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Banking in the Mediterranean

Financing Needs and Opportunities in Turbulent Times

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About the Economics Department of the EIB

The mission of the EIB Economics Department is to provide economic analyses and studies to support the Bank in its operations and in its positioning, strategy and policy. The Department, a team of 25 economists and assistants, is headed by Debora Revoltella, Director of Economics.

Disclaimer

The views expressed in this document are those of the authors and do not necessarily reflect the position of the EIB.

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PREFACE

Over the last couple of years the Mediterranean partner countries have gone through an unprecedented phase of transformation, forcing them to tackle a multitude of economic, political and social challenges. While the region benefits from a vast growth potential, arising not only from its geographical location and climate, but also from its young and well-educated population, it has in the past failed to generate the growth required for sustained and inclusive economic development. Job creation is now the priority of policymakers across the region and this has put the banking sector increasingly in the spotlight. A consensus is emerging that sustainable growth and employment can only stem from private sector-led growth. Banks are thus increasingly being called upon to support private sector development by increasing credit supply to businesses and entrepreneurs. This is a role that the sector, despite its size, has only partly fulfilled in the past.

Throughout this challenging period, the EIB-FEMIP, as the EU bank, has sustained its support for the Mediterranean partner countries. The EIB has received a reinforced mandate, and has consequently adapted its activity to the new economic and social reality in the region. Overall, the bank has been very active in supporting the private sector's access to finance over the past decade, and is ready to increase its efforts in this area in order to contribute to the development of a dynamic private sector and job creation in the FEMIP region.

This study was prepared for the EIB's roundtable discussion on Banking in the Mediterranean. It was put together by the EIB's Economics Department to support the Bank's new initiatives in the regional banking sectors and to contribute to a better understanding of recent market developments. The study provides an informative overview of recent developments and the challenges and opportunities ahead.

Philippe de Fontaine Vive
EIB Vice-President responsible for FEMIP

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Executive Summary

The Mediterranean partner countries (MPCs) are a diverse set of countries of different income and human development levels. Despite their differences, the MPCs face the common challenge of improving their economic performance, especially in the aftermath of the Arab Spring. GDP per capita has increased only slowly over the last decade, particularly compared to some other emerging market economies. At the same time the population in the region has been growing at a rapid pace. The combination of low growth and a rapidly increasing working age population has caused unemployment to skyrocket − especially among young people. In addition to structural shortcomings, the implications of the Arab Spring coupled with a difficult international economic environment have put strains on the MPC economies. GDP growth has slowed down and recovery is sluggish; increased expenditure has deepened government budget deficits; and current account deficits have widened especially as the European economy has weakened. The difficult economic situation of some of the MPCs has been reflected in a deterioration of their sovereign risk ratings.

Current uncertainties notwithstanding, the private sector will have to play an increasingly important role in the MPC economies to create sustainable employment in order to absorb the large unemployed workforce and the youth entering the labour markets in the coming years. Developing a dynamic private sector is therefore key to achieving more inclusive growth and reducing unemployment. However, success in doing so will crucially depend on the ability of entrepreneurs to obtain financing to implement business ideas. The private sectors in the MPCs are largely dependent on the banking sectors for external debt financing as financial markets are dominated by banks. Banking sectors in the region are generally large. However, financial inclusion is still relatively low in the FEMIP region, with more than half of the adult population without an account in a formal financial institution.

The relatively low access to financial services in the region often hits SMEs particularly hard. Bank lending is traditionally concentrated in large, corporate customers, and banks in some FEMIP countries use a substantial amount of their available liquidity to fund government debt. Generally, banking intermediation remains relatively weak in the region. Private sector credit as a percentage of GDP is particularly low in Egypt, where the government finances its increasing debt mainly through the domestic banking sector and over a third of the banking sector's balance sheet consists of government securities. At the same time, some countries exhibit low loan-to-deposit ratios, e.g. Lebanon where less than half of the banking sector's large deposit base is used to extend loans to the economy. In contrast, Morocco and Tunisia have loan-to-deposit ratios in excess of 100%. In both countries the banking sectors have difficulties matching rapid loan growth with adequate deposit growth, which leaves them in a difficult liquidity position. This can, on the upside, lead to banks looking for a diversification of their funding sources, such as bond markets, which is a trend observable to some extent in Morocco.

The overall soundness and profitability of banking sectors in the region have deteriorated but nevertheless remain reasonable despite the difficult domestic and international economic environment of recent years. As expected, the economic downturn in some countries is impacting the performance of banks and especially the loan quality of banks' loan portfolios. The most affected banking sectors are in Tunisia and Egypt given the severity of the economic and political struggles in the aftermath of the revolutions in both countries. In other countries in the region the repercussions are also tangible, for instance through liquidity squeezes. Regulators in most countries in the region have reacted by implementing different measures to support banks. However, further measures to strengthen the banking sectors and improve regulation and supervision will be necessary in some countries to increase the capacity of banks to support more efficiently the development of the private sector.

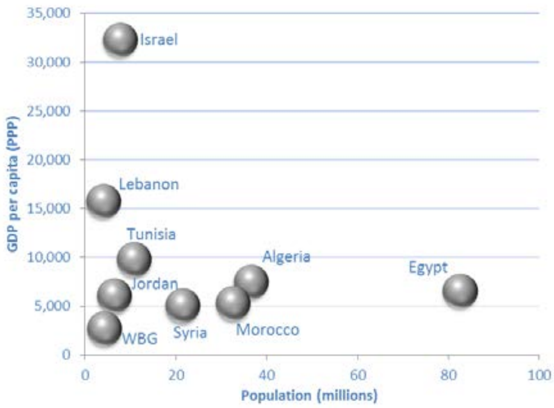
Moving forward, the economic development of the region will require a stronger, more vibrant private sector served by a financial sector that caters to an increased number of users, households as well as enterprises. Financial inclusion can be addressed in several different ways, one of which is mobile banking services. Mobile phone penetration is very high in the whole region, and there is tremendous scope in using the existing dense mobile networks – alongside commercial banks – to expand access to finance to the unbanked. Mobile banking can reduce transaction costs through the use of prepaid platforms, agent networks, alternative risk management policies, optimisation of remittances and new or reformed retail payment structures. On the other hand, mobile banking is just one of many instruments to expand the usage of financial services, and this is not without some challenges of which regulatory aspects and the potential impact on the stability of the overall financial system should be mentioned.

Macroeconomic Overview

The Mediterranean Partner Countries (MPCs) are a diverse set of countries of different income and human development levels. Figure 1 shows the different levels of income in relation to the countries' population. There is only one high-income country (Israel), while the others are either upper-middle income countries (Algeria, Jordan, Lebanon and Tunisia) or lower-middle income countries (Egypt, Morocco, West Bank/Gaza and Syria). Taken together, the region accounts for 1.3% of world GDP and 3% of the world's population. Some of the economies in the region are well endowed with natural resources, such as Algeria where hydrocarbon production accounts for 37% of GDP. In some other countries the service sector is substantially more important, such as in Lebanon which has the largest financial sector in the region in terms of GDP, or Tunisia and Morocco where tourism represents a key revenue source. Economic models in general differ significantly across the region, ranging from the centralised economy of Algeria to market-oriented economies, such as Israel.

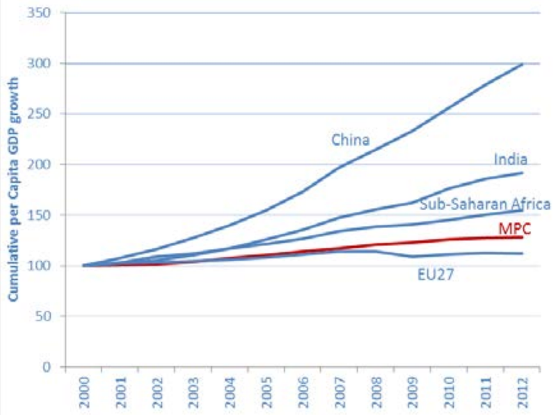
In terms of human development, some countries in the region still struggle with poor literacy rates, gender disparities and discrepancies between rural and urban areas. Nevertheless, the UNDP Human Development Report characterises all countries in the region as medium human development countries, except Tunisia and Lebanon (high human development) and Israel (very high human development).

Figure 1. Population and GDP per capita (2012)



Source: IMF and IHS Global Insight
Note: Syria 2010 data.

Figure 2. Cumulative per capita GDP growth



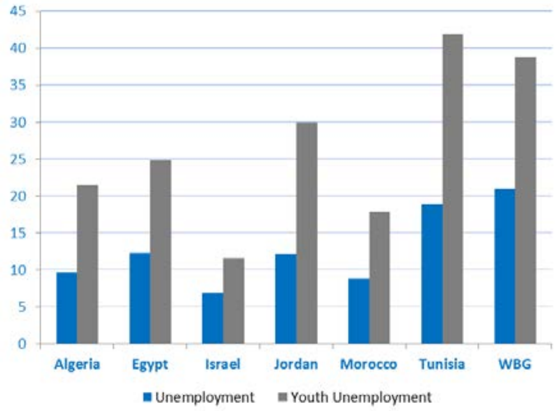
Source: IMF and ECON calculations
Note: Sub-Saharan Africa excluding South Africa.

Despite their differences, the MPCs face the common challenge of improving economic performance, especially in the aftermath of the recent political turmoil. Between 2000 and 2012, average GDP per capita in the region increased by a mere 25%. While this is significantly better than the performance of the EU27 (+12%), it is dismal in comparison to other emerging markets. As Figure 2 shows, China's GDP per capita grew by 200% over the same period, India's by 90% and that of sub-Saharan Africa by 80%.

A combination of low growth and a rapidly increasing working age population has caused unemployment to skyrocket - especially among young people (see Figure 3). The population bracket aged below 15 equals about 30%. Every year, millions of youths enter the labour market looking for employment opportunities that their economies cannot provide. Jump-starting growth to provide employment for a young, well-educated and increasingly restless population is the key challenge facing the MPCs today.

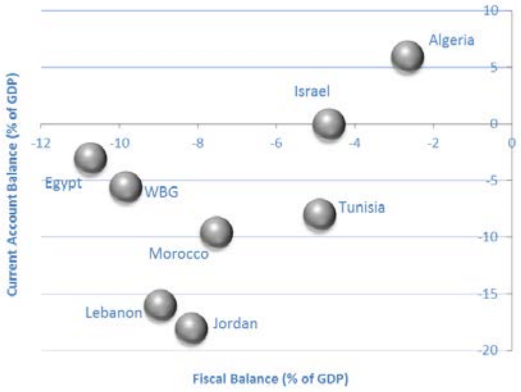
In addition to structural shortcomings, the implications of the Arab Spring have put strains on the MPC economies since the beginning of 2011. In 2012, GDP growth in the Mediterranean partner countries averaged 2.7%. While most economies recorded slightly stronger growth than in the previous year, challenging domestic and international conditions impeded a more vigorous recovery. The continuing euro area crisis weighed on demand for exports, remittances and tourism. High food and oil prices adversely affected commodity importers. The policy uncertainty associated with transitional governments depressed private investment. Tunisia recovered and recorded a growth rate of 3.6% of GDP. Growth in Egypt just matched population growth. In Morocco, a drought reduced agricultural output, leading to growth of 3.0% compared to 5.0% in 2011. The conflict in Syria escalated, and both Jordan and Lebanon had to cope with a large number of refugees.

Figure 3. Unemployment and Youth Unemployment (latest data available)



Source: World Bank, IMF
Note: Data for Lebanon not available.

Figure 4. Current Account and Fiscal Balance (2012)



Source: IMF and IHS Global Insight

In response to the Arab Spring, governments in the region sharply increased expenditure, largely devoted to higher food and fuel subsidies as well as public sector wages. Though effective at buying political support, the measures reinforced existing distortions and led to large government deficits in 2011. The governments of Jordan, Morocco and Tunisia have since undertaken steps to replace some of the subsidies with targeted transfers, but their deficits nevertheless continued to increase in 2012. Egypt and Lebanon recorded the highest deficits, equalling 10.7% and 9.0% respectively (see Figure 4). In conjunction with low growth, the deficits led to rising debt ratios. Public debt approached 80% in Jordan and Egypt, and remained at almost 140% in Lebanon.

Though external balances had already been under strain in 2011 they deteriorated further in 2012. Owing to the recession in Europe, demand for goods and services produced by the Mediterranean partner countries weakened. At the same time, high prices for food and fuel added to the cost of imports. Tourism receipts recovered but still remain below 2010 levels in Egypt, Jordan, Lebanon and Tunisia. At 18.1% and 16.1% respectively, Jordan and Lebanon recorded the highest current account deficits, followed by Morocco and Tunisia.

The difficult economic situation of some of the MPCs has been reflected in a deterioration of the sovereign risk ratings. This is particularly true for Egypt and Tunisia, which have seen their ratings slashed over the last two years (see Table 1).

Table 1. Sovereign Ratings

	Fitch Current Rating	# of notches changed since Dec 2010	Moody's Current Rating	# of notches changed since Dec 2010	S&P Current Rating	# of notches changed since Dec 2010
Egypt	B-	↓ 5	Caa1	↓ 6	CCC+	↓ 6
Israel	A	0	A1	0	A+	↑ 1
Jordan	--	--	B1	↓ 2	BB-	↓ 1
Lebanon	B	0	B1	0	B	0
Morocco	BBB-	0	Ba1	0	BBB-	0
Tunisia	BB+	↓ 2	Ba2	↓ 3	BB-	↓ 4

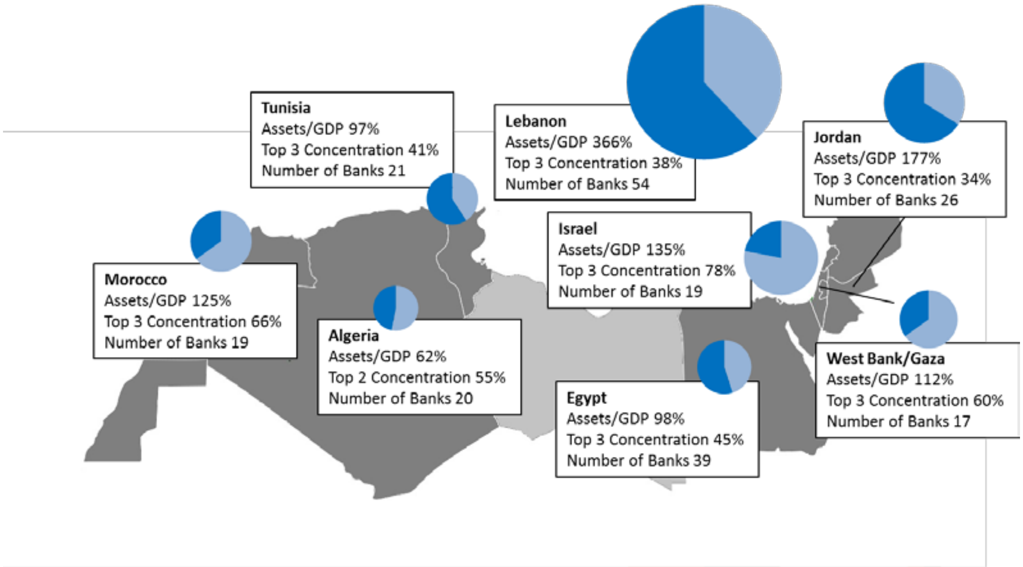
Source: Fitch, Moody's, Standard and Poor's.

