

GCC Financial Market Quarterly

Spring in the air

The opening months of 2012 saw an impressive revival, albeit still somewhat uneven, of activity virtually across the breadth of the GCC financial markets. Reduced regional and global risk aversion helped bridge some of the persistent gap that has existed between market behavior and the economic fundamentals. Nonetheless, while the underlying outlook remains positive, the multitude of structural weaknesses globally still continues to pose a risk of significant discontinuities.

- **Banks resume lending.** The regional banking sector, with the exception of Kuwait and the UAE, has continued its recovery and lending activity is now advancing at rates in or close to the double digits in most GCC economies. With the health of banks generally strong, lending activity is increasingly well aligned with structural economic needs.
- **Equity markets rebound but IPOs fail to follow.** The performance of the regional stock exchanges has reflected the improving mood with substantial gains over last year's lackluster performance. Progress was particularly strong in Saudi Arabia and Dubai. Nonetheless, IPO activity has remained subdued and the pipeline vulnerable to changing market conditions.
- **Good news for bonds and sukuk.** The GCC bond and sukuk markets have led the positive progress with particularly welcome developments in the sukuk space. Saudi Arabia saw its first sovereign-backed issue while there are signs of private companies tapping the market. Overall, the remarkable rebound of last year looks set to continue. Substantial refinancing requirements remain the main risk factor for bonds, especially in Dubai, which has nonetheless seen risk perceptions improve markedly.
- **Positive signs for some alternatives.** Government spending remains the most important alternative with the Kuwaiti budget continuing the regional penchant for a relatively permissive fiscal stance. Although private equity deals are still small in number, the market is seeing more activity with some expectations of a rebound going forward. The main source of concern is the relative retreat of European lenders from the syndicated loan market. They have served as a key source of capital for some regional economies and the ability of regional and non-European banks to fill the vacuum is in considerable doubt.

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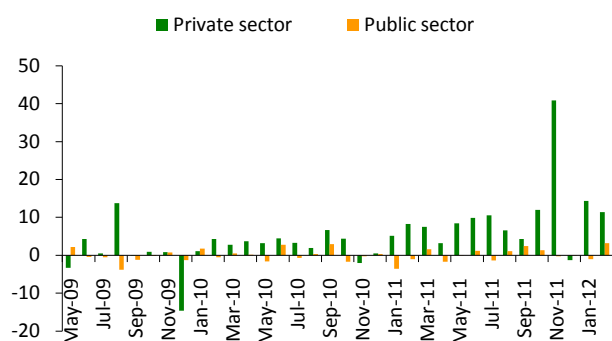
Bank credit: Continued momentum

Bank lending in the GCC has generally continued to gather momentum in recent months, although country-specific factors still play an important differentiating role. In particular, Kuwait and the UAE have to date struggled to match the positive trends seen elsewhere in the region. In general, the outlook for regional bank credit is very benign. The economic outlook is favorable and the banking sector solid, typically with ample liquidity to mobilize in the market, especially now that regional banks have by and large dealt with the non-performing loans produced by the downturn. Lending should further benefit from the low interest rate stance produced by the Dollar pegs (outside of Kuwait), although external risk factors still possess the potential for disruptions.

Saudi Arabia: Fastest growth since 2009

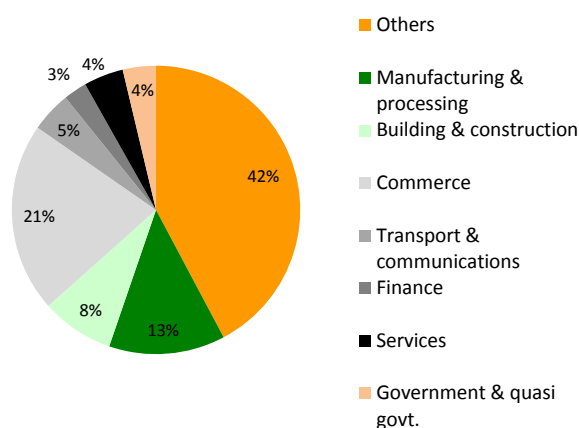
Saudi Arabia has increasingly established itself as the regional leader in credit growth. Overall lending during the three months to February averaged 16.4% more than the same period a year earlier with lending to the private sector rising by 16.3%. After a lengthy period of relative stagnation, even loans to the public sector have become to increase fairly clearly. The YoY rise in February attained 23%, although the average in December-February was up by a more modest 9.1% YoY. Overall bank lending in February was SAR918.1bn, of which SAR884.1bn was lent to the private sector. Loan growth is set to remain strong as banks prioritize asset growth in an environment of robust growth and growing confidence. The banking system benefits from high liquidity and generally healthy balance sheets.

Saudi Arabia bank credit, monthly changes (SAR bn)



Source: SAMA

Sectoral breakdown of Saudi bank credit, 4Q11



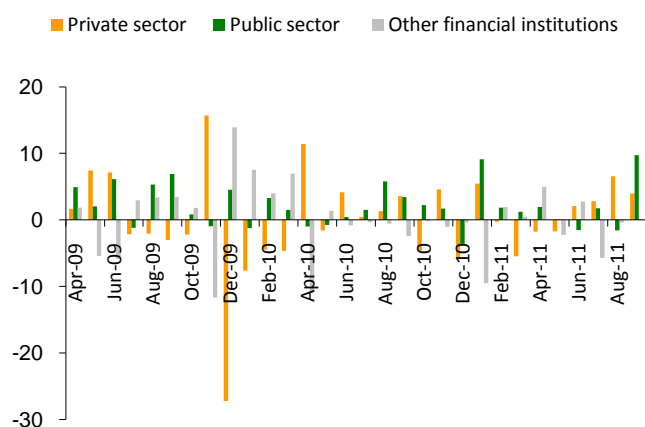
Source: SAMA

The UAE: Persistent stagnation

The UAE has continued to lag behind the rest of the region in terms of bank lending. Overall credit growth attained a mere 1.6% YoY in December with the total loans standing at AED998.4bn. Growth in lending to the private sector was even somewhat lower with a 1.4% YoY gain as of December to a total of

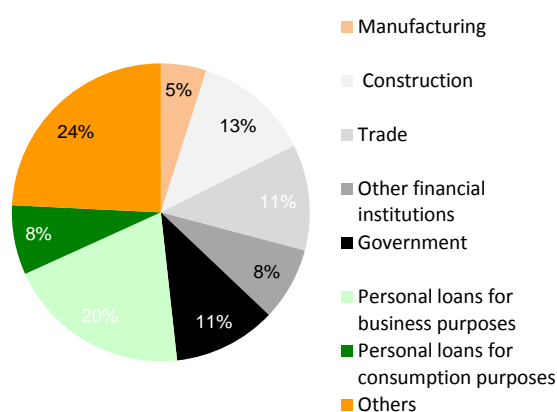
AED732.2bn. Bank lending in the UAE has remained stagnant due to depressed deposit growth and efforts to by the Central Bank to impose stricter standards on lending. Also the real estate sector is yet to emerge from the crisis even though pockets of strength are beginning to appear.

UAE bank credit, monthly changes (AED bn)



Source: Central Bank of the UAE

Sectoral breakdown of UAE bank credit, 3Q11

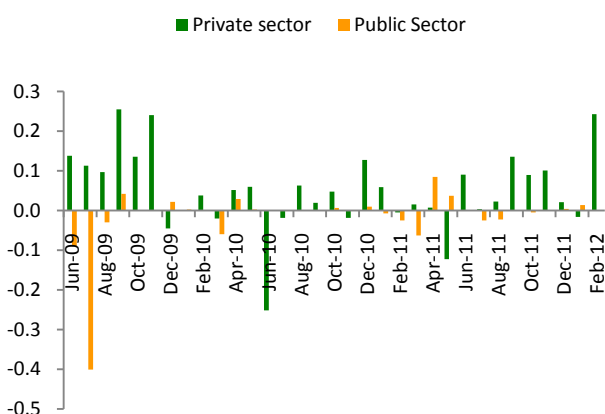


Source: Central Bank of the UAE

Kuwait: Modest progress

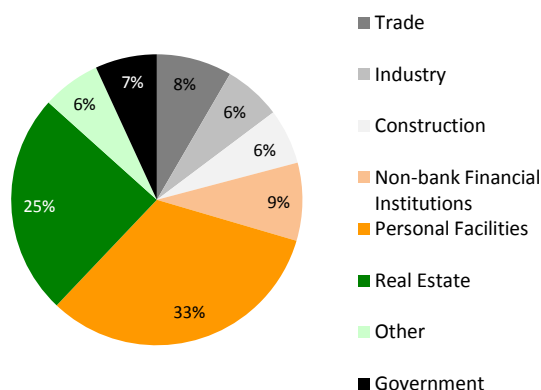
The minimal progress made in unleashing the planning government spending has contributed to the lack of progress in Kuwaiti bank credit, although the latest monthly figures showed signs of a more positive momentum emerging. The annual pace of expansion in February was 2.2%, ahead of the 1.6% figure recorded during the three months to February. Public sector credit remained particularly anemic with a 1.2% YoY gain to KWD1.9bn whereas lending to the private sector rose by 2.3% to KWD25.8bn.

