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Tough funding conditions for GCC corporates: the hidden effect of lower oil prices

Tighter liquidity conditions in the GCC region since mid-2014...

Oil prices declined by around 75% between mid-2014 and January 2016, with Brent crude prices falling as low as $28 a barrel. Since then, prices have risen back up by nearly 85%, to around $50 a barrel. Nevertheless, persistently low prices are continuing to weigh on liquidity conditions across Gulf Cooperation Council (GCC) countries. Firstly, these countries are still heavily dependent on oil, despite efforts made towards greater economic diversification. Between 2011 and 2014, hydrocarbon revenues accounted for 70% of exports and over 80% of total fiscal revenues, on average[1]. Secondly, low energy prices have been dragging down governments' fiscal revenues, which has in turn weighed on the results of corporates and the liquidity of the banking sector. As a result, both financial and business conditions have deteriorated since the beginning of the decline in oil prices. Real GDP growth across the region fell to 1.9% in 2016, down from an average of 4.9% between 2010 and 2015[2]. Growth is expected to edge up marginally, to 2.1% in 2017, supported by the recovery in oil prices.

The slowdown in fiscal revenues and economic growth has pushed governments in the GCC region to adopt austerity measures such as raising administrative fees, reducing (or even eliminating) some subsidies, cancelling low-priority projects and trying to contain salaries. Governments are continuing to examine measures to raise additional budgets through other taxes and fees (such as VAT, taxes on business profits and income tax). The region's budgets for 2017 showed reductions in public spending which will lead to the postponement of some important projects. This will make cash flow management more difficult for companies and reduce the opportunities for banks to finance mega-projects (one of their main sources of profitability).

Higher interest rates are another cause of tightening liquidity. GCC countries (with the exception of Kuwait[3]) have their currencies pegged to the US dollar. The Fed has hiked its rates four times within the last 16 months, from 0%, to 0.25%, to 1%, to 1.25%. As a result, some of the central banks in the GCC region have raised policy rates, as they endeavour to protect their currencies.

At the beginning of 2017, the Saudi Arabia Monetary Authority (SAMA) raised the reverse repo rate (the rate at which commercial banks deposit money with the central bank), from 0.75% to 1.25%. The repo rate, however, which central banks use to lend money to commercial banks, remained unchanged at 2%.
The Central Bank of Kuwait (CBK) raised its discount rate by a quarter percentage point, up from 2.50% to 2.75%. The Central Bank of the UAE raised interest rates on the issuance of its certificates of deposits and the repo rate for borrowing short-term liquidity from CBUAE against certificates of deposits by 25 basis points, increasing the latter to 1.5%.
The Central Bank of Bahrain (CBB) raised its key policy interest rate, on the one-week deposit facility, from 1% to 1.5%. The CBB has also decided to increase the overnight deposit rate from 0.75% to 1.25%, to adjust the one-month deposit rate from 1.50% to 2.15%, and to raise the lending rate from 2.75% to 3.25%. GCC central banks are likely to deliver further rate hikes, in line with any from the US Fed.