Banking in the Mediterranean

Challenges and Opportunities

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The EIB Economics Department mission is to provide economic analysis and studies to support the Bank in its operations and in the definition of its positioning, strategy and policy. The EIB Economics Department consists of a team of 25 economists and staff, under the responsibility of the Director Debora Revoltella.

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EXECUTIVE SUMMARY

Basic economic and social indicators highlight significant heterogeneity across the nine Mediterranean Partner Countries (MPC). At the same time, economic models are very different ranging from the centralized, resource-driven economy of Algeria to market-oriented economies, such as Israel. The Arab Spring represents an opportunity for change, in democratic and economic terms for the region, but opens important challenges for the future.

In the short run, the Arab Spring has been associated with increased macroeconomic volatility,also because it coincided with a period of elevated oil and commodity prices, as well as a slowdown in US and European markets. The combination of these three shocks is having economic consequences. Growth in MPCs is estimated at some 2.6 percent in 2011, with substantial downward risks. Public finances have been adversely affected by the social and political turmoil, while external balances have also deteriorated. The increased macroeconomic uncertainty is also highlighted by the drop in foreign exchange reserves, particularly in Egypt.

Going forward, the most important challenge for policy makers across the region will be to ensure job creation. The fact that unemployment has been so persistent, especially among young people and the well-educated, shows that it is a structural problem requiring structural reforms as well as more inclusive economic growth. Reforms to address weaknesses in the business environment will be an important part of initiatives to promote the development of the private sector.

The add-on pressures on socio-economic development stemming from the Arab Spring are also forcing the financial sector across the region to respond to new and expanded challenges. In the coming years, the sector's role in promoting inclusive growth via job creation, domestic resource mobilisation and financial stability will be ever more pronounced. Increased access to finance remains a top policy priority across the MPCs.

As it stands today, financial intermediation shares a significant number of common features across the region.

- Financial sectors are clearly dominated by commercial banks, mostly relying on traditional business models, while non-banking financial institutions and capital markets are still premature. In the banking sector, market structure varies among countries, with the share of state owned banks remaining generally high, compared to the example of the European Union New Member States (NMSs) and of the BRICS (Brazil, Russia, India, China and South Africa) , as a consequence of a different road towards modernisation of the financial industry followed so far. Foreign banks have however a strong footprint in most of the countries.
- Supported by a solid deposit base, the banking sectors of MPCs are relatively large, particularly when the size of MPCs economies is accounted for. The share of total banking assets over GDP stands at 129 percent in the MPCs, not too far from the EU-15 countries and well above that recorded in the NMCs or in the BRICS. That said, financial intermediation is weak, as a significant share of deposits is typically channelled to fund government debt. This protected business model has led to a concentration on a relatively limited number of clients and activities and to the relatively low access to finance by individuals and SMEs. Furthermore, the uncertain economic environment pushes banks (and economic agents in general) towards short-term activities, in detriment of longer-term investments.
- This conservative management style – as well as weak competition – has nonetheless resulted in typically well-capitalized and reasonably profitable banking sectors, although non-performing loans remain relatively high. At this level, a positive development over the last few years was the overall improvements to the regulatory and supervisory frameworks in a number of MPCs, the robustness of which could be put to a test as asset quality suffers the combined effects of the Arab Spring and of the on-going weakening in global economic activity.

With the balance of economic risks over the short- and medium-term weighing on the negative side, the necessary strengthening of private sectors to match the employment challenges is closely dependent on the capacity of banks and other financial institutions to finance longer-term investment projects.

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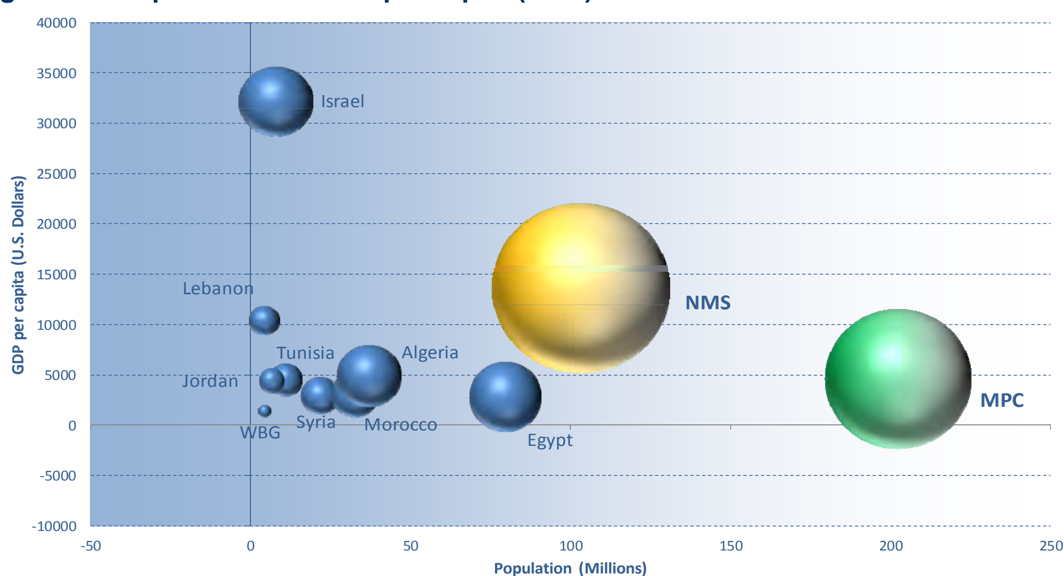
1. Macroeconomic Overview

Basic economic and social indicators highlight significant heterogeneity across the nine Mediterranean Partner Countries (MPC). The region has one high-income country (Israel), two upper-middle income countries (Algeria and Lebanon), while all the others have lower-middle income status (Figure 1.1). The high population growth rates imply populations skewed to the young end of the distribution. This means that the economies must continue to grow rapidly not only to maintain growth in per capita income, but also to provide employment opportunities for the young and well-educated labour force (Figures 1.2 and 1.3). The competitive advantage of the economies of the MPCs is largely based on geography and climate. Tourism represents a key revenue source for Egypt, Tunisia and Morocco, and to a lesser extent Syria and Lebanon. Natural resources are especially important for Algeria, which is a major oil and gas exporter accounting for 2.3 percent of world oil production and 12 percent of European gas supplies, as well as Egypt, Syria, and more recently Israel.

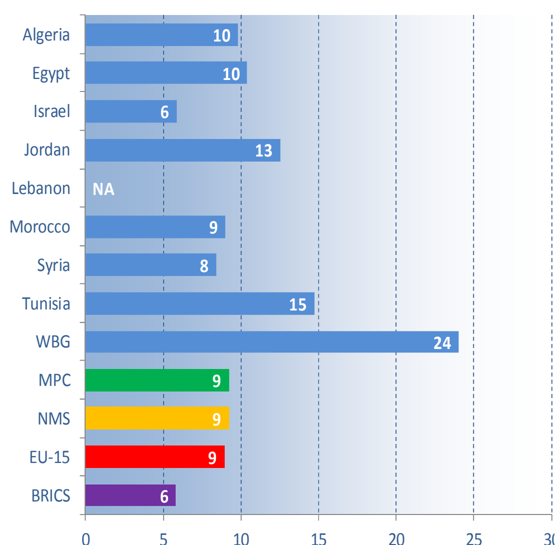
Figure 1.1: Population and GDP per capita (2010)



Source: IMF
Note: The size of the spheres represent the size of the economy in terms of GDP.

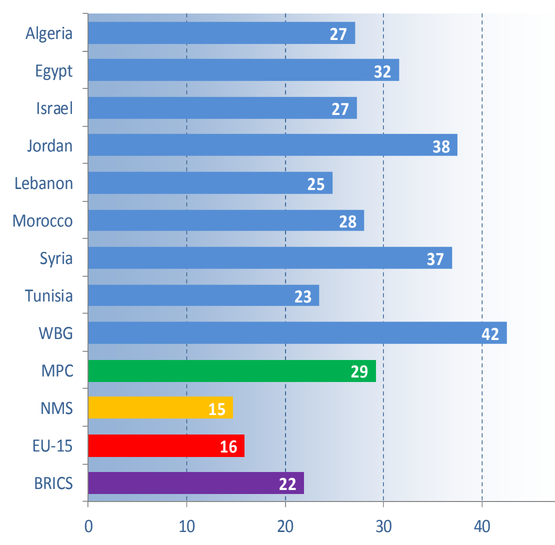
Economic models also differ significantly across the region, ranging from the centralized, resource-driven economy of Algeria to market-oriented economies, such as Israel. The World Bank's 2012 Doing Business Report ranks Israel (34th out of 183 countries) and Tunisia (46th) as the two most business friendly countries in the region, while at the other end of the spectrum are West Bank/Gaza (131st), Syria (134th) and Algeria (148th) (Table 1.1). Over the past few years, a number of countries in the region have introduced policies aimed at improving the business environment and beef up economic competitiveness. In fact, Morocco topped the reformers' list – among all the 183 countries reviewed – in the latest Doing Business report, just like Egypt had done in the 2008 report. These reforming efforts notwithstanding, the economies of the region continue to show weak competitiveness – with the exception of Israel and, to a certain extent, Tunisia. Indicators such as the Global Competitiveness Index of the World Economic Forum highlight some of the regional structural deficiencies (Table 1.1). Access to finance and inadequate supply of infrastructure are repeatedly pointed out across MPCs as strong impediments to economic development. Governance weaknesses – namely in terms of government effectiveness, regulatory quality and the rule of law – add to the list of commonly suggested factors for why the region has trailed behind other emerging market economies and have led to the weak job creation and lack of economic opportunities that contributed to trigger the on-going Arab Spring.

Figure 1.2: Unemployment rate (2010)



Source: IMF

Figure 1.3: Percent of population below 15 years (2010)



Source: IMF

In 2011 the economies in the region have been affected by both external and internal shocks. The Arab Spring coincided with a period of elevated oil and commodity prices, as well as a slowdown in US and European markets. The combination of these three shocks is having economic consequences throughout the region. In Egypt and Tunisia the economies were affected by strikes and disruption to production, as well as reduced tourism, FDI and remittances. Both countries have similar dependence on tourism revenues (6 of GDP), and the depth of the macroeconomic shock will depend on how soon these revenues can be restored. Current indications are that GDP growth in Egypt and Tunisia will fall well below the rate of population growth. The latest IMF projections for 2011 show Egypt slowing to 1.4 percent and Tunisia to 0.0 percent, while Morocco appears to have escaped serious damage with growth of 4.6 percent (Figure 1.4). Syria faces increasing economic disruption due to protests and repression as well as economic sanctions. Its current forecast indicate a decline in GDP of -2.0 percent in 2011, following a growth rate of 3.2 percent in 2010. Lebanon, with its close ties to the Syrian economy has also been affected and growth for 2011 has been revised down to 1.5 percent. Moreover, the range of uncertainty around outcomes for 2011 remains unusually wide given the underlying social and political uncertainties.

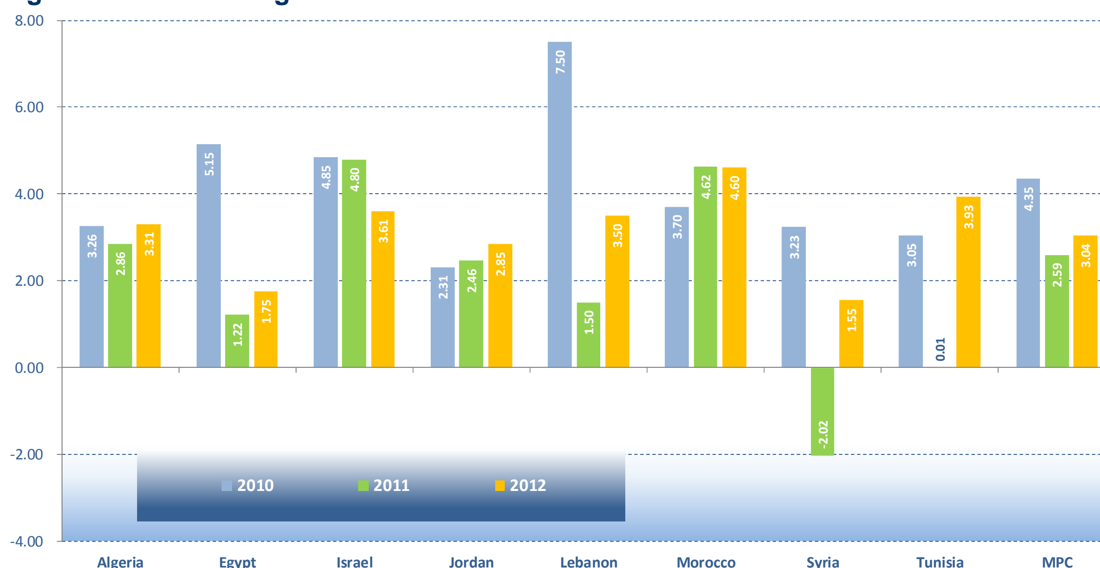
Table 1.1: Doing Business and Competitiveness Index

	Ease of Doing Business (Rank out of 183)	WEF Competitiveness Index (Rank out of 139)
Algeria	148	86
Egypt	110	81
Israel	34	24
Jordan	96	65
Lebanon	104	92
Morocco	94	75
Syria	134	97
Tunisia	46	32
West Bank/Gaza	131	--

Source: World Bank, World Economic Forum

Public finances have been adversely affected by the social and political turmoil. In the first instance, governments responded to the growing tensions with increased spending. The pre-existing budget deficits widened further, with the exception of Algeria with its oil windfall. None of the countries was in a position to bring forward major infrastructure programmes; instead the response focused on recurrent expenditures. Tunisia increased food and fuel subsidies and social transfers; Syria increased its social programme, and Egypt and Jordan increased pay to public employees. While higher spending helped support consumption and domestic demand in the short term, it led to widening fiscal deficits. Furthermore, elevated oil and commodity prices raised the cost of subsidy programmes for the oil importers and added further to fiscal deficits. Subsidy programs may damp inflationary pressures in the short term, but only at the cost of widening fiscal deficits.

