Qatar Banking Sector

Sector Analysis

May 2019

Table of Contents

1. Qatar Banking Industry Overview

Qatar's economic performance remained resilient in 2018. Growth in the hydrocarbon sector remained modest at 0.2% as a result of the OPEC production cut agreement and maintenance works on LNG infrastructure. The continued investment in infrastructure to support construction projects related to Qatar's National Vision 2030 and the 2022 FIFA World Cup were one of the key drivers of a robust 5.0% non-hydrocarbon growth in 2018. The manufacturing sector also contributed significantly as projects aimed at greater self-sufficiency and food security started to take effect. Overall GDP growth remained solid at 2.6% in 2018. Going forward, end of maintenance work and temporary shutdowns would trigger a recovery in LNG output, while the OPEC cut agreement should moderately impact oil production output. These effects will lift the hydrocarbon output, leading to a 0.7% growth rate in 2019. The non-hydrocarbon sector is forecasted to grow by 5.3% on the back of continued infrastructure spending as well as government policies to strengthen the private sector and boost self-sufficiency. Sectors involved in logistics, manufacturing, transportation and food security are expected to be the key beneficiaries. Continued population growth will also spur additional domestic demand, resulting in an expected GDP growth of 3.2% for 2019 (QNB.com, 2018).

Qatar's financial sector remains healthy with credit continuing to flow, ample liquidity and robust profitability. The banking system remains well capitalized with banks' capital adequacy ratio (CAR) over 16%, well above Basel III guidelines (QNB.com, 2018). Global credit rating agency Moody's has upgraded Qatar's banking sector outlook to stable from negative, reflecting the resilience of the country's economy and banking system. Moreover, Qatar banking sector profitability is expected to remain stable with strong capital buffers (Perumal, 2018). International ratings agencies and Qatar Stock Exchange (QSE) have expressed confidence in the financial stability of the country's banks with strong liquidity levels and solid earnings (Oxford Business Group, 2018).

Qatar's eight-largest banks posted combined net profits of QR 12bn ($3.3bn) for the first half of 2018, a 10.6% year-on-year (y-o-y) increase on 2017, according to data released by the Qatar Stock Exchange (QSE). The net profit of Qatar National Bank (largest commercial lender) increased by 6.7% y-o-y to QR 6.65bn ($1.8bn), while Qatar Islamic Bank (largest Islamic bank) registered a growth of 13.8% in net profits, reaching a six-month total of QR 1.33bn ($365m). Higher profits were due to a combination of asset growth, improved returns on investment and earnings from lending. Although slowing of activity in some key sectors was witnessed, including hospitality and real estate, but this was balanced by state investments in infrastructure projects (Oxford Business Group, 2018). The outflow of external financing for Qatari banks as a result of the blockade, primarily non-resident deposits and interbank placements, was offset by liquidity injections by Qatar Central Bank and repatriation of about $40bn in public sector, mostly Qatar Investment Authority assets held abroad into the domestic banking sector. In recent times, there has been an inflow of non-resident deposits from the US, European and Asian countries reflecting the confidence of foreign depositors in the Qatari financial system. Qatar's banking system remains well capitalized with banks' capital adequacy ratio (CAR) rising to 16.8% in 2017 (2016: 16.1%) and well above the Basel III guidelines (John, 2018). Moreover, Qatar's small & concentrated population means that banks can service their customers without the need for an extensive and costly branch network. Therefore, the system's cost-to-income ratio will remain between 25% and 30% in 2019, the lowest among GCC banks (Perumal, 2018).

2. Industry Structure & Updates

Qatar's banking sector comprises of 18 banks that serve a population of around 2.6 million. The banking sector is dominated by Qatar National Bank (QNB) as it has a major share of domestic loans with smaller lenders competing for the remaining opportunities. This has led to intense price competition, resulting in pressure on loan yields and profitability (Perumal, 2018). As far as bank deposits are concerned, competition for deposits has pushed banks to pay more, thereby driving up their funding costs. Government deposits in the banking system were on a declining trend, however, the trend has reversed since June 2017 due to liquidity injections made by Qatar Central Bank to offset the outflow of foreign funds. This resulted in an increase in government deposits to 38% of total deposits in the banking system as of June 2018 as compared to 26% prior to the dispute.