Looking forward, most governments in the region face the challenge of reducing their fiscal deficits at a time of strong social discontent. The increased expenditures following the Arab Spring have greatly diminished the existing buffers, and fiscal stimulus gives way to consolidation. Yet growth remains weak. This leaves governments with few options to counter renewed claims from populations, which could have severe adverse implications for economic sentiment and the reform process. The events in Syria and Egypt constitute an additional uncertainty, as they could negatively impact neighbouring countries. The commodity importers among the Mediterranean partner countries remain vulnerable to high food and fuel prices, which will keep current account deficits elevated and, via subsidies, increase deficits. Though a deterioration of the European sovereign debt crisis appears less likely now than during the year before, it could further reduce demand for exports, lower remittances and depress tourism revenues.

Banking Sector Overview

As the region’s young labour force looks for employment, the private sector has to play a more significant role in job creation. Neither the government nor state-owned enterprises – traditionally large employers in the region – are able to create enough sustainable employment to absorb the large unemployed workforce. Developing a dynamic private sector is therefore key to achieving more inclusive growth and reducing unemployment. However, success in doing so will crucially depend on the ability of entrepreneurs to obtain financing to implement business ideas.

Figure 1. Main Banking Sector Characteristics in MPCs

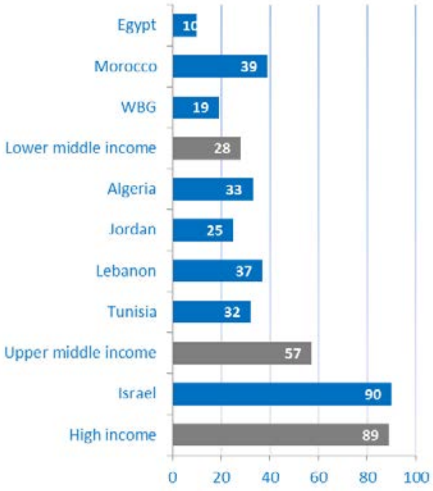

Tunisia
Assets/GDP 97%
Top 3 Concentration 41%
Number of Banks 21
Lebanon
Assets/GDP 366%
Top 3 Concentration 38%
Number of Banks 54
Jordan
Assets/GDP 177%
Top 3 Concentration 34%
Number of Banks 26
Israel
Assets/GDP 135%
Top 3 Concentration 78%
Number of Banks 19
Morocco
Assets/GDP 125%
Top 3 Concentration 66%
Number of Banks 19
Algeria
Assets/GDP 62%
Top 2 Concentration 55%
Number of Banks 20
West Bank/Gaza
Assets/GDP 112%
Top 3 Concentration 60%
Number of Banks 17
Egypt
Assets/GDP 98%
Top 3 Concentration 45%
Number of Banks 39

Source: National Central Banks, IMF, ECON
Note: Latest available data. The size of the circle indicates the size of the banking sector in terms of GDP. Light blue colour in circles indicates Top 3 asset concentration. Algeria: Top 2 asset concentration.

Debt capital markets in the Mediterranean partner countries are generally very shallow and dominated by sovereign issuance. The private sector is thus largely dependent on the banking sector for external debt financing. FEMIP banking sectors are generally large. On average, bank assets amount to around 130% of GDP, similar to EU-15 and far above what can be observed in new EU member states or in the BRICS. Lebanon has the deepest banking system (total assets to GDP stand above 300%), reflecting its traditional role as a regional financial centre, the country’s large bank-financed public debt and a large base of deposits from its diaspora. Most other Mediterranean partner countries – Israel, Jordan, Morocco, and WBG – also display relatively deep banking sectors, with assets in excess of 100% of GDP (see Figure 1). Asset concentration varies from country to country, with the least concentrated banking sector being Tunisia where the three most important banks account for 38% of total assets. At the other end of the spectrum are Israel and Morocco, which have very high levels of asset concentration (the top three banks account for 78% of total assets in Israel and 65% in Morocco).

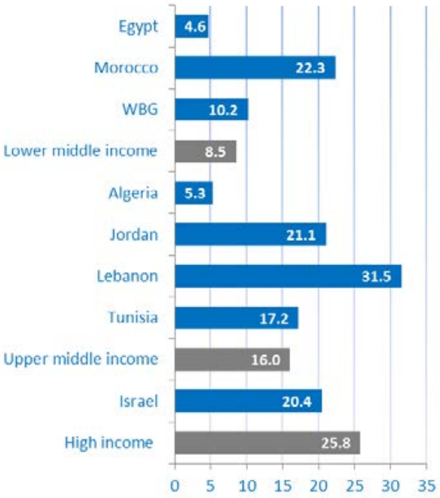
While asset-to-GDP ratios are high, financial inclusion is still relatively low in the FEMIP region. The percentage of adults with an account in a formal financial institution is low especially in Egypt (10%), WBG (19%) and Jordan (25%) compared to their respective income group (account penetration for lower middle income countries stands at 28% on average, and for upper middle income countries at 57% − see Figure 2). At the same time, the number of bank branches per inhabitant is particularly low in Egypt and Algeria (see Figure 3). Otherwise the countries in the region have a good coverage of bank branches given their income levels. However, in rural areas the local populations are still facing problems with access to financial services as bank branches are mainly clustered in urban areas. This problem is particularly pronounced in countries with large rural populations such as Morocco and Egypt.

Figure 2. Percentage of Adults with an Account in a Formal Financial Institution



Source: World Bank Global Findex Database

Figure 3. Number of Bank Branches per 100,000 Adults (2011)

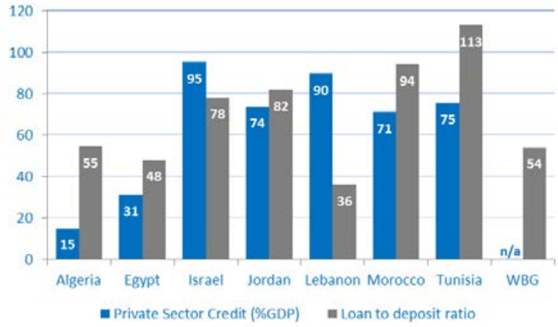


Source: World Bank WDI
Note: Egypt 2010 data

Overall, banking intermediation remains weak in the region. Figure 4 shows that the ratio of private sector credit to GDP as well as the loan-to-deposit ratio reflect the poor levels of intermediation in the region, notably in Algeria, WBG and Egypt. In Lebanon, where the banking sector is very large, the loan-to-deposit ratio is remarkably low at less than 40%. The main reason for this is the large exposure of the Lebanese banking sector to government debt. On the other hand, Morocco and Tunisia have very high loan-to-deposit ratios at around 100% – despite their ratio of private sector credit to GDP being only around 70%. The intermediation in both countries is high from a regional perspective, only outperformed by Lebanon and Israel. Overall, this combination of high loan-to-deposit ratio and relatively low private-sector-credit-to-GDP ratio points at liquidity problems in the banking sector. Deposits remain the main funding source of commercial banks in the whole region, and banks are unable to increase their deposit base at a pace fast enough to sustain rapid loan growth. In addition, the unbanked parts of the population have mostly low incomes and are expensive to reach, making it difficult for banks to raise more funds through deposits to supply the growing economies with much needed credit.

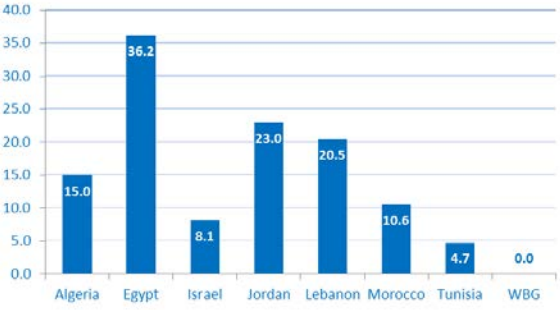
SMEs are often hit particularly hard by weak banking intermediation levels as bank lending is traditionally concentrated in large, corporate customers and banks often prefer using their excess liquidity to buy government debt. In Egypt, Jordan and Lebanon the exposure of the local banking sectors to their respective governments is particularly high (see Figure 5). According to the World Bank Enterprise Survey more than 40% of small firms in Morocco and Egypt, more than 50% of Algerian firms and a quarter of Jordanian firms consider access to finance a major obstacle in the business environment. Banks consider it more difficult to assess the risk of SMEs as they are usually less transparent than larger firms, and banks also typically face higher transaction costs per loan extended when lending to small firms. In addition, SMEs are often not able to fulfil the mostly very demanding collateral requirements stemming from conservative lending practices. Underdeveloped credit registries as well as the lack of well-functioning collateral registries exacerbate the problem. In some countries, notably Tunisia, bank financing of the private sector is additionally constrained by caps on lending rates.

Figure 4. Private-Sector-Credit-to-GDP and Loan-to-Deposit Ratios



Source: World Bank, National Central Banks

Figure 5. Exposure to Government: Percentage of Total Assets in Government Securities



Source: National Central Banks

The aftermath of the Arab Spring, coupled with spillovers from the European sovereign debt crisis, are still impacting the performance and soundness of the banking sectors in some countries in the region. Initially the impact of the events was direct, notably in Egypt and Tunisia, through the closure of businesses, including banks, for an extended period of time and some, albeit very few, incidents of looting and destruction of branch offices. The major impact came, however, indirectly through the negative effect of the events on the real economy. Most affected are the banking sectors in the countries where revolutions led to regime changes, i.e. Tunisia and Egypt, but even in other countries the impact is non-negligible. For instance, the Lebanese banking sector, through its large exposure to Syria as well as through the close trade ties between the two countries, has seen its risk exposure increase. In Morocco, the difficult economic environment has led to a slowdown in the growth of deposits, leading to a liquidity squeeze. The most affected banking sectors are, however, the Tunisian and Egyptian ones. In Egypt one of the main issues is the banks' need for foreign currency, as the foreign exchange reserves have dropped significantly over the last two years, leading to the Central Bank restricting access to foreign currency. In Tunisia the crisis has shown and aggravated some deep structural problems affecting the banking sector, such as its large exposure to the structurally weak tourism industry. NPLs are now increasing and the recapitalisation of some banks seems inevitable.

Regulators in most countries in the region have reacted by implementing different measures to support banks in the more difficult operating environment. In Lebanon, for instance, the Central Bank has urged banks to take adequate provisions for their risk exposure to Syria and to run regular stress tests. In Morocco the Bank Al-Maghrib has increased its liquidity injections, a measure also taken by the Tunisian Central Bank. In addition to the direct liquidity support, the Tunisian regulator implemented some exceptional measures regarding the classification of doubtful loans as well as increased provisioning rules. Further measures to strengthen the banking sectors and improve regulation and supervision will be necessary in some countries to increase the capacity of banks to support more efficiently the development of the private sector.

Islamic Banking in the Mediterranean Partner Countries

The conventional form of banking is not a suitable model for financial intermediation under Islamic religious rules as they prohibit interest payments. Therefore, *Shari'a* compliant banking is based on different types of incentive structures, such as profit sharing or leasing arrangements.

Following the Arab Spring events and regime changes, many Mediterranean partner countries are increasingly keen on expanding their Islamic financial sectors. So far, existing Islamic financial institutions in MPCs account for only a small share of the total size of their banking sectors. Jordan, with its strong ties to the GCC countries, has the largest share of Islamic banking assets at 12% of the total size of its banking sector (2010 data). In Egypt and Syria the share is lower at about 4% of total assets, and in Tunisia at about 2%. In Algeria and Lebanon the share is even less significant with about 1% of assets of the banking sector in Islamic banking, and in Morocco Islamic banking products are yet to be introduced. Overall, Islamic banking remains a niche market in most Mediterranean partner countries.

There are several reasons behind the low development of *Shari'a* compliant banking in the region. One is the relatively limited development of sophisticated banking systems in most countries of the region; another is the limited awareness and knowledge of the local population of Islamic banking products. Most importantly, however, is the lack of government support, which slowed down or even prevented the sector from developing.

Globally the Islamic financial industry is growing rapidly, especially in the GCC countries as well as in some Asian countries, notably Malaysia. One of the reasons for the increasing importance of Islamic banking is that it caters to the financial needs of individuals who are not willing to use conventional banking services as they conflict with their religious values. Consequently, Islamic banking can contribute to increased banking penetration and intermediation to some extent. In addition, the development of Islamic banking can contribute to broadened access to funding sources for corporates and sovereigns in the region, as it can help the local economies to mobilise long-term savings and investments from Islamic investors. There is a lot of surplus in the often oil-rich Islamic world which is not used productively due to a lack of *Shari'a* compliant investment opportunities. Also, Islamic banking can simplify the transfer of remittances notably from the GCC countries, which can be relevant in Jordan, Egypt and Lebanon in the FEMIP region, as those countries have a large number of citizens working in the Gulf countries.

Overall, there is scope for Islamic banking to gain ground in most MPCs. Most governments in the region are now moving towards opening up their local financial sectors to Islamic financial institutions and products. Governments themselves are interested in using Islamic instruments, such as *Sukuk*, to attract funds from Islamic investors in order to finance their growing fiscal deficits. Legal and regulatory issues are now being addressed, and the development of sovereign *Sukuk* markets can help the development of Islamic banking as they can ultimately be used as an important benchmark in the sector.

Mobile Financial Services in Mediterranean Partner Countries[1]

Access to financial services across most Mediterranean partner countries is relatively low, as only 36% of the population aged over 15 has an account with a formal financial institution. Excluding Israel, whose access to finance ratio (at 90%) is at par with that of high income countries, the average of the remaining seven MPCs stands at 28%. This is lower than the average for the upper middle income group of countries (of which Algeria, Tunisia, Jordan and Lebanon are part) and approximately the same as the average for lower middle income countries (of which Morocco, WBG and Egypt are part). Thus, countries in the region face an important challenge in terms of access to finance which, to some extent, jeopardizes their economic development and contributes to income inequality.

In sharp contrast with relatively low access to finance, mobile phone penetration is very high across almost all MPCs – the average penetration rate is 106%. This combination of high mobile penetration and low access to financial services suggests that mobile financial services can be a useful instrument to increase the use of formal financial services in all the countries in the region – perhaps with the exception of Israel.

That large potential notwithstanding, mobile banking offerings can only become a useful tool in expanding access to finance to households and small businesses in MPCs if they meet potential customers' needs. Supply should adjust to prevailing conditions and not give in to the temptation of blindly adopting models that were successful in other parts of the world. In particular, it needs to recognise that financial sectors in MPCs are bank dominated and that mobile banking services should complement existing banking products and serve as a means to expand banking services to larger segments of the population.

That said, even well designed business models face a significant number of implementation challenges, of which the flexibility and adaptability of existing regulatory frameworks is undoubtedly the most relevant. But the success of those offerings will also depend critically on a few basic infrastructures such as (dense) distribution networks, risk analysis databases and methodologies as well as retail payment architectures that ensure interoperability and decrease transaction costs. On the other hand, some favourable conditions such as international remittances can provide the necessary lever for a successful uptake of mobile banking in MPCs.

1. **Flexibility and adaptability of existing regulatory frameworks.** Currently, the regulatory frameworks of Egypt and Jordan can be considered enabling and evolving towards enabling in Morocco; restrictive in Lebanon and Tunisia; in Israel also enabling, although there is no interest in launching transformational business models. In WBG and Algeria it does not exist.

[1] This chapter has been contributed by Francesc Prior Sanz (FIR Advisors). It is based on the study 'Mobile Financial Services in Mediterranean Partner Countries', financed by the EIB FEMIP Trust Fund and conducted by FIR Advisors. The study reviewed the development of mobile financial services in Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Tunisia and West Bank/Gaza.