Figure 1.4: Real GDP growth rates

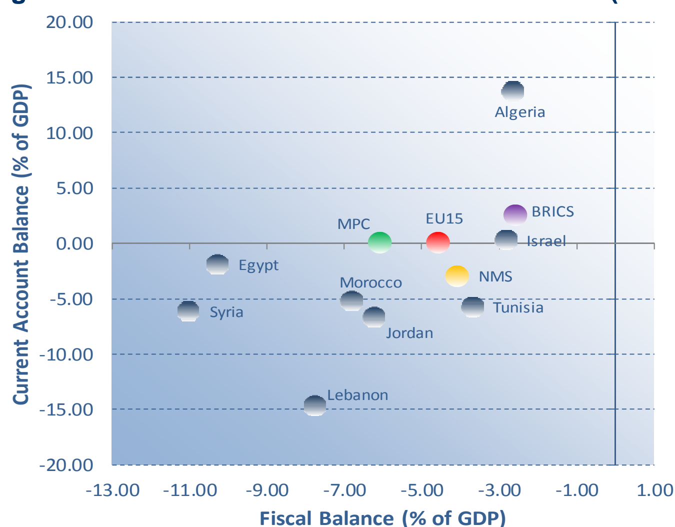


Source: IMF
Note: 2011 and 2012 are forecasts from the latest available World Economic Outlook (September 2011).

External balances have also deteriorated. The current account deficit is a particular concern for Jordan, Lebanon, Morocco and Tunisia, which are dependent on commodity imports and are thus exposed to increased food and energy prices. Their already large current account deficits are expected to widen this year, reaching a range of 5.7 percent in Tunisia to 14.7 percent in Lebanon. In Syria the current account deficit will also increase as non-oil export revenues are falling and the EU has introduced a ban on oil exports. The Egyptian the external position remains however relatively contained due to revenues from the Suez Canal and oil and gas revenues.

The increased macroeconomic uncertainty is also highlighted by the drop in foreign exchange reserves, particularly in Egypt. The Egyptian Pound has come under pressure over the last months, and the foreign exchange reserves have declined considerably by about one-third since January 2011 as the central bank has been drawing on official reserves to stabilize the exchange rate and foreign capital is fleeing the country. In Tunisia the situation is similar with reserves having declined significantly since the revolution, and a prolonged economic downturn could lead to further downward pressures on the Tunisian Dinar. Despite these developments, the exchange rates of most countries in the region have proven rather resilient to the recent economic disturbances.

Figure 1.5: Current Account and Fiscal Balances (2011)



Source: IMF
Note: Forecasts from the latest available World Economic Outlook (September 2011).

The most important challenge for policy makers across the region over the next years will be to ensure job creation. The fact that unemployment has been so persistent, especially among young people and the well-educated, shows that it is a structural problem requiring structural reforms as well as more inclusive economic growth. Reforms to address weaknesses in the business environment will be an important part of initiatives to promote the development of the private sector.

Table 1.2: Sovereign Risk Ratings

	Moody's Current Rating	# of notches changed since Dec 2010	Fitch Current Rating	# of notches changed since Dec 2010	Standard & Poor's Current Rating	# of notches changed since Dec 2010
Egypt	B1	-3	BB	-1	BB-	-2
Israel	A1	0	A	0	A+	+1
Jordan	Ba2	0	--	--	BB	0
Lebanon	B1	0	B	0	B	0
Morocco	Ba1	0	BBB-	0	BBB-	0
Tunisia	Baa3	-1	BBB-	-1	BBB-	-1

Source: Fitch, Moody's, S&P

2. Financial Sector Overview

Notwithstanding the notable heterogeneity among the Mediterranean Partner Countries (MPC) and the idiosyncratic features of the respective financial sectors, financial intermediation shares a significant number of common features across the region. Financial sectors are clearly dominated by commercial banks, mostly relying on traditional business models, while non-banking financial institutions and capital markets are still premature. Supported by a solid deposit base, the banking sectors of MPCs are relatively large, particularly when the size of MPC economies is accounted for. That said, financial intermediation is weak, as a significant share of deposits is typically channelled to fund government debt. This protected business model has led to a concentration on a relatively limited number of clients and activities, and to a relatively low access to finance by individuals and SMEs. Furthermore, the uncertain economic environment pushes banks (and economic agents in general) towards short-term activities, in detriment of longer-term investments. This conservative management style – as well as weak competition – has nonetheless resulted in typically well-capitalized and reasonably profitable banking sectors, although non-performing loans remain relatively high. At this level, a positive development over the last few years was the overall improvements to the regulatory and supervisory frameworks in a number of MPCs, the robustness of which could be put to a test as asset quality suffers the combined effects of the Arab Spring and of the on-going weakening in global economic activity.

Table 2.1: Banks' Ownership Structure in % of total assets (2010)

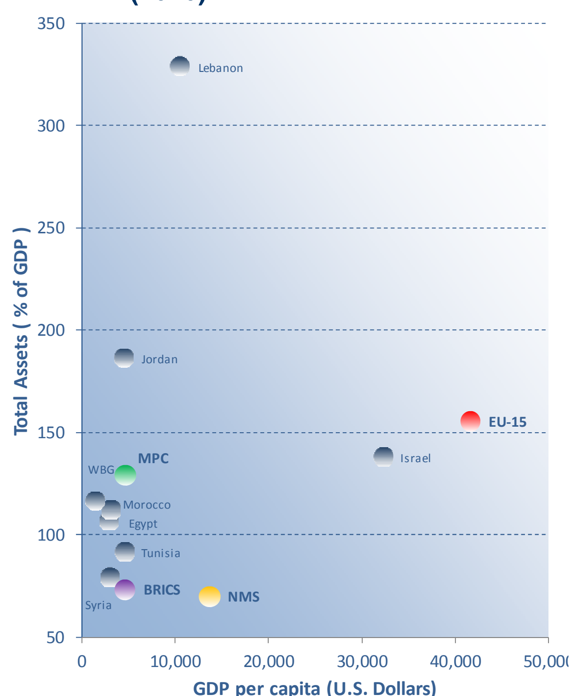
	State ownership	Foreign ownership	Concentration (top 3 banks)
Algeria	90	10	- -
Egypt	43	11	45
Israel	- -	2	73
Jordan	0	11	48
Lebanon	- -	- -	44
Morocco	28	21	66
Syria	71	- -	71*
Tunisia	- -	- -	39
WBG	- -	- -	- -

Source: National Authorities
* Top 6 Banks

The depth of the banking sectors has improved on account of recent reforms in many of the MPCs, but continues to vary among them (Figures 2.1 and 2.2). In terms of banks' assets relative to GDP, Lebanon has the deepest banking system (the total banks' assets to GDP stand at 329 percent), which reflects its traditional role as a regional financial centre with relatively sophisticated banks, the country's large and bank-financed public debt, as well as a large base of deposits from its diaspora. In addition, most of the other MPCs – Egypt, Israel, Jordan, Morocco, and West Bank and Gaza (WBG) also display a relatively deep banking sector, with their banks' assets in excess of 100 percent of GDP. While Syria and Tunisia come closer to the group of these countries, the depth of the Algerian banking sector remains rather shallow. For comparison, the average ratio of total assets to GDP stands at 70 percent for the New member States (NMS), while for the EU-15 banking assets account for 156 percent of GDP.[1]

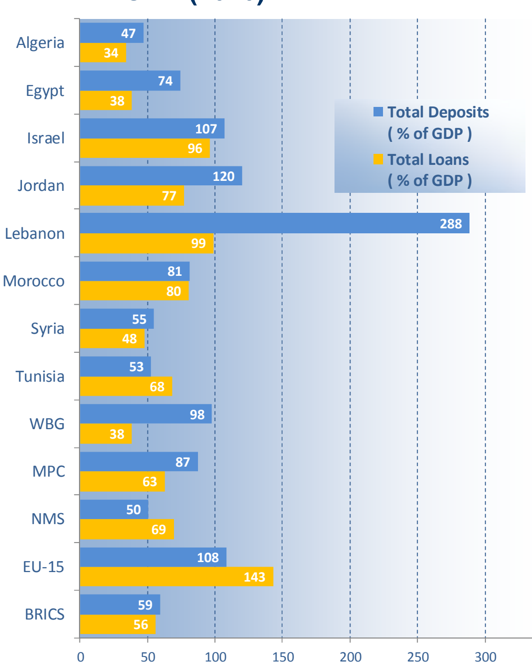
[1] New Member States stands for the 12 countries that joined the European Union in 2004, while EU-15 denotes the pre-exisiting members at that time.

Figure 2.1: GDP per capita and Total Assets (2010)



Source: IMF, World Bank, National Authorities

Figure 2.2: Deposits and Loans in % of GDP (2010)



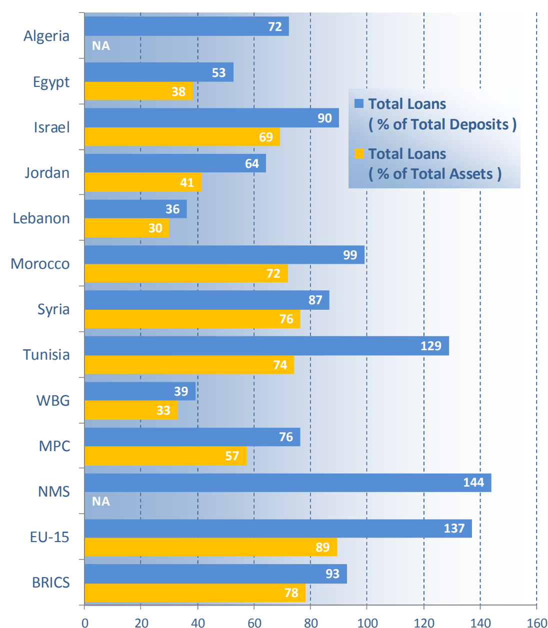
Source: IMF, World Bank, National Authorities

Banking intermediation in most of the MPCs is weak – despite the relatively deep banking sectors. The loans-to-deposit ratio of MPCs averaged 76 percent in 2010 (Figure 2.3). This structural funding surplus shows that banks collect more than enough deposits to cover lending to the private sector. Nevertheless, credit to the private sector as a ratio of GDP is low in Algeria, Egypt, Syria, Tunisia and WBG compared to not only other regions, but also the MPC average of 54 percent (Figure 2.4). Domestic credit to the private sector as a ratio of GDP stands at around 146 percent in EU-15, and 64 percent in NMS. Moreover, the banks' balance sheets further reveal that in several MPCs (Egypt, Lebanon, Jordan and WBG) total loans account for a relatively small share of total assets. Furthermore, the surplus of deposits over loans plays an important role in channelling savings to fund the deficits of the state and the publicly-owned enterprises (Figure 2.5). In countries with a relatively large state presence in the banking sector (Algeria, Egypt, Tunisia and Syria) and/or relatively high returns on government securities, the intermediation indicators are less favourable in general and/or for the private sector in particular, than in the banking sectors with a larger presence of private ownership, a more mature yield curve or sounder fiscal policies.

Access to finance remains a significant constraint on enterprises in most MPCs (except Israel), with the region clearly lagging behind most other regions in the world. According to the Wold Bank's Enterprise Survey, the MPCs score lower than the world average on most access to finance indicators.[2] In MPCs, 29 percent of firms have a line of credit from a financial institution compared to 35 for the world and 44 for Eastern Europe and Central Asia (ECA). In addition, the percentage of firms using banks to finance investments is also rather low at 10 percent, while the ratio for ECA is at 37 percent and for the world average at 25 percent. Furthermore, 34 percent of firms in the MPCs identify access to finance as a major constraint, more than in any other region except for Sub-Saharan Africa with 45 percent. This constraint is particularly severe in Algeria and Lebanon, where 50 percent and 42 percent of firms identify the constraint as being a major one, respectively. Insufficient suitable collateral is among the main reasons for difficult access to finance, with financial institutions being reluctant to accept movable property as collateral. Approximately 83 percent of loans in MPCs require collateral, which amounts to 133 percent of the loan value, comparable to ECA. Moreover, the prevailing lending model in MPCs is still for loans to be extended on the basis of personal knowledge of borrowers. Finally, the Doing Business Surveys suggest a similarly difficult situation regarding access to finance, looking at the issue from a more legal and regulatory aspect.

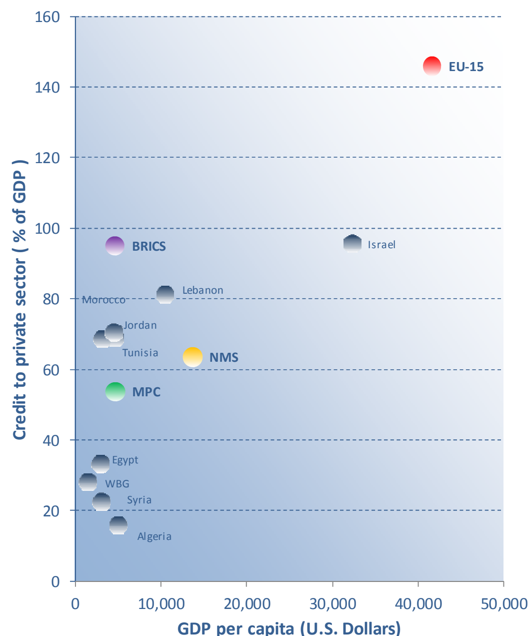
2 Israel and Tunisia are not included.