2.1. Major Banks Financial Snapshot

Sr. #	Bank	Total Assets	Net profit	Credit Growth	NPL Ratio[1]	CAR[2]
1	Qatar National Bank	QAR 862bn	QAR 13.8bn	5.0%	1.9%	19.0%
2	Qatar Islamic Bank	QAR 153bn	QAR 2.7bn	-0.4%	1.2%	18.8%
3	Commercial Bank of Qatar	QAR 135bn	QAR 1.6bn	-6.1%	5.6%	15.5%
4	Doha Bank	QAR 96bn	QAR 0.83bn	-0.01%	5.9%	17.0%
5	Al Khaliji	QAR 52bn	QAR 0.60bn	-11.0%	1.9%	16.9%

[1] Non-performing Loan, [2] Capital Adequacy Ratio

The table above shows financial figures of major banks operating in Qatar with QNB being the industry leader in terms of its asset size and Qatar Islamic Bank, the distant second. Major Banks have remained profitable in 2018 despite external pressures and rising funding cost. However, only QNB showed positive credit growth in 2018 as the bank's focus was on utilities, transport and food security sectors as well as the FIFA 2022 World Cup. Moreover, Commercial Bank of Qatar credit contraction was highest amongst these banks, and it was mainly due to a reduction in government temporary overdraft facility & translation of Turkish Lira into reporting currency. Additionally, significant credit contraction was witnessed in Al Khaliji Bank as it divested from non-core assets and aligned its core-lending portfolio to Qatar centric strategy. The banking system remained well capitalized as depicted by healthy capital adequacy ratios (CAR) of banks. The CAR is an international standard that measures a bank's risk of insolvency from excessive losses. Under Basel III, the minimum CAR that banks must maintain is 8%.

2.2. Energy Bank Update

Qatar will launch Energy Bank with a targeted capital of $10bn to fund hydrocarbon projects, both at home and abroad. The establishment of the bank comes at a time when Qatar is expanding its annual liquefied natural gas production by 40% to 110 million tonnes by 2024 (current capacity: 77 million tonnes). Energy Bank has already got commitments amounting to $2bn from international investors out of the $2.5bn paid up. The bank intends to progressively scale up its capital base to become the world's largest Islamic lending institution. It is expected to be operational by the fourth quarter of 2019 and plans to have representative offices in the Middle East, North Africa region and other parts of the world. Energy Bank will specialize in funding projects related to oil and gas, petrochemicals and renewable energy (Perumal, 2019).

Qatar Energy Industry and the Islamic Finance Industry are expected to experience considerable growth in the coming years. Therefore, Energy Bank will play a pivotal role in the economic landscape of the country by operating at the intersection of these two fast-growing industries. Islamic finance assets are forecasted to be worth $3.2tn by 2020, while the global energy industry is also forecasted to grow exponentially, particularly renewable energy which has continued to grow despite hurdles faced by traditional oil and gas (Perumal, 2019).

2.3. Barwa Bank and International Bank of Qatar Merger Update

Slow growth and subdued credit demand in the region is one of the biggest drivers of consolidation. Furthermore, consolidation in the Qatar Banking system was expected given that 18 banks serve a small population. A merger of local banks is a relatively less risky inorganic growth strategy as compared to expansion into international markets, which are riskier than the home market.