Key elements for the implementation of mobile financial services are the e-money and agent regulation aspects of the regulatory framework. Financial regulators in the region are looking into these issues in order to better understand how mobile financial services can be used to increase access to financial services while maintaining the stability of the financial system. Definitions of electronic money vary by jurisdiction, but a common definition is — monetary value stored on an electronic device which is issued on receipt of funds and accepted as a means of payment by parties other than the issuer. The key question is whether non-bank organisations are permitted to issue e-money as well, and if so, under what conditions and subject to what prudential and non-prudential regulation.

The use of retail agents introduces new risks. For example, agents present a variety of operational risks to the provider (particularly reputational risk, given that the agent is the public face of the provider) and to the consumer (particularly in terms of agent liability). Moreover, the use of agents adds a special dimension to the challenge of satisfying AML/CFT norms and to consumer protection — two other topics critical to mobile financial services.

2. **Access to dense distribution networks**. Physical access to financial services in the MPCs is relatively low with about 16 bank branches per 100 000 adults in 2011, a number that jumps to 24 per 100 000 adults if the network of postal branches – which has a dominant position in the distribution of retail financial services and payments in MPCs – is added to conventional bank branches. This compares to a ratio of about 33 bank branches per 100 000 adults in OECD countries. Money exchanges, payment service providers and microfinance institutions also have large networks in MPCs. However, the density of Mobile Network Operator networks franchises is by far the highest in the region, although the potential of these networks for cash in/cash out purposes remains to be exploited.

3. **Access to tailored risk analysis databases and methodologies.** Databases, such as credit bureaus, collect not only economic and payments information, but also socio-demographic variables, which require large infrastructures to process and analyse information. Their development strengthens the ability to select customers and therefore expand, solving the Know Your Customer, Anti-Money Laundering and Counter Financing Terrorism risks. Additionally, these databases use systems that, thanks to the use of electronic payment methods, allow mobile financial services operators to track credit risk very efficiently using systems such as behavioural scoring.

   While the quality of credit reporting has improved in the MPCs in recent years, especially in Morocco, Egypt and WBG due in large part to the introduction of new credit bureaus, much remains to be done, both in terms of design and coverage. Six of the countries studied have Public Credit Registries (PCR) while only three have Private Credit Bureaus (PCB). PCRs are administered by central banks or bank supervisors and basically collect information from supervised institutions. PCBs constantly seek to expand the scope of their information and thus develop a more complete picture of a borrower's financial dealings. Because participation in PCRs is mandatory, they can build a picture of the regulated financial system relatively quickly, and support the oversight functions of the regulators. As a result, if PCRs had broad enough coverage they could help non-bank mobile financial services operators enter the mobile financial services market.

4. **Creation of new retail payments architectures.** These will ensure interoperability and therefore allow for the exploitation of the economies of scale necessary to decrease transaction costs while encouraging competition. Economic theory suggests that in the absence of public intervention, competitive pressures will lead financial institutions not to share technological infrastructures, thus foregoing significant savings. As a result public policies are needed in order to create interoperable nodal network systems that ensure widespread adoption and cost efficiencies. This kind of public intervention could come from the creation of a state-owned switch, such as the one the Central Bank of Jordan is currently implementing and the one the Palestinian Monetary Authority would like to set up; or through public incentives that favour joining an existing network (Egypt, Tunisia, Lebanon, Algeria); or by increasing competition through multiple interoperable networks (Morocco, Israel).

5. **Worker remittances, a lever for regional banking services?** International remittances could be one of the mobile financial services most in demand in MPCs due not only to the importance they have for the economies of the region in terms of GDP, especially for the lower income segments of their populations, but also because prices of remittances in the region are still high compared to other regions. The uptake of mobile financial services in countries like the Philippines or Kenya is mostly explained by the success of operators such as M-Pesa, G-Cash, or Smart in providing remittances services, whether international (the Philippines) or domestic (Kenya). Through the receipt of remittances into a bank account, the system acquires greater liquidity and exploits scope and economies of scale fundamental to reducing transaction costs. Besides, the operational synergies generate substantial efficiency gains since the value chains of remittances and mobile financial services operators have common elements such as distribution networks and databases to process information.

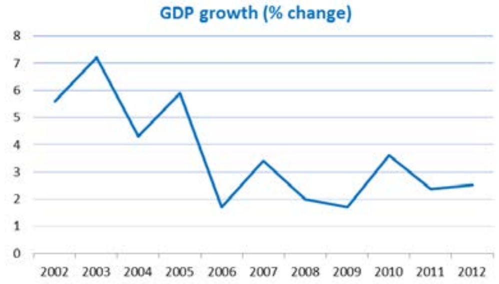
In addition to promoting the financial inclusion of households and small businesses across the region, mobile banking can also play a pivotal role in the development of local microfinance institutions (MFIs). Mobile financial services can help MFIs improve microcredit payment mechanisms, as well as the efficiency of their operations. However, serving the microfinance industry will be successful if MFIs are allowed to offer not only microcredit but also the disbursement of the microcredit. Similar experiences in other countries prove that the receiver will keep approximately 15 to 20% of the microcredit balance in the e-wallet if they are offered useful payment services and trust in the system. The biggest obstacle to widespread adoption of mobile financial services for microfinance is, however, the MFIs' lack of understanding of mobile financial services. As a result, assistance in training MFIs on how to use and offer mobile financial services to their customers is needed.

Algeria

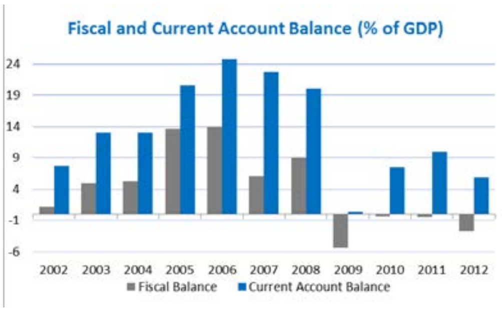
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

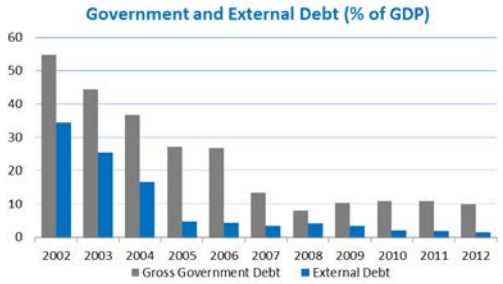
The continued contraction of the hydrocarbon sector stresses the need for diversification of the economy and an increased non-hydrocarbon growth performance.



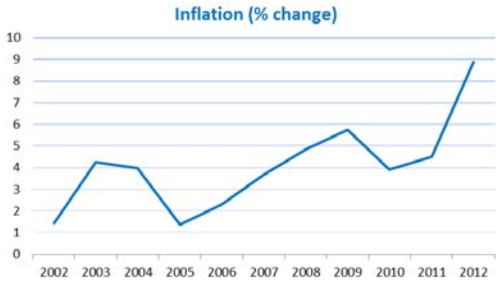
Further increases in public expenditure have led to a deepening fiscal deficit and contributed to the shrinking current account surplus.



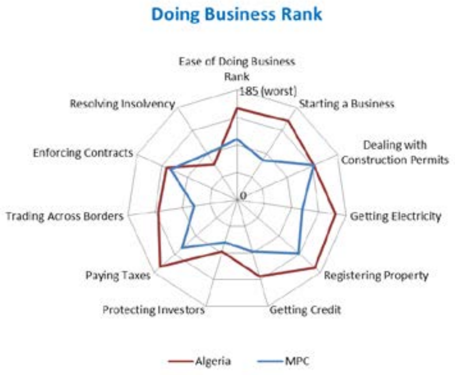
Algeria's public debt nevertheless remains very low and its external position robust.



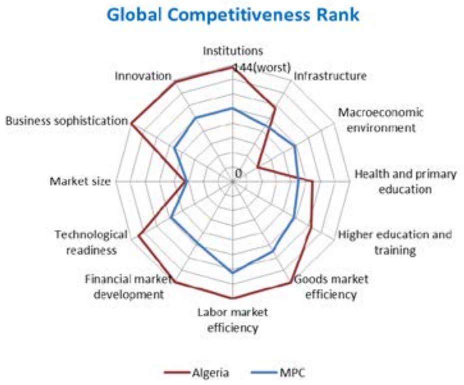
Inflation has been rising over the last few years on account of the expansionary fiscal policy and increasing international prices of agricultural goods.



Algeria has the lowest Doing Business rank in the region, with property registration and the paying of taxes being particularly burdensome.



The competitive environment in Algeria is very weak. The country is ranked last regarding institutions as well as business sophistication, and scores very poorly in several other categories.

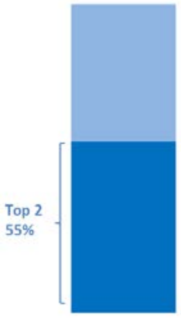


Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

Algeria's banking sector is heavily dominated by state-owned banks and remains centred on the domestic economy. In 2011 there were 20 licensed commercial banks operating in Algeria, of which six are publicly owned and the remaining 14 private banks are all foreign. Total assets of the banking sector account for about 62% of GDP. Asset concentration is very high with the two largest banks, both state-owned, representing more than half of the sector's assets (see Figure 2). Overall, the state-owned banks account for 88% of total assets of the banking sector, and their activity is very much focused on financing the country's public enterprises which account for a large part of the economy. At the same time, private banks' activity continues to progress both in terms of resource mobilisation and credit distribution operations.

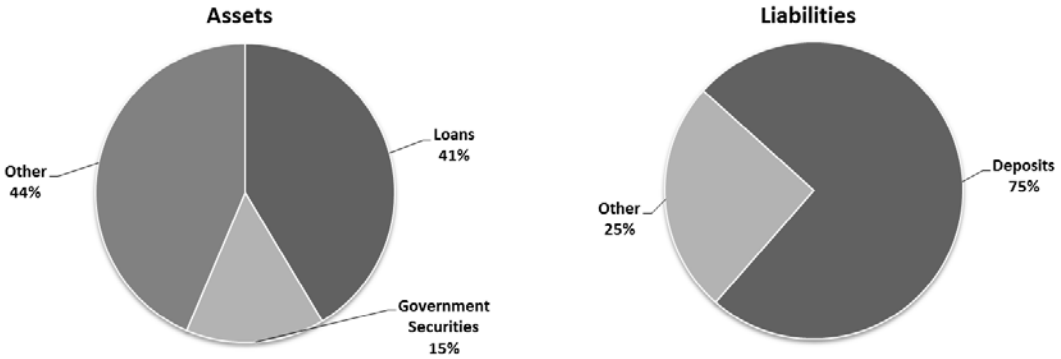
Figure 2. Asset Concentration (2011)



Source: Bank of Algeria

Intermediation levels in Algeria remain very weak. Although private-sector credit is on the rise, it remains low and reflects poor access to finance for both businesses and households. Private sector credit to GDP stood at 15% in 2011, which nevertheless represents an improvement compared to 8% a decade earlier. Particularly low is the level of credits to households, as the Algerian government put in place a ban on consumer credit in 2009 in an attempt to limit imports following a significant fall in oil prices. The ban is widely seen as a negative signal to foreign investors and has considerably limited the sphere of intervention of private foreign banks to essentially foreign trade operations, commercial credits and mortgages.

Figure 3. Assets and Liabilities – Basic Structure (2011)



Source: Bank of Algeria

Commercial banks in Algeria, both domestic and foreign-owned, fund themselves mainly through domestic deposits. Deposits account for about three quarters of total assets (see Figure 3) and have been growing at a relatively sustained pace. Government measures aimed at enhancing households' purchasing power in response to growing social tensions, essentially through raising wages, have contributed to increasing deposits. Privately owned banks have seen more sustained deposit growth than public banks – in 2011 private banks' deposits grew by 29% compared to 15% growth in public banks. At the same time private banks also slightly boosted their position in the credit market, bringing their share of total loans to 14% in 2011 compared to 12% in 2009. In the overall banking sector, loans account for a mere 41% of total assets.

Overall, Algerian banks are profitable, adequately capitalised and liquid. The average capital adequacy ratio reached almost 24% in 2011 − well above the regulatory minimum of 8%. The high liquidity in the sector stems from the country's large hydrocarbon wealth and is of structural nature. The Central Bank, Banque d'Algérie, has implemented several measures aimed at mopping up the excess liquidity as pressures on prices have increased, such as specific and limited liquidity-absorbing facilities, and it increased the minimum reserve requirements from 9% to 11% in May 2012. The level of NPLs remained high at more than 14% in 2011, but a clear improvement can be observed as NPLs stood at more than 20% two years earlier. The level of NPLs is much higher in the country's publicly owned banks, with a NPL ratio barely exceeding 4% in the privately held banks.

In an environment of reinforced prudential measures and evolving supervisory frameworks for banks, BdA has moved towards greater adaptation of its prudential apparatus. Improvements have been made to reinforce the regulation of banks and financial institutions and to better supervise interbank and liquidity risk exposures. Besides deploying efforts to adapt and reinforce Algeria's banking regulatory framework, BdA has been pursuing its mission of modernising the control processes carried out by the General Inspectorate. These efforts include the development of a bank rating system consistent with international standards as well as new management and control procedures.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	--	26.2	23.6	23.7	--
Tier 1 capital adequacy ratio	--	--	--	--	--
Asset quality					
NPLs to gross loans	--	21.1	18.3	14.4	
Loan loss provision/NPL	--	67.8	74.4	72.0	--
Earnings and profitability					
Return on assets (ROA)	1.0	1.3	1.3	--	--
Return on equity (ROE)	--	26.0	26.2	24.6	--
Liquidity					
Liquid assets to total assets	--	--	--	--	--
Liquid assets to short terms liabilities	--	114.7	114.4	103.7	--
Foreign exchange exposure					
Net open FX position to capital	--	--	--	--	--
FX denominated assets to total assets	--	--	--	--	--
FX denominated liabilities to total liabilities	--	--	--	--	--

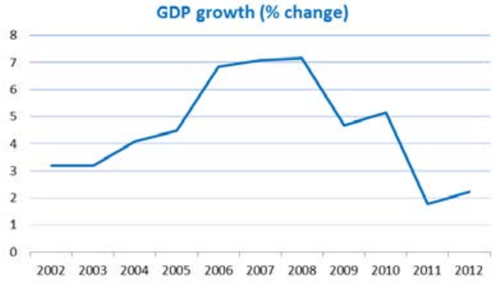
Source: IMF, Bank of Algeria

Egypt

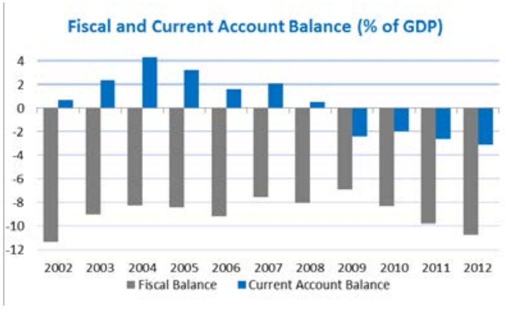
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

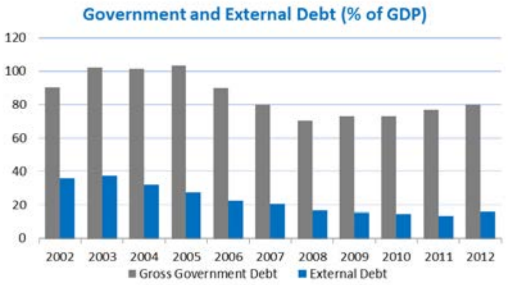
GDP growth slowed to 1.8% in 2011 and remained low at 2% in 2012, and with tourism remaining depressed the tentative recovery in construction was more than offset by the decline in manufacturing.