Figure 2.3: Total Loans in % of Deposits and Assets (2010)



Source: IMF, World Bank, National Authorities

Figure 2.4: Credit to the Private sector and GDP per capita (2010)



Source: IMF, World Bank

Furthermore, evidence suggests that SMEs are disproportionately hampered by credit constraints. The share of SME in the region with a line of credit is significantly smaller than that of large firms. On average, 24 percent of small firms and 41 percent of medium-sized firms in MPCs have a credit line, while the ratio is 57 percent for large firms.[3] Access to credit appears a relatively smaller problem in the ECA region than for MPCs. In ECA, for example, 35 percent of small firms receive a credit line, while the ratio stands at 49 percent for medium-sized firms. Most banks in MPCs actually do regard the SME market segment as potentially profitable and they are involved in SME lending to some extent. However, lending volumes are not very impressive, with banks quoting the lack of transparency and the weak financial infrastructure (weak credit information and credit rights, collateral infrastructure) as the main obstacle for further involvement in SME financing. In the region itself, SME lending to total landing is relatively low in Syria (4 percent), Egypt (5 percent), WBG (6 percent) and Jordan (10 percent), and somewhat higher in Tunisia (15 percent) and Lebanon (16 percent). Morocco's banks appear to be somewhat less risk-averse when it comes to extending credit to SME, which hold 24 percent of total lending.

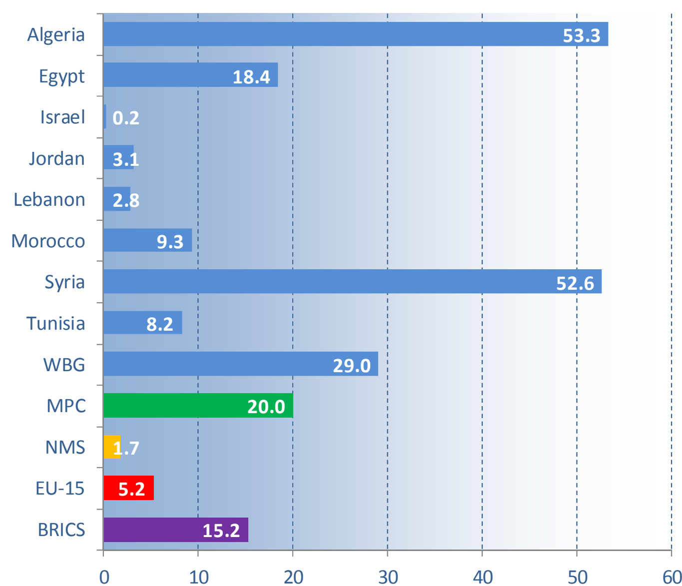
Immediate risks to the stability of the banking sectors in MPCs are relatively small, but pressure has built on banks stemming from the Arab Spring. Most banking sectors in the region are well capitalized and reasonably profitable, but non-performing loans (NPL) remain relatively high in some of the countries. The capital adequacy ratio (CAR) ranges from 12.3 percent in Morocco to 25 percent in WBG, while at the regional level it averages 15.9 percent, and is thus very much in line with EU standards – NMS and EU-15 stand at 14.4 and 14.3 percent, respectively.[4] In addition, while MPC banks' profitability has decreased after the 2008 financial crisis, at 14.7 percent banks' return on equity is still relatively high, apart from Jordan (8.8 percent). Banks profitability in the EU is smaller with the ROE at 6 percent for EU-15 and 11 percent for NMS. Progress has been made with reducing NPL in most of the MPCs, but the asset quality remains problematic for several countries. NPLs are particularly sticky in Algeria, with almost 15 percent. On average, 8.6 percent of loans are non-performing in MPCs, compared to 2.7 for BRICS and 4.4 for EU-15.[5] Provisions for NPL have however increased in MPCs to an average of 74 percent.

[3] Egypt, Israel and Tunisia are not included.

[4] These numbers are not stricitly comparbale as not all of MPCs have adopted Basel II methodology for the capital adequacy ratio.

[5] BRICS stands for Brazil, Russia, India, China, and South Africa.

Figure 2.5: Loans to the Public Sector in % of Total Loans (2010)



Source: IMF, World Bank, National Authorities

Going forward, the add-on pressures on socio-economic development placed by the Arab Spring on MPC economies are also forcing the financial sectors across the region to respond to new and expanded challenges. The sector's role in promoting inclusive growth via job creation, domestic resource mobilisation and financial stability will be ever more pronounced. Increased access to finance remains a top policy priority across the region. Financial intermediation can thus be expected to expand vigorously over the medium-term, as current levels are not only small in absolute terms, but also in comparison with countries at similar levels of economic development (Figure 2.4). On the other hand, the balance of risks over the short and medium-term appears weighed on the negative side. In addition to domestic developments, and while not particularly affected by the 2008-09 global financial crisis, the strong links between the MPCs (particularly in the Maghreb) and the EU make the region exposed to an economic slowdown in Europe and more broadly to the on-going weakening of global economic activity.

ALGERIA

1. Macroeconomic Overview

Algeria is an upper-middle income country with a GDP per capita of 4,435 USD (6,950 in PPP terms) and a population of 36 million in 2010. Social indicators such as life expectancy (72.9 years) and adult literacy (77.6 percent) characterize Algeria as a high human development country with a ranking of 84 out of 169 countries surveyed in the 2010 UNDP Human Development Report. The country's economy is highly dependent on hydrocarbons, accounting for roughly 30 percent of GDP and 95 percent of export earnings, and financing around 80 percent of total public spending. Algeria's private sector is weak, with public enterprises dominating the economy.

Algeria weathered the global financial crisis well and was in a strong position to face the global recession after several years of strong economic performance on account of high oil prices and public spending, via which the government is trying to reduce the economy's dependence on the hydrocarbon sector. In 2010 GDP growth reached 3.3 percent as the global recovery has gone hand in hand with the rise in the demand and prices of hydrocarbons. At the same time the government has maintained high levels of public investment and subsidies, therefore recording its second budget deficit in over a decade in 2010 at 2.7 percent of GDP. However, Algeria holds significant resources to finance its deficit, and fiscal policy is expected to remain expansionary over the next years. The country's external position also remains very strong, with a current account surplus of 9.4 percent of GDP and reserves covering almost 40 months of imports.

The biggest challenges Algeria is facing today are high unemployment and rising food prices. Despite a steady decrease of the unemployment rate from almost 30 percent ten years ago to 10 percent in 2010, youth unemployment remains high. Further, a skills mismatch between the opportunities provided by the market and the supply of labour is a source of growing dissatisfaction among the educated youth, as highlighted by the recent turmoil in the entire region. As a response, the Algerian government introduced several measures to alleviate the rise of consumer prices and to tackle unemployment. Authorities instituted price ceilings on sugar, oil and wheat products, and new jobs were created in the agriculture sector and by financing public works. In addition, the authorities are allocating substantial resources to the creation and financing of small and medium enterprises, industries and micro-businesses. Algeria is not rated by any of the three external agencies.

2. Banking Sector

Algeria is characterized by a unique combination of a mainly state-owned banking sector and an expanding domestic capital market, fuelled by the financing needs of public enterprises and the government ambitious national investment program. In 2011, the Algerian banking industry consists of 35 financial institutions, including 20 commercial banks. Most banks are public, while private banks are all foreign-owned. Public banks account for about 90 percent of the banking system assets. The banking sector remains small compared to other countries in the region, with credit to the economy accounting for about 34 percent of GDP in 2009 and credit to the private sector for around 16 percent in 2010. Furthermore, banking penetration in Algeria remains relatively limited, as commercial banking deposits amount to around 47 percent of the country's GDP.

The high liquidity levels in Algerian banking system stem from the country's abundant hydrocarbon wealth. Most of this wealth is channeled to the Oil Stabilization Fund, which is held in local currency at the central bank. High hydrocarbon revenues combined with the obligation to sell foreign exchange to the central bank have created substantial liquidity, which the central bank has absorbed through various instruments. Furthermore, the cash surplus of the National oil company is deposited in Algeria's largest public bank, the Banque Extérieure d'Algérie (BEA). The central bank sterilizes these inflows via deposit auctions. In addition, an ambitious public investment program has raised public expenditure and generated a new source of excess liquidity in the banking system. Consequently, liquidity in commercial banks has increased substantially, with money supply growing and credit to private sector booming, although from a low base.

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Regulation and supervision of the banking sector in Algeria is shared between three institutions, but the Bank of Algeria has the main responsibility both operationally and through the central role of the governor. The central bank has played a major role in promoting the modernization and liberalization of the banking system. Laws and regulations underpinning bank supervision are formally adequate and comparable to international standards, but the extensive state ownership of banks undermines regulatory governance. Enforcement of key prudential regulations thus remains limited in public banks. However, efforts to strengthen the banking supervision are underway. The central bank is moving towards a more risk-based supervision, and has been developing a new bank rating system in order to improve the assessment, management and control of risk. Stress test are also being developed, which will help shape the announced financial stability report and identify potential risks in the financial system. This work is part of the responsibilities assigned to the central bank by the 2010 amendment to the banking law to ensure financial stability.

The banking sector appears well capitalized, and is profitable and extremely liquid. The capital adequacy ratio has increased significantly since the 2009 quadrupling of the minimum capital requirements. The overall adequacy ratio stood at 18.4 percent in June 2010, with foreign private banks scoring higher at 29.7 percent, compared to 15.9 percent for the public banks. However, the public banks enjoy a recourse to the government support and have been bailed out regularly (by repurchase of bank debt by means of Treasury bonds swap and capital injections). Moreover, the NPLs remain high at 14.9 percent of gross loans for the system, and the bulk of them are concentrated within the public banks (16.8 percent NPL to total loans). Private foreign banks hold a rather limited amount of non-performing loans, which account for 2.6 percent of their total loans. Provisions for NPL have increased in recent years to 74 percent in June 2010. Algerian banks are highly profitable, with the ROE equal to 20.7 percent.

The performance and soundness indicators of Algerian banks do not point to immediate risks to the stability of the banking system. However, the loan quality is weak and the regular repurchases of nonperforming loans made by public banks to public enterprises have created significant moral hazard. This has undermined the credit culture and may lead to weak risk management by lenders. In addition, the net effect of excess liquidity on the development of the domestic banking system and its ability to support private sector growth is ambiguous. On the one hand, structural excess liquidity encourages banks to explore lending options, including to the private sector, leading to a rapid credit growth. On the other hand, this leads to increased credit risk taking. Indeed, the absence of a reliable yield curve may lead to suboptimal resource allocation and excessive credit growth. In addition, weak credit monitoring, unreliable financial statements and a weak legal and judicial system may adversely affect banks' loan portfolio. Furthermore, the more liquid banks are, the less likely they are encouraged to attract deposits, develop long-term savings, and improve their asset-liability management skills. In addition, the concentration of oil-related liquidity in one bank, the BEA, distorts competition, further hampering the development of the banking system.

The development of the corporate bond market has been a main achievement since 2002. Corporate bond financing has become an alternative source of financing for state-owned companies. A number of large public, as well as a few private enterprises, have issued corporate bonds to finance their investments. However, public banks remain the main buyers of these bonds. Algeria's corporate bond market is large compared to other countries in the region. The government encouraged public enterprises to issue bonds after it started issuing its debt on a regular schedule. Outstanding stock of corporate bonds in Algeria was about four times larger than the average for comparator countries and accounted for half of medium/long-term bank credit to public enterprises. In October 2011, six companies are listed on the exchange, 3 issuing bonds and 3 issuing equity, and the market capitalization stands at about 0.1 percent of GDP.

Algeria

	2007	2008	2009	2010	2011
	Macroeconomic Indicators				
GDP per capita (USD)	3,904	4,940	3,926	4,366	5,001
Real GDP growth (% change)	3.0	2.4	2.4	3.3	2.9
CPI Inflation (% change)	3.6	4.9	5.7	3.9	3.9
Current Account Balance (% of GDP)	22.8	20.2	0.3	7.9	13.7
Fiscal Balance (% of GDP)	6.2	9.1	-5.4	-1.1	-2.6
Gross government debt (% of GDP)	12.5	8.2	10.4	10.4	10.7
Population (Millions)	34.4	34.5	35.6	36.1	36.7
	Banking Sector				
Assets/GDP	- -	- -	- -	- -	- -
Deposits/GDP	46.4	44.9	46.7	- -	- -
Loans/GDP	31.5	26.3	33.8	- -	- -
Loans/Deposits	67.7	58.6	72.4	- -	- -
Asset Concentration (top 3 banks)	- -	- -	- -	- -	- -
Number of banks	- -	- -	- -	- -	20
NPLs/Gross Loans	22.1	15.7	14.5	14.9	- -
CAR	12.9	16.5	21.8	18.4	- -
ROE	24.6	25.2	25.7	20.7	- -
Loan loss provisions/NPLs	- -	- -	68.3	74.1	- -
Capital/Assets	- -	- -	- -	- -	- -

Source: IMF, World Bank, National Authorities

EGYPT

1. Macroeconomic Overview

Egypt is a middle-income country with a GDP per capita of USD 2,788 in 2010 (USD 6,417 in PPP terms). This, together with social indicators such as life expectancy of 70.5 years and adult literacy of 66.4 percent, characterizes Egypt as a medium human development country (rank 101 out of 169 countries surveyed in the 2010 UNDP Human Development Report). Agriculture, which was formerly the backbone of the economy, has declined in importance, while tourism, revenue from the Suez Canal, and the oil and gas sector are increasingly important drivers of growth.

Although the situation remains very uncertain there are early indications that the Egyptian economy is starting to recover from the impact of unrest in early 2011. The economy had the advantage of a favorable pre-crisis position. Growth performed better than expected following the global financial crisis, with a recovery to 5.1 percent in 2010, following 4.7 percent in 2009. The tourism sector, which normally accounts for around 5-6 percent of GDP, recovered to 55 percent of its normal seasonal level by mid 2011, following the virtual shut-down at the height of the unrest. Export revenues were also affected by terrorist attacks on the gas export pipelines to Jordan and Israel. However, Egypt has to some degree benefited from high commodity prices which are reflected in the price of liquefied natural gas exports to Europe.

