposition of the growth rate of bank credit; ΔCPS = ΔSF–ΔAUF)



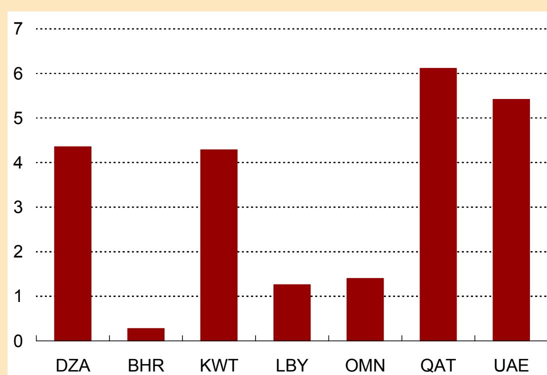
Sources: IMF, *International Financial Statistics;* and IMF staff calculations.

[1] From trough of international reserves up to most recent date.

Figure 1.11

Recent Increases in Reserves[1]

(Billions of U.S. dollars)



Sources: IMF, *International Financial Statistics;* and national authorities.

[1] From trough of international reserves up to most recent date.

Saudi Arabia and the United Arab Emirates), with a focus on large public investment projects. Projections for fiscal balances vary noticeably between GCC and non-GCC countries. For the first group, fiscal surpluses are projected to decline in 2009, and then recover in 2010. For the second, a slight improvement is forecast for 2009, with little change in 2010 (Figure 1.13). Given the uncertainty regarding the pace of global recovery and in light of the anticipated increase in oil prices, continued spending in 2010 is both warranted and feasible in countries with ample fiscal space (Appendix).

In due course, as guided by developments in the global and domestic economies, an exit strategy from the recent exceptional measures to support the financial sector would need to be considered. In fact, in cases where commercial banks have been building up their reserves in the central bank and clear signs of a sustained recovery emerge, the authorities should assess when government funds in the banking system would no longer be needed.

Caution is needed in some low-income MENAP oil exporters to ensure that debt does not rise to unsustainable levels. As a result of the substantial widening of their fiscal deficits—by about 2½ percentage points of GDP in 2009—Sudan and Yemen are likely to record troubling increases in their ratios of public debt to GDP in 2009 and 2010.

Key improvements in financial regulation and supervision already in place in some MENAP oil exporters will continue to be crucial for safeguarding the financial system against future shocks. The spillover among GCC financial

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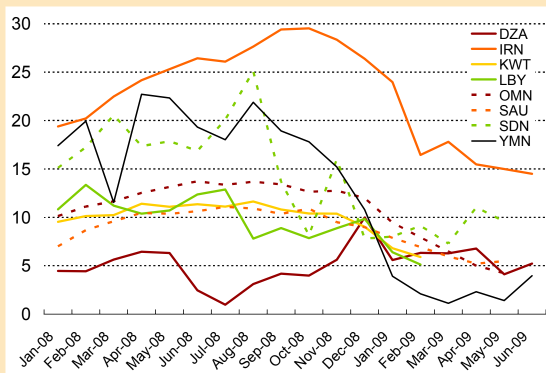
Figure 1.13

No Sign of Inflationary Pressures Yet

(Consumer price inflation; average; percent: year-on-year)



Source: IMF, Information Notice System.

markets—where difficulties faced by large businesses in one country affected the banking system in another—also underscores the need for these countries to harmonize their regulatory efforts.

Furthermore, to reduce vulnerability to external sources of funding, domestic financial systems should be further developed. Most businesses are concentrated in retail, trade, construction, and real estate—sectors that have been hit hard by the crisis and borrow from banks that rely heavily on external funding.

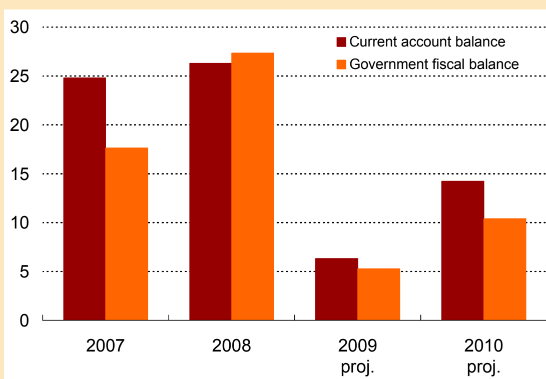
Medium Term: Promoting Greater Diversification

Looking ahead, ongoing initiatives to diversify financing channels away from banks need to be pursued. In particular, GCC policymakers increasingly see value in developing alternatives to bank financing, such as local debt markets for large corporates, thus allowing banks to concentrate more on financing small and medium-size enterprises that create private sector jobs and more diversified economies. At the same time, this would attenuate the adverse impact of banking distress on the provision of credit and help enhance corporate governance as debt issuance will demand more rigorous financial disclosure and transparency.

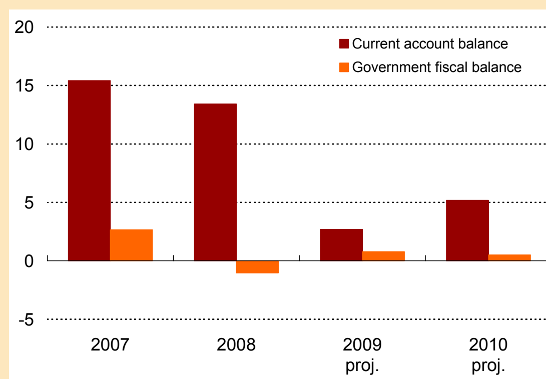
Figure 1.14

External and Fiscal Balances Should Improve As Global Economy Recovers

(GCC: percent of GDP)



(Non-GCC: percent of GDP)



Sources: National authorities; and IMF staff estimates and projections.

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