

***Gulf countries responses to crisis:
pragmatism, timeliness and some concerns***

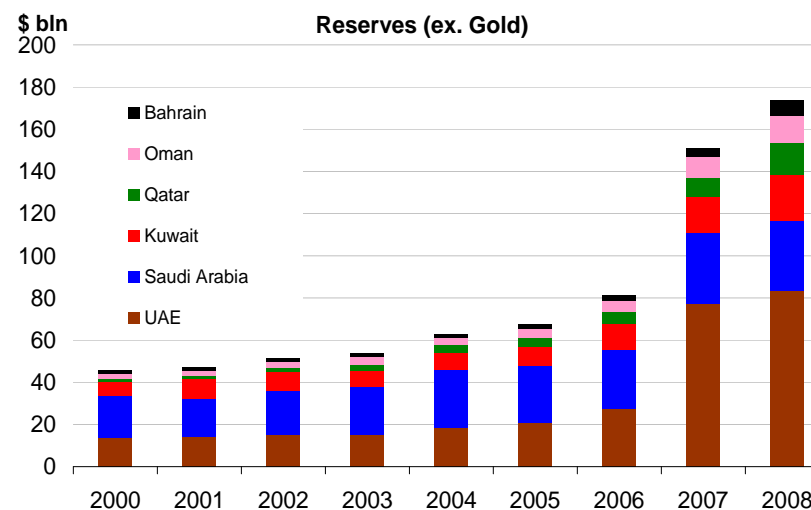
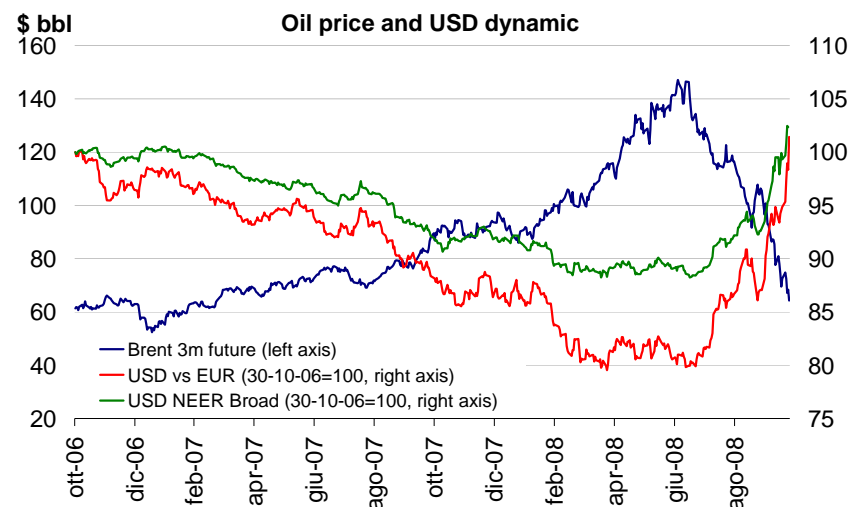
***ABI – Rome, October 2008
Forum Internazionalizzazione 2008***

Luigi Ruggione

Gulf countries

Main economic and financial events

- With Brent price following a clear upward trend in 2007 and the first half of 2008, before pointing South as a consequence of the global financial crisis (end of speculation on primary goods?) and the expectation of a deep recession, and with USD going first down and, more recently, up, Gulf countries have to make their strategic decisions in a very uncertain environment
- Fluctuations of hydrocarbons and global credit crunch will undoubtedly impact of gulf countries growth and investment projects. Some countries appear more vulnerable than others, Oman, for instance, is being caught by the crisis in the middle of a successful effort to repay debt and diversify the economy, Dubai has a high debt and some leveraged sectors may slow down because of the credit crunch
- However, the enormous amount of reserves accumulated in the last few years make this area, **in principle**, less risky in the current environment than most other parts of the globe