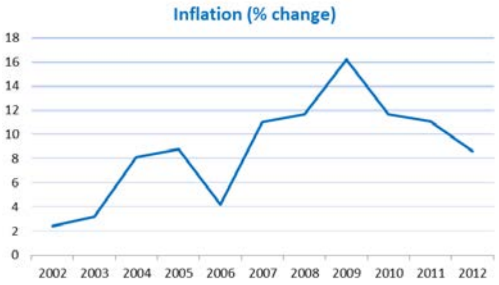
The general government deficit was 9.9% of GDP in 2011 and widened to over 11% in 2012. Depressed tourism and declining gas export revenues have contributed to the widening current account deficit.



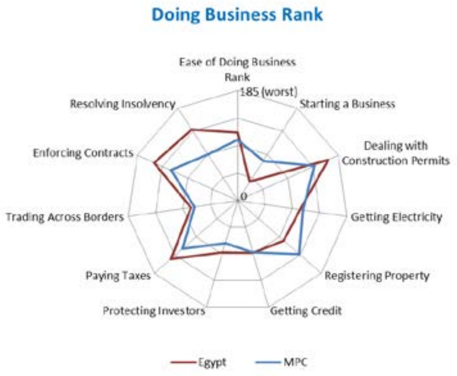
Government debt is on a rising trend and the fiscal deficit has been financed largely through the issuance of T bills that have been absorbed by the banking sector.



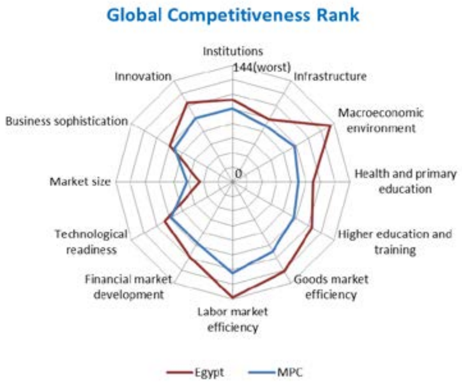
Annual inflation has been on a downward trend since 2009 but monetary policy was tightened in early 2013 in order to offset the inflationary impact of global commodity price increases and support the value of the EGP.



The business environment is challenging, particularly with regard to resolving insolvency, enforcing contracts and dealing with construction permits.



The macroeconomic environment and labour market inefficiencies are important constraints on the competitiveness of the Egyptian economy.

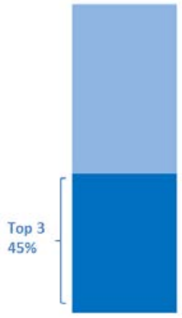


Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

The banking sector, as at the end of financial year 2011/12, consisted of 39 banks, five of which were public sector banks, 27 private sector and seven private and joint venture banks. The five state-owned banks accounted for around 40% of deposits. There has been a steady increase in the number of branches but this has not kept pace with population growth over the last two years and banking density has declined slightly, reaching one branch per 22 700 of population in 2012.

Figure 2. Asset Concentration (2012)



Source: Central Bank of Egypt and company reports

The circumstances for the financial sector have changed since the revolution. What was previously regarded as a structural surplus in liquidity has now been absorbed by the growth in government debt and shortages of foreign exchange have emerged. The Central Bank of Egypt (CBE) has already intervened on a number of occasions to provide liquidity to the inter-bank market, and local currency liquidity appears to be adequate. However there is an emerging gap in terms of foreign exchange which is likely to be a constraint on lending to the corporate and SME sectors.

Despite the adverse macroeconomic developments the banking sector has not been destabilised, though the risks have increased largely because of the increase in sovereign risk and the substantial holdings of government securities by the banking sector. Egypt has had a long period without any major disruption of financial stability. According to the IMF systemic banking crisis database, the last banking crisis in Egypt took place in 1982 when the government closed several large investment companies, and the last debt crisis was in 1991/2 with Paris club rescheduling. Although there have been a number of instances where banks have got into difficulties in recent years, the CBE has provided support and none has been allowed to default. Moreover, the balance sheets of the banks as well as the system of supervision and regulation have been strengthened by successive reforms since 2004.

The indicators for the banking sector are holding up well despite the economic slowdown of 2012. The Tier 1 capital ratio stood at 13.5% in 2012 (vs. 13.6% in 2010), reported NPLs were 10.0%, and earnings remained stable. Some banks have experienced deteriorating asset quality and there may be further deterioration that is not yet captured in the reported NPL statistics due to non-disclosure, deferred instalments allowed by the CBE to support key sectors of the economy, and debt rescheduling. However, the overall structure of portfolios is well diversified without excessive concentration on the tourism and real estate sectors. Given the increased pressure on the Egyptian Pound (EGP), the FX exposure of banks could become a concern. About a quarter of loans are in foreign currency, and a further depreciation of the EGP could increase credit risks. On the liability side the dollarization rate of deposits stands at about 24%. The CBE, in light of the fragile operating conditions, implemented additional currency controls in December 2012 limiting foreign currency cash withdrawals and cross-border transfers to contain the increased demand for currency conversions.

The demand for credit to the private sector has declined since the beginning of 2011 as the economy has slowed down, and the need for government financing has increased. As a consequence the composition of domestic credit has significantly shifted towards the public sector. The ratio of public (government and public enterprises) to private (private enterprises and households) credit shifted from 46:54 in 2010 to 60:40 in 2012. This trend combined with the tightening of liquidity and increase in interest rates raises concerns about crowding out.

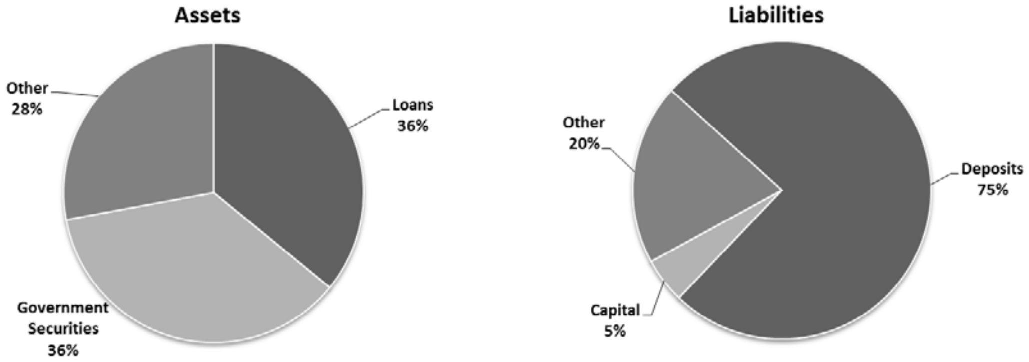
Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	14.7	15.1	16.3	15.9	15.9
Tier 1 capital adequacy ratio	11.5	12.0	12.7	13.3	13.5
Asset quality					
NPLs to gross loans	14.8	13.4	13.6	10.5	10.0
Loan loss provision/NPL	92.1	100.4	92.5	94.5	97.1
Earnings and profitability					
Return on assets (ROA)	0.8	0.8	0.8	0.8	1.0
Return on equity (ROE)	15.0	14.4	13.5	13.0	14.3
Liquidity					
Liquid assets to total assets	26.7	32.3	35.3	39.6	43.7
Liquid assets to short terms liabilities	--	--	--	--	--
Foreign exchange exposure					
Net open FX position to capital	--	--	--	--	--
FX denominated assets to total assets	--	--	--	--	--
FX denominated liabilities to total liabilities	24.1	20.9	19.0	21.0	21.4

Source: Central Bank of Egypt

Confidence in the banking sector has remained good, and although there have been some marginal decreases in certain categories of deposits from month to month, there has been no significant withdrawal. The trend in 2012 was one of slightly increasing deposits and as credit slowed, the loan-to-deposit ratio fell below 50%. This decline in the loan-to-deposit ratio, which follows the longer-term trend since 2006, gives an indication of the constraints on the banks and the lack of opportunities to expand lending to the private sector.

Figure 3. Assets and Liabilities – Basic Structure (2012)



Source: Central Bank of Egypt

Banking regulation and supervision were substantially reinforced following the adoption of the Banking Law of 2003 which strengthened the CBE's independence. The first phase of financial sector reform running from 2004 to 2008 delivered tangible results in consolidating and strengthening the banking sector. The second phase, focusing on improved market efficiency, is now approaching completion with the application of Basel II in the Egyptian banking sector. Banks will be required to apply Basel II pillar I regulations starting from December 2012 and June 2013 depending on the end of the financial year of each bank.

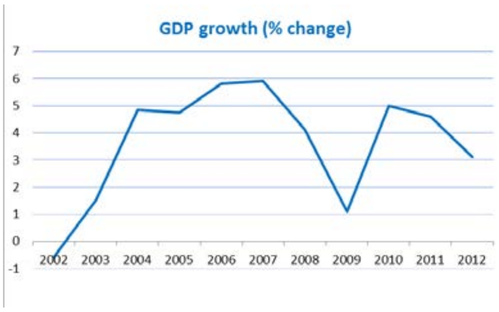
Egypt does not have a deposit insurance scheme. However, the state plays an active role in the sector and in the past the authorities have demonstrated the willingness to step in to support troubled Egyptian banks. A number of Egyptian banks have faced difficulties in the past but none has been allowed to default. The response of the CBE has been a combination of regulatory forbearance, allowing the bank time to work its way out of trouble, capital injection, and merger with state-owned banks. However, the capacity of the state to intervene in the banking sector has declined since the revolution. The higher fiscal deficits and higher levels of public debt mean that the resources available for government intervention in the banking sector − should it be necessary − have been reduced.

Israel

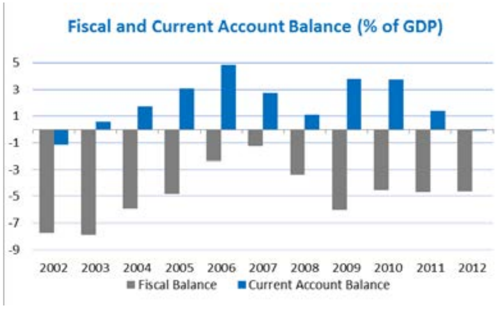
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

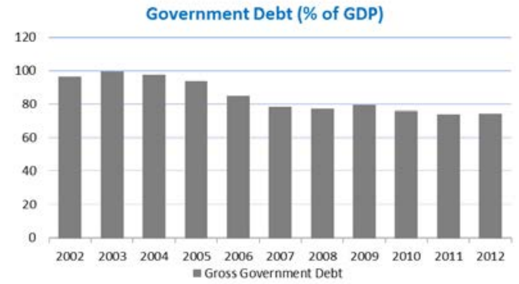
Israel's economy emerged fairly unscathed from the financial crisis. GDP growth averaged 4.4% from 2004 to 2012.



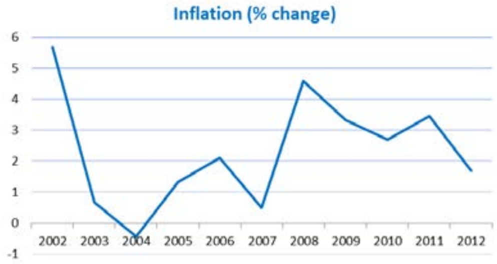
While additional measures are needed to reduce the fiscal deficit, the development of offshore gas fields will push the current account into surplus.



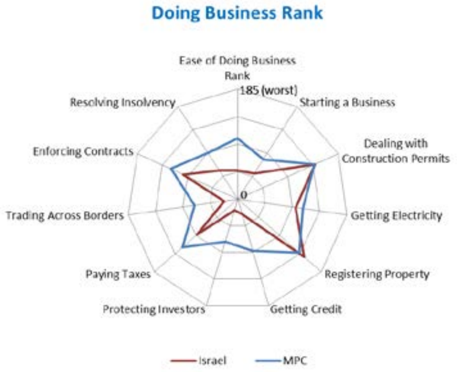
Israel has reduced government debt from 100% of GDP in 2003 to 75% in 2012.



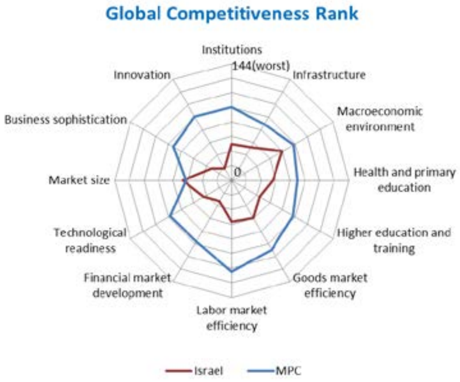
Inflation is within the current target range of 1 to 3%.



Israel has the leading business environment in the region, though property and construction-related rules could be improved.



Israel stands out in terms of its capacity to innovate, supported by world-class research institutes and easy access to venture capital.

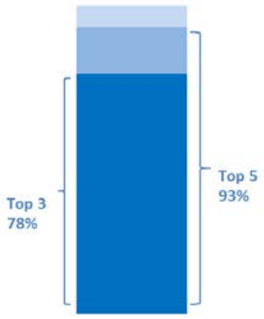


Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

Despite many reforms to increase competition, including among banks themselves, the banking sector remains highly concentrated. Currently, there are 15 local banks and four foreign branches operating in Israel. The local ones are, however, bundled into five banking groups and three individual banks. The two largest banking groups, Bank Leumi and Bank Hapoalim, account together for almost 60% of the banking sector's total assets. Furthermore, the largest five banking groups account jointly for over 93% of total assets. The activity of foreign banks in Israel remains limited, with five foreign branches focusing on the corporate sector.

Figure 2. Asset Concentration (June 2012)

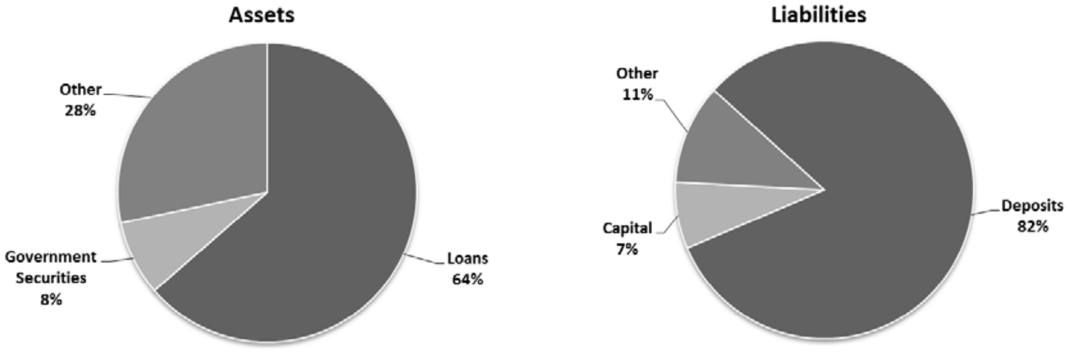


Source: Bank of Israel

The main banks' activities are focused on traditional lending activities. Loans account for 63% of total assets with credit to the government being negligible. Private individuals account for 36% of total credit, almost evenly split between housing and non-housing credit. Within the corporate sector, construction and real estate account for 17% of total credit, followed by manufacturing with 10% and financial services with 8%. As a result, industry concentrations in the corporate sector are elevated. The same applies to single-name concentrations as a limited number of large conglomerates are served by the same banks.