Kuwait bank credit, monthly changes (KWD bn)



Source: Central Bank of Kuwait

Sectoral breakdown of Kuwaiti bank credit, 4Q11

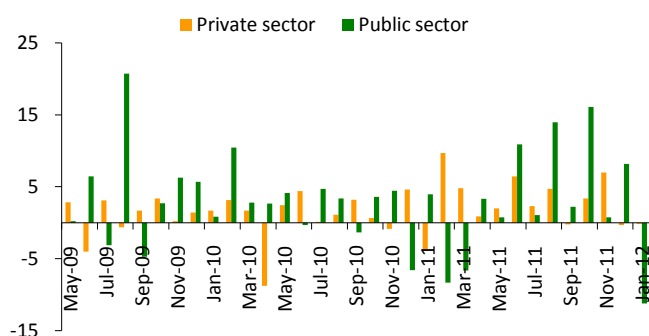


Source: Central Bank of Kuwait

Qatar: Robust progress

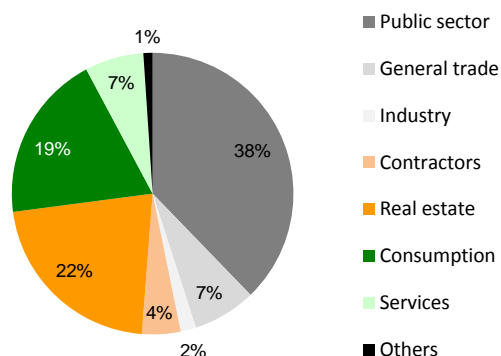
Bank credit growth in Qatar remains robust with the average annual pace of credit growth in the three months to January reaching an impressive 25.7% YoY. However, the positive momentum remains critically linked to the public sector with the annual pace of increase in lending to the government as much as 34% YoY in the three months to January, which took overall public sector loans to QAR365.3bn. There has been a welcome recovery in credit to the real estate which was hit during the crisis. Total real estate loans by Qatari banks rose by 95.1% YoY in October 2011, although the pace moderated to 61.7% YoY in November.

Qatar bank credit, monthly changes (QAR bn)



Source: Qatar Central Bank

Sectoral breakdown of Qatari bank credit, 4Q11

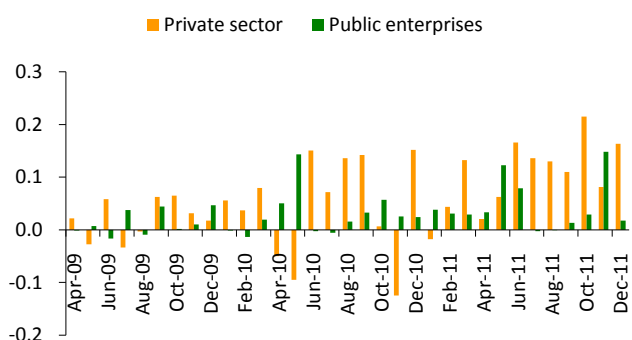


Source: Qatar Central Bank

Oman: Government help

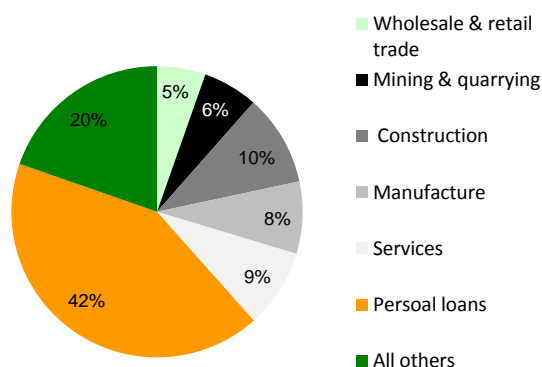
Omani bank credit has continued to grow at a brisk pace with a 16% YoY average gain during the last quarter of 2011 to a total of OMR12.3bn as of December. Much of the momentum still came from lending to the public sector which advanced by 46.7% whereas private sector loans grew by 12.3%.

Oman bank credit, monthly changes (OMR bn)



Source: Central Bank of Oman

Sectoral breakdown of Omani bank credit, 4Q11

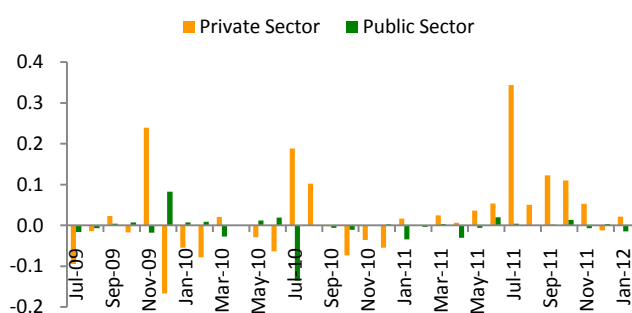


Source: Central Bank of Oman

Bahrain: A turnaround losing steam?

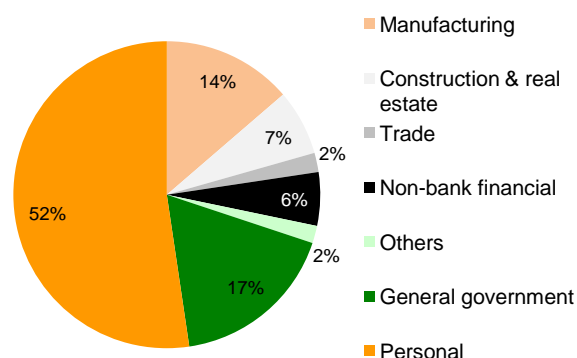
After a challenging year, the normalization in credit condition in Bahrain is continuing, although the MoM increments have been trending down. During the three months to January, the annual pace of credit growth was a relatively high 13.4%, although some of this was still attributable to the inclusion of the government-owned Eskan Bank's housing loans in total bank credit as of July. Lending to the private sector rose by 14.9% YoY while public –sector credit was down by 7.65% YoY. Total bank credit in the country stood at BHD6.45bn.

Bahrain bank credit, monthly changes (BHD bn)



Source: Central Bank of Bahrain

Sectoral breakdown of Bahraini bank credit 4Q11



Source: Central Bank of Bahrain

Equity markets rally while IPOs lag behind

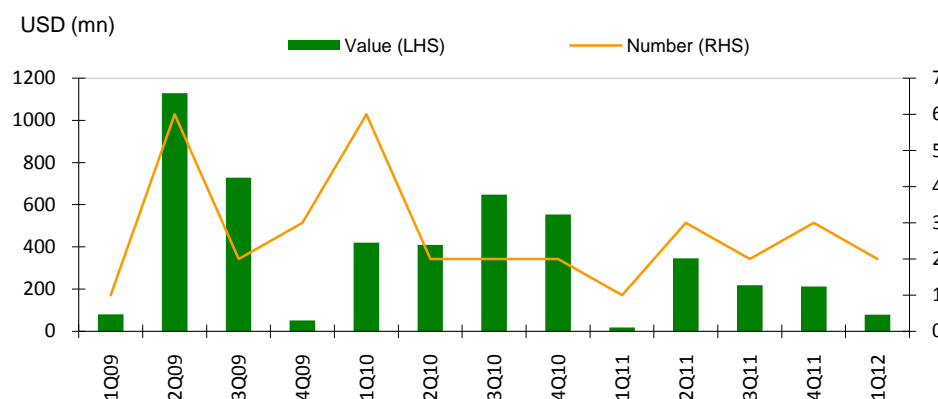
Q1 was marked by a impressive consolidation of the equity market rally that began to take shape the in the closing months of last year. Saudi Arabia and Dubai led the rebound with gains in excess of 20% during the quarter. Elsewhere in the region, however, the gains remained in the single digits or altogether absent.