The economic disruption in early 2011 led to a rising fiscal deficit. On the one hand, tax revenues have decreased due to the slower economic activity, and were exacerbated by the 15 percent increase in civil service pay and pensions, and on the other the social unrest led to higher subsidies. The interim Egyptian government is focusing on stability, while economic reform is on hold pending the election of a new government. The authorities revised their plans for the 2011/12 budget in June and declined a USD 3 bn stand-by arrangement that had been agreed with the IMF. The revised budget includes a lower target for the overall deficit of 8.6 percent of GDP (versus the previous 11 percent target). In addition to raising debt on the domestic bond market, the authorities are in discussion with a number of multilateral and bilateral partners. Saudi Arabia has pledged USD 4 bn, and a similar amount is expected from Qatar. International reserves have declined from USD 36.0 billion at the end of January 2011 to USD 25.7 bn at the end of July. However, the external position is relatively contained due to revenues from the Suez Canal (2.2 percent of GDP) and oil and gas revenues (5.1 percent of GDP), which are expected to hold up except in the most extreme scenarios.

Egypt's rating of Ba2 (Fitch) / Ba3 (Moody's, S&P) is supported by its substantial stock of foreign reserves, a relatively well diversified economy and a favorable public debt structure. The rating is however constrained by Egypt's uncertain political outlook, a wide fiscal deficit and substantial public debt (about 75 percent of GDP), a low income per capita and persistent inflationary pressures.

2. Banking Sector

The banking sector dominates the financial system and consists of 39 banks. Despite a still high number of banks operating in Egypt, the banking sector remains rather concentrated. The largest bank (National Bank of Egypt – state-owned) accounts for about 25 percent of total assets and deposits of the banking sector, and the largest three banks (including Banque Misr (state-owned) and Commercial International Bank (private)) add up to 45 percent and 47 percent, respectively. Only three banks remain state-owned (including Banque du Caire), but given that two of them are the largest ones, they account for about 45 percent of deposits and 34 percent of loans. While the number of banks has decreased, there has been a steady increase in the number of branches, reaching one branch per 22,300 of population in March 2011.

Intermediation in the banking sector remains weak. Although the ratio of banks' assets to GDP reaches around 107 percent, private sector credit to total credit stands at about 37 percent. In addition, bank loans account for about (only) 37 percent of banks' total assets, while securities (of which 87 percent are government paper) have an equally important share with 36 percent. Such a structure is not surprising given that the yields on T-Bills are higher than interest rates on loans, and real borrowing interest rates often negative. Within loans, about 81 percent are

extended to the private sector. In terms of economic sectors, 29 percent of total lending is extended to the industry, followed by services with 25.6 percent, households with 20.8 percent and trade with 8.2 percent. The government receives 8.6 percent of all bank lending, while the external sector accounts for 3.9 percent. At the bottom of the list comes the agriculture sector with 1.7 percent of total lending.

Banks mainly fund themselves with households' deposits, which correspond to 73 percent of total liabilities and equity. Foreign currency deposits account for about 20 percent of total deposits, while time and savings deposits and saving accounts add up to 83 percent of total deposits. The deposit base is rather stable and continuously available, although the real deposit rates have been negative. Bonds and long-term loans account for only 2 percent of banks' liabilities.

Prior to the 2008 global crisis as well as the ongoing transition the key performance indicators show that the system has been well-placed to absorb the shocks. Commensurate with narrow intermediation, Egyptian banks have displayed relatively high liquidity levels, with loans-to-deposit ratio of 50 percent. The banking sector reforms have brought about progress with the cleanup of NPL, which have reduced from about 19 percent in 2007 to around 11 percent of gross loans in June 2011. However, the levels of NPL are likely to remain elevated given the expected economic slowdown and higher unemployment levels. At the same time, loan-loss provisions have increased and stand at around 94 percent of NPL. Furthermore, the aggregate capital adequacy ratio was on an increasing path and reached 16.3 percent in 2010, compared to the 10 percent required, while the Tier 1 ratio was around 12.7 percent. Moody's estimates that by weighting these assets at 100 percent instead of zero, the CAR for the banking system would fall to about 11 percent. Moreover, the two largest (state-owned) banks show weak capital levels. The current economic slowdown, as well as wage increases (in the sate banks), will likely constrain profitability. The average net profit-to-equity ratio stood at 13 percent in March 2011, down from 16 percent in mid-2008, while the average net profit-to-assets ratio remained stable at 0.8 percent.

Banking regulation and supervision have been substantially reinforced following the adoption of the Banking Law of 2003 which strengthened the CBE's (Central bank of Egypt) independence. In addition, capacity at the CBE has been strengthened with the support of technical assistance funded by the European Union and coordinated by the European Central Bank. The objective of regulation has shifted from the previous system of compliance-based supervision to a risk-based system that is more consistent with international standards. This has required development and upgrading of specialised skills and the implementation of enhanced risk assessment procedures by the banks as well as capacity building in the supervisory departments of the CBE. Overall, the regulatory reform appears to have been a success with consistent application of the regulations and close monitoring by the authorities. However, the regulatory framework will take time to mature, and enhanced risk management procedures by banks require accumulation of historical data on loan performance. In addition, new regulations will be required specifically in connection with Basel II.

Risks to the stability of the banking system are currently contained, but they could increase in the case of a significant deterioration in the operating environment. Political uncertainty continues, while the economic activity is slowing down. Consequently, the pressure may increase on already weak asset quality. Exposure to the (downgraded) sovereign is likely to increase due to higher borrowing requirements, affecting credit quality and de facto capital adequacy, while putting downward pressure on bank ratings. In addition, higher exposure to the sovereign/public may crowd out lending to businesses and households. This would reinstate the already inefficient intermediation, which has constrained growth. Profitability may also be affected due to higher provisions necessary in light of potential increase in NPL and higher expenses like wages at public banks.

In light of the current situation in Egypt's banking sector, narrow banking intermediation offers opportunities for growth, particularly in the SME sector. Egypt has a large SME market, mostly untapped, which has high potential to create a significant number of jobs that are so needed to absorb the high numbers of the unemployed and new entrants into the labor market. Of course, constraints on both sides (banks and SME) are present which have prevented SME lending to flourish – currently, SME lending accounts for 5 percent of total lending. In addition, further consolidation and privatization could increase efficiency and productivity in the banking sector,

making it easier to expand into new (riskier) market segments (e.g. SME). In this respect, the banks would profit from the ongoing reforms of the financial system.

The Egyptian capital markets are well developed when compared to the regional peers. As a part of a program of modernization and cleanup of the Egyptian stock markets, the Cairo and Alexandria stock exchanges were merged in 2008 into the Egyptian Stock Exchange. The stock market reforms have led to significant improvements in technology, market liquidity and efficiency, as well as a better regulatory framework, which reflects international standards. The number of listed companies has reduced from over 1000 in 2002 to 221 in October 2011. The reduction included the delisting of companies in violation of disclosure or trading rules and inactive companies. While the number of new IPOs has not entirely offset the decline, daily trading volumes have increased fifteen-fold from 2004 to 2010 and the stock market capitalization peaked at 80 percent of GDP in 2006. However, market capitalization has fallen since, mainly on account of the global financial crisis and also the recent regional turmoil, and stood at around 31 percent of GDP in the first quarter of 2011. Market concentration continues to be the main problem of the Egyptian Stock Exchange, while the turnover remains relatively low. Furthermore, not all companies conform to the regulatory rules. In parallel, the Nilex, a specialized SME market, started to trade in June 2010 and now has 19 listed companies.

Egypt

	2007	2008	2009	2010	2011
Macroeconomic Indicators					
GDP per capita (USD)	1,771	2,160	2,456	2,808	2,922
Real GDP growth (% change)	7.1	7.2	4.7	5.1	1.2
CPI Inflation (% change)	11.0	11.7	16.2	11.7	11.1
Current Account Balance (% of GDP)	2.1	0.5	-2.3	-2.0	-1.9
Fiscal Balance (% of GDP)	-7.5	-7.8	-6.9	-8.3	-10.3
Gross government debt (% of GDP)	87.1	74.7	75.6	73.8	76.2
Population (Millions)	73.6	75.2	76.8	77.8	79.4
Banking Sector					
Assets/GDP	145.0	122.0	117.0	107.0	- -
Deposits/GDP	87.3	83.4	77.7	74.0	- -
Loans/GDP	47.3	44.6	41.0	38.4	- -
Loans/Deposits	54.4	53.7	53.1	52.2	49.9
Asset Concentration (top 3 banks)	- -	- -	- -	45.1	- -
Number of banks	- -	39	39	39	39
NPLs/Gross Loans	19.0	14.8	13.4	13.6	11.0
CAR	14.8	14.7	15.1	16.3	16.0
ROE	- -	16.0	14.0	13.0	13.0
Loan loss provisions/NPLs	- -	92.1	100.4	92.5	93.6
Capital/Assets	- -	6.2	6.4	6.7	6.4

Source: IMF, World Bank, National Authorities

ISRAEL

1. Macroeconomic Overview

Gradual liberalization and structural reforms have transformed Israel from a public sector dominated and closed economy to an open and diversified one, exploiting its comparative advantage in high-tech goods and tourism. At the same time, macroeconomic policies became more prudent, improving Israel's growth performance and prospects. This has boosted Israel's income per capita (USD 28,700 in 2010), which together with good social indicators, especially high education levels, characterizes Israel as a high human development country (rank 15 out of 169 surveyed countries according to the UNDP human development index).

Israel's economy enjoyed continued growth in economic activity in 2010, on account of the high increase in global and domestic demand, and real GDP grew by 4.7 percent. Concurrently, employment increased and the unemployment rate fell to 6.6 percent. Monetary policy gradually adjusted its policy interest rate to the improvement in economic activity and price increases from 1 percent at end-2009 to 2 percent at end-2010. The interest-rate gap between the local interest rates and the interest rates in developed countries increased, leading to the appreciation of the shekel. Despite this, the current account remained stable, and reached 3.1 percent of GDP. Asset prices rose considerably, with the Tel-Aviv 100 Index gaining 15 percent. Positive effects from economic growth were also reflected in households' confidence and their increased demand by 5 percent. In addition, exports increased by 13.4 percent and investment by 13 percent. In the first half of 2011, economic activity slowed down and the central bank's latest forecast for real GDP growth is 4.7 percent, while inflation is expected to be at the upper limit of the 1-3 percent target range. Furthermore, fiscal developments so far indicate that the budget deficit for 2011 may likely be slightly below the 3-percent deficit ceiling.

Fiscal issues however remain a key challenge for Israel. Public debt is high at about 75 percent of GDP and the credibility of the new debt and expenditure ceiling rules has yet to be established. However, fiscal risks are mitigated by the authorities' commitment to continuous fiscal consolidation. All of these factors, together with access to considerable financial resources from the Jewish diaspora and the US, should help the government cope with its high debt level.

The country is rated A1 by Moody's and S&P, and A2 by Fitch. Israel's rating is supported by its high per capita income, consensus on the need for structural reform and fiscal consolidation, and a very resilient economy in the face of repeated hocks. However, the rating is constrained by the large outstanding government debt, fragmented and fractious political system, and geopolitical concerns.

2. Banking Sector

The Israeli banking sector is relatively deep and well developed, but it remains highly concentrated. The total assets of the banks account for 138 percent of GDP in 2010. There are five major banking groups in Israel, which hold 93 percent of the total assets of the banking system (Leumi – 28.7 percent, Hapoalim – 28 percent, Discount – 16.2 percent, Mizrahi-Tefahot – 11.7 percent and First International – 8.8 percent). In addition, there are three independent banks – Union Bank (3 percent of total assets), Bank of Jerusalem and Dexia Israel Bank, each with less than one percent of total banking sector assets. Five branches of foreign banks (Barclays Bank, Citibank, HSBC, BNP Paribas and the State Bank of India) constitute about two percent of the banking system.[6] The high concentration in the banking system is directly linked to the concentrated structure of the Israeli economy, where a number of conglomerates (often family-owned) control leading positions in several industries. In recent years, the greatest impact on the competitive environment has come from the rapid development of the domestic (corporate) bond market, while banks retain more competitive power in their household lending business.

The banking system's balance sheet reflects that of a conservative banking system which is mainly based on the classic banking activities of extending credit and raising deposits. Credit accounts for around 69 percent of total assets, with credit to the government being negligible. In

[6] The foreign branches operate in niche markets where they enjoy a relative advantage (e.g. companies in process of raising capital abroad, companies active in global capital markets, wealthy individuals.)

terms of sectors, Israeli banks have the largest credit exposure towards private individuals (34.2 percent of total credit, with almost half of this being housing loans). Construction and real estate are the second largest recipient of bank credit with 16.2 percent, followed by borrowers' activity abroad with 13 percent, and manufacturing with 10 percent. After credit, the second largest item on the asset side of the balance sheet are securities, which represent 13.8 percent of total assets, with 66 percent of them being government bonds. Israeli banks mainly fund their activities with a broad and stable deposit base, which represents 77.2 percent of total liabilities and equity. At the same time, they exhibit low reliance on wholesale debt, given the loan-to-deposit ratio of less than 100 percent (90 percent). Bonds and subordinated loans account for 7.9 percent of total liabilities and equity.

Following two years of high volatility, credit to the public increased by 7.2 percent in 2010. Particularly noticeable were business credit, which returned to an upward trend following a decline in 2009, and credit to private individuals, mainly consisting of housing credit, which continued to grow at double-digit rates for the third consecutive year. On the liabilities side, there was a noticeable increase in bonds and subordinated debt notes of almost 13 percent, representing a continuation of the rapid growth trend in debt securities over the last three years. Deposits on the other hand recorded a relatively small growth of 1.2 percent.