Banks benefit from a sound funding profile. The loan-to-deposit ratio equals 78%, and deposits account for 82% of total liabilities. The high level of customer deposits results from Israel's high saving rate. Deposits have shown a high degree of stickiness despite the absence of formal deposit insurance. Though market funding plays a limited role quantitatively, it constitutes an important source of term funding. Demand comes mainly from domestic institutional investors and has proven resilient.

Figure 3. Assets and Liabilities – Basic Structure (June 2012)



Source: Bank of Israel

After 2008 the banking sector quickly returned to profitability. Earnings benefit from a relatively wide interest margin, which reflects low competition for funds. At the same time, operating efficiency is moderate, with labour costs accounting for a high share of gross income. As a result, ROEs are similar to those in comparator economies.

Israeli banks' Tier 1 capital ratios have recently increased but are still rather low relative to comparator countries. To address this issue the central bank requires a minimum core Tier 1 ratio of 9% from 2015 onward, and the two largest banks need to further increase it to 10% by 2017.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	11.2	13.7	14.0	14.0	14.4
Tier 1 capital adequacy ratio	7.6	8.3	8.0	7.9	8.3
Asset quality					
NPLs to gross loans	1.5	1.4	1.2	2.8	2.9
Loan loss provision/NPL	--	--	44.8	44.2	43.9
Earnings and profitability					
Return on assets (ROA)	0.0	0.8	0.9	0.6	0.6
Return on equity (ROE)	0.3	8.8	9.8	10.2	9.0
Liquidity					
Liquid assets to total assets	16.1	22.8	20.2	--	--
Liquid assets to short terms liabilities	27.3	37.5	34.0	40.0	39.7
Foreign exchange exposure					
Net open FX position to capital	-15.5	-9.6	-1.9	-1.9	--
FX denominated assets to total assets	32.7	26.4	22.8	22.7	--
FX denominated liabilities to total liabilities	48.5	46.2	39.9	29.1	--

Source: Bank of Israel

Banks are supervised by the Bank of Israel (BoI). The regulation and supervision of Israeli banks are good and have contributed significantly to the resilience of the banking sector during the financial crisis. In 2010, the supervisor got formal independence with the new Bank of Israel Law. Basel III is being implemented, and will lead to better capitalisation of the Israeli banking system.

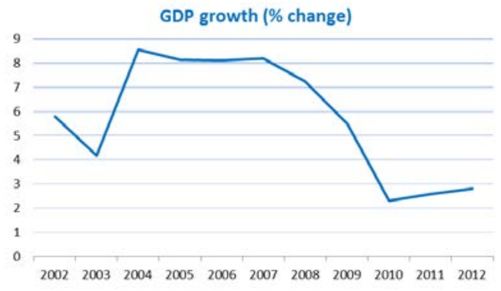
Between January 2008 and January 2013, nominal house prices increased by 72%. In response, the BoI has imposed a maximum loan-to-value ratio of 70% for housing loans, and 50% for investment properties. Since then, a new guideline has increased risk weights and provisioning requirements for housing loans.

Jordan

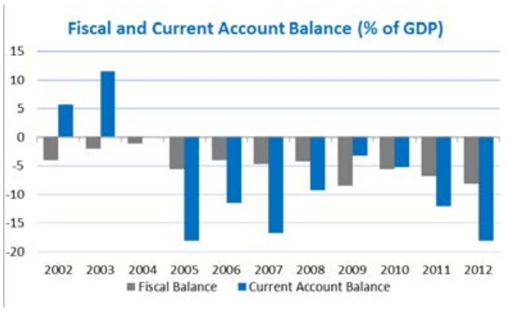
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

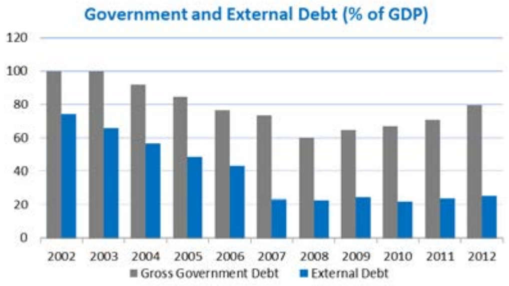
After many years of strong economic performance, a negative shock to Jordan's energy sector coupled with the negative impact of the conflict in neighbouring Syria have led to a slowdown in economic growth.


GDP growth (% change)

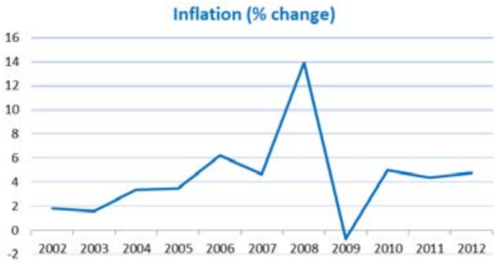
Repeated disruptions to the supply of natural gas and expensive oil imports have led to a widening of the current account deficit.


Fiscal and Current Account Balance (% of GDP)

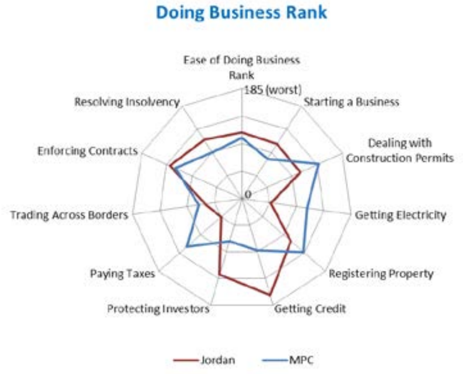
After a period of successful fiscal consolidation, public debt has increased again, largely financed by the domestic banking system.


Government and External Debt (% of GDP)

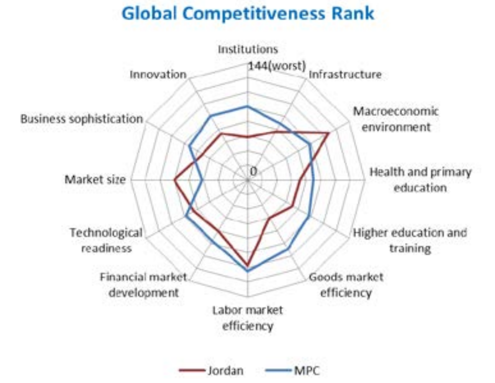
Increases in electricity and fuel prices exerted upward pressure on inflation in 2012.


Inflation (% change)

Difficult access to credit and weak investor protection stand out when comparing Jordan's business environment to that of other MPCs.


Doing Business Rank

The quality of institutions and goods market efficiency compare well to other countries in the region.

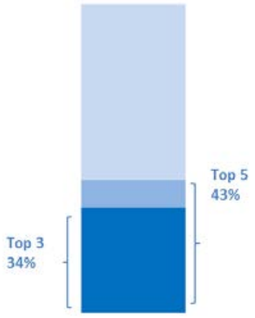

Global Competitiveness Rank

Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

The Jordanian financial sector is dominated by banks. In 2011, there were 26 banks licensed to operate in the country. Sixteen banks are Jordanian (three of which are Islamic banks) and ten are foreign banks. In 2011, a Saudi Islamic bank, Al Rajhi Bank, opened the first branch in Jordan, making it the first foreign-owned Islamic bank in the country. The number of Islamic banks increased to four in 2011, reflecting increasing demand for Islamic banking products. Concentration ratios have decreased in recent years. The three largest banks, which are all domestically owned, held about 33% of total sector assets in 2011 (Figure 1) compared to 48% in 2007. The largest player in the country accounts for 18% of sector assets.

Figure 2. Asset Concentration (end-2011)



Source: Jordinvest

The banking sector in Jordan is relatively large with total assets equalling 177% of GDP in 2012. The Jordanian banking sector experienced a prolonged period of rapid expansion with assets growing at an average rate of 11% between 2000 and 2011. In 2012, asset growth decelerated to 4.2%.

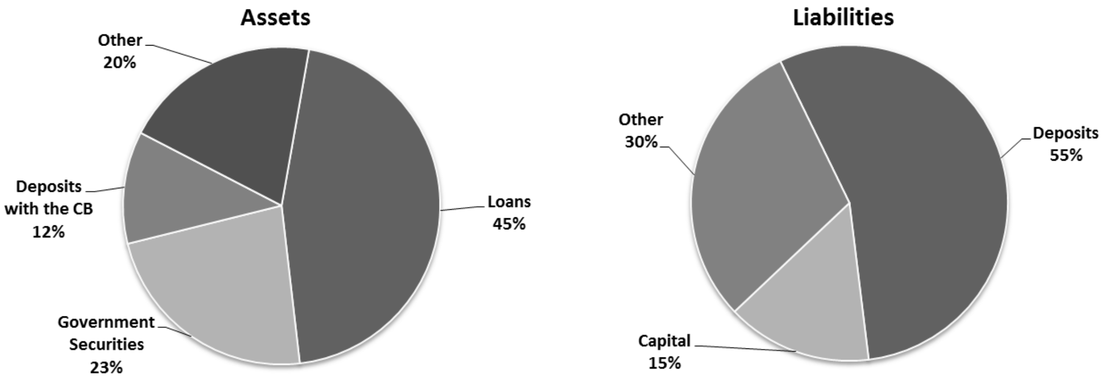
Though the banking sector in Jordan is large, and the ratio of private sector credit to GDP above the regional average, access to finance remains a problem. According to the World Bank, the share of firms using banks to finance investments is below 10%. Particularly in rural areas, access to finance remains limited as 62% of bank branches are located in the capital.

Government debt increased from 60% of GDP in 2008 to 80% in 2012, and the increased government refinancing needs crowd out private investment. Banks use their funds to buy high-yielding government debt instead of engaging in more resource intensive and risky SME lending. This trend is clearly visible in the banking sector’s asset structure. The share of government securities increased to 23% in 2012 compared to 11% in 2007. Over the last four years, banks’ claims on central government doubled to JOD 9 billion in 2012. In contrast, credit to the private sector relative to GDP fell from 81% in 2008 to 72% in 2011.

Deposits are the main source of funding for Jordanian banks, accounting for 55% of total liabilities. 70% of deposits are term deposits, with 66% of them coming from the private sector in 2012. Jordanian banks have been highly successful in attracting deposits from other countries in the region, such as Iraq, Palestine and Syria. Deposit growth has, however, slowed down over the last few years, reaching only 3% in 2012, mainly on account of the difficult economic situation and increasing regional uncertainties.

Financial soundness indicators suggest that the Jordanian banking sector has remained relatively strong despite the recent economic turmoil. The sector is profitable and well-capitalised. The minimum capital adequacy ratio of 12% required by the Central Bank of Jordan (CBJ) has been consistently exceeded over the last few years and stood at 18.6% in June 2012.

Figure 3. Assets and Liabilities – Basic Structure (2012)



Source: Central Bank of Jordan

The difficult operating environment and slowing economic activity have affected banks' loan portfolios. The share of NPLs in total loans has doubled since the onset of the financial crisis. NPLs stood at 8.4% in mid-2012 compared to 4.2% in 2008. The downturn has affected small banks to a greater extent than large banks. Medium-sized and small banks record NPLs above 10%, compared to NPL ratios between 6% and 9% among the top three banks. Loan loss provisions used to cover about 50% of NPLs, but had increased to 63% of NPLs at end-June 2012. Liquidity in the sector remains high, as indicated by a loan-to-deposit ratio of 82%. Owing to CBJ's requirement to keep liquid assets above the level of short-term liabilities, the liquidity ratio of the sector stands well above the required level of 100%, reaching 148% in June 2012.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	18.4	19.6	20.3	19.3	18.6*
Tier 1 capital adequacy ratio	--	--	--	--	--
Asset quality					
NPLs to gross loans	4.2	6.7	8.2	8.5	8.4*
Loan loss provision/NPL	63.4	52.0	52.4	52.3	62.3*
Earnings and profitability					
Return on assets (ROA)	1.4	1.1	1.1	1.1	1.2*
Return on equity (ROE)	11.5	8.8	8.8	8.3	9.6*
Liquidity					
Liquid assets to total assets	--	--	--	--	--
Liquid assets to short terms liabilities	141.2	159.1	161.4	152.9	148.4*
Foreign exchange exposure					
Net open FX position to capital	9.3	0.6	9.8	--	--
FX denominated assets to total assets	26.4	20.9	21.3	21.3	23.3
FX denominated liabilities to total liabilities	25.8	20.9	20.6	21.1	25.6

Source: Central Bank of Jordan, IMF
*Note: * June 2012 data*

The sector’s profitability remains adequate despite higher loan loss provision charges. The domestic return on assets averaged 1.2% in mid-2012, which is in line with the previous five-year average. The return on equity displays a similar pattern, averaging about 8% in recent years. The key driver of profitability remains interest income, which accounts for about 70% of gross income. Regional turbulences have led to an increase in dollarization. In 2012, foreign currency denominated liabilities accounted for 26% of deposits, up from 20%-21% during previous years. On the assets side, the share of FX denominated assets increased slightly to 23%.

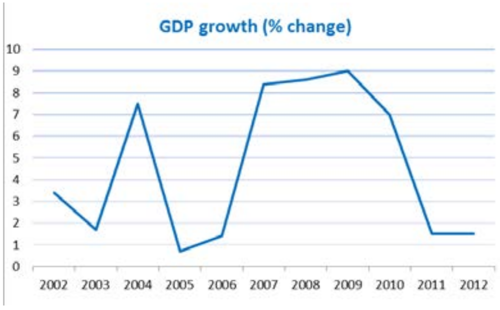
Banking supervision and regulation in Jordan are provided by the Central Bank, which has adopted supervision and regulatory frameworks that are in broad compliance with international supervision and accounting standards. This has contributed to the sound development of the financial sector. The control 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 Basel II (Pillars I and III) regulations and ongoing efforts to ensure compliance with Pillar II guidelines for risk management. In addition, the CBJ is studying their capacity for implementing Basel III.

Lebanon

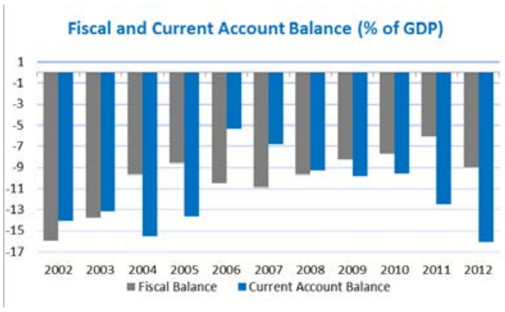
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

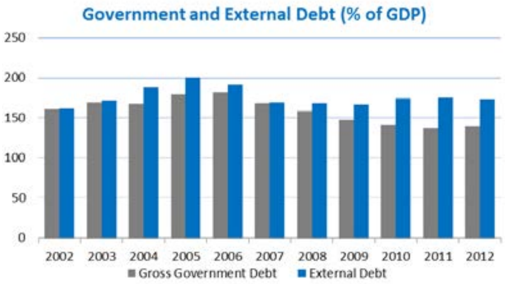
The performance of the Lebanese economy is strongly linked to domestic and regional factors, particularly security and politics. Unrest in Syria as well as domestic political tensions have slowed down growth in 2011 and 2012.



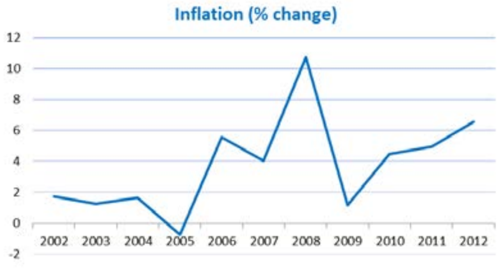
In this difficult economic environment, the country's twin deficit has deepened in 2012. In general, public finances point to a chronic deficit…



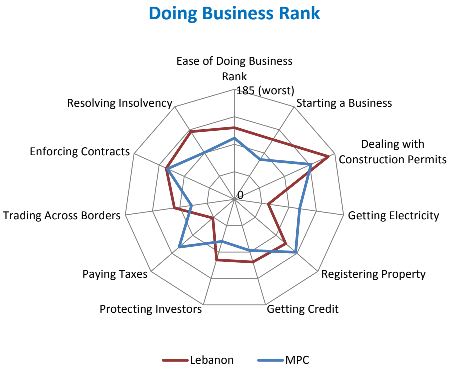
… partly because of the high cost of servicing the sky-high public debt.



