

Crunch May Help Gulf Grow

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The widening credit crunch is rapidly draining international funds from the Gulf, raising borrowing costs and forcing the region's banks to withhold cash from more high-flying projects, bankers and economists say.

But even as the credit crunch is tolling the death knell for some of the biggest western banks, experts say that tighter credit may help put Gulf economies on a healthier growth trajectory. Tighter credit is likely to ease inflation, reducing the cost of raw materials.

"If one unintended consequence of this is to put a brake on the volume of projects, then this is probably also a good thing," said Jeremy Parrish, the chief executive of Standard Chartered Bank's operations in Abu Dhabi.

The world's biggest government banks managed to revive the global financial system yesterday with a US\$180 billion (Dh661bn) deluge of public cash, a move that helped arrest the freefall in financial markets but failed to lift fears that more giant banks might still be doomed.

While foreign investors have been pulling cash out of regional markets for weeks, the latest turmoil on Wall Street has crippled the crucial market for loans between banks. For local banks, which have been tapping this so-called interbank market as lending outpaces deposits, the result is rapidly rising funding costs that are making them less willing to finance riskier investments.

"The cost of borrowing here has increased significantly," said Giyas Gokkent, an economist at the National Bank of Abu Dhabi. "Banks everywhere are much more cautious in terms of their lending activity right now."

The situation on the world's major financial markets continues to darken. Morgan Stanley, the Wall Street firm created during the Great Depression, became the latest bank set scrambling for a buyer after investors abandoned its stock. Morgan was reportedly in merger talks with Wachovia.

Reports also said that Washington Mutual, another big bank struggling with mortgage-related losses, had put itself up for sale. The damage spread across the Atlantic, as Halifax Bank of Scotland (HBoS), Britain's largest lender, was sold to Lloyds TSB.

Following the failure of Lehman Brothers on Monday and the bailout of American International Group (AIG) by the Federal Reserve on Wednesday, investors have been scrambling to sell riskier assets in favour of the perceived safety of gold and government bonds.

While borrowing costs for banks and companies have soared, prices for three-month US Treasury bills have risen so much that the effective interest rate on the securities was 0.07 per cent yesterday, up slightly from 0.03 per cent on Wednesday, its lowest point since the Second World War.

Stocks in Asia and the Middle East slumped following a rout on Wall Street on Wednesday that sent the Dow Jones Industrials Average down 4.1 per cent. Japan's benchmark stock index dropped 2.2 per cent and stocks in Dubai fell as much as three per cent. Stocks in Doha dropped as much as 3.66 per cent.

The most dramatic action, however, was in gold, which on Wednesday staged an 11 per cent increase, its biggest gain in recorded history. Oil prices also rose as commodities regained some favour as a hedge against the sinking US dollar.

But US stock index futures recovered slightly yesterday, following the injection by central banks.

The Fed joined yesterday with the European Central Bank, the Bank of Canada and the Bank of England to pump \$180bn into the interbank market. Concerns that more banks might go the way of Lehman, or have money locked up in contracts with Lehman, have paralysed the interbank market, posing a risk to the global financial system that relies on it.

Lehman's collapse underscored the risk of such failures to international commerce. But after the bailouts of Bear Stearns, Fannie Mae, Freddie Mac and this week AIG, economists are voicing concern that the measures being used to save capital markets are socialising them, and in the process using taxpayer funds to bail out wealthy bankers and their clients.

And while capitalism is sure to survive, the rapid demise of Wall Street's biggest banks appears to be hastening a shift from an age in which finance was dominated by investment banks, reliant on complex borrowing, to big commercial banks backed by massive pools of cash supplied by legions of depositors.

"The broker-dealers were performing many of the economic functions of banks," said Brad Setser, an economist at the Council on Foreign Relations in New York. "They no longer can access the debt market. That is a problem."

Morgan's search for a buyer came after its shares, and those of Goldman Sachs, came under attack on Wednesday. The two firms are the only large independent American investment banks left, following Lehman's failure and Merrill Lynch's sale on Sunday to the Bank of America.

Some say that the credit crunch besieging the big American banks is partly the fault of big sovereign wealth funds (SWFs) and foreign central banks, which have been shifting with other investors into US government debt and selling US stocks and corporate bonds.

Last year, SWFs stirred controversy by stepping in to help recapitalise cash-strapped US banks. The Abu Dhabi Investment Authority (Adia), for example, took a 4.9 per cent stake in Citigroup for \$7.5bn last November. Citigroup's shares have since fallen by roughly 55 per cent. Under the terms of the deal, Adia receives 11 per cent annually for its investment, but it must pay at least \$31.83 per share for its stake. Citigroup closed on Wednesday at \$14.53. Worse, Adia has to find a way to reinvest its Citigroup payments into markets that are now sinking.

Concerns about the health of the property market, the global economy and tightening liquidity are combining to push up borrowing costs for local borrowers. Credit default swaps – contracts designed to hedge against the risk of a borrower defaulting – on Dubai's debt were being sold at 3.2 percentage points over the

benchmark London interbank offered rate (Libor), up from just 1.5 points a month ago. Prices on Abu Dhabi's debt by comparison were at just 1.6 points over Libor yesterday, according to traders.

"What happened is you now have a situation where credit risk in Dubai has gone up fairly significantly," said Abdul Kadir Hussain, the chief executive of Mashreq Capital in Dubai. "Liquidity in the local interbank market has become relatively tight, so we are dealing with something that you might call our own credit crunch."

Tightening credit could force some borrowers to seek temporary government financing, bankers say, until the situation in global credit markets calms.

Yet local economies should remain on keel, they say. Ample government surpluses will keep government infrastructure projects going, maintaining economic growth. The reduced availability of cash, moreover, will help ease inflation and reduce the cost of key building materials.

Oil prices, while falling, remain well above where they were a year ago, and at least triple the price used in government budget projections, analysts say.

Source: The National