Israeli banks are relatively well capitalized and liquid, but their profitability and efficiency are constrained by high labour costs. Israeli banks' regulatory capital ratios have improved since the crisis. Tier 1 capital adequacy ratio stood at 8.7 percent in December 2010, compared to the 7.5 percent regulatory minimum. In addition, the overall capital adequacy ratio reached 14.3 percent. Credit quality has improved over the years, with the share of NPL in total credit falling to 1.2 percent in 2010 from 2.5 percent in 2004. Furthermore, a significant reduction in NPL will come from the new 2011 loan classification and provisioning norms that will lead to the write-off of provisioned legacy NPL. Israeli banks are relatively liquid, with the liquidity levels increasing after the financial crisis. The ratio of liquid assets to liquid liabilities increased from 28.8 percent in 2007 to 37.5 percent in 2009. In 2010, the liquidity levels somewhat decreased on account of a rebound in credit growth and the ratio fell to 32.8 percent. Banks' profitability has improved after the financial crisis, with ROE increasing from 0.7 percent in 2008 to 13.8 in 2010 and ROA increasing from 0 percent to 0.9 percent during the same period. However, such profitability remains rather low compared to Israel's peers.

Banks are supervised by the Bank of Israel. The regulation and supervision of Israeli banks is relatively good and has contributed significantly to the resilience of the banking sector during the financial crisis. The banking system adopted Basel II on 31 December 2009 and is preparing to gradually introduce the system of international standards as required by Basel III. Nevertheless, areas for improvement exist and the Bank of Israel continues to enhance its regulatory and supervisory framework. In 2010, banking supervision focused on strengthening the banking system's capital base, corporate governance and risk management. The supervision department also conducted the extreme-scenario stress testing of the banking system. The new Bank of Israel Law (effective 1.6.2010) defines supporting financial stability in the whole financial system as one of the bank's objectives. Although it is clear that achieving this objective implies that supervisory authority should come under the auspices of the central bank, the debate on this topic in Israel is still underway.

Performance and soundness indicators of Israeli banks do not point to immediate risks to the banking sector's stability. The banks enjoy stable funding profiles and healthy liquidity, while the economy's strong performance has supported asset quality. Israeli banks' presence in most customer segments and a broad product range further support their earnings. Furthermore, the banks benefit from a very high likelihood and capability of systemic support, while the supervisory approach of the Bank of Israel is conservative and proactive. Nevertheless, while the capital adequacy ratios are above the regulatory minimum, they lag that of similarly-rated international peers and provides only a moderate cushion to absorb losses during a severe scenario. In addition, their profitability and efficiency are constrained by the heavy operating expenses. High corporate credit concentration and a large housing loans segment expose Israeli banks to increased risks of large losses during negative economic cycles. Moreover, given the concentrated banking system, failure of any of the five major banks would have severe economic and social consequences. Finally, the domestic market is mature and as such does not provide significant business growth opportunities over the medium term.

Capital markets have grown rapidly in the last years, following several reforms to increase competition in the financial sector. The most notable reforms in this context were the ones that had significant effects on the development of the corporate bond market. The balance of corporate bonds, small and insignificant at the beginning of the decade, grew within a few years at an exceptional pace, from 8 percent of GDP in 2002 to 36 percent in 2009. The bond market was dominated by government bonds still in mid-2000s, when they represented over 90 percent of the bond market capitalization, but since 2007, the corporate market has caught up and now represents about 50 percent of corporate credit.

Equity market capitalization has also increased significantly since the beginning of the decade (54 percent of GDP in 2000 to 107 percent in 2010), but the developments in the equity market have been more uneven. Like in all other market segments, the daily turnover has increased significantly, reflecting improving liquidity of the markets. A large proportion of Israeli companies is issuing abroad, notably in the high-tech sector (e.g. on NASDAQ). There were 613 companies listed at the Tel-Aviv Stock Exchange in October 2011.

Israel

	2007	2008	2009	2010	2011
			Macroeconomic Indicators		
GDP per capita (USD)	24,008	28,347	26,802	29,264	32,298
Real GDP growth (% change)	5.5	4.0	0.8	4.8	4.8
CPI Inflation (% change)	0.5	4.6	3.3	2.7	3.4
Current Account Balance (% of GDP)	2.9	0.8	3.6	2.9	0.3
Fiscal Balance (% of GDP)	-0.2	-2.8	-5.6	-4.1	-2.8
Gross government debt (% of GDP)	78.1	77.1	80.7	77.4	71.1
Population (Millions)	7.0	7.1	7.3	7.4	7.6
			Banking Sector		
Assets/GDP	146.0	146.0	142.0	138.0	- -
Deposits/GDP	119.0	116.0	112.0	107.0	- -
Loans/GDP	96.0	101.0	94.0	96.0	- -
Loans/Deposits	81.0	87.0	84.0	90.0	- -
Asset Concentration (top 3 banks)	75.7	74.5	74.0	72.9	- -
Number of banks	21	20	19	15	16
NPLs/Gross Loans	1.4	1.5	1.4	1.2	2.8
CAR	11.0	11.3	13.7	14.3	13.8
ROE	19.5	0.7	13.5	13.8	16.8
Loan loss provisions/NPLs	- -	- -	- -	- -	- -
Capital/Assets	9.0	9.1	10.6	11.2	10.9

Source: IMF, World Bank, National Authorities

JORDAN

1. Macroeconomic Overview

Jordan is a lower-middle income country with a GDP per capita of USD 4,326 (USD 5,767 in PPP terms) in 2010 and a population of 6.3 million. Social indicators such as life expectancy (73 years) and adult literacy (91 percent) characterize Jordan as a high human development country with a rank of 82 out of 169 countries in the 2010 UNDP Human Development Report. The kingdom is one of the few economies in the Middle East with relatively scant natural resources, with phosphates being its only extensive natural deposit. The country has no oil and lacks water, and it is vulnerable to geopolitical risks.

The Jordanian economy performed strongly in the years preceding the global financial crisis, with the average annual growth of 8 percent over the period 2004 to 2008. However, the global financial crisis led to a downturn: in 2009 real GDP growth reached 5.5 percent and in 2010 only 2.3 percent. The current political turmoil in the region as well as the difficult global economic situation are putting an additional strain on the Jordanian economy. Forecasts for this year put GDP growth at 2.5 percent. The kingdom's external position will also remain weak, with the current account being increasingly in deficit. As Jordan is heavily dependent on commodity imports, high food and energy prices are expected to lead to a worsening of the situation this year; for 2011 a widening of the current account deficit to 6.7 percent is forecasted, compared to a deficit of 4.9 percent in 2010.

The government's debt metrics have improved in recent years, mainly on account of an external debt buyback by the Jordanian authorities in early 2008. However, public debt still remains relatively high at above 60 percent of GDP, and it is expected to increase further as the effort to reduce government expenditures has been undermined by new spending commitments made as a result of the recent protests.

Jordan is rated Ba2 by both Moody's and Fitch. The rating derives support from the government's coherent economic policy framework, large inflows of foreign investment and relative political stability. It is however constrained by the country's vulnerability to exogenous shocks, high unemployment and the volatile regional political environment. At the beginning of the year the outlook has been worsened from stable to negative by both agencies on the back of the recent political events in the region.

2. Banking Sector

The Kingdom's financial sector is dominated by banks. In 2010 there were 25 licensed banks, with total assets representing 186.4 percent of GDP. 16 of these banks are Jordanian (out of which 3 are Islamic banks), and the remaining 9 are foreign owned, with two thirds being Arab banks. Concentration is relatively high with the largest three banks (Arab Bank, The Housing Bank for Trade and Finance and Jordan Islamic Bank) accounting for about 47.5 percent of total banking sector assets. Driven mainly by improved monetary and financial stability and the convertibility of the Jordanian Dinar (JOD), the Jordanian economy has attracted significant amount of foreign investments. This has been reflected in an increase of the ownership ratio of foreign investors in the Jordanian banking system from 38.6 percent in 2003 to 46.7 percent in 2010.

In the last years the banking activity in terms of consolidated assets of operating banks expanded rapidly thanks to strong real growth rates achieved by the economy. Total assets more than doubled in the period 2003 to 2010, growing by more than 11 percent on average per year. Despite the rapid growth of the sector, access to finance remains limited in rural areas as most bank branches and ATMs are located in the capital and the governorates of Amman and Aqaba.

The main funding source of banks are customer deposits, accounting for 64 percent of total aggregated banks balance sheets by end-August 2011. The deposit base in the economy has more than doubled since 2003, mainly on account of continuing economic stability, increased interest rate margins between the Jordanian Dinar and foreign currencies, the establishment of the Deposit Insurance Corporation as well as the government's blanket guarantee of deposits of the banking system. Bank deposits are mainly denominated in JOD, accounting now for more

than 77 percent of total deposits. This is a significant increase compared to a decade ago when almost 40 percent of all deposits were in foreign currency, highlighting the increased confidence of depositors in the JOD as a savings currency.

On the asset, total credit facilities to total assets account for only 42.1 percent, suggesting a rather weak banking intermediation. The bulk of credit facilities were extended to the private sector, with a ratio of 96 percent of private sector credit to total credit. Also, banks' credit to the private sector has demonstrated notable growth between 2003 and 2008, averaging at 17 percent year-on-year growth. However, this trend has slowed down in 2009 and 2010. On the demand side, the underlying reasons were the global crisis and the subsequent decline in domestic activity, while on the supply side the main driver was the increased risk awareness. During this period, banks preferred to invest in low risk and low return assets such as government securities. The banks provide credit facilities to various sectors of the economy. As of August 2011, the largest sectoral allocations were made to trade (23.6 percent of total credit facilities) and construction (21.5 percent).

The banking sector's macro-prudential indicators remained strong throughout the global financial crisis. The Jordanian banking sector is profitable and well capitalized. The minimum capital adequacy ratio of 12 percent required by the central bank has been consistently outperformed by Jordanian Banks over the last 10 years, reaching a low of 15.9 percent in 2003 and a high of 21.4 percent in 2006. In 2010 the CAR was at 20.3 percent. Non-performing loans have declined significantly from 15.5 percent in 2003 to 4.2 percent in 2008. However, the global financial crisis had a major impact on the Jordanian economy, triggering an increase in NPLs which reached 8.2 percent of total loans in 2010. In addition, the loan loss provision to NPLS decreased from 63.4 percent in 2008 to 52.4 percent in 2010. The liquidity of the sector remains however very high with a ratio of liquid assets to short term liabilities of 161 percent last year. Profitability, as measured by ROE, has decreased from its highest level of 20.9 percent in 2005 to 8.8 percent in 2010 as the crisis impacted the sector negatively and shareholders' equity of banks has risen. Return on assets also decreased from 1.4 percent in 2008 to 1.1 percent in 2010.

The banking supervision and regulation in Jordan is provided by the central bank, which has adopted supervision and regulatory frameworks which are in broad compliance with international supervision and accounting standards. This has contributed to the sound development of the financial sector. The control tools employed by the CBJ comprise licensing and on- and off-site supervision. Over the past few years, the CBJ has enhanced its effective banking regulation and supervision by putting further measures in place such as regular stress testing of banks, an automated data collection system to improve off-site monitoring and the introduction of Basle II (Pillars I and III) regulations and ongoing efforts to ensure compliance with Pillar II guidelines for risk management.

Even though the Jordanian banking sector has so far proven rather resilient to global and regional economic and political events, the risk of a further deterioration of the credit quality and therefore profitability nevertheless persists. The rapid credit growth observed in recent years could affect underlying asset quality and with it the financial strength of commercial banks. However, on the upside, banks seem to display potential for deepening their operations by providing increased access to finance to SMEs, which are so far facing significant barriers to access to finance. Only about 10 percent of total loans are extended to SMEs in Jordan, but banks are now starting to recognize this segment of the economy as potentially profitable. The implementation of a new credit bureau and improved collateral laws aim at encouraging this development, which could in turn lead to increased job creation and spur economic growth.

The Amman Stock Exchange was created in 1999 and has since then played an increasingly important role in the Jordanian economy. With a market capitalization reaching 122.7 percent of GDP in 2010 it is one of the larger stock markets of the region. At end-March 2011 a total of 276 companies were listed. Currently, 43.5 percent of shares are held by Jordanian investors, 49.6 percent by foreign investors and 6.9 percent by the government via the Jordan Investment Corporation. Since the 2008 financial crisis, the performance on the Jordanian stock exchange has deteriorated, with the trading volume to the market capitalization falling from 80 percent in 2008 to 18 percent in the first quarter of 2011.

Jordan

	2007	2008	2009	2010	2011
			Macroeconomic Indicators		
GDP per capita (USD)	2,990	3,757	3,987	4,326	4,542
Real GDP growth (% change)	8.2	7.2	5.5	2.3	2.5
CPI Inflation (% change)	4.7	13.9	-0.7	5.0	5.4
Current Account Balance (% of GDP)	-16.8	-9.3	-3.3	-4.9	-6.7
Fiscal Balance (% of GDP)	-4.7	-4.3	-8.5	-5.4	-6.2
Gross government debt (% of GDP)	73.8	60.2	64.5	66.8	68.5
Population (Millions)	5.7	5.9	6.0	6.1	6.3
			Banking Sector		
Assets/GDP	221.1	191.1	189.0	186.4	- -
Deposits/GDP	131.8	116.1	120.0	119.9	- -
Loans/GDP	93.1	83.7	78.7	77.0	- -
Loans/Deposits	70.7	72.1	65.6	64.2	65.4
Asset Concentration (top 3 banks)	47.8	48.3	47.5	47.5	- -
Number of banks	23	23	23	25	- -
NPLs/Gross Loans	4.1	4.2	6.7	8.2	- -
CAR	20.8	18.4	19.6	20.3	- -
ROE	12.6	11.5	8.8	8.8	- -
Loan loss provisions/NPLs	67.8	63.4	52.0	52.4	- -
Capital/Assets	6.6	6.6	7.0	6.9	- -

Source: IMF, World Bank, National Authorities

LEBANON

1. Macroeconomic Overview

Lebanon is an upper-middle income country with a GDP per capita of USD 10,041 (USD 15,239 in PPP terms) in 2010 and a population of 4 million. The country has reasonably good social indicators such as an adult literacy of around 90 percent and a life expectancy of 72 years. Despite healthy rates of economic growth over the past few years, Lebanon suffers from high levels of unemployment, which vary greatly across its regions. The main pillars of the Lebanese economy are the service sector (banking and tourism) (75.8 percent of GDP), construction (19.1 percent) and agriculture (5 percent). The country has adopted a pegged exchange rate regime since 1999, which has enabled it to weather various shocks and periods of political instability successfully. As a consequence, the economy is highly dollarized.