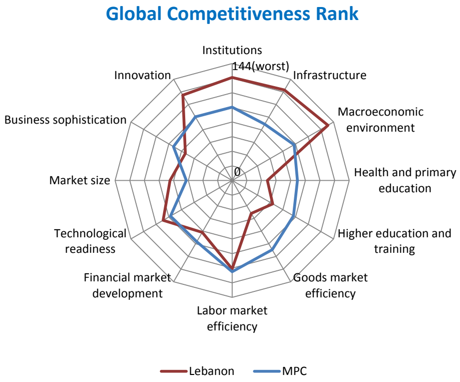
Inflation increased last year on the back of a sub-index update in July, which backloaded the last three years of inflation in housing prices onto 2012.



Regarding the business environment, slow progress in the reform process has held back improvements in the country's investment climate.



Lebanon's competitive advantages lie especially in the country's high level of human development as well as in high goods market efficiency.



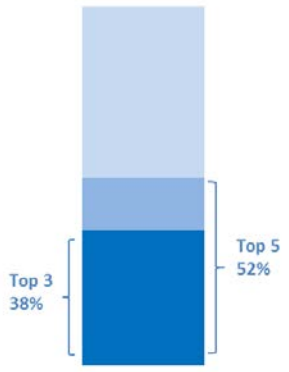
Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

The banking sector of Lebanon consists of 54 commercial banks. The banking sector has been a major driver of economic growth, stability and employment. Over the last two decades the consolidated assets of Lebanese banks have grown significantly and now represent about 366% of GDP. Lebanese banks are present in several countries; most large banks are for instance present in Syria, Egypt, Jordan and increasingly in Iraq, and some banks also have subsidiaries in sub-Saharan Africa. The regional political turmoil has, however, put a halt to some banks' expansion plans. The situation in Syria represents a risk to the Lebanese banking system owing to the large presence of Lebanese banks in the neighbouring country, as well as through its impact on the real economy.

Competition in the sector is relatively high and asset concentration of the three most important banks amounts to only 38%, which is low in comparison to the rest of the region. There are 12 foreign-owned banks in Lebanon, controlling almost 30% of total assets. Penetration of banking services is relatively high in Lebanon, and the number of bank branches per capita in the country is close to standards prevailing in developed countries. However, banking services are concentrated in Beirut and other large cities in the coastal area, leaving parts of the rural population with more difficult access to financial services.

Figure 2. Asset Concentration (end 2011)

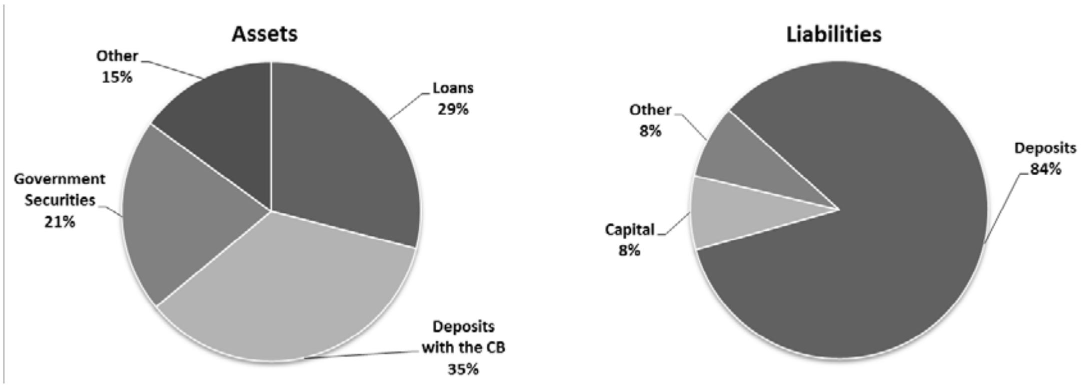


Source: Banque du Liban

The biggest funding source of Lebanese banks are deposits, which represent 87% of the banking sector's total liabilities. Deposit growth has been strong over the last few years. Traditionally, deposit inflows stem largely from the Lebanese diaspora, and these inflows have proven very resilient even in times of deep political crises such as the assassination of Rafiq Hariri or the 2006 war with Israel (the drop in inflows did not exceed about 5% on both occasions and quickly stabilised again). Almost 20% of banking sector deposits are held by non-residents and the main sources of those non-resident deposits are GCC countries and sub-Saharan Africa. The maturity structure of deposits is largely short-term: about 70% of deposits in the banking system have a maturity of less than 30 days. Even though deposits are very sticky, the funding practice of banks exposes them to a significant maturity mismatch in their balance sheets.

The composition on the assets side of the banking sector's balance sheet indicates relatively weak intermediation. Lending to the private sector is low and the loan-to-deposit ratio barely reaches 40%. The main reason for low private sector lending is the banks' large exposure to government debt. A total of 21% of total banking sector assets were in government securities at end-2012. Banks also follow very conservative lending practices, with lending activity directed mainly at already known customers.

Figure 3. Assets and Liabilities – Basic Structure (end-2012)



Source: Banque du Liban, Moody's

The Lebanese banking system's soundness indicators show that banks are adequately capitalised with a capital adequacy ratio of 11.6% at end-2012, and display relatively high levels of liquidity with liquid assets to short-term liabilities at almost 50%. Non-performing loans have declined significantly over the past few years and are now at a low 3.5% of gross loans. NPLs are, however, expected to increase as the continued difficult political and economic environment is impacting the performance of all economic sectors. The banks' exposure outside Lebanon, particularly in Syria and Egypt, is also expected to contribute to a decrease in the quality of banks' loan portfolios.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	11.9	12.5	12.2	11.8	11.6
Tier 1 capital adequacy ratio	11.3	11.4	11.4	11.3	--
Asset quality					
NPLs to gross loans	6.8	5.6	3.9	3.5	3.5
Loan loss provision/NPL	73.4	76.1	77.3	77.0	--
Earnings and profitability					
Return on assets (ROA)	1.2	1.0	1.3	1.1	1.0
Return on equity (ROE)	15.2	15.0	17.8	14.8	12.5
Liquidity					
Liquid assets to total assets	42.3	46.5	45.1	42.8	--
Liquid assets to short terms liabilities	50.1	54.2	52.9	49.7	--
Foreign exchange exposure					
Net open FX position to capital	18.9	15.4	14.2	15.1	--
FX denominated assets to total assets	66.9	62.0	61.3	64.2	--
FX denominated liabilities to total liabilities	65.3	60.9	60.3	63.1	--

Source: Banque du Liban, Bank Audi

The slowing economy, coupled with pressures on earnings stemming from growth in operating expenses outperforming growth in operating income, have led to a decline in profitability, with returns on average equity dropping from 17.8% in 2010 to 12.6% in 2012. The strong dollarization of banks' balance sheets has been steadily declining over the past few years, but nevertheless remains very strong at more than 60% of total assets and liabilities. This contributes to the vulnerability of the banking sector's liquidity position to political risk. Heightened political instability could lead to deposit outflows and to a large-scale conversion of Lebanese Pound (LBP) denominated deposits to USD, squeezing local currency liquidity (the Central Bank does not allow open FX positions and banks convert LBP assets to foreign currency in order to ensure matching positions).

Banque du Liban (BdL) and the Banking Control Commission (BCC) are supervising and regulating the country's banking sector. Two important spreads, vital to the functioning of the fine-tuned equilibrium of the Lebanese economy with its large public debt held mainly by the domestic banking sector, are closely monitored by BdL: (i) the spread between the return on LPB versus the return on USD in Lebanon (to keep the demand for USD within the Lebanese banking system under control), and (ii) the spread between the return on USD in Lebanon versus the international return on USD (to keep inflows into the Lebanese banking system high).

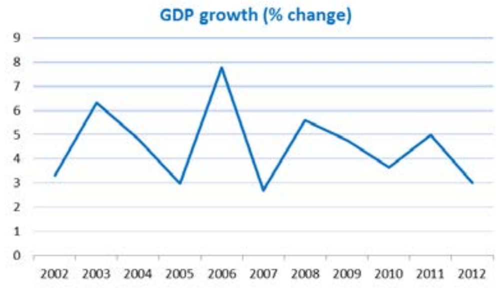
The Lebanese banking system is compliant with Basel II prudential rules, and with a view to implementing Basel III BdL has developed an action plan for banks to meet new capital and liquidity requirements. So far the regulatory capital adequacy ratio stands at 10% (Tier 1 CAR at 8%), which is to be gradually increased to 12% by end-2015 (Tier 1 CAR up to 10%). Lebanon's minimum reserve requirements are amongst the highest in the world at 25% of local currency demand deposits and 15% of local currency term deposits as well as 15% of all foreign currency deposits.

Morocco

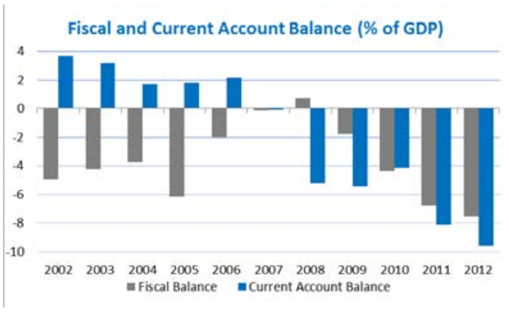
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

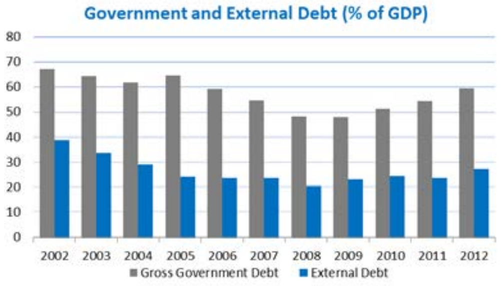
GDP growth is rather volatile in Morocco, mainly on account of the relatively large importance of rain-fed agriculture in the country's economy.


GDP growth (% change)

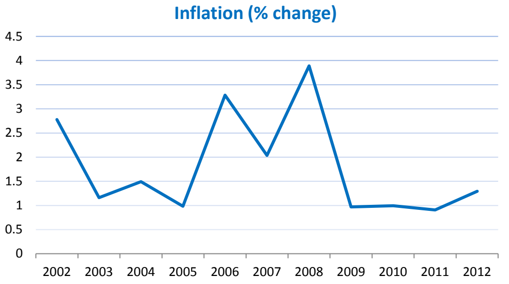
After a period of consolidation, the difficult regional environment and the crisis in Europe have led to a worsening of the fiscal and current account balances …


Fiscal and Current Account Balance (% of GDP)

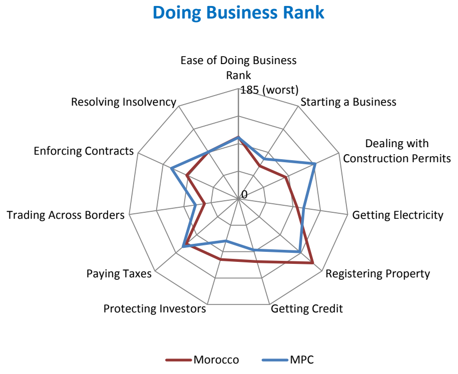
… which is reflected in the deterioration of the government's debt-to-GDP ratio.


Government and External Debt (% of GDP)

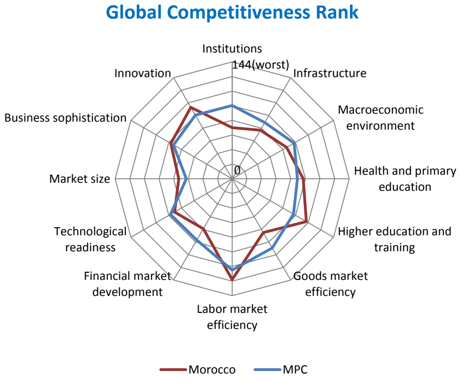
Inflation has been relatively stable over the last few years, but is rising moderately as increases in administered energy prices feed through.


Inflation (% change)

After being top performer in last year's Doing Business ranking, Morocco has suffered a setback by losing four places in the 2013 ranking.


Doing Business Rank

In terms of competitiveness, Morocco compares poorly to the rest of the region regarding innovation and higher education and training.


Global Competitiveness Rank

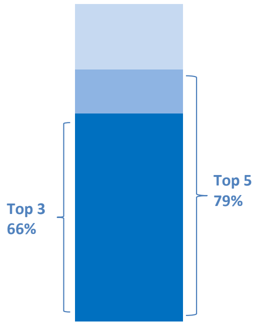
Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted.

Banking Sector

The Moroccan banking sector has expanded rapidly over the past few years and now comprises 19 commercial banks. After growing at almost 10% per annum on average over the past decade, the sector has reached a size of about 125% of GDP. Compared to its regional peers the country's banking sector is relatively well developed and has reached a level of sophistication which has allowed some Moroccan banks to gain increasing importance as players in the region as well as in the sub-Saharan African market. A lot of the problems encountered currently by banks in sub-Saharan Africa have been surpassed by Morocco only recently or are currently being addressed, such as low access to finance and weak intermediation. Therefore, Moroccan banks see themselves well placed to gain importance in those developing markets, and to bring value added to the local banking systems by making them benefit from their expertise. In addition, banks also aim to assist clients in the process of deepening commercial ties between Morocco and other North African as well as West African countries.

Asset concentration in Morocco is very high for regional standards, with the three largest banks accounting for 66% of total banking sector assets. In terms of ownership, the state is a majority shareholder in five banks (accounting for 15% of total assets) and there are seven foreign-owned banks (accounting for 20% of total assets). Penetration of banking services remains rather low in Morocco with about half of the adult population being unbanked. The recent licensing of the postal Al-Barid Bank has helped to increase access to financial services. The lack of access to financial services is mainly a rural phenomenon, meaning that reaching the unbanked is a logistical challenge and entails high costs. In light of a squeeze in resources to sustain credit growth, some banks are nevertheless trying to reach this segment through innovative measures such as mobile bank branches.