IPO activity lagged far behind the positive secondary market momentum, however. The region saw a total of only two new offerings during the quarter, both of them in Saudi Arabia. The total value of the Q1 IPOs was a modest USD78.4mn, which was significantly down on the already modest total of three listings worth USD212.2mn. By contrast, 1Q11 saw only one offering worth USD17.9mn.

Takween Advanced Industries IPO'ed in January. The al Khobar-headquartered company was established in 1993 and was previously known as Al Othman Plastic Products Co. Takween produces packaging for beverages and unwoven fabrics for the health sector. The company sold 30% of its SAR300mn capital with a total sales price of SAR234mn (USD62.4mn). 50% of this was allocated to retail investors who registered total applications reached SAR668mn. The institutional portion was 234% oversubscribed.

Tokio Marine Saudi Arabia Co conducted its SAR60mn (USD16mn) initial offering in March. The insurance company listed 30% of its SAR200mn capital. The company had a number of founding shareholders including Alinma Bank, Tokio Marine & Nichido Fire Insurance Co, and SABIC Industrial Investments Co.

GCC IPO activity



Source: Zawya

In addition, Saudi Arabia's Etihad Atheeb Telecommunication Co (GO) in March returned to the market by offering 117.5mn new shares at SAR10 each, which took the total number of issued shares to 157.5mn. The company's shares had

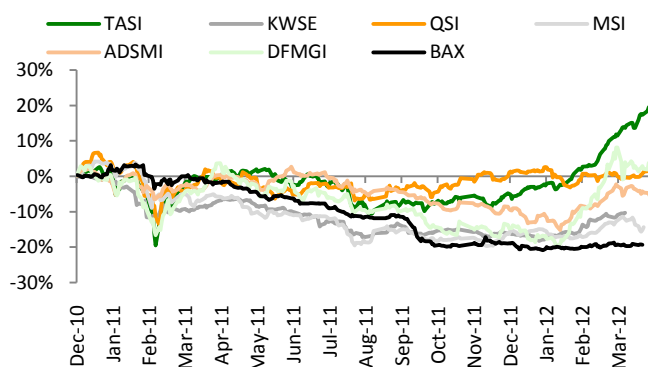
been suspended in May 2011 after accumulated losses reached 95%, which prompted the company to cut its capital by 60% to SAR400mn.

The market mood improves

Recent months have seen the GCC markets shed the persistent sense of malaise that has held back their performance for a number of years. This improvement has been particularly palpable in Saudi Arabia where a 5% rebound during 4Q11 was followed by a further 22.1% advance in 1Q12. The strong upward progress has gone hand in hand with a strong positive momentum in the daily value of trading. Having remained well below SAR10bn a day throughout 2011, the total rose to more than SAR20bn at its peak and has remained fairly firmly in the double digits in recent weeks. Also the Dubai market has experienced a comparable turnaround during the opening months of this, closing the quarter 21.8% up, in a sharp contrast to a 5.5% drop in 4Q11. The performance of the other regional bourses has been more muted, however. Abu Dhabi and Kuwait were up by some 6% and Bahrain by just under a percent. Qatar and Oman were virtually flat.

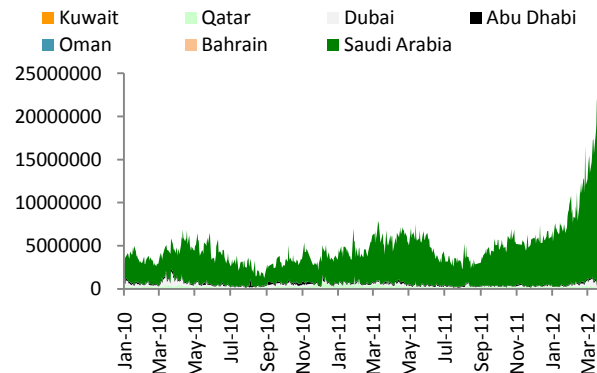
The increase in overall optimism seems closely linked to the global market situation where the erstwhile worries about the US Dollar have somewhat diminished and a temporary respite was observed in the Euro-zone crisis after the latest Greek bail-out deal. Even though both stories possess considerable potential for renewed deterioration, the news flow, at least for now, turned decidedly less negative. But also the Gulf region has made good progress in boosting investor confidence. Most GCC governments have significantly boosted their spending in areas such as housing, job creation, and social benefits which has addressed persistent social concerns but also boosted economic activity. The fiscal implications of the increased spending have been manageable thanks to high oil prices and increasing production. Specifically Dubai has benefited from signs of bottoming out in the housing sector and indications of progress in addressing its leverage burden without major discontinuities. In general, the economic fundamentals remain attractive and the growth prospects benign.

The performance of the GCC benchmark indices



Source: Bloomberg, regional exchanges

Market turnover (USD '000)



Source: Bloomberg, regional exchanges

Moreover, the fact that the generally healthy regional banking sector is regaining its appetite for lending means more broad-based growth than has been the case during the global crisis. Overall, mood is brighter in a way that seems generally consistent with the economic realities. The markets are further benefiting from reasonable valuations which, at least for now, make especially the Saudi bubble fears somewhat exaggerated. What is somewhat more of a concern is the ongoing capital wave from other assets classes, notably land, into equities. This is at least partially linked to worries about new taxes for undeveloped land and hopes for the next step in opening up the Saudi market.

The pipeline still solid

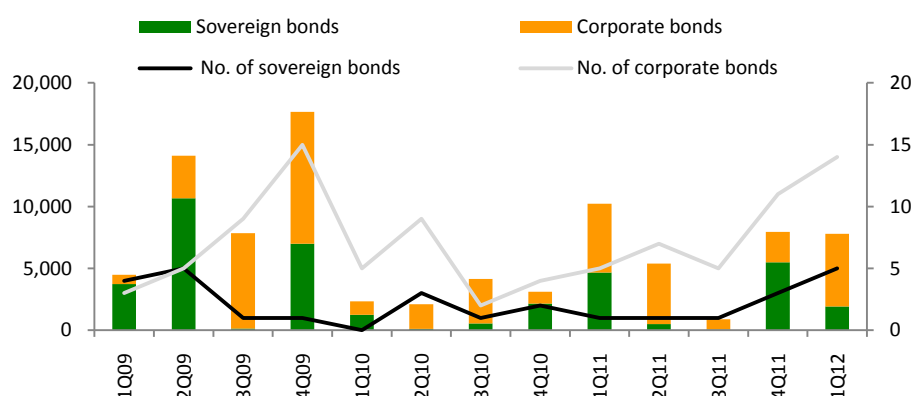
The regional IPO pipeline still remains fairly sizeable, although the volume of concrete near-term IPO prospects suggests minimal qualitative change from the conditions observed in recent years. Many issuers remain cautious in an uncertain market environment and issues sometimes get delayed for years.

Saudi Arabia has seen the approval of Najran Cement Co's IPO in April. The company is selling 50% of its shares for a total of SAR850mn (USD226.7mn), a fairly sizeable offering by recent standards. Other possible IPO prospects in Saudi Arabia this year include the Aujan Group (food and beverages), Al Akhawain Co (agriculture), HUTA Group (construction), Gulf Stevedoring Contracting Co (transport), Alkifah Construction Equipment (industrial manufacturing), Rotana Holding (media), Nas Holding (transport), and Al Oula Real Estate Development Co. The Omani pipeline of announced IPOs includes a USD155.8mn offering by Bank Nizwa as well as offerings by Oman Arab Bank, Al Khalili United Enterprise (construction), and Northern Minerals Co (mining). Announced UAE offerings include Al Benaa Real Estate Investment Co, Tasheed Holding Co, Orbit Showtime Network, Metito Overseas (power and utilities), Daman Investments, Buildan Development (Financial services), and AlWaseet International for Publishing and Distribution. The Kuwait Energy Co, Kuwait Airways, the Kuwait Stock Exchange, Qatar Airways, and al Jazeera Finance of Qatar are the most important announced issues elsewhere in the region.