After the war in 2006, economic growth has paced up averaging at 6.6 percent during the period 2006 to 2010. In the meantime, the economy weathered the global crisis well, thanks to a healthy and highly-liquid banking system. It actually benefited from the global crisis to some extent, since it was perceived as a safe haven in the region. However, the recent political turmoil in Arab countries as well the domestic political uncertainty have severely affected the economic growth prospects of Lebanon. The IMF revised its 2011 real GDP growth estimate for this year down from 7.5 percent to 1.5 percent. Moreover, substantial domestic political risk prevails since the current government has only been recently formed following the breakdown of the coalition in January 2011.

The Lebanese government is highly indebted, with public debt amounting to 134 percent of GDP in 2010. In general, public finances point to a chronic deficit, partly because of the high cost of servicing the massive public debt – debt interest payments account for about one-third of government expenditure. The budget deficit has decreased since 2006 but is expected to deteriorate again in 2011 to 7.8 percent, adding further to the debt burden. Paris III donors' grants and loans are still being gradually disbursed since 2007.

Lebanon is rated B2 by Fitch and S&P, while Moody's has upgraded the country to B1 last year. All three agencies assign a stable outlook to the rating. Lebanon's strengths include the high level of external liquidity, the deposit-rich banking sector, the government's strong track record of debt servicing and stable donor support. On the other hand, Lebanon suffers from the fragile domestic and regional political environment, massive public debt and wide fiscal and current account deficits.

2. Banking Sector

The financial sector consists of several market participants including commercial banks (55), representative offices of foreign banks, financial institutions and leasing companies and brokerage firms. The banking sector in Lebanon has been a major driver for economic growth, stability and employment. Since the mid-1990s the consolidated assets of Lebanese banks have grown at an average rate in excess of 10 percent per year to reach 132 billion USD in the first half of 2011, representing more than 300 percent of GDP. There are more than 800 bank branches throughout the country or roughly one branch for every 5000 inhabitants, a figure closer to European standards than to those prevailing in the region. Banks are considerably concentrated in Beirut.

Commercial banks in Lebanon fund themselves mainly through deposits. As of July 2011 the ratio of private sector deposits (resident and non-resident) to total assets amounted to 82 percent. Deposit growth has been strong over the last years, reaching a high at 23.4 percent in 2009 when Lebanon benefited from the global crisis as depositors were seeking relatively safe bank environments and the country remained rather insulated from spillover effects. In 2010 deposit growth has slowed down to 12.4 percent, but Lebanese banks nevertheless sustain their deposit-rich nature.

The composition on the asset side of the banking sector's balance sheet indicates a relatively weak intermediation. Total loans extended to the private sector accounted for a low 28 percent of total assets in July 2011. However, loan growth has been impressive at 23.1 percent in 2010, supported by increasing capital inflows. The sectoral composition of the loan book seems to be

relatively well diversified, with the trade sector receiving 35.8 percent of all private sector credit, followed by personal loans (24 percent), construction (16 percent) and industry (11.6 percent). Sovereign exposure of banks still remains rather high with claims on the public sector as share of total assets at 20 percent in July 2011.

Another main characteristic of the Lebanese banking sector's balance sheet is the high level of dollarization. For most of the 2000s, more than 80 percent of all loans extended by Lebanese banks were denominated in dollars. On the liability side, dollar denominated deposits accounted for more than 70 percent of total deposits during the period 2005 to 2009. The ratios on both sides of the balance sheet have been decreasing in 2009 and 2010, with loan dollarization standing at 84.5 percent and deposit dollarization at 67.5 percent at end-2010. However, in the first half of this year deposits denominated in USD have been increasing again in the presence of rising domestic and regional risks, reaching 66.8 percent of total deposits in June 2011. The high dollarization is a long standing feature of Lebanese banks and while it makes financial stability hinge on the sustainability of the exchange rate peg, it does not otherwise threaten the health of the financial sector.

The Lebanese banking system's soundness indicators have remained rather strong throughout the global financial crisis and are now displaying significant improvements. Banks are adequately capitalized with a capital adequacy ratio of 13.4 percent in the first half of this year, exceeding the central bank requirement of 12 percent. Performance indicators show that the NPL ratio to gross loans has been significantly declining over the last years, from more than 20 percent in 2005 to only 7 percent in 2010. This improvement comes from increased loan growth, NPL write-offs encouraged by the BdL and better than expected recoveries. In addition, NPL provisions have significantly increased from less than 80 percent of NPLs in 2005 to 92.5 percent in 2010. Profitability of banks has also improved over the same time period, with ROA reaching 1 percent in 2010, up from 0.8 percent in 2005, and ROE increasing to 14.5 percent in 2010, from 10.7 percent in 2005.

One of the strengths of the Lebanese banking sector is the solid regulatory and supervisory environment, managed by the Banque du Liban and its sister institution, the Banking Control Commission (BCC). The BCC is fully independent and legally autonomous from the central bank. Banks are required to have their own internal audit units and submit regular reports to those two institutions and should satisfy a set of regulations ranging from reserve requirements to foreign exchange trading. The regulatory and prudential supervisory framework registers a high level of compliance with the Basel Core Principles and appears to be quite adequate to the particular risks faced by the Lebanese economy, thus minimizing the odds of systemic risk stemming from the sector.

The business environment in Lebanon is hampered by the constant political uncertainty, and the banking sector has faced considerable difficulties in the past on that account. However, there have been no default episodes, even though the country has endured many sensitive political episodes over the last three decades. Even though asset quality has considerably improved, it might worsen again in the medium term depending on the outcome of the current political turmoil in the region.

In sharp contrast to the large and well developed banking sector, capital markets play only a minor role in the Lebanese economy. Only 11 companies are listed on the Beirut Stock Exchange, and its market capitalization was low at about 32 percent of GDP at end 2010. The market still lacks the depth and the liquidity necessary to contribute significantly to resource mobilisation in the economy.

Lebanon

	2007	2008	2009	2010	2011
	Macroeconomic Indicators				
GDP per capita (USD)	6,666	7,900	9,054	10,041	10,474
Real GDP growth (% change)	7.5	9.3	8.5	7.5	1.5
CPI Inflation (% change)	4.1	10.8	1.2	4.5	5.9
Current Account Balance (% of GDP)	-6.8	-9.2	-9.7	-10.9	-14.7
Fiscal Balance (% of GDP)	-10.8	-9.5	-8.2	-7.3	-7.8
Gross government debt (% of GDP)	167.7	156.3	146.5	134.1	126.4
Population (Millions)	3.8	3.8	3.9	3.9	4.0
	Banking Sector				
Assets/GDP	328.3	313.3	330.0	328.6	- -
Deposits/GDP	287.8	275.8	290.4	288.3	- -
Loans/GDP	- -	- -	- -	98.6	- -
Loans/Deposits	- -	- -	- -	36.1	37.4
Asset Concentration (top 3 banks)	- -	43.4	43.8	- -	- -
Number of banks	54	53	53	54	55
NPLs/Gross Loans	13.9	10.7	9.5	7.0	- -
CAR	12.7	12.2	12.8	13.0	13.4
ROE	12.1	13.8	14.4	14.5	- -
Loan loss provisions/NPLs	84.7	87.7	88.8	92.5	- -
Capital/Assets	8.5	8.6	8.8	9.0	- -

Source: IMF, World Bank, National Authorities

MOROCCO

1. Macroeconomic Overview

Morocco is a lower-middle income country with a GDP per capita of 2,861 USD (4,794 USD in PPP terms) in 2010 and a population of 32 million. Social indicators such as life expectancy (72 years) and adult literacy (56 percent) characterize Morocco as a medium human development country, 114 out of 169 countries in the 2010 UNDP Human Development Report. Poverty and unemployment (9 percent in 2010) have been steadily declining over the last years, but youth unemployment remains a major issue in the country. Despite government strategies to diversify the country's economy, it remains highly dependent on agriculture, which accounts for 15 percent of GDP and employs 40 percent of the labour force. Agriculture is mainly rain-fed, and the economy is thus very vulnerable to climatic shocks.

GDP growth in 2010 declined to 3.7 percent (from 4.9 percent in 2009) as agricultural performance was hit by bad weather, which led to a sharp contraction of output in the sector. On the other hand, the non-agricultural sector performed strongly, mostly driven by domestic demand and some rebound in exports, despite on-going growth sluggishness in the EU, Morocco's largest trading partner. Morocco's economy is expected to continue on a strong growth path in 2011 with real GDP growth expected at 4.6 percent, but political developments in the region have increased uncertainty regarding economic developments, notably through the potential impact on tourism and FDI flows. Tourism data show a modest increase in visitors in the first half of 2011 as Morocco has suffered less from regional political instability than its peers, but much of the increase has come from visiting Moroccans. The external balance is slightly deteriorating, with an expected widening of the current account deficit from 4.3 in 2010 to 5.2 in 2011. Although Moroccan exports have performed well and tourism receipts and remittances have grown, this is not sufficient to offset the increase in imports caused by rising international food and oil prices. However, inflation remains under control. Reaching only a moderate one percent in 2010 and an expected 1.5 percent this year, the increase in prices is well contained, mainly thanks to the control on prices of certain food items and petroleum products through the subsidy system and the good agricultural performance.

Total external debt remains manageable at 25 percent of GDP. Fiscal policy is expected to remain expansionary and subsidies will place an on-going burden on public finances. A sharp increase in expenditures, largely due to an increase in food and fuel subsidies, is expected to lead to an increase of the budget deficit to 6.8 percent of GDP in 2011, compared to 3.5 percent in 2010. Consequently, government debt has increased from 48 percent in 2009 to almost 55 percent this year, and is expected to continue to increase moderately over the next couple of years.

Morocco's sovereign rating of Baa3 (S&P, Fitch) / Ba1 (Moody's) derives support from the country's political stability, the considerable progress in the area of fiscal reforms and a sound and liquid financial system. It is, however, constrained by the above mentioned relatively low level of per capita income, limited expenditure flexibility and the high volatility of output.

2. Banking Sector

Morocco has implemented significant structural reforms in the financial sector, which has improved its financial development. Consequently, the non-bank financial institutions are increasingly contributing to financial deepening, but banks still play a key role in the financial system. The total assets of banks account for 112 percent of GDP and the banking sector, with 32 percent at end-2010, is the largest contributor to the stock market capitalization. The banking sector includes 19 banks, of which 7 are majority foreign owned, 6 are majority publicly owned and the remaining 6 are private domestic banks. The concentration in the banking system remains relatively high, with the three largest banks accounting for 65.5 percent of total assets, 67.4 percent of total deposits and 62.7 percent of total loans. Furthermore, in terms of ownership, domestic private banks dominate the system, with 50.6 percent of total assets, 60.3 percent of total deposits and 51 percent of total loans. While the importance of public banks has decreased, they still hold a significant share of total assets – 28.3 percent. Finally, foreign banks account for about 20 percent of the system's assets, deposits and loans, and provide valuable technical know-how to the baking sector.

The composition of the banking sector's balance sheet suggests a relatively favourable banking intermediation. Securities do not account for more than 16.3 percent of total assets, while total loans account for 71.8 percent. In addition, gross loans represent 80.3 percent of GDP. Moreover, the maturity of loans is relatively long, with 29 percent of loans classified as long term and 31 percent as medium term (more than 2 years). Furthermore, sectoral distribution of loans seems to be relatively well diversified. The largest share – 28 percent – goes to households, followed by industry with about 19 percent, construction and public works with 13 percent, and financial services with 12 percent. Trade, transport and communications, and hotels account for 6, 4 and 3 percent, respectively. However, agriculture, which contributes a significant share to GDP and employment (about 20 and 40 percent, respectively), receives 4 percent of customer loans. However, the sector is highly volatile and continues to carry a high default risk. SME account for 24 percent of total loans. Finally, credit to the private sector (households and enterprises) represents 91 percent of total credit and 73 percent of GDP. Treasury bonds represent 8.1 percent of total assets.

Deposits remain the main funding source for banks, although their slower growth has forced banks to seek funding in financial markets. They account for 72.5 percent of total liabilities and equity. Bonds and subordinated debt follow with 8 percent, and loans of other financial institutions with about 7 percent. Within deposits, a substantial amount – 41 percent – comprises term deposits and savings accounts. The largest share of deposits stems from individuals (44.8 percent). In addition, 20.5 percent of deposits come from Moroccans living abroad. Private and public enterprises contribute 27.6 percent and financial institutions 7 percent of total deposits.

The central bank – Bank Al-Maghrib – supervises and regulates banks. The regulatory and supervisory framework has improved significantly over the past years as Morocco has implemented major structural reforms, including in the financial system. The central bank enjoys the necessary independence and has built up the required expertise to supervise the sector. Banking supervision complies with the majority of Basel Core Principles. Since June 2007, the central bank applies the standardized approach to credit risk under Basel II, and has continued to improve their capacity in stress-testing and macroprudential analysis.