Figure 2. Asset Concentration (2012)

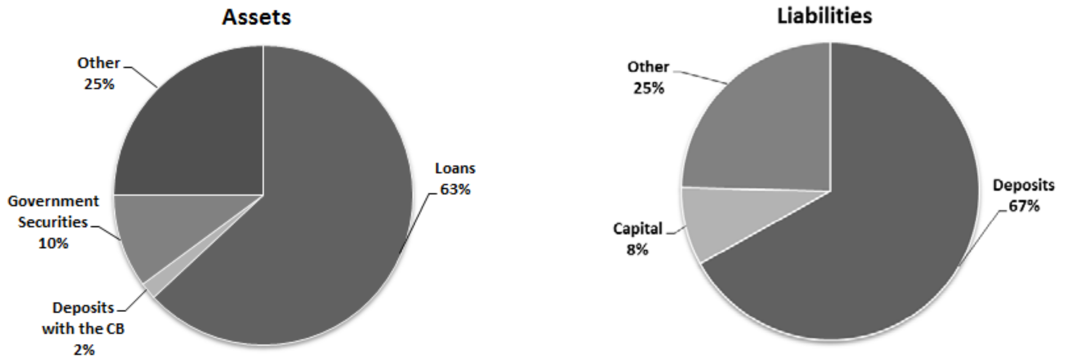


Source: Bank Al-Maghrib

Deposits remain the main funding source for banks, accounting for 67% of total assets. However, deposit growth has slowed down over the last couple of years. About a fifth of deposits stem from Moroccans living abroad, and these deposits have seen the most pronounced decline in growth rates, but resident deposit growth has also slowed down. The eurozone crises and slower economic expansion are the main reasons for the decline in deposit growth. At the same time loan growth has remained strong and has outperformed deposit growth over the last years. Loans have grown at about 14% per annum on average over the period 2007 to 2012, compared to deposit growth of about 8% per annum over the same period. This development has led the loan-to-deposit ratio of the banking sector to approach 100% and has left banks in a difficult liquidity position. This has prompted banks to look for other resources, and therefore bonded debt has seen a sustained increase over the last few years, reaching almost 9% of total assets in 2011 compared to 6% in 2008.

Nevertheless, banks are in need of additional liquidity in order to be able to sustain their credit growth ambitions.

Figure 3. Assets and Liabilities – Basic Structure (2012)



Source: Bank Al-Maghrib

Overall, Moroccan banks appear strong and profitable. However, the strong loan growth has led to a worsened liquidity position, with the ratio of liquid assets to total assets decreasing from 18.6% to 10.5% over the past five years. The funding shortage has also impacted banks' profitability as it has led to an increase in price competition to attract depositors. This has lowered profit margins and consequently profitability. At the same time, the Moroccan banking sector has improved the quality of its loan portfolio substantially over the past number of years, with the share of non-performing loans to total loans decreasing from about 19% in 2004 to only 5% in 2012. The capitalisation of banks remains adequate, with an average capital adequacy ratio of 12.3% in 2012.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	11.2	11.8	12.3	11.7	12.3
Tier 1 capital adequacy ratio	9.5	9.2	9.7	9.6	10.1
Asset quality					
NPLs to gross loans	6.0	5.5	4.8	4.8	5.0
Loan loss provision/NPL	75.3	74.1	70.1	69.0	68.0
Earnings and profitability					
Return on assets (ROA)	1.2	1.2	1.2	1.1	1.0
Return on equity (ROE)	16.7	15.2	14.2	13.4	11.8
Liquidity					
Liquid assets to total assets	18.6	17.3	12.0	11.4	10.5
Liquid assets to short terms liabilities	24.7	23.0	16.0	16.1	14.7
Foreign exchange exposure					
Net open FX position to capital	6.5	13.5	10.3	7.3	7.4
FX denominated assets to total assets	7.1	7.3	6.5	6.1	--
FX denominated liabilities to total liabilities	2.9	3.0	3.5	4.3	--

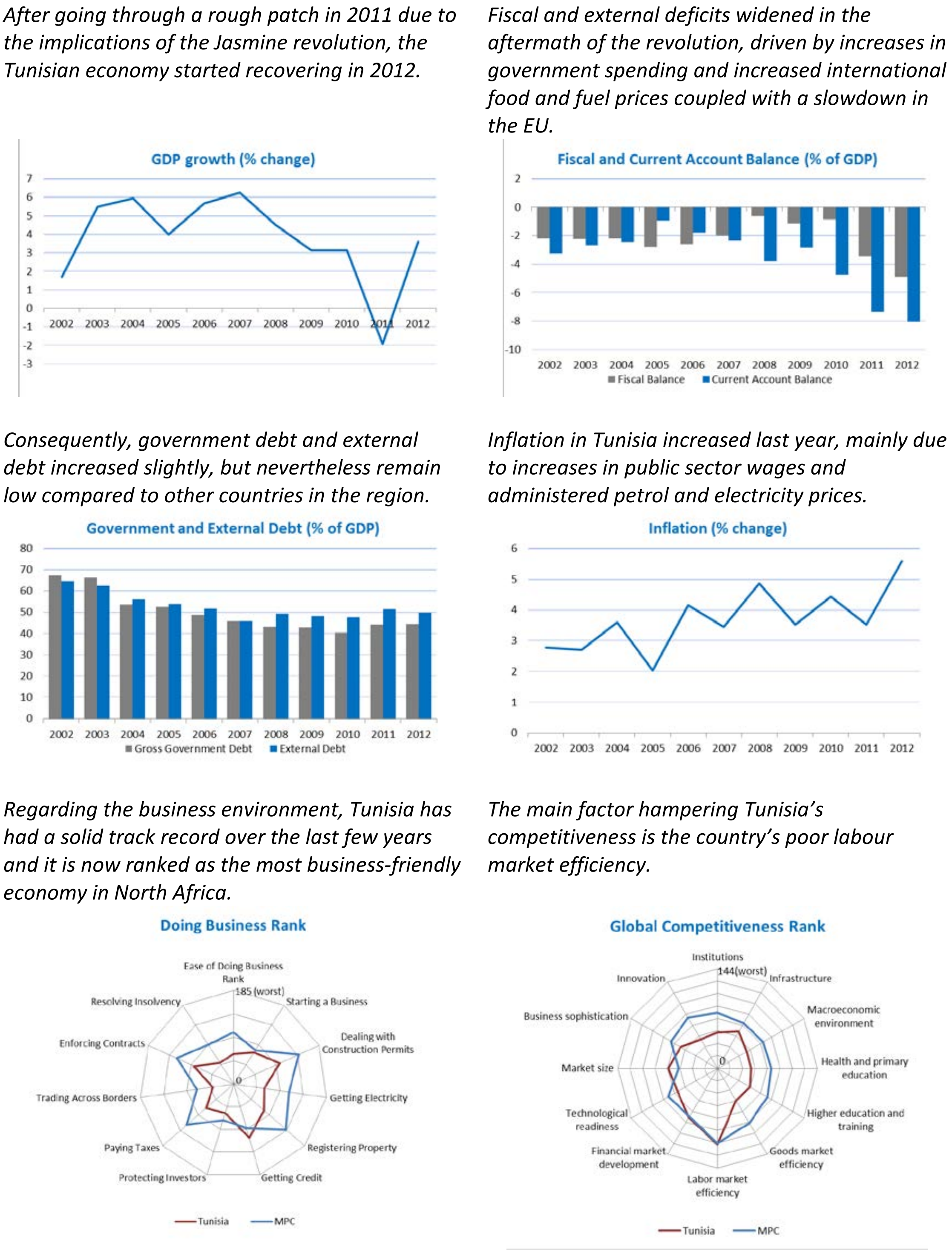
Source: Bank Al-Maghrib

The Central Bank − Bank Al-Maghrib (BAM) − supervises and regulates licensed banks in Morocco. BAM has been subject to a series of reforms in 2006, which gave it more supervisory powers and more independence. In terms of prudential rules, Moroccan banks implemented Basel II in 2007. With a view to adopting Basel III the Central Bank has increased the solvency ratio from 10% to 12%, and the Tier 1 solvency ratio from 8% to 9%, applicable as from June 2013. To ease the difficult liquidity situation, BAM has provided extensive liquidity support to the banking sector through regular liquidity injections and by reducing the reserve requirement to 4%.

Tunisia

Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators



After going through a rough patch in 2011 due to the implications of the Jasmine revolution, the Tunisian economy started recovering in 2012.

Fiscal and external deficits widened in the aftermath of the revolution, driven by increases in government spending and increased international food and fuel prices coupled with a slowdown in the EU.

Consequently, government debt and external debt increased slightly, but nevertheless remain low compared to other countries in the region.

Inflation in Tunisia increased last year, mainly due to increases in public sector wages and administered petrol and electricity prices.

Regarding the business environment, Tunisia has had a solid track record over the last few years and it is now ranked as the most business-friendly economy in North Africa.

The main factor hampering Tunisia's competitiveness is the country's poor labour market efficiency.

GDP growth (% change)
7
6
5
4
3
2
1
0
-1
-2
-3
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
Fiscal and Current Account Balance (% of GDP)
2
0
-2
-4
-6
-8
-10
Fiscal Balance
Current Account Balance
Government and External Debt (% of GDP)
80
70
60
50
40
30
20
10
Gross Government Debt
External Debt
Inflation (% change)
Doing Business Rank
Ease of Doing Business Rank
185 (worst)
Starting a Business
Dealing with Construction Permits
Getting Electricity
Registering Property
Getting Credit
Protecting Investors
Paying Taxes
Trading Across Borders
Enforcing Contracts
Resolving Insolvency
Tunisia
MPC
Global Competitiveness Rank
Institutions
144(worst)
Infrastructure
Macroeconomic environment
Health and primary education
Higher education and training
Goods market efficiency
Labor market efficiency
Financial market development
Technological readiness
Market size
Business sophistication
Innovation
Tunisia
MPC

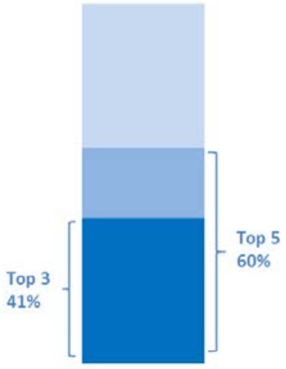
Source: IMF, World Bank, World Economic Forum.
Notes: MPC averages are GDP weighted. The Global Competitiveness Rank is based on the WEF GCI 2011-2012, as Tunisia was not included in the WEF GCI 2012-2013.

Banking Sector

The Tunisian banking sector is one of the smallest in the region, with total assets of commercial banks representing 97% of GDP. Banks had already been struggling with structural problems before the Arab Spring, and the difficult economic situation resulting from the political transformation has accentuated those vulnerabilities. One major problem is the large exposure of some banks to the troubled tourism sector, which has been facing deep structural problems for several years now. At the same time the economic downturn has had consequences for the overall soundness and profitability of the sector. Tunisian banks are still turned almost exclusively to the domestic market, despite some privately owned banks having considered expansion targeting other North African countries as well as French-speaking countries in West Africa, largely following the Moroccan model. However, the sector's current difficult situation has put on hold any expansionary ambitions for the time being.

With 21 commercial banks, the Tunisian banking sector is fragmented (the largest player barely reaches 15% of the market, and the largest three banks account for about 41% of the market in terms of assets). Of the largest five banks, three are publicly owned and control 38% of total assets. The four largest foreign banks present in the country, of which two are French, one Moroccan and one Jordanian, account for about 24% of total assets.

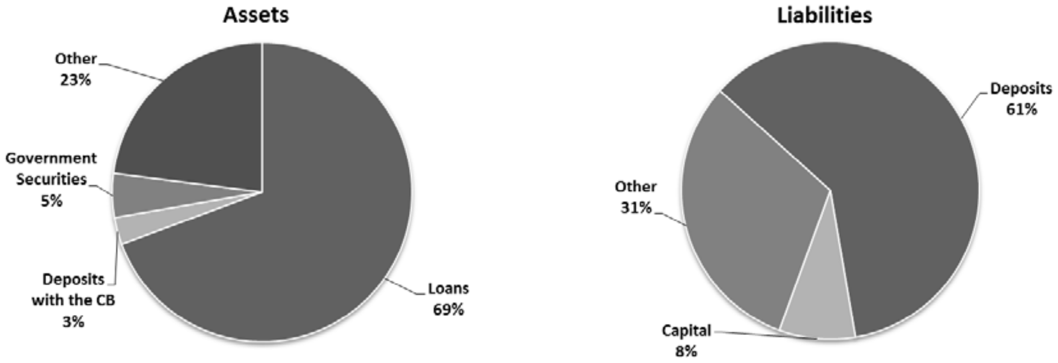
Figure 2. Asset Concentration (end-2011)



Source: Banque Centrale de Tunisie

Deposits, which are the banks' biggest funding source, had been growing strongly in the years preceding the revolution, but deposit growth has slowed down significantly since then. In 2011 the growth rate of deposits reached only 5%. This compares to relatively strong loan growth of almost 14%, which has left banks in a challenging position to attract enough resources to support the increase in lending. The loan-to-deposit ratio, which was already high in comparison with the rest of the region, consequently increased and reached 113% at end-2011. Despite rapid loan growth there is still room for increased banking intermediation, as highlighted by the ratio of credit to the private sector in terms of GDP of 75%, which is relatively low for an upper-middle income country. One factor hampering deeper intermediation is the regulation on lending rates. The caps imposed by the Central Bank limit the ability of banks to price higher risk profiles, which implies that some higher-risk counterparts, such as SMEs, have difficulties accessing bank financing. Lending is therefore concentrated in relatively large corporate clients, which benefit from low interest rate loans funded by banks through low cost deposits.

Figure 3. Assets and Liabilities – Basic Structure (end-2011)



Source: Banque Centrale de Tunisie

Overall, the soundness of the sector has deteriorated since the revolution. Banks appear undercapitalised (even though almost all banks comply with the regulatory minimum capital adequacy ratio of 8%) and the liquidity situation has worsened. At the same time profitability has reached a new low with returns on equity at barely 8% and returns on assets at 0.7%. Despite the difficult economic environment, the already high NPL ratio remained artificially stable in 2011 thanks to exceptional measures concerning the classification of doubtful loans: the Central Bank effectively introduced a moratorium on reclassification requirements for loans with late repayments by preventing banks from placing loans into the doubtful or non-performing loan category even if repayments fell behind by more than three months. The main effects of this measure were the sector’s artificially low NPL ratio, the ensuing lower provisioning, and the banks’ ability to tap larger amounts of liquidity injections by the Central Bank using the non-reclassified loans as collateral. Public banks are disproportionately affected by the increase in bad loans, a particular concern being some banks with large exposure to the tourism sector.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	11.7	12.2	11.6	11.9	12.3
Tier 1 capital adequacy ratio	10.6	10.7	10.2	10	10.3
Asset quality					
NPLs to gross loans	15.5	13.2	13.0	13.3	13.5*
Loan loss provision/NPL	56.8	58.3	58.5	57.3	57.3*
Earnings and profitability					
Return on assets (ROA)	1.0	1.0	0.9	0.6	0.8
Return on equity (ROE)	11.2	11.7	10.2	6.6	9.9
Liquidity					
Liquid assets to total assets	31.6	32.1	29.8	26.5	28.2
Liquid assets to short terms liabilities	124.0	119.1	104.1	89.4	89.2
Foreign exchange exposure					
Net open FX position to capital	1.4	1.5	1.4	1.9	2.3
FX denominated assets to total assets	--	--	--	--	--
FX denominated liabilities to total liabilities	--	--	--	--	--

Source: Banque Centrale de Tunisie, IMF
*Note: * September 2012 data*

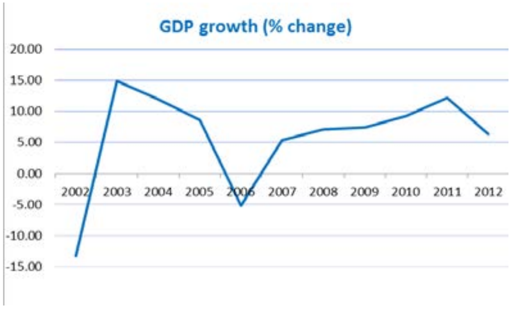
Banking supervision and regulation is the role of Banque Centrale de Tunisie (BCT). In terms of prudential norms, Basel I seems to be applied throughout, but Tunisian banks have missed the train in terms of adjusting to Basel II and BCT has not yet set a clear agenda for Basel II implementation. BCT has implemented several measures in response to the difficult operating conditions of banks since the revolution, notably a sharp increase in liquidity support through direct injections and the decrease of reserve requirements from 5% to 2%. Other measures included (i) the reduction of the policy interest rate, (ii) the effective suspension of reclassification of loans with late repayment mentioned above, (iii) the introduction of collective provisioning for non-impaired loan classes, (iv) the introduction of a maximum deposit rate to prevent banks from aggressively competing for deposits in the low-liquidity environment.