Bonds: Banks dominate

After a bumper quarter closed an exceptionally volatile year in 2011, 1Q12 marked relative normalization for the GCC conventional bond markets with overall primary market activity roughly halving in value from 4Q11. Total issuance in Q1 reached USD5.9bn and involved eight corporate issuers and a total of 14 different issues. This compares to aggregate issuance of USD11.9bn in 4Q11 (issues with tenors in excess of a year) and USD9.4bn a year earlier in 1Q11. These figures were broadly consistent with the continued strength of emerging bond markets globally where overall issuance reached USD464bn in the course of 2011 and some USD10bn in the first quarter of this year, according to Dealogic estimates.

GCC conventional bond issuance (USD mn)



Source: Zawya, Bloomberg

Corporate issuance

Continuing an established pattern, new issuance activity was once again decisively dominated by the financial services sector. UAE and Qatari banks accounted for USD4.3bn, or just under three quarters of the total. Other issuance was limited to Dolphin Energy and KIPCO.

The quarter saw a number landmark issues by regional financial service providers. Qatar National Bank (QNB) in January raised USD1bn with a five-year tenor, while Emirates NBD undertook a pioneering RMB1bn (USD158mn) 'Dim Sum' issue in February followed by a five-year USD1bn bond in March. National Bank of Abu Dhabi (NBAD) raised USD750mn with a five-year tenor followed by a ten-year HKD335mn in March. Doha Bank was the second Qatari lending to tap the markets during the quarter with a USD500mn five-year issue in March.

Bank borrowing was driven by a combination of refinancing needs and efforts to raise new funding for expansion. For instance Emirates NBD has a total of AED8.5bn (USD2.3bn) of repayments due this year. It has been hit by bad loans, although profits still improved by 8% last year. The coupon on bank bonds

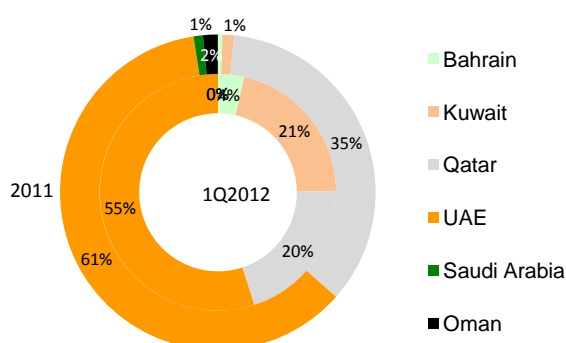
reflected the improvement in market conditions, albeit with pronounced jurisdictional variation. Dubai-based Emirates NBD's USD1bn issue was priced at 4.625% while its Abu Dhabi neighbor NBAD is paying only 3.25% for its five-year bond. QNB is paying 3.375% and Doha Bank a slightly higher 3.5%. The demand for bank paper has remained strong with for instance the Doha Bank bond oversubscribed nearly eight times.

Q1 saw only two issuances outside the banking sector. Dolphin Energy in February issued a USD1.3bn 10-year Eurobond. The Kuwait Projects Company (KIPCO) recently completed a KWD80mn (USD290mn) bond issue, the largest local corporate issue in Kuwaiti history. The four year notes were issued in a fixed and floating tranches with the the fixed offering having a coupon of 4.75%.

Sovereign issuance

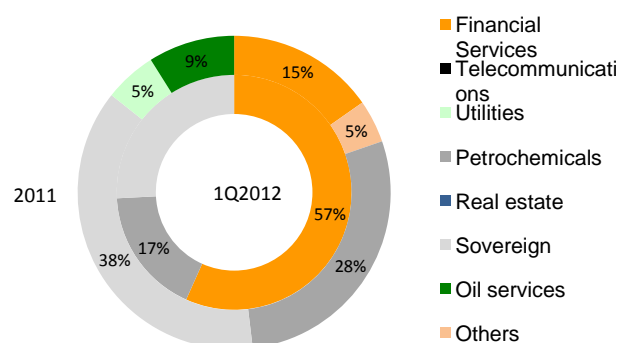
Sovereign issuance during the quarter was limited ongoing short-term T-bill issuance. The longest tenors were one year: four sovereign issuances by the Central Bank of Kuwait totaling USD1.7bn at a coupon of 1.25%. The Central Bank of Bahrain had issued a bond at USD265.3mn in March with a fixed coupon.

Geographic breakdown of GCC bonds, 1Q12 and 2011



Source: Zawya, Bloomberg

Sectoral breakdown of GCC bonds, 1Q12 and 2011



Source: Bloomberg

An ambitious pipeline for tough times

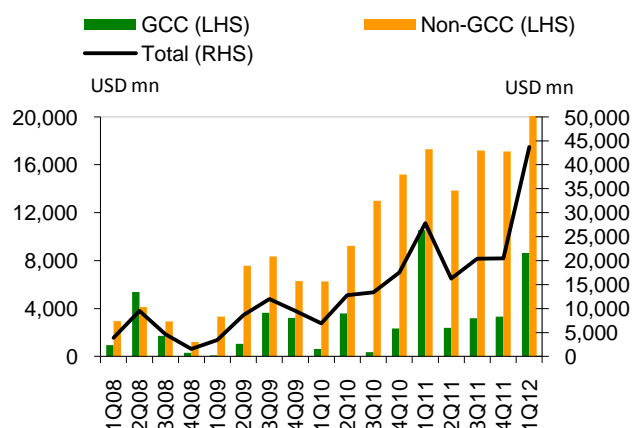
Refinancing requirements are likely to be a key driver of market activity during the year. In particular, regional banks are likely to remain active in the bond markets during the year. Commercial Bank of Qatar is meeting with investors having established a USD5bn issuance program in August. Also Doha Bank's recent bond represents merely the first tranche of a USD2bn program. A number of Omani banks have, similarly, indicated interest in tapping the bond markets. In Saudi Arabia, Kingdom Holding is planning a maiden bond issue. The company currently has bank loans of some SAR1.5bn. Among the regional utilities, Dubai's Dewa has ruled out a near-term bond issue, although the company has a AED1.2bn (USD326.7mn) syndication due this year.

Sukuk toward new highs

The extraordinary sukuk market rally of last year is showing signs of developing even further momentum this year. Overall global sukuk issuance reached USD43.3bn in 1Q12, more than double the USD21.0bn recorded in 4Q11 and comfortably ahead of the 1Q11 total of USD27.7bn. Broadly similar trends were observed in the GCC. Q1 issuance of USD8.6bn marked a sharp rebound over the USD3.3bn seen in 4Q11, although it fell slightly short of the USD10.7bn figure recorded a year earlier in 1Q11. Indeed, GCC sukuk sales during Q1 have been close to last year's total: some USD6bn in Q1 as compared to USD7.3bn during all of 2011.

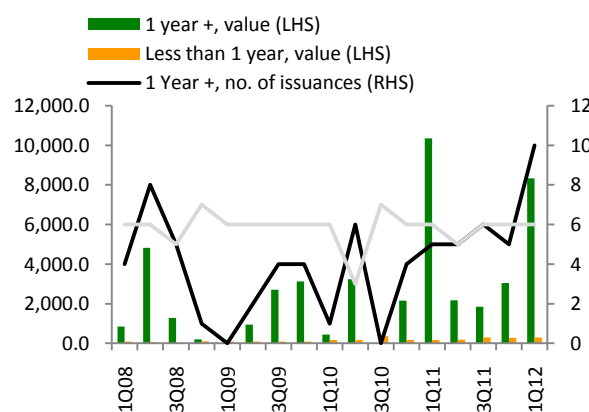
The strong quarter was particularly positive for Saudi Arabia which now emerged as the largest regional sukuk issuer, shaking the historic dominance of the UAE. Its total volume of USD6.4bn was far ahead of the USD1.9bn issued by UAE names. In spite of the growing positive momentum, the GCC is still lagging fairly far behind Malaysia in overall issuance activity.