The banking system appears well capitalized and profitable, but some banks have failed to reach the central bank's threshold for the core capital solvency ratio. Moroccan banks have reached a capital adequacy ratio (Basel II calculation) of 12.3 percent at end-2010, compared to the 10-percent regulatory minimum. In addition, the Tier 1 ratio stood at 9.7 percent. The non-performing loans (to total gross loans) have significantly and continuously decreased from around 19 percent in 2004 to 4.8 percent in 2010. The low level reflects partially the cleanup of balance sheets by writing off old NPL that are fully provisioned and partially some restructuring of problem loans. Concurrently, loan-loss provisions to gross loans have increased from around 60 percent in 2004 to 70 percent in 2010. Profitability has decreased since the 2008 financial crisis, with the average return on equity falling from 20.6 percent in 2007 to 14.2 percent in 2010. The average return on assets has however been more stable, at 1.2 percent. Liquidity levels have been on an decreasing path since 2004, with the ratio of liquid assets to short term liabilities falling from 42.4 percent to 16 percent in 2010.

Risks to the system are mitigated by effective banking supervision as well as a relatively stable and inexpensive deposit base. Nevertheless, the banking penetration in Morocco (also on the deposit side) is relatively low in light of a still relatively low per capita GDP, and remains concentrated in urban areas. On the one hand, this low penetration offers growth opportunities to banks, especially in the retail and SME segment. On the other hand, however, the banking system would need to mobilize additional resources to keep growing, presumably from the financial markets.

Although banks remain the key sector of the financial system, capital markets in Morocco have developed considerably in recent years. The Casablanca stock exchange is nowadays one of the most capitalized and diversified in terms of sectors in Africa. The market capitalization of 75 listed companies on three different boards – main, development and growth – equals about 70 percent of GDP. These companies represent 22 different economic sectors. However, the number of stocks and the concentration of trades still point to a developing market which has yet to play a larger economic role.

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Morocco

	2007	2008	2009	2010	2011
	Macroeconomic Indicators				
GDP per capita (USD)	2,439	2,851	2,885	2,861	3,162
Real GDP growth (% change)	2.7	5.6	4.9	3.7	4.6
CPI Inflation (% change)	2.0	3.9	1.0	1.0	1.5
Current Account Balance (% of GDP)	-0.1	-5.2	-5.4	-4.3	-5.2
Fiscal Balance (% of GDP)	1.5	1.4	-2.2	-3.5	-6.8
Gross government debt (% of GDP)	54.6	48.2	48.0	51.1	54.2
Population (Millions)	30.8	31.2	31.5	31.9	32.2
	Banking Sector				
Assets/GDP	- -	110.9	113.1	111.9	- -
Deposits/GDP	- -	83.1	82.1	81.1	- -
Loans/GDP	- -	75.4	77.5	80.3	- -
Loans/Deposits	- -	90.7	94.5	99.0	- -
Asset Concentration (top 3 banks)	- -	65.0	66.0	65.5	- -
Number of banks	16	18	19	19	- -
NPLs/Gross Loans	7.9	6.0	5.5	4.8	- -
CAR	- -	11.2	11.8	12.3	- -
ROE	- -	16.7	15.2	14.2	- -
Loan loss provisions/NPLs	75.2	75.3	74.1	70.1	- -
Capital/Assets	- -	7.3	7.6	8.5	- -

Source: IMF, World Bank, National Authorities

SYRIA

1. Macroeconomic Overview

Syria is a lower middle-income country with a per capita GDP of USD 2,823 in 2010 and a population of over 21 million. Social indicators, such as life expectancy (74.6 years) and adult literacy (84.7 percent), characterise Syria as a medium human development country with a ranking of 111 out of 169 countries surveyed in the 2010 UNDP report. Developmental and social pressures also stem from high population growth (2.5 percent per year on average over the past ten years) as well as significant unemployment/low participation rates. According to the 2010 Doing Business, Syria has the most difficult business environment amongst Mediterranean Partner Countries.

A wide range of structural reforms towards economic diversification and liberalization had been undertaken before the current unrest, but the policy of gradually liberalizing Syria's centrally-planned economy has been reversed as a result of the turmoil. Increased oil production in 2010 still led to an expansion of economic activity of 3.2 percent, but growth was limited by slower exports, including tourism, and the continued weakness of the agricultural sector and increased food imports. However, economic activity is slowing down on account of the unrest and the economy is expected to contract by about 2 percent in 2011 (according to the IMF's September forecast). The unrest has also prompted fears of a run on the Syrian pound, which led the central bank to reintroduce restrictions on foreign-currency transactions, in order to be able to defend its currency – the pound has been loosely pegged to the IMF's Special Drawing Rights. Inflation is also likely to increase to about 6 percent, mainly on account of the shortages due to import restrictions. Furthermore, the current account deficit will increase to about 6 percent of GDP in 2011, mainly on account of the falling non-oil exports and the EU ban on oil exports.

The government is struggling with the slowing economy as well as the impact of foreign sanctions. Recent public spending pledges and the impact of the EU sanctions on oil revenue will likely result in a much higher fiscal deficit than previously expected – about 11 percent of GDP (EU buyers have accounted for about 95 percent of Syria's oil exports or 20-25 percent of the government revenue and current account receipts). However, the worsening of the fiscal accounts takes place against the background of relatively low government debt, standing at about 28 percent of GDP.

2. Banking Sector

Over the past decade, Syria's financial sector has undergone some rapid changes. With the aim of improving the investment environment, as well as deepening the financial sector, the government has demonstrated a strong commitment to encourage private sector investment by enabling the establishment of private banks, insurance companies and microcredit institutions. As a result, total assets of the banking sector have grown at a rapid pace, reaching an average annual growth rate of more than 11 percent during 2007-2010. Despite these developments, Syria's financial sector still only has a moderate presence in the economy: the size of the banking sector in terms of total assets represented 79 percent of GDP in 2010. Access to finance remains rather low with a ratio of one branch per 41,000 residents.

As of June 2011, the banking sector consisted of 20 licensed banks, out of which six are state-owned. Of the remaining 14 banks, three are Islamic banks and eleven are private commercial banks. The latter group held 24 percent of total assets of the banking sector in 2010 up from around 7 percent in 2005. Non-financial institutions consist of thirteen insurance companies, one of which is state-owned, as well as three microfinance institutions. The six state-owned banks still hold the lion's share with 72 percent of total assets in May 2011, documenting the low fragmentation in the sector. In the last years, there has been a number of cross-border investments from the neighbouring countries with relatively well-developed financial sectors, such as Lebanon and Jordan, and all private banks in Syria are joint ventures between local investors and regional banks from Lebanon, Jordan and the Gulf Arab states.

The main funding source of Syrian banks are deposits, accounting for 63.2 percent of total assets in December 2010. Out of total deposits 55 percent were private sector (resident) deposits, and 13 percent were denominated in foreign currency. The deposit base has expanded rapidly in recent years, with an average growth rate of 18.5 percent per year over the

period 2006 to 2009. In general, private banks are much more deposit driven than public banks. This is due to the fact that public banks are backed by the State and Central Bank in terms of sources of funding.

On the asset side of the banking sector balance sheet, loans to the private sector represent 28.4 percent of total assets, and claims on the public sector 31.5 percent. The largest portion of the private sector credit is provided by the six commercial public banks, albeit a decline from 96 percent in 2005 to 78 percent in 2010. Credit is channeled primarily to the wholesale and retail trade sectors, followed by construction and agriculture industries. This sectoral breakdown of credit facilities has changed slightly over the past few years, concerning mainly the agriculture industry. While 19 percent of the banks' credit facilities were allotted to the agriculture sector in 2005, this has decreased to 12 percent in 2010. This has been accompanied by an increase of similar magnitude in credit allocation to trade. For the agriculture sector, public banks provide almost all the credit. In the same way, public banks have been the largest creditors for the construction industry. On the other hand, the private banks are the leaders in financing the mining, manufacturing and utilities' sector.

The soundness indicators of the banking sector showed that the risk weighted capital adequacy was at 20.8 percent for the whole banking sector, while capital to assets ratio was at 6.5 percent. Capital adequacy varied across different types of banks: private and Islamic banks had CA ratios of 15.3 and 18.5, respectively, while public banks had a ratio of 23.1. Regarding asset quality, there are noticeable differences between the performance measures of private and public banks. While public banks have a much higher ratio of bad loans (at 5.9 percent of their total loan portfolio), the non-performing loans of private banks represent only 1 percent

The regulation and supervision of banks is under the responsibility of the Credit and Money Council (CMC), an inter-governmental body headed by the Central Bank of Syria's Governor. The enforcement of those regulations and the actual supervision of the banking sector are managed by the CB's Banking Supervision Department. According to the laws of the CMC banks send on different periodic bases financial reports to the Off-Site Supervision Division. Banks also have to present summaries of a set of International Accounting Standards.

The Damascus Securities Exchange was launched in March 2009, and has since seen a rapid increase in trading value. It remains however very small and does therefore not play an important role in resource allocation in the Syrian economy. Only 21 companies are listed on the stock exchange and the market capitalization is very low at about 5 percent of GDP.

Syria

	2007	2008	2009	2010	2011
	Macroeconomic Indicators				
GDP per capita (USD)	2,014	2,554	2,593	2,823	3,050
Real GDP growth (% change)	5.7	4.5	6.0	3.2	-2.0
CPI Inflation (% change)	4.7	15.2	2.8	4.4	6.0
Current Account Balance (% of GDP)	-0.2	-1.3	-3.6	-3.9	-6.1
Fiscal Balance (% of GDP)	-3.0	-2.9	-2.9	-5.1	-11.0
Gross government debt (% of GDP)	43.2	37.4	31.4	29.7	27.5
Population (Millions)	20.1	20.6	20.8	21.0	21.2
	Banking Sector				
Assets/GDP	79.0	70.0	78.0	79.0	66.0
Deposits/GDP	52.9	49.2	52.9	54.8	44.1
Loans/GDP	37.0	40.0	44.0	47.5	41.7
Loans/Deposits	69.9	81.3	83.2	86.7	94.6
Asset Concentration (top 3 banks)	82.0	78.0	75.0	71.0	72.0
Number of banks	- -	- -	- -	- -	20
NPLs/Gross Loans	5.3	5.1	4.8	5.9	- -
CAR	- -	21.0	20.8	- -	- -
ROE	23.9	19.1	14.7	- -	- -
Loan loss provisions/NPLs	25.0	18.0	19.0	- -	- -
Capital/Assets	6.5	6.5	6.3	6.5	- -

Source: IMF, World Bank, National Authorities

TUNISIA

1. Macroeconomic Overview

Tunisia is a lower middle income country with a GDP per capita of USD 4,593 in 2010 (9,558 in PPP terms) and a population of 10.7 million. Social indicators such as life expectancy (74 years) and adult literacy (80 percent) characterize Tunisia as a high human development country with a rank of 81 out of 169 countries in the 2010 UNDP Human Development Report. Over the last decades the country has made considerable progress in improving social conditions, and the incidence of poverty is now one of the lowest in the region according to official figures from the ousted government. Structural problems, such as high unemployment especially among the youth, are however omnipresent, as highlighted by the recent events.

Tunisia's growth performance has been relatively satisfactory with about 4.5 percent real GDP growth annually over the past 10 years. However, the changing political environment has taken a toll an Tunisia's economy and has brought uncertainty to its outlook. The longer political dynamics domestically and in neighbouring Libya remain in flux, the greater will the disruption to economic activity be. The tourism industry has already been severely affected, with major cancellations from European travellers, and FDI flows are also expected to decline significantly. Consequently, the IMF revised its projection of GDP growth from an expected 4.8 percent prior to the revolution to no economic expansion at all for this year. In addition, the current account deficit is expected to widen from 4.8 percent in 2010 to 5.7 percent in 2011, as the fall in exports of goods and services, particularly tourism, more than offset the decline in import growth.

The authorities announced an emergency plan to alleviate the negative economic effects of the revolution. It intends to boost growth by creating jobs, to support firms damaged by the unrest, to provide financial incentives for investment and to support exports. The interim government has also increased transfers to the unemployed and the poorest segments of the population, suspended adjustments in regulated prices and extended subsidies on basic food items. The costs of the emergency plan and the reduction in the tax take resulting from the slowdown of the economy will lead to a widened budget deficit in 2011, projected currently at 3.7 percent of GDP by the IMF. Government debt is however expected to remain sustainable at 41.7 percent of GDP.

During the first three months of this year, all three rating agencies have downgraded Tunisia by one notch to Baa3 and assigned it a negative outlook. The rating derives support from the country's track record of control over public finances, debt reduction and macroeconomic stability. It is however constrained by uncertainties surrounding both the economic and political outcome of the regime change.

2. Banking Sector

Despite some progress over the last couple of decades, Tunisia has a medium-sized financial sector, which is heavily dominated by banks, with the equity and the corporate bond markets playing secondary roles. Commercial banking assets amounted to 91.6 percent of the country's GDP at the end of 2010. Banking services are relatively well disseminated throughout the country, with one agency for every 8,600 inhabitants.

Currently, the Tunisian banking industry consists of 53 credit institutions, including 21 commercial banks, 9 leasing institutions, 2 factoring companies, 2 merchant banks, 8 off-shore banks, and 11 agencies representing foreign banks. Commercial banks hold more than 80 percent of the total assets and are responsible for more than 93 percent of the loans extended to the Tunisian economy. The banking system is fragmented with the largest 3 banks (Société Tunisienne de Banque (STB), BIAT and Bank Nationale Agricole (BNA)) each having a market share of slightly above 10 percent in terms of assets. BIAT, which is a private bank, is the leader in deposit market share (15 percent), followed by three state owned banks: STB, BNA and Banque de l'Habitat (BH).

In 2010, the outstanding balance of loans granted by the financial system to the economy reached 28.5 billion Tunisian Dinars, a 12.3 percent increase from 2009. The maturity composition of Tunisian banks' private sector credit portfolio shows that, while 78 percent of

total loans have been placed as short and medium term credit facilities, 22 percent has been allocated as long term loans.