Palestine

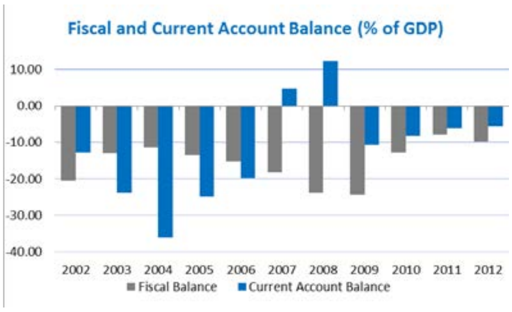
Macroeconomic Developments

Figure 1. Selected Macroeconomic Indicators

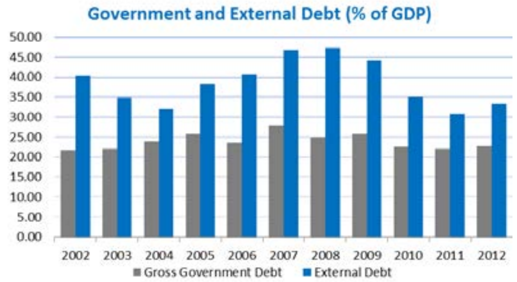
Following years of strong performance, the Palestinian economy slowed sharply in 2012, reflecting substantial shortfalls in aid, limited easing of restrictions imposed by Israel as well as increased political uncertainty.



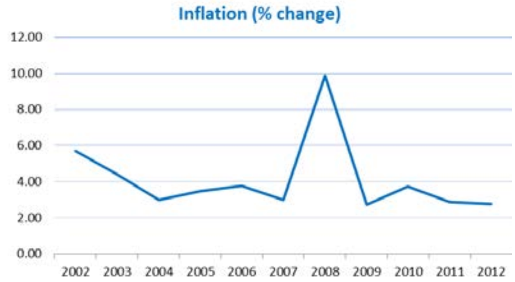
The slowdown in economic growth has led to a higher fiscal deficit and to the accumulation of large arrears vis-à-vis both employees and private sector suppliers of the Palestinian Authority (PA).



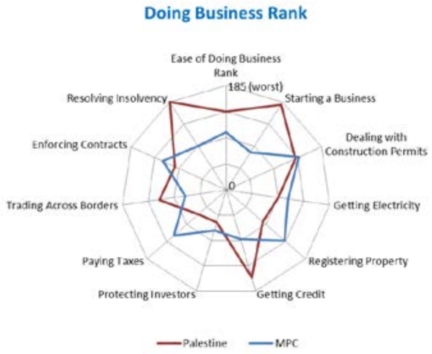
Comparatively low levels of government debt mask the liquidity crisis engulfing the PA, which continues to depend on donor budget support. The build-up in arrears has made the domestic private sector reluctant to fund the government.



Palestine benefits from relatively low and stable inflation.



Palestine's business environment suffers from the restrictions imposed by Israel on the movement of people, access to natural resources as well as markets.



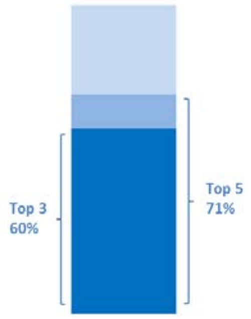
Source: IHS Global Insight, World Bank
Notes: MPC averages are GDP weighted.

Banking Sector

Banking services in Palestine are currently provided by 17 commercial banks, two of which are Islamic banks. Ten banks are foreign-owned. Jordanian banks in particular maintain a strong presence in the country. Most of the foreign banks operating in Palestine entered the market after 1993, when the Oslo I accords were signed. Concentration ratios suggest that the market is dominated by a few large players. The three largest banks account for 60% of the sector's total assets.

Given Palestine's political situation and the constraints imposed on its economy, the banking sector appears surprisingly large. Total assets of the banking system accounted for 112% of GDP in 2012. The banking sector has continued to expand in recent years with total assets growing at an average rate of 6.75% since 2009. Owing to its conservative stance and the isolation of the Palestinian economy, the banking sector emerged fairly unscathed from the global financial crisis.

Figure 2. Asset Concentration (2012)



Source: Association of Banks in Palestine

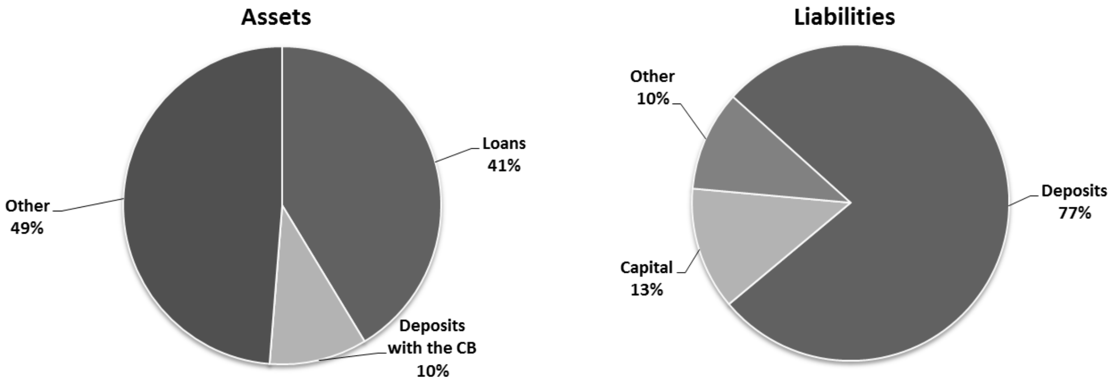
Though the Palestinian banking sector is fairly large, intermediation remains weak. The share of adults with a bank account equals 19% and is lower than the average of middle income countries. At 10.2 branches per 100 000 inhabitants the density of bank branches, however, is above the lower-middle income average.

Though Palestinian banks do not hold government bonds, they fund the government through loans. As a result of the PA's liquidity problems, the banking system's exposure to the PA had increased to USD 1.4bn by the end of 2012. This amounts to 112% of the banking sector's equity, up from 62% in 2008. In addition, banks are indirectly exposed to the PA via loans to PA employees, whose loan delinquencies tend to temporarily increase following delays in wage payments. Moreover, the risk of payment delays has contributed to rising demand for bank loans on the part of PA employees. Bank lending to PA employees has therefore more than doubled since 2010 and reached USD 0.7bn at the end of 2012.

Financial soundness indicators do not point to immediate financial stability risks. Palestinian banks remain well capitalised and profitable. The capital adequacy ratio stood at 20.3% in 2011, compared to a regulatory requirement of 12%. However, the banking sector's large direct and indirect exposure to the government constitutes a financial stability risk.

The asset quality of Palestinian banks has improved significantly. The share of non-performing loans had decreased from 8% in 2008 to 3.3% in 2012. The strengthening of the credit registry and the credit scoring system has helped the channelling of bank loans to creditworthy borrowers and thus contributed to the fall in non-performing loans. However, if the Palestinian Authority is unable to clear arrears to its private sector suppliers this could in turn undermine its ability to service its bank debts, leading to a rise in the NPL ratio.

Figure 3. Assets and Liabilities – Basic Structure (2012)



Source: PMA

Banks' profitability has been high, with a return on assets of 1.8% in 2012 and a return on equity of 16.3%. Large spreads between lending and deposit rates support profitability, but may in turn be one cause for the low ratio of private sector credit to GDP.

Banks are supervised by the Palestinian Monetary Authority (PMA). A new banking law was adopted in 2010, bringing the PMA's regulatory capabilities into line with Basel recommendations and international standards. The law provides a legal framework for the establishment of deposit insurance to replace the implicit blanket guarantee, and the management of the Real Time Gross Settlement (RTGS) system introduced in 2010. The PMA conducts stress tests on a quarterly basis, which testify to the resilience of Palestine's banking system.

Table 1. Performance and Soundness Indicators (in %)

	2008	2009	2010	2011	2012
Capital adequacy					
Capital adequacy ratio	23.9	22.0	21.5	21.1	20.4
Tier 1 capital adequacy ratio	--	--	23.3	22.9	22.1
Asset quality					
NPLs to gross loans	8.2	4.1	3.1	2.7	3.3
Loan loss provision/NPL	--	--	70.4	60.9	56.0
Earnings and profitability					
Return on assets (ROA)	19.7	17.6	21.1	17.0	16.3
Return on equity (ROE)	1.6	1.8	2.1	1.9	1.8
Liquidity					
Liquid assets to total assets	43.0	42.4	40.9	36.8	38.4
Liquid assets to short terms liabilities	52.1	55.9	52.1	49.0	--
Foreign exchange exposure					
Net open FX position to capital	--	--	--	--	--
FX denominated assets to total assets	--	--	--	--	--
FX denominated liabilities to total liabilities	44.5	42.8	41.9	39.0	40.9

Source: PMA, IMF

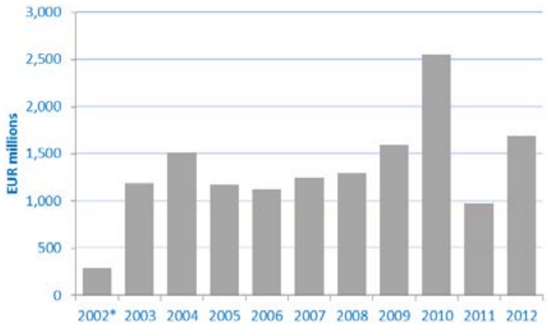
The EIB in FEMIP

The EIB is the European Union's bank. As the world's largest multilateral borrower and lender, the EIB provides finance and expertise for sound and sustainable investment projects in the EU and more than 130 other countries. The Bank is owned by the 28 Member States and the projects it supports contribute to furthering EU policy objectives. Outside the EU, the EIB supports projects that contribute to economic development in countries that have agreements with the EU or its Member States.

EIB-FEMIP, the Facility for Euro-Mediterranean Investment and Partnership, is the financial arm of the European Investment Bank in the southern Mediterranean region[1]. EIB-FEMIP is committed to helping Mediterranean partner countries achieve sustainable economic development and social growth. EIB-FEMIP has two investment priorities in the region, namely to provide support to the private sector and create an investment-friendly environment. It also promotes dialogue between Euro-Mediterranean partners. In order to attain its objectives, EIB-FEMIP provides a broad range of financial instruments suited to the needs of the Mediterranean partner countries, from loans to risk capital, technical assistance and guarantees. Projects in FEMIP can come from any of the following sectors: energy, transport and telecoms, environment, human and social capital, industry, tourism and services.

Since the launch of FEMIP ten years ago, the EIB has supported the region through 192 projects spread across all nine FEMIP countries with EUR 14.2bn of funding (see Figure 1). About 2 500 SMEs have received financing and have benefited from the EIB's experience and expertise gained in the EU. A total of EUR 22m went towards financing for local microfinance institutions, which have over 830 000 micro-borrowers, of whom 53% are women. Twenty-four projects were signed to protect the Mediterranean environment, amounting to EUR 1.4bn. In addition, about EUR 130m was dedicated to technical assistance to help implement projects and EUR 36m from the FEMIP Trust Fund was allocated for regional and sectoral studies. Finally, the EIB invested more than EUR 300m in 36 funds to support private sector development. Over the last ten years, the leading beneficiaries of the EIB-FEMIP assistance were Egypt and Morocco, which each account for about a quarter of total lending. Tunisia follows closely reaching about 22% (see

Figure 1. EIB FEMIP Signatures 2002-2012

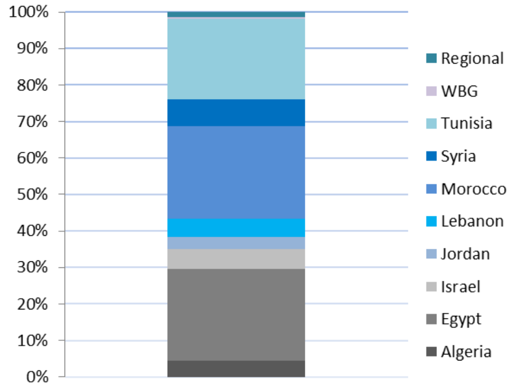


Source: EIB
*Note: * 2002 data refers to 1st October to end 2002.*

[1] Algeria, Egypt, Gaza/West Bank, Israel, Jordan, Lebanon, Morocco, Syria and Tunisia (and soon Libya). Following EU sanctions in November 2011, the EIB suspended all disbursements for loans and technical assistance contracts with the Syrian state.

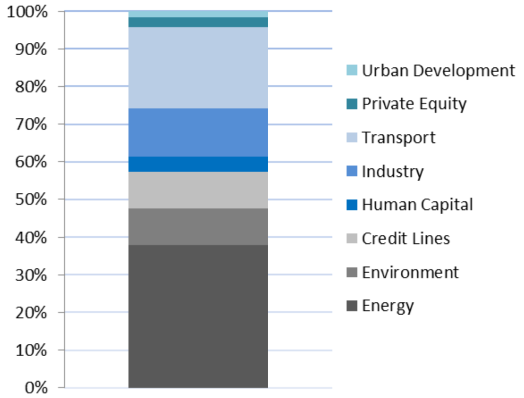
Figure 2). In terms of sectoral allocation, almost 60% of lending went to the transport and energy sectors (see Figure 3).

Figure 2. EIB FEMIP Signatures 2002-2012 Breakdown by Country



Source: EIB

Figure 3. EIB FEMIP Signatures 2002-2012 Breakdown by Sector



Source: EIB

EIB-FEMIP gives priority to projects with high value added, meaning that when assessing a project its financial and economic aspects are balanced with its expected social and development impact. For this purpose, all EIB operations under external mandates are evaluated according to a newly established Results Measurement Framework (REM). Of the sixteen new projects approved last year, thirteen have already been fully rated according to the REM. A total of twelve projects qualified as fulfilling the EIB's highest requirements.

The Bank's response to the Arab Spring

As the FEMIP region entered a challenging political and economic transformation in the wake of the Arab Spring, the EIB provided a sustained response to the needs of the countries despite the very challenging business environment during 2011. While the lending volume decreased compared to 2010, it nevertheless reaffirmed the volume trend over the past decade. In 2012 the EIB received an increased mandate aimed at fostering private sector development, socioeconomic infrastructure, climate change and regional integration. Consequently, the EIB adapted its activity to the new economic and social reality in the MPCs and the newly reinforced mandate, and financed more operations with high social impact such as rural infrastructure, social housing or microfinance. It stepped up its support by investing EUR 1.7bn in the region through 20 loans and four private equity operations. Disbursements reached an exceptionally high level and 15 technical assistance operations were signed.

At the same time the EIB has also engaged at new levels with the Mediterranean partner countries. The Bank has actively participated in the EU Tunisia, EU Jordan and EU Egypt Task Forces, and has taken an active role in the Deauville Partnership and the Deauville Transition Fund. It has also engaged in a new generation of partnerships, such as the partnership agreement with the Spanish Agency for International Development (AECID) to support private sector development in MPCs, cooperation with the Government of Luxembourg to support the development of microfinance in Tunisia, and cooperation with the Arab Financing Facility for Infrastructure to boost public-private partnerships in the Mediterranean.

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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 signed more than EUR 14.2 billion worth of investments in support of these countries.

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