Global sukuk issuance reaching new highs



Source: Zawya, Bloomberg

Renewed momentum in the GCC



Source: Zawya

Corporate sukuk

The first quarter saw a substantial pick-up in GCC issuance activity with very strong demand as indicated by high oversubscription rates. The regional heavyweights led the market rebound but there were also welcome maiden issuance. For instance the Saudi dairy producer Almarai raised SAR1bn (USD266.6mn) from its debut sukuk in March. The orders for the sukuk reached a remarkable SAR4.7bn.

Saudi Electricity Company issued the first US Dollar-denominated Saudi sukuk in since SABIC's USD1bn issue in October 2010. This was SEC's first ever global issue. The USD1.75bn issue attracted subscriptions of more than USD17.5bn.

The issue was made up of USD500mn five-year tranche priced at 2.665% and a USD1.25bn 10-year tranche with a profit rate of 4.211%. The sukuk was mainly offered to European, Middle Eastern, and Asian investors. Sales in Saudi Arabia were done on a private placement basis.

In the banking sector, Saudi British Bank issued its first even domestic SAR1.5bn (USD400mn) sukuk in March. The issue was a private placement. The sukuk will yield 120 bps over midswaps as compared to 140-195 bps for SEC.

In the UAE, Emirates Islamic Bank (EIB), the Shariah-compliant subsidiary of Emirates NBD, played an important part in the broader group's fundraising. EIB in January placed a USD500mn sukuk maturing in 2017. Also Abu Dhabi's First Gulf Bank (FGB) issued a USD500mn sukuk which was oversubscribed 2.8 times. Reflected the persistent differential in the credit profiles of the two emirates, the FGB sukuk pays 4.046%, whereas EIB has a profit rate of 4.718%. In an important development of the UAE housing sector, the restructured mortgage lender Tamweel placed a USD300mn five-year sukuk in January. The profit rate was set at 5.154% with a 400 bps spread over midswaps.

In a welcome sign of purely private companies turning to the market, the Dubai-based mall developer Majid al Futtaim in February placed a USD400mn sukuk which is thought to herald much more regional corporate issuance. MAF paid 5.85% for its sukuk..

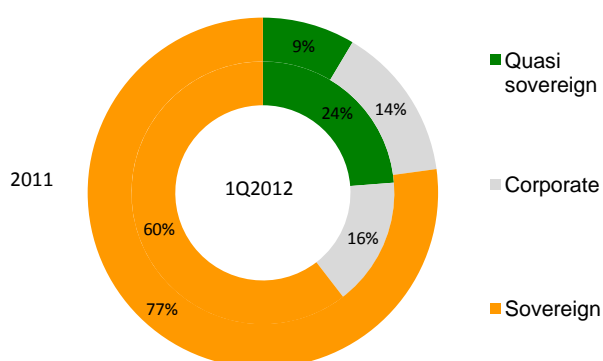
Abu Dhabi National Energy Company sold its first USD215mn sukuk in Malaysia. The issue size was increased from USD160mn in view of strong investor demand. TAQA established a USD1.1bn sukuk program last October.

Sovereign sukuk

The landmark event for the regional sukuk market during Q1 was the eagerly anticipated SAR15bn (USD4bn) 10-year issue by the General Authority of Civil Aviation in January. The issue was for the purpose of funding Jeddah's new King Abdulaziz International Airport and enjoyed a sovereign guarantee. The murabaha-structured note was the largest single-tranche sukuk ever issued. Although the profit rate at 2.5% was only 50 bps above US Treasuries, the sukuk was 3.5 times oversubscribed. The buyers included banks, pension funds, insurance companies, and corporates, suggesting considerable pent-up demand for quality paper.

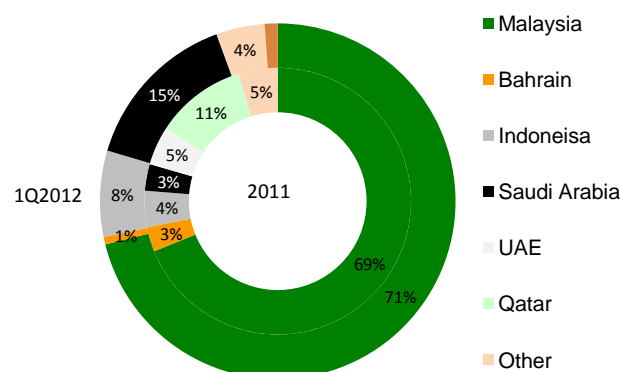
In the absence of direct sovereign issuance in Saudi Arabia, the GACA issue is likely to gain the status of a benchmark for placing local currency sukuk. It will likely also play an important role in absorbing some of the liquidity of Saudi banks while offering them a welcome long-term investment opportunity. SAMA has approved the issue for repo arrangements with zero risk for capital adequacy calculations.

Geographic breakdown of sukuk, 2011 and 1Q12



Source: Zawya,

Sectoral breakdown of GCC and global sukuk, 2011 and 1Q12



Source: Zawya

Strong issuance activity ahead

Global sukuk issuance this year appears on track for another all-time record with last year's USD85.4bn set to be comfortably exceeded even under the more cautious projects. In view of current trends it appears likely that aggregate issuance will clearly exceed USD100bn this year. Market innovation looks set to continue. For instance, the Clean Energy Business Council of the Middle East and North Africa along with the Gulf Bond and Sukuk Association have launched a Green Sukuk Working Group with a view to better aligning the climate change and capital market development agendas in the region.

Saudi Arabia. Saudi sukuk issuance is expected to continue to grow markedly this year. Among the recurrent issuers, SABIC in December gained CMA approval for a sukuk issuance of up to USD5bn. But also new corporate issuers, such as Ma'aden, are understood to be eyeing the market. After the SATORP sukuk last year, some of the large petrochemical investments are seen as particularly promising for funding solutions that may involve sukuk. For instance, Saudi Aramco and Sumimoto Chemical are planning to raise USD6bn to boost the capacity of the Rabigh petrochemicals plant. The plan is to raise PetroRabigh's capacity to 3.7mn tn a year. Similarly, Saudi Aramco and Dow Chemical are developing a USD20bn Sadara Chemical joint venture which will reportedly benefit from a loan issued by the Public Investment Fund of the Saudi government. However, overall funding decisions are expected to be delayed to Q2-3, partly because of the cluster of large projects coming to the market. This has also tended put upward pressure on rates.

The UAE. Abu Dhabi's Al Hilal bank issuing a USD500mn sukuk this year. The unlisted bank is fully owned by the Abu Dhabi Investment Council.

Qatar. Qatar Petroleum is understood to be considering a corporate sukuk this year in a pioneering move by a regional national oil company. This could

potentially trigger issuance by other government-related entities, eg Industries Qatar, as a way of diversifying funding sources.

Other. The sukuk market is fairly consistently expanding its global footprint thanks to a growing number of regulatory initiatives and product innovation. In a potentially important new departure for the Middle East region, Egypt is redrafting its regulatory framework so as to make it easier for companies to issue sukuk. Also the Egyptian government has announced plans for a USD2bn sovereign sukuk. The ascendant Freedom and Justice Party is generally keen to promote Shariah-compliant finance. In the corporate sphere, Al Baraka Egypt has announced plans for a USD200mn sukuk by the end of the year.

The Asian markets are expected to drive global sukuk issuance with Malaysia likely continuing to account for some 60% of overall issuance. Also Indonesian sukuk issuance is expected to roughly double from last year's USD1,9bn. The government has so far sold USD1.5bn of local sukuk, a figure that may be matched in the second half of the year. This year is also expected to see some US Dollar-denominated corporate issuances.

The Asian financial hubs Singapore and Hong Kong are seeking to boost their role in Shariah-compliant capital markets. Singapore equalized the tax treatment of sukuk and conventional bonds in 2006 but has seen only three issues since, although a number of companies are planning to tap the market this year with City Development running a SGD1bn Islamic trust certificate program. The Monetary Authority of Singapore started a SGD200mn sukuk program in 2009, issuing SGD105mn in FY2010-11.