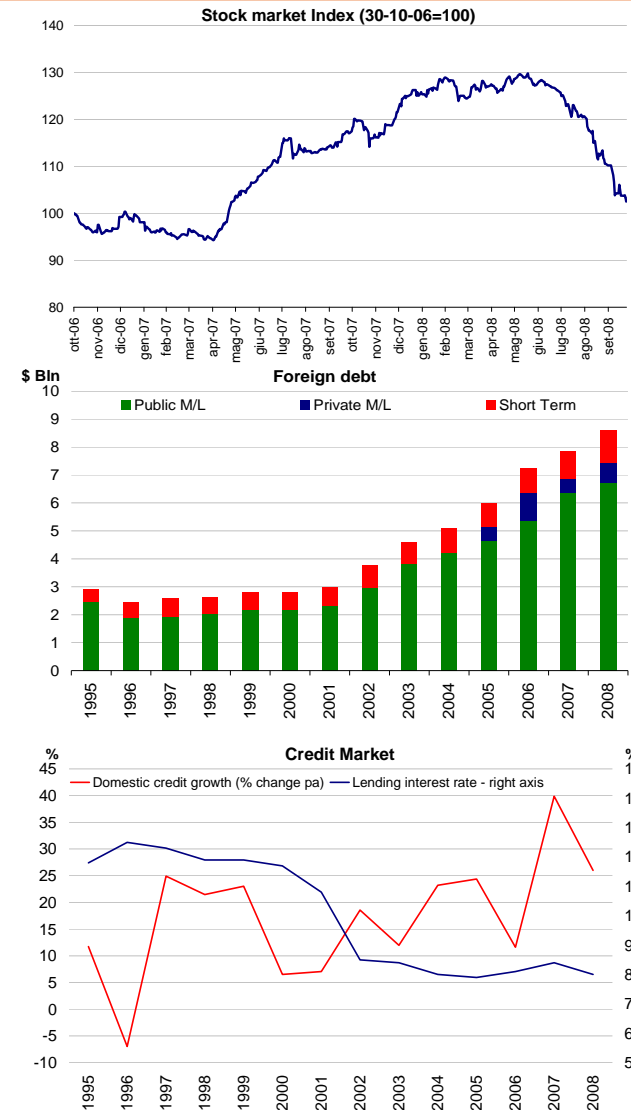
Policy reactions to crisis

Kuwait	<ul style="list-style-type: none"> The discount rate was cut on 8 Oct by 1.25 ppt to 4.5%. The repo rate was cut by 1.0 ppt to 2.5% 	<ul style="list-style-type: none"> Central bank deposits were shifted from government institutions to commercial banks Central bank has been injecting liquidity into the banking system since end-September 	<ul style="list-style-type: none"> Kuwait has refrained from guaranteeing bank deposits – but could do this if necessary
UAE	<ul style="list-style-type: none"> The overnight repo rate was lowered to 1.5% from 2.0% on 8 October 	<ul style="list-style-type: none"> The six-day overdraft rule has been temporarily suspended and from 25 September, lenders can withdraw 100% of their reserve requirements The UAE government has set aside Dh120bn (\$33bn) for the support of local banks. This comprises: <ul style="list-style-type: none"> A Dh25bn capital injection to local banks (by 24 October). This will be in the form of 2yr deposits proportionate to bank assets A Dh 50bn Dh (\$14bn) lending facility, which local banks can draw upon when needed at a rate of UST + 120bp or 4.00 %, whichever is larger (announced: 22 September) 	<ul style="list-style-type: none"> The government has guaranteed deposits and savings in all national banks It has also guaranteed interbank lending operations (even covering foreign banks with 'significant' operations in the UAE). This is applicable for three years
Saudi Arabia	<ul style="list-style-type: none"> The benchmark repo rate was reduced by 0.5ppt to 5%, while the reverse repo was unchanged at 2% (announced: 12 October) 	<ul style="list-style-type: none"> The Reserve requirement ratios have been lowered to 10% from 13%. This amounts to about \$5bn Saudi Arabia's government has injected up to \$3bn into local banks to meet a shortfall of dollar funding in the domestic banking sector (announced: 21 October) 	<ul style="list-style-type: none"> The central bank has set up an emergency fund and SR150bn (\$40bn) will be available to banks if needed (announced:12 October)
Bahrain	<ul style="list-style-type: none"> The benchmark 1wk deposit rate has been reduced by 0.25 to 1.75%. The overnight deposit rate was also lowered by 0.25 to 1.25%. The repo and lending rates were cut by 0.5 pts to 4.75% (announced: 9 October) 	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Central bank has released statements emphasizing its readiness to provide liquidity if necessary
Oman	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> The central bank has released statements emphasizing its readiness to provide liquidity if necessary
Qatar	<ul style="list-style-type: none"> Qatar has maintained that has no plans to reduce its benchmark interest rates (announced: 9 October) 	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Qatar has propped up its stock market and banks by buying stakes in local institutions. The QIA announced it would contribute 10-20% to the capital of local banks to boost the banks' capacity to finance developmental projects (announced:12 October)