Barwa Bank and International Bank of Qatar (IBQ) have announced that they have signed a final agreement regarding the merger of the two banks to create a leading Sharia-compliant financial institution to support Qatar's economic growth and financial development initiatives in line with Qatar National Vision 2030. Initially, the two banks planned a three-way merger with another lender, Masraf Al Rayan. However, that deal did not materialize. The merger of Barwa Bank and IBQ will create a combined entity with total assets of QAR 80bn and a shareholder equity base of over QAR 12bn. The combined entity intends to support the economic development of Qatar by creating a strategic partner for the Government and the public sector while assisting the growth of the private sector. Moreover, the combined lender will be rebranded as Lusail Bank. The two banks have agreed to appoint a top tier management consultant in order to develop an integrated plan & identify the strategy and achieve the desired objectives of the combined entity including revenue enhancement and cost reduction (Merger Agreement between Barwa Bank and International Bank of Qatar | Barwa Bank, 2018).

The proposed merger between Barwa Bank and International Bank of Qatar (IBQ) is expected to alleviate profitability pressure in the banking system and ease the funding costs, though integration challenges will have to be addressed. The merger would create the third largest Islamic bank in Qatar and the sixth largest Qatari bank with a 5% market share of domestic loans. The merger would strengthen the business proposition of the combined entity leading to diverse financing and depositor profile (Perumal, 2018). Both Barwa Bank and IBQ display a concentrated deposit base, with their top 20 depositors accounting for a significant share of total deposits. IBQ, however, has considerably less reliance on government deposits (30% of total deposits in 2017 as compared to 43% for Barwa Bank), with large deposits from private banking as its main funding source. As a result, the combined entity's depositor profile would be more diverse than is the case for the individual entities. Barwa Bank's strength lies in consumer and corporate business, whereas IBQ is a niche player in private banking. The expanded capital base of the merged entity would enable it to participate in larger syndicated loans regionally, providing geographical diversification. Given the small size and limited opportunities in the home market, a merger of local banks is a relatively less risky inorganic growth strategy (Perumal, 2018).

3. Qatar Banking Industry Challenges

Banking Industry challenges remain despite resilience demonstrated by the banking system. Major challenges faced by Qatar Banking Industry include non-performing loans, increasing regulatory requirements, introduction of VAT and rapid pace of digital transformation. In response to these challenges, banks are reshaping strategies by targeting higher quality domestic assets and searching for diversified funding sources.

3.1. Non-performing Loans

Although a modest rise in non-performing loans are expected necessitating moderately higher provisioning charges, however, adoption of IFRS 9 accounting standard in the first quarter of 2018 means early recognition of expected losses which will ultimately support profitability over the long term (Perumal, 2018).

S&P Global expects approximately 5% growth in bank loans in GCC region this year and for asset quality to stabilise, after the banks took the opportunity to recognize more potentially problematic loans following the introduction of a new accounting standard IFRS 9, last year (Fahy, 2019).

3.2. Increasing Regulatory Requirements

The regulator will continue to implement the Basel III capital requirements, with additional domestic systemically important banks and counter-cyclical buffer requirements to be gradually phased in, resulting in higher capital adequacy requirements for banks to meet. Increasing regulatory requirements such as IFRS 9 and Basel drive complexity, administrative burden, and risk cost on banks (QNB.com, 2018). However, these requirements are also necessary to ensure resilience and robustness of the banking system.

3.3. Introduction of Value Added Tax Regime

Tax will continue to be on banks agenda with the introduction of value added tax (VAT) expected across the GCC throughout 2018/2019. Banks will need to be proactive and assess the potential impact of VAT on their businesses. Given the margin pressures, cost & operational efficiencies are expected to remain high on the management agenda (Kanady, 2018).

A value added tax (VAT) regime in Qatar is expected to be effective beginning from January 1st, 2020 with VAT being broadly imposed at a rate of 5%. VAT is expected to affect all businesses in Qatar, either directly or indirectly and will have implications for most sales of goods and services in Qatar (KPMG, 2019).