Also Hong Kong is considering plans to amend the taxation of Islamic financial products. The debt issuance was a RMB500mn (USD79mn) three-year sukuk by Malaysia's Khazanah in October 2011. However, the issue benefited from the tax exemption as its underlying assets were in Malaysia. Tokyo is the third Asian financial center jockeying for the sukuk market, although new deals are not seen as imminent. Japan has undertaken a comprehensive review of its tax law and market infrastructure to facilitate sukuk issuance. National Australia Bank is understood to be discussing a sukuk with regulators.

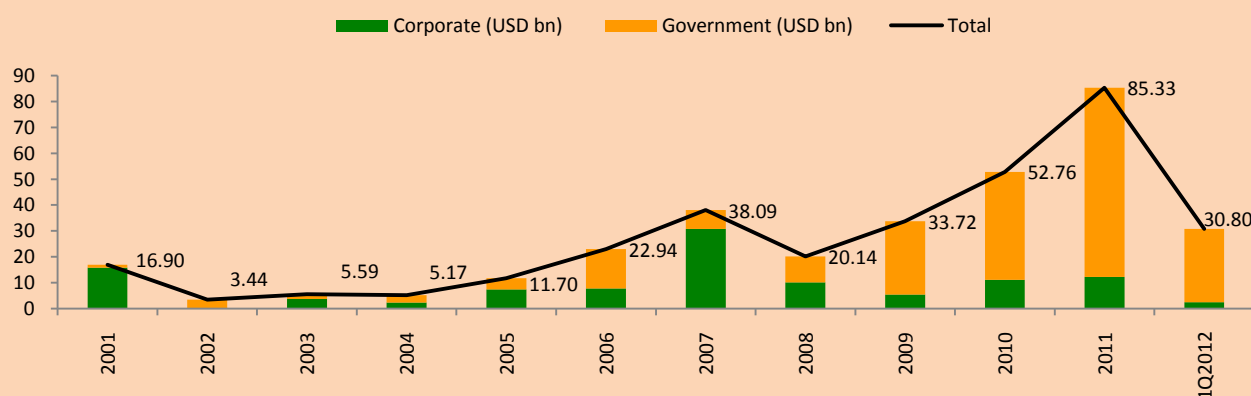
London-based Ethical Asset Management recently launched a product billed as the first ever "investment sukuk," designed as an equity investment instead of seeking to modify the structure of a conventional bond. The company's objective is to raise GBP200mn over the coming 12-18 months. The sukuk is structured as a closed-end private placement fund. The funds raised will be invested in student housing which is expected to generate annual returns in the order of 4-6%. These assets will be formally owned by the investors. The maturity is expected to be 5-6 years.

Malaysia dominate the global sukuk market

As much GCC sukuk issuance has rebounded impressively in recent months, Malaysia remains the undisputed leader in the sector, typically accounting for more than 70% of the global total. This state of affairs has persisted in spite of the fact that, more generally, the GCC countries have generally established themselves as the second major global hub for Shariah-compliant financial solutions. Moreover, in purely GDP terms, Malaysia lags far behind the Gulf: just under USD200mn as opposed to some USD1trn for the Gulf countries taken together. Malaysia's population reached 28mn in 2011, whereas the GCC total is around 40mn. The discrepancy is particularly striking in view of the fact that the Gulf economies are among the leading global spenders on infrastructure, which should in principle open important new opportunities for Shariah-compliant capital market development. Nonetheless, GCC sukuk issuance in 2011 totalled 19bn as opposed to USD58.7bn in Malaysia. The corresponding figures in 1Q12 were USD 30.7bn for Malaysia and USD 8.6bn for the GCC.

Two main factors account for much of this seeming paradox by highlighting the differences between Malaysian and GCC markets. Firstly, the Malaysian government is strongly committed to supporting the development of Shariah-compliant finance as part of its broader capital market development objectives since Asian crisis shook its economy just over two decades ago. The government has embraced important institutional and regulatory initiatives designed to stimulate the development of Islamic capital markets. These have included a centralized Shariah-board, tax equalization, support to new product development, and the institutionalization of capital markets. In the GCC, the process has been much less centralized and organic. Shariah-compliant finance does not typically enjoy differential regulatory treatment or dedicated institutions. Consequently, product innovation has tended to be led by individual issuers in a non-centralized manner, although it has benefited from the guidance of various Islamic financial institutions.

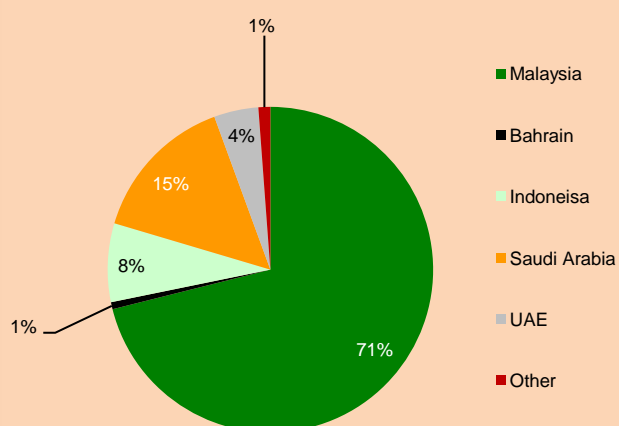
Malaysia sukuk issuance by type, 2001 to 1Q2012



Source: Zawya

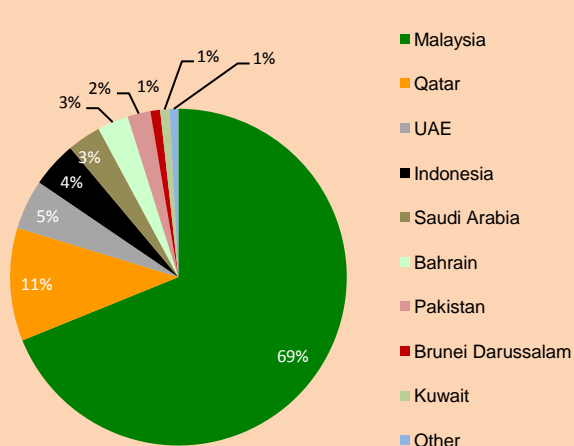
Secondly, the Malaysian dominance among global issuers is more or less matched by the overriding importance of public sector issuers in Malaysia. Especially after the initial years, the leader sukuk issuers in the country have been the Ministry of Finance, Bank Negara Malaysia and various government infrastructure and housing institutions such as Cagamas Bhd, and Khazanah Nasional Bhd. They have in turn stimulated the development of Islamic financial institutions which have found an ideal home for their long-term assets in such paper. Similar public sector issuance in the Gulf still remains rare. Bahrain is the only Gulf country with ongoing issuance beyond short-term liquidity management instruments, although lately also Qatar and some UAE names have tapped the market. The King Abdulaziz Airport sukuk is the first sovereign-backed Saudi issue. The government issuance in Malaysia has in turn put in place benchmarks, yield curves, and product solutions which has stimulated the broader development of market. Project sukuk issuance has begun in the Gulf but lags far behind the established practices in Malaysia.

Global sukuk issuance (Value) by country, 1Q2012



Source: Zawya,

Global sukuk issuance (Value) by country, 2011



Source: Zawya

Secondary markets favor sukuk

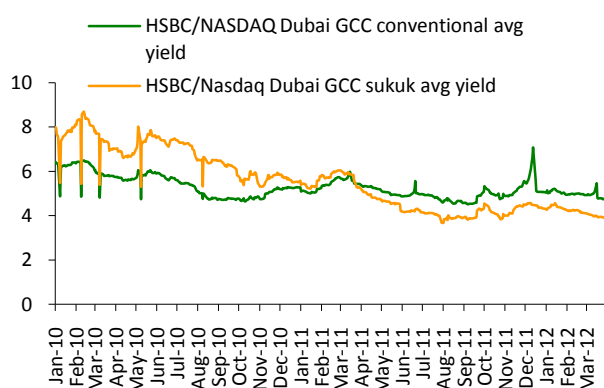
In spite of recurrent periods of stress linked to the situation in Iran, the regional secondary markets have been marked by relative continuity as sukuk have continued to outperform conventional bonds. This state of affairs reflects the continued popularity of an asset class dominated by high-quality corporate names.

In general, markets during Q1 benefited from diminished risk aversion globally, although stress points still remain. In particular Dubai has as much as USD15bn of debt maturing this year. The authorities have repeatedly signaled their belief that the refinancing requirements will be met without disruptions, a position boosted by the timely repayment of a USD500mn bond by Dubai Holding Operations Group due on 1 February. Dubai International Capital, Dubai Holding's private equity group, in April also renegotiated USD2.5bn of loans with its lenders in a deal that provides for 2% over the coming five years for a total of USD2.15bn of this.

Among the most challenged Dubai issuers, DIFC Investments is understood to be looking for a loan of up to USD1bn to help repay a USD1.25bn five-year sukuk maturing in June. Loans have generally proven much easier to deal with than capital market instruments at times of market difficulty when renegotiations become necessary. An ever larger hurdle is presented by the AED7.5bn (USD2bn) sukuk of Jebel Ali Free Zone which falls due in November. Also Abu Dhabi-listed Dana Gas has caused market nervousness due to a lack of clarity of refinancing its USD920mn sukuk maturing in October.

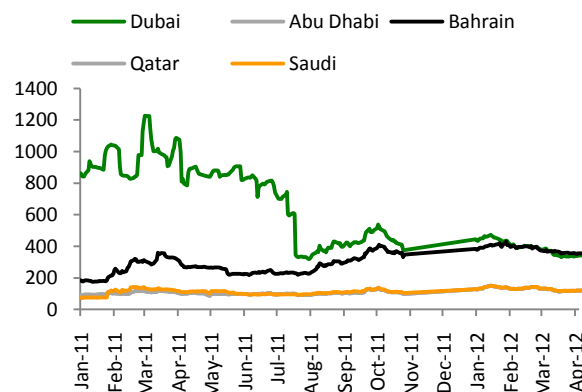
Reflecting the greater market confidence about Dubai's ability to handle the pending redemptions, the emirate's credit default swaps have been steadily converging with those of Bahrain. While Dubai's CDS spreads have almost halved to the upper 300's, Bahrain have risen from just below 200 in early 2011 to more than 350.

Average yields of sukuk and GCC conventional bond spreads



Source: HSBC/NASDAQ Dubai, Bloomberg

GCC Credit Default Swaps

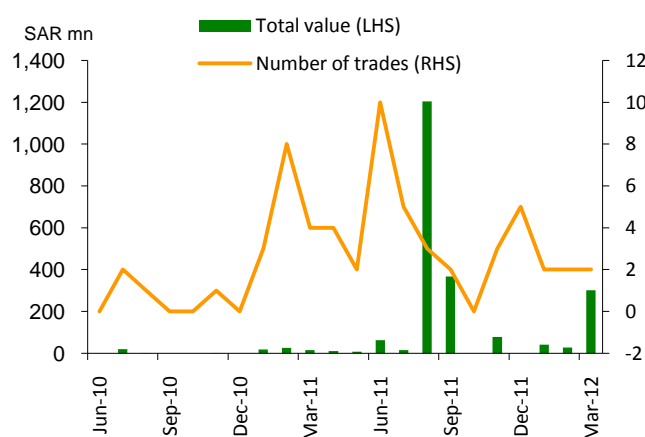


Source: Bloomberg

Trading in the organized secondary markets in the region has remained modest. Tadawul's organized sukuk market saw only six transactions worth SAR369.8mn, which was nonetheless sharply up on SAR77.8mn a quarter earlier. The combined value of 97 transactions on the Muscat platform was OMR2.2mn, just below OMR2.3mn a quarter earlier.

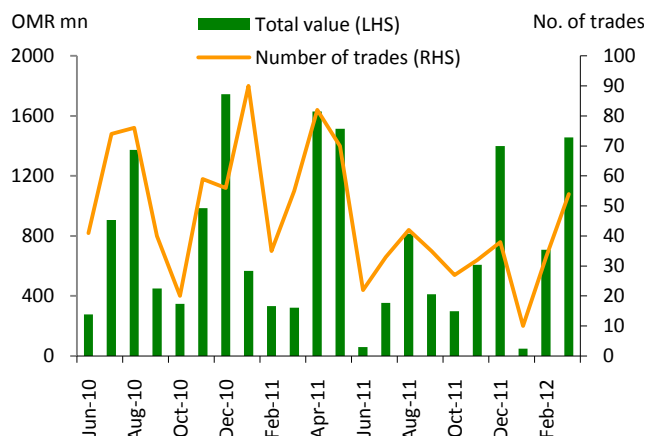
Qatar Exchange now operates an organized secondary market. Only one trade worth QAR49.2mn was recorded during the quarter, in January.

Tadawul secondary sukuk market activity



Source: Tadawul

Muscat secondary bond market activity



Source: Muscat Securities Market

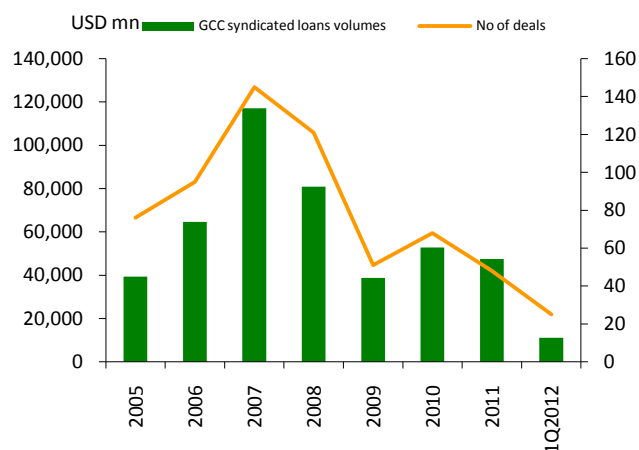
Alternative sources

Syndications squeezed

1Q12 saw a total of USD11.2bn worth of loan syndications in the GCC. This compared to USD39.1bn in 4Q11 and USD83bn a year earlier in 1Q11. Among important deals Saudi Electricity Company negotiated a USD1.4bn loan syndication with a group of European and Asian banks for its Rabigh plant. The project will be carried out by a Korean consortium and the 15-year loan was further backed by guarantees from Korean trade agencies.

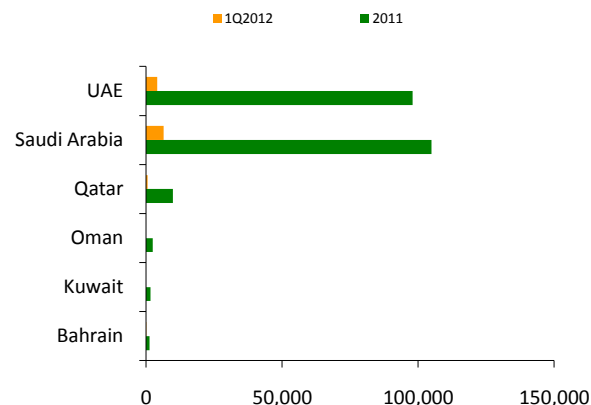
The GCC syndicated loan market is going through a period of adjustment, above all due to the financial difficulties and recapitalization requirements of European banks which have historically played an important role as suppliers of credit. Moody's in March expressed concern that the retreat of European lenders would cause short-term shortages as well as a longer-term structural challenge. Moody's estimates Saudi Arabia, Kuwait, and Oman to be least reliant on European banks with total financing equal to some 10% of GDP. Qatar and the UAE have European bank loans equal to some 25% of GDP. For Bahrain the figure is as much as 75%, given the high reliance of the onshore retail banks on European syndications. However, Bahraini banks have successfully matched foreign assets and liabilities. European funding, furthermore accounts for some 40% of the USD120bn of liabilities held by Bahraini offshore wholesale banks.