Source: Barclays Capital Research

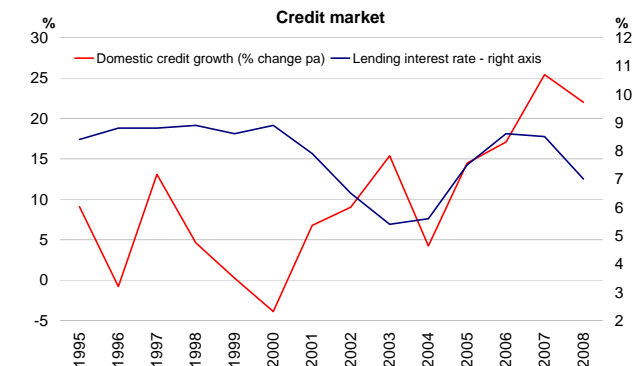
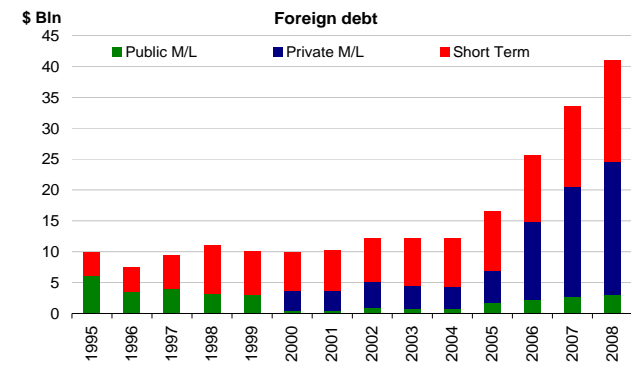
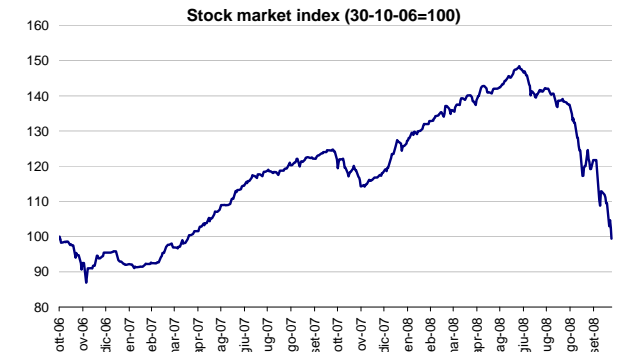
Bahrain