3.4. Digital Transformation & Innovation

The rapid pace of innovation and digital transformation is putting pressure on the banking sector. New non-bank incumbents, such as Bigtech companies, Fintech and digital platform companies are increasing competition and eroding margins (QNB.com, 2018). The ncreasing importance of digital banking has led to the closure of many bank branches across the world. The issue of bank layoffs due to the digital transformation of banks around the world was discussed at one of the sessions of the Conference at 5th Doha Islamic Finance Conference. Dr. Umar Oseni, acting CEO at International

Islamic Liquidity Management Corporation, added that by 2030, about 80% of heritage financial services firms will go out of business, become commoditized or exist only formally but not competing effectively. According to him, these firms will struggle for relevance as global digital platforms, Fintech companies and other nontraditional players gain greater market share, using technology to change the economics and business models of the industry (Dizon, 2019).

4. Qatar Banking Industry Outlook

Qatar's economic growth is expected to be 3% in 2019, accelerating to 3.2% in 2020 and to 3.4% by 2021, as the country continues with government-financed infrastructure projects in preparation for the 2022 World Cup. In addition, higher infrastructure spending on Qatar National Vision 2030 projects aimed at diversifying the economy should help boost investor confidence and promote economic growth (Al-Saeed, 2019). Higher economic growth is beneficial for the operating environment of the banks as it leads to lending growth and asset deployment at attractive rates. The Qatari economy has been able to successfully rebalance as the supply chain disruptions following the blockade recovered rapidly with initial levels of imports restored in less than four months into the blockade, thus illustrating the economy's flexibility and policy effectiveness in re-routing supplies (Perumal, 2018). A favourable macroeconomic outlook will have a positive effect on the banks due to higher levels of investment in certain sectors. Qatar's GDP growth will benefit from strengthening market conditions, particularly from the continued recovery in oil & gas prices. Further investment opportunities in new gas production capacity for instance, will certainly help the banking sector and provide a big stimulus (Oxford Business Group, 2018).

According to Moody's, Qatari bank's profitability is expected to remain stable with return on assets at around 1.4% in 2019 and interest rate margins around 2.2% because the gaps between credit growth and deposit growth have been narrowing, thereby supporting funding costs. Moreover, Qatari banks have started re-pricing assets, which will further support an increase in funding costs due to the current rising interest rate environment (Perumal, 2018). Furthermore, lending growth is projected to stabilise at around 5% in 2019 as compared to 4.7% in 2018 (Anderson, 2018).

Although a modest rise in non-performing loans (NPLs) is expected as the adoption of the IFRS 9 accounting standard means the early recognition of expected losses. Problem loans will increase due to the lagging effect of the economic slowdown in previous years. NPLs are expected to stand at 3% of total loans in 2019 whereas capital adequacy ratio is expected to increase to 15.7% in 2019 from 15.5% in 2017 with liquid assets at 24% of total assets. The bulk of these liquid assets are held in Qatari government securities (Perumal, 2018).

The focus on innovation and efficiency will continue as banks look to differentiate themselves in a competitive market with increasing regulatory requirements. Active monitoring of the cost side of the business is expected to ensure profitable growth remains, and cost-to-income ratios are maintained at low levels. Qatari banks are likely to continue focusing on the local market with the FIFA 2022 World Cup approaching as opposed to considering overseas for growth (Kanady, 2018).

Solid loan performance, strong capital and improving operating conditions, means Qatar banks have a stable outlook for 2019. Current oil prices will support increased government spending, and stimulus packages such as Qatar FIFA 2022 will reinforce banks stable financial performance. Government willingness to support banks remains high and their capacity to support is also strong. According to Moody's Outlook for 'GCC Banks for 2019', Qatar's banking system exhibited stability in all the seven components of credit drivers including operating environment, asset risks, capital, profitability & efficiency, funding & liquidity and government support. Qatar is among the two countries in the region which ticked all these boxes as 'stable' in Moody's Outlook (Kanady, 2018).