GCC syndicated loan volumes



Source: Dealogic, Bloomberg, Thomson Reuters, NCB estimates

Geographic breakdown of syndicated loans



Source: Dealogic, Bloomberg, Thomson Reuters, NCB estimates

European banks currently (as of September) account for some USD237bn, or roughly 40% of the total foreign financing in the GCC. As the Europeans retreat in relative terms, Asian banks are expected to assume a greater role. Leading foreign syndicated lenders include Singapore's DBS Group and Standard Chartered. To an extent, the European funding may shift from loans to bonds and sukuk as more companies tap the capital markets and appeal to European institutions. Also especially Japanese and South Korean export credit agencies

are seeking a greater role as a source of funding as trade flows intensify. Among other things, they played an important role in enabling Qatar Petroleum to raise USD7.2bn for the Barzan gas field last year. Japan Bank for International Cooperation has a USD19.3bn Middle East portfolio which it is looking to expand further. In reflection of similar tendencies, China signed a pioneering bilateral currency swap agreement with the UAE in January. The value of the deal is RMB35bn (USD5.5bn) and it is designed to boost two-way trade and investment.

Private equity

The reported deal flow in the regional private equity space remains fairly modest, although anecdotal evidence is pointing toward increased activity. Particularly defensive areas supported by strong structural growth drivers – such as employment services, education, health care, retail, and oil and gas support – are attracting more interest. Most reported transactions during 1Q12 took place in the UAE while Al Tala International Transportation Co was only recorded deal in Saudi Arabia.

Reach Group in the UAE is a contract staffing and temporary employee provider which benefited from a AED100mn capital injection designed to enable the it to expand in the region. The sale of the Entertainer publications and consumer service company is estimated by various analysts to have cost as much as USD15mn, although the deal size was not reported.

Recently reported GCC private equity deals

Date	Buy/Sell	Target company	Country	Sector	Industry	Size (USD mn)
Jan 2012	Sell	Al Tala's International Transportation Company	Saudi Arabia	Transport	Automotive rental services	N/A
Feb 2012	Buy	REACH Group	UAE	Services	Business consulting	27.2
Mar 2012	Buy	The Entertainer	UAE	Media	Publishers	N/A
Mar 2012	Buy	Sakr Energy Solutions	UAE	Industrial manufacturing	Distributors	25.0
Mar 2012	Buy	Laimoon.com	UAE	Information technology	Website solutions	N/A
Mar 2012	Buy	Box & Automation Solutions	UAE	Information technology	IT & network solutions	0.8

Source: Zawya, media

Government spending set to remain strong

The regional governments are continuing to support economic activity in important ways at a time when efforts are underway to drive the massive infrastructure pipeline in a bid to foster more inclusive growth through the greater prioritization of areas such as housing. The higher-than-expected oil prices and a tendency to increase production are allaying near-term concerns about overspending and fiscal sustainability, although notably the UAE authorities have

taken steps towards fiscal consolidation. The IMF expects overall public sector spending in the UAE to drop by some USD5.6bn this year as the key government authorities seek to rebalance their books after a period of aggressive spending.

Kuwait serves as an example of the broader regional tendency to continued fiscal permissiveness. The government is planning to increase spending by 13.4% to KWD22bn (USD79bn) in its FY2012-13 budget. The government's conservative revenue estimate is KWD14bn (USD50.3bn) based on a price assumption of USD65 per barrel. Qatar has postponed its FY2012-13 budget to late May due to accounting changes.

Appendix

Sources of funding

Asset class			
Bank credit (USD bn):			
	2009	2010	2011
- Saudi Arabia	196.5	206.8	237.4
- UAE*	261.2	264.9	270.3
- Kuwait	96.3	96.6	98.6
- Qatar	69.2	80.7	103.5
- Bahrain	15.7	15.1	17.1
- Oman*	25.1	27.4	31.9
IPO (USD bn):			
	2010	2011	1Q2012
- Saudi Arabia	1.02	0.46	0.08
- UAE	0	0.27	0
- Kuwait	0	0	0
- Qatar	0.14	0	0
- Bahrain	0.39	0	0
- Oman	0.47	0	0
Bonds and sukuk (USD bn):			
	2010	2011	1Q2012
- Saudi Arabia	6.59	5.77	6.4
- UAE	13.79	21.59	6.0
- Kuwait	6.80	0.57	0
- Qatar	10.15	12.01	0
- Bahrain	5.35	0.13	0.3
- Oman	0.77	0.42	0
Foreign direct investment inward (USD bn):			
	2008	2009	2010
- Saudi Arabia	38.2	32.1	28.1
- UAE	13.7	4.0	3.9
- Kuwait	-0.1	1.1	0.8
- Qatar	3.8	8.1	5.5
- Bahrain	1.8	0.3	0.2
- Oman	2.5	1.5	2.0
Private equity investments (USD mn):			
	2010	2011	1Q2012
- Saudi Arabia	154.36	0	0
- UAE	128	384.4	53.02
- Kuwait	0	0	0
- Qatar	0	0	0
- Bahrain	25	0	0
- Oman	0	0	0

Source: Bloomberg, Zawya; & Central Banks.

* Bank credit for Oman and UAE are up till october and september 2011, respectively

Key sukuk and conventional bonds issuance and IPO in 1Q2012

Issuer	Issue date	Tenor	Amount issued (USD mn)
Sovereign sukuk issuance			
General Authority of Civil Aviation	10-Jan-12	10 Year	3,999.70
Central Bank of Bahrain	17-Jan-12	182 Days	53.1
Central Bank of Bahrain	23-Jan-12	5 Year	500
Central Bank of Bahrain	23-Jan-12	91 Days	47.7
Central Bank of Bahrain	16-Feb-12	182 Days	53.1
Central Bank of Bahrain	27-Feb-12	91 Days	47.7
Central Bank of Bahrain	20-Mar-12	182 Days	53.1
Central Bank of Bahrain	26-Mar-12	91 Days	47.7
Corporate sukuk issuance			
FGB Sukuk Company Limited	18-Jan-12	5 Year	300
Tamweel Funding III	18-Jan-12	5 Year	500
EIB Company Ltd	18-Jan-12	5 Year	500
MAF Sukuk Ltd	7-Feb-12	5 Year	400
Abu Dhabi National Energy Company	26-Feb-12	10 Year	211.3
Almarai Company	7-Mar-12	7 Year	266.6
SABB	28-Mar-12	5 Year	400
Saudi Electricity Global Sukuk Co.	28-Mar-12	5 Year	500
Saudi Electricity Global Sukuk Co.	28-Mar-12	10 Year	1,250
Sovereign bond issuance			
Central Bank of Kuwait	25-Jan-12	1 Year	215.7
Central Bank of Bahrain	7-Mar-12	1 Year	265.3
Central Bank of Kuwait	7-Mar-12	1 Year	359.6
Central Bank of Kuwait	14-Mar-12	1 Year	719.2
Central Bank of Kuwait	21-Mar-12	1 Year	359.6
Corporate bond issuance			
National Bank of Abu Dhabi PJSC	3/23/2012	4/4/2022	43.13
Emirates NBD PJSC	3/22/2012	3/29/2017	5.00
Emirates NBD PJSC	3/22/2012	3/29/2017	5.00
Emirates NBD PJSC	3/21/2012	3/28/2017	1,000.00
National Bank of Abu Dhabi PJSC	3/19/2012	3/27/2017	750.00
HSBC Bank Middle East Ltd	3/15/2012	4/2/2015	70.00
ADCB Finance Cayman Ltd	3/13/2012	4/2/2027	50.00
Emirates NBD PJSC	3/9/2012	3/12/2015	39.61
Doha Finance Ltd	3/7/2012	3/14/2017	500.00
Emirates NBD PJSC	3/5/2012	3/12/2015	118.92
HSBC Bank Middle East Ltd	2/28/2012	3/6/2015	350.00
Emirates NBD PJSC	2/27/2012	2/28/2017	28.20
QNB FINANCE LTD	2/14/2012	2/22/2017	1,000.00
Dolphin Energy Ltd	2/7/2012	12/15/2021	1,300.00
HSBC Bank Middle East Ltd	1/27/2012	2/6/2015	272.89
HSBC Bank Middle East Ltd	1/25/2012	2/3/2015	52.45
Kuwait Projects Co Holding KSC	1/16/2012	1/16/2016	112.66
Kuwait Projects Co Holding KSC	1/16/2012	1/16/2016	173.46
IPO			
Subscription Period			
Takween Advanced Industries	16-Jan-12	22-Jan-12	62.39
Tokio Marine Saudi Arabia	19-Mar-12	22-Mar-12	16

Source: Bloomberg & Zawya

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