As for sources of funding, Tunisian banks finance most of their activities through deposits, which account for 56 percent of total liabilities (end-May 2011). The banks have been able to attract a stable pool of resources, with deposits growing by more than 12 percent in 2010. The relatively large and growing deposit base is a strength for Tunisian banks and their reliance on the whole-sale markets as well as central bank funding is limited. This has contributed to the financial stability in the market. However, liquidity pressures may arise due to climbing NPLs. In addition, the loan to deposit ratio has been around 128.8 percent in 2010. Nevertheless, the banks hold a significant amount of liquid assets to be mobilized in need.

Regarding profitability, the banking sector has experienced an upward trend in the recent years. Net banking income (NBI) has increase by more than 10 percent on average during the period 2005 to 2009. In 2009, while 58.6 percent of NBI stemmed from the interest margin, non-interest incomes constituted slightly more than 40 percent of NBI. The return on equity has stayed at 11 percent in 2009 and 2010, whereas the return on assets stayed at 1 percent.

Capital adequacy levels, although above the 8 percent Basel threshold, are not very high at 12 percent and do therefore not provide enough risk protection. In 2010, capitalization has been stretched, as the banks held no buffer to absorb any shortfalls. Particularly, the largest state-owned banks are likely to need cash injections in the near future.

One of the prevailing weaknesses of the Tunisian banking sector is the poor asset quality, which has become even more pronounced in light of the recent political developments. Despite the noticeable decline since 2005 from 23.6 percent of gross loans to 12 percent in 2010, non-performing loans continue to represent a significant vulnerability. Furthermore, they are expected to increase in the short-term due to political and economic instability. While previously NPLs reflected mainly poor management and weak supervisory standards, especially of government-owned banks, the current situation stems from the high exposure to corporate or individual clients with links to the ousted regime. Thus, further deterioration in asset quality is expected, though the extend still remains unclear. Fitch Ratings calculate this exposure to account for at least 67 percent of the banks' 2010 equity. In addition, Tunisian banks have under-provisioned their accounts. Despite gradual improvements since 2005, loan loss provisions accounted only for 58 percent of doubtful loans at the end of 2010.

All credit institutions are regulated by the Banque Centrale de Tunisie (BCT), which has played a major role in Tunisia's economic reform efforts since 1987, promoting the modernization and liberalization of the banking system while improving prudential supervision. Any credit institution must provide the Central Bank with all the information regarding its activity on a periodical basis – monthly or quarterly – and show their compliance with the regulation that governs loan and exchange controls and the control of loan establishments. The Central Bank also performs on-site inspections of the credit institutions to check the accuracy of the conveyed information and the evaluation of the organization and the internal functioning of the loan establishment. In the past, however, these inspections had a tendency to be rather infrequent, and inspection standards on private banks have a reputation of being considerably stricter than those on public banks.

The high fragmentation of the banking sector in Tunisia poses risks for the efficient functioning of the financial sector. Apart from the privatisation of a small bank in 2007, Tunisia's major banks have carried out very little consolidation in recent years. At the end of 2010, the central bank announced an important plan to restructure the state-owned banking sector with the aim of generating cost and activity synergies. The planned merger of STB and BH constituted the first part of this restructuring programme. However, the whole plan was put on hold in the face of the upheaval in Tunisia at the beginning of 2011.

The Tunisian Stock Exchange (Bourse de Tunis) is small and does not yet play a major role in resource allocation in the economy. As of June 2011 a total of 57 companies were listed on the stock exchange. Stock market capitalization in 2010 was low at 24.1 percent of GDP, even though it increased compared to the previous year when it stood at 20.8 percent of GDP. Foreign investors have been allowed to invest in the Tunisian stock market since early 2005, and currently hold about 20 percent of total market capitalization. As a result of the 'Arab Spring'

the stock exchange has seen a rather poor performance this year, with market capitalization decreasing in the first half of the year, leaving it at 19.6 percent of GDP in June 2011.

Tunisia

	2007	2008	2009	2010	2011
Macroeconomic Indicators					
GDP per capita (USD)	3,807	4,346	4,171	4,199	4,593
Real GDP growth (% change)	6.3	4.5	3.1	3.1	0.0
CPI Inflation (% change)	3.4	4.9	3.5	4.4	3.5
Current Account Balance (% of GDP)	-2.4	-3.8	-2.8	-4.8	-5.7
Fiscal Balance (% of GDP)	-2.0	-0.6	-1.5	-1.3	-3.7
Gross government debt (% of GDP)	45.9	43.3	42.8	40.4	41.7
Population (Millions)	10.2	10.3	10.4	10.5	10.7
Banking Sector					
Assets/GDP	83.0	84.4	88.3	91.6	- -
Deposits/GDP	45.7	47.5	50.5	52.7	- -
Loans/GDP	58.1	59.4	61.8	67.9	- -
Loans/Deposits	127.1	125.0	122.4	128.8	- -
Asset Concentration (top 3 banks)	- -	- -	- -	38.7	- -
Number of banks	20	20	20	21	- -
NPLs/Gross Loans	17.6	15.5	13.2	12.1	20.0
CAR	11.6	11.7	12.4	12.6	12.5
ROE	10.5	11.2	11.0	11.0	- -
Loan loss provisions/NPLs	53.4	56.8	58.3	60.0	- -
Capital/Assets	13.2	13.4	13.6	13.4	13.1

Source: IMF, World Bank, National Authorities

WEST BANK/GAZA

1. Macroeconomic Overview

Economic and social developments in West Bank and Gaza (WBG) are tightly constrained by the lasting political and military conflict. The economy has been devastated since 2000 by physical destruction, underinvestment, blockades and closures. Real GDP per capita has fluctuated widely since 1994 and stood at USD 1,827 in 2010. Poverty remains widespread – 16 percent in the West Bank and 33 percent in Gaza, and the unemployment rate is very high – 17 percent in the West Bank and 38 percent in Gaza. Together with social indicators such as adult literacy rate of 93.8 percent and life expectancy of 73.9 years, WBG is characterized as a medium human development country, ranking 97th out of 169 countries surveyed in the 2010 UNDP Human Development Report.

In 2010, macroeconomic performance improved, with real GDP growing at around 9 percent (8 percent in West Bank and 15 percent in Gaza). This strong growth was supported by the easing of Israel's restrictions on imports into Gaza, as well as higher private sector confidence and good management and reforms of the Palestinian Authority (PA), supported by donor aid, in the West Bank. In addition, inflation decreased from 5 to 3 percent during 2010, also mainly on account of the easing of Gaza's blockade.

Continuous public finance reforms have enabled the PA to control expenditures, prepare and execute budgets, and establish fiscal transparency and accountability in line with international standards. In 2010, the fiscal performance was broadly in line with the planned 2010 budget, with a significant reduction of the recurrent deficit from 26 to 16 percent of GDP. However, the delays in donor aid contributed to domestic payment arrears and borrowing from commercial banks. The draft Palestinian National Plan for 2011-13 foresees the recurrent budget deficit to decline to about 4 percent of GDP by 2013. Despite these positive developments, a meaningful improvement in the security situation remains the single most important precondition for a tangible strengthening of the macroeconomic outlook. A relaxation of Israeli restrictions and continued donor support will also be crucial. However, even in a best-case scenario, constraints on growth will remain high in the near future.

2. Banking Sector

The banking sector dominates the financial system in West Bank and Gaza, which besides banks includes insurance, mortgage and leasing companies, as well as the Palestine Securities Exchange. There are 18 banks operating in WBG, of which 8 are local banks, including two Islamic banks, while the remaining 10 are foreign banks – one Egyptian, HSBC and 8 Jordanian banks.

Although the total assets of the banking system represent a high share in GDP – 116 percent in 2010, banking intermediation remains narrow, with the credit to the private sector standing at about 28 percent of GDP in 2010. Moreover, in June 2011 total bank credit facilities account for about (only) 38 percent of the total banking sector assets. That said, credit to the private sector grew by 34.8 percent in 2010, supported by an increase in private deposits of 22 percent, the mandatory increase in paid-up capital in 2009 and by a significant improvement in the financial market infrastructure, including the establishment of a credit registry. Improved domestic credit opportunities have been accompanied by a decrease in the share of bank deposits placed abroad.

Banks do not hold any local government debt, but 29 percent of total credit is extended to the public sector. Business and consumer services are the second largest economic sector that benefits from bank credit, with 14.5 percent of total credit. Local and foreign trade finance and real estate and construction follow with 13.6 and 11.7 percent, respectively, while mining and manufacturing represents about 9 percent of total bank credit. Specific to WBG, consumption credit accounts for only 5.5 percent of total credit. Any other economic sector accounts for less than 3 percent of total credit. Balances with banks abroad represent a relatively high share of the total assets – 25.6 percent, while (portfolio) investments amount to about 10 percent.

The main funding source for WBG banks are deposits – 83.8 percent of total liabilities and capital, and the rest is their capital. Most of the deposits stem from resident (individual)

customers, 70 percent of total liabilities and capital. Virtually all loans and deposits are denominated in foreign currencies, mainly USD, ILS and JOD.

The Palestine Monetary Authority (PMA) regulates and supervises banks, which are governed by the Banking Law of 2002. The PMA has made significant progress in institutional reforms since 2007 and is now in position to carry out the functions of a central bank. These reforms have enabled the application of a rigorous supervision and regulation through regular on and off-site supervision. The PMA's prudential instruments include required reserve ratios, minimum capital requirements, minimum liquidity ratios, limits on credit concentrations, outside placements and currency exposures. Since 2008, the PMA has monitored banks' compliance with a Basel Committee compliant corporate governance code. The implementation of Basel II standards is underway and expected to be fully completed by mid-2012. The credit scoring system, integrated into the credit registry in 2010, seems to have been an important contributor to the increase in credit to the private sector. Furthermore, a deposit insurance scheme is being developed and expected to be ready in 2012. In 2010, an electronic payment system was put in place, including the RTGS. This has significantly improved banks' efficiency and reduced liquidity risk. A new Banking Law was enacted in 2010 to strengthen the financial sector's legal framework. In addition, a new Central Bank Law is underway, which will guarantee the independence of PMA.

Supported by this positive supervisory environment, commercial banks continue to perform well, with very limited exposure to the global financial markets and conservative lending practices. The WBG banks have achieved a significant improvement in terms of asset quality. The share of NPL in total loans has been on a downward path and reached 2 percent at end-2010. In addition, the capital adequacy ratio was relatively high at end-2010, 25 percent, compared to the prudential requirement of 12 percent. Furthermore, the banking sector is liquid, with the loans-to-deposits ratio of 47 percent. Banks' profitability has been high, with ROE reaching 15 percent in 2009 and ROA at 1.8 percent.

The performance and soundness indicators do not point to any immediate elevated risks to the banking sector stability. WBG banks are well capitalized, profitable and liquid. However, their particular geopolitical context exposes them to liquidity risk related to the transfer of cash to Gaza. In addition, the banking sector is considerably exposed to the public sector, which could affect the stability of the banking sector in the event of any public financial or political crisis, particularly in the context of the instable finance resources for the public budget, heavily dependent on external aid.

The juvenility of the banking sector presents an opportunity for significant growth and development in the near future. In particular, credit to households, currently very low at about 5.5 percent of total credit, as well as SME lending, could considerably benefit from further banking sector development. However, at the same time the current level of economic development, as reflected in a low GDP per capita, presents a constraint on banking sector development.

The securities exchange of WBG, the Palestine Exchange (PEX), was established in 1995 and was fully automated upon establishment. The PEX became a public shareholding company in February 2010. The exchange operates under the supervision of the Palestinian Capital Market Authority. There are 45 listed companies on PEX as of October 2011 with market capitalization of about USD 2.8 billion, or around 39 percent of GDP, across five main economic sectors; banking and financial services, insurance, investments, industry, and services. Most of the listed companies are profitable and trade in Jordanian dinar, while others trade in US dollars. Only stocks are currently traded on PEX, but there is potential and readiness to trade other securities in the future.

West Bank & Gaza

	2007	2008	2009	2010	2011
			Macroeconomic Indicators		
GDP per capita (USD)	- -	1,597	1,565	1,827	2,028
Real GDP growth (% change)	- -	7.1	7.4	9.3	9.0
CPI Inflation (% change)	- -	9.9	2.8	3.7	4.0
Current Account Balance (% of GDP)	- -	8.7	1.9	-8.9	-8.9
Fiscal Balance (% of GDP)	1.2	4.3	2.1	-0.7	- -
Gross government debt (% of GDP)	28.0	24.9	25.7	25.2	- -
Population (Millions)	- -	- -	- -	4.0	- -
			Banking Sector		
Assets/GDP	- -	121.2	127.9	116.2	- -
Deposits/GDP	- -	102.6	108.3	97.7	- -
Loans/GDP	- -	28.2	35.1	38.2	- -
Loans/Deposits	- -	27.4	32.5	39.1	46.5
Asset Concentration (top 3 banks)	- -	- -	- -	- -	- -
Number of banks	- -	- -	- -	- -	18
NPLs/Gross Loans	- -	8.1	4.1	2.0	- -
CAR	- -	23.9	21.9	25.0	- -
ROE	- -	14.9	15.0	- -	- -
Loan loss provisions/NPLs	- -	- -	- -	- -	- -
Capital/Assets	- -	11.6	12.2	12.8	12.8

Source: IMF, World Bank, National Authorities

European Investment Bank

The EU Bank

The EIB, the leading financial investor in the Mediterranean

The European Investment Bank (EIB) is the European Union's financial institution and the leading financial investor in the Mediterranean through FEMIP (the Facility for Euro-Mediterranean Investment and Partnership), which provides support for economic and social development in the Mediterranean with the aim of improving people's living conditions.

Since FEMIP was created in 2002, the EIB has been constantly increasing the quality and diversity of its action in the region, acting as a financial catalyst by attracting other investors in its wake. Since 2002 it has mobilised more than EUR 12.6 billion worth of investments in support of these countries.

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