5. References

- Perumal, S. (2018). *Moody's upgrades Qatar banking sector outlook to 'stable'*. [online] Gulf-Times. Available at: https://www.gulf-times.com/story/608272/Moody-s-upgrades-Qatar-banking-sector-outlook-to-s [Accessed 10 May 2019].
- Oxford Business Group. (2018). *Qatar's banking sector maintains solid growth*. [online] Available at: https://oxfordbusinessgroup.com/news/qatar%E2%80%99s-banking-sector-maintains-solid-growth [Accessed 10 May 2019].
- John, P. (2018). *PressReader.com - Your favorite newspapers and magazines.* [online] Pressreader.com. Available at: https://www.pressreader.com/qatar/gulf-times-business/20181228/281487867469445 [Accessed 11 May 2019].
- Perumal, S. (2018). *A merger of Barwa Bank, IBQ to ease profitability, funding pressures: Moody's*. [online] Gulf-Times. Available at: https://www.gulf-times.com/story/606758/A-merger-of-Barwa-Bank-IBQ-to-ease-profitability-f [Accessed 11 May 2019].
- Perumal, S. (2019). *Qatar to launch 'Energy Bank' with targeted $10bn capital*. [online] Gulf-Times. Available at: https://www.gulf-times.com/story/626326/Qatar-to-launch-Energy-Bank-with-targeted-10bn-cap [Accessed 12 May 2019].
- Merger Agreement between Barwa Bank and International Bank of Qatar (ibq) | Barwa Bank. (2018). *Merger Agreement between Barwa Bank and International Bank of Qatar (ibq)*. [online] Available at: https://www.barwabank.com/media-center/press-release/merger-agreement-between-barwa-bank-and-international-bank-qatar-ibq [Accessed 12 May 2019].
- Perumal, S. (2018). *A merger of Barwa Bank, IBQ to ease profitability, funding pressures: Moody's*. [online] Gulf-Times. Available at: https://www.gulf-times.com/story/606758/A-merger-of-Barwa-Bank-IBQ-to-ease-profitability-f [Accessed 13 May 2019].
- Fahy, M. (2019). *Take five: Key points on the outlook for the GCC from S&P Global's briefing*. [online] Zawya.com. Available at: https://www.zawya.com/mena/en/economy/story/Take_five_Key_points_on_the_outlook_for_the_GCC_from_SP_Globals_briefing-ZAWYA20190220064343/ [Accessed 13 May 2019].
- Kanady, S. (2018). *Qatar's banking sector remains resilient: KPMG*. [online] The Peninsula Qatar. Available at: https://www.thepeninsulaqatar.com/article/01/05/2018/Qatar%E2%80%99s-banking-sector-remains-resilient-KPMG [Accessed 14 May 2019].
- Al-Saeed, A. (2019). *Investing in Human Capital is Key to Sustainable Growth in GCC*. [online] World Bank. Available at: http://www.worldbank.org/en/news/press-release/2019/05/01/investing-in-human-capital-is-key-to-sustainable-growth-in-gcc [Accessed 14 May 2019].
- Anderson, R. (2018). *GCC banks expected to stabilise in 2019 - S&P*. [online] Gulf Business. Available at: https://gulfbusiness.com/gcc-banks-expected-stabilise-2019-sp/ [Accessed 15 May 2019].

- Qnb.com. (2018). *Annual Report 2018*. [online] Available at: https://www.qnb.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1355614987439&ssbinary=true [Accessed 15 May 2019].
- KPMG. (2019). *Qatar: VAT regime now expected in 2020*. [online] Available at: https://home.kpmg/xx/en/home/insights/2019/02/tnf-qatar-vat-regime-expected-2020.html [Accessed 24 May 2019].
- Dizon, L. (2019). *Technology is eating jobs, banking sector under pressure: Islamic finance expert*. [online] The Peninsula Qatar. Available at: https://www.thepeninsulaqatar.com/article/21/03/2019/Technology-is-eating-jobs,-banking-sector-under-pressure-Islamic-finance-expert [Accessed 24 May 2019].
- Kanady, S. (2018). *Qatar banks' outlook for 2019 remains stable: Moody's*. [online] The Peninsula Qatar. Available at: https://www.thepeninsulaqatar.com/article/06/12/2018/Qatar-banks%E2%80%99-outlook-for-2019-remains-stable-Moody%E2%80%99s [Accessed 20 May 2019].