- **Bahrain** is probably the most vulnerable of Gulf countries to oil price fluctuations, as it is a small producer and its public finance basically depend upon a single field, managed by Saudis, which provides 80% of the country's production
- Fiscal order is made all the more difficult to adjust in case of tougher crisis, considering that, in the last three years, public spending has been growing 18% a year on average
- Furthermore, the debt position of Bahrain - slightly below 40% of GDP - has been deteriorating since 2002, with public debt increasing remarkably and also the private sector accumulating a growing external exposure since 2005
- However, it must be stressed that the track record of Bahrain as a debtor is spotless and, in case of major disruptions, there is a good chance for the country to rely on its historical allies, the US and, more importantly in the current circumstances, Saudi Arabia
- The usual regional concerns about inflation and the lack of an entirely free monetary policy apply, obviously, to Bahrain. The stability of the banking sector is of paramount importance for the country which is the banking hub of the Gulf



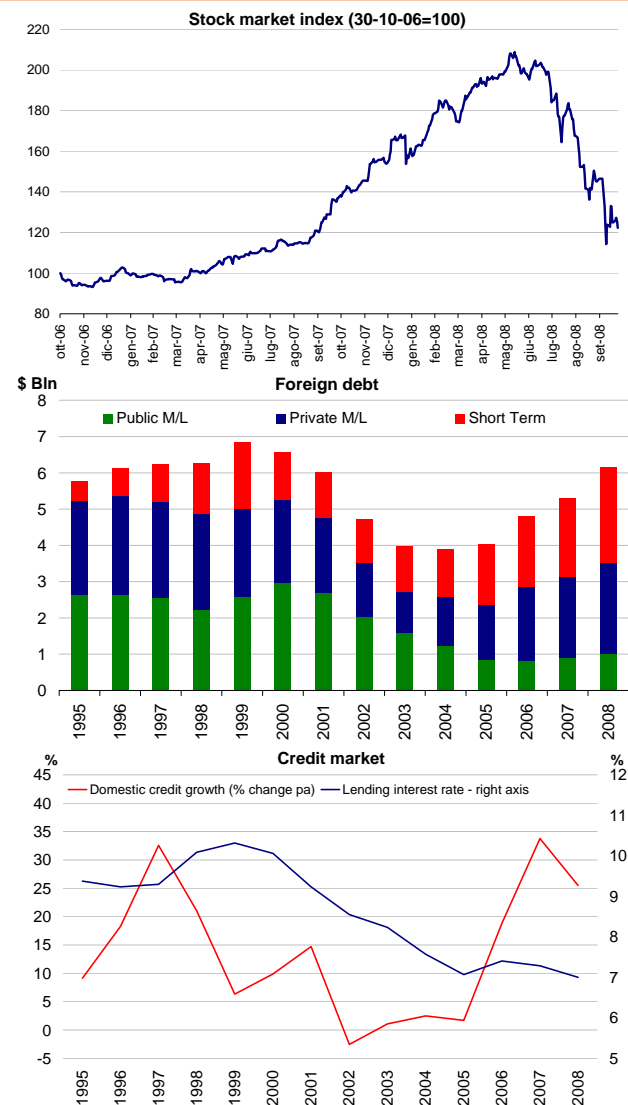
Kuwait

- Kuwait's** reaction to the global financial crisis has set the standards in the Gulf countries. After tightening the money market rate in August, the central bank offered liquidity to banks that helped pull down interbank rates, then the Kuwait Investment Authority intervened both directly and indirectly to sustain the stock market, finally, in a move that pre-empted the FED cut, the CBK slashed its discount rate by 125 bps. to 4.5% on October 8th
- In the current junction, the CBK has announced that the inflation rate - running close to 12% - is no longer the major concern, but the focus is the health and liquidity of the banking sector. This is wise, also in view of the fact that, with respect to other countries/areas of the world, the credit growth in Kuwait is at more manageable levels, given the growth of economic activity to remain above 8% in 2008 and to slightly decrease in 2009-2010
- The major risks that we foresee for Kuwait are to be found in the solution of the inflation vs. credit crunch equation and the appropriate level of interest rate after the peak of the crisis is behind. We see also political risks increasing, as the government is under growing pressure from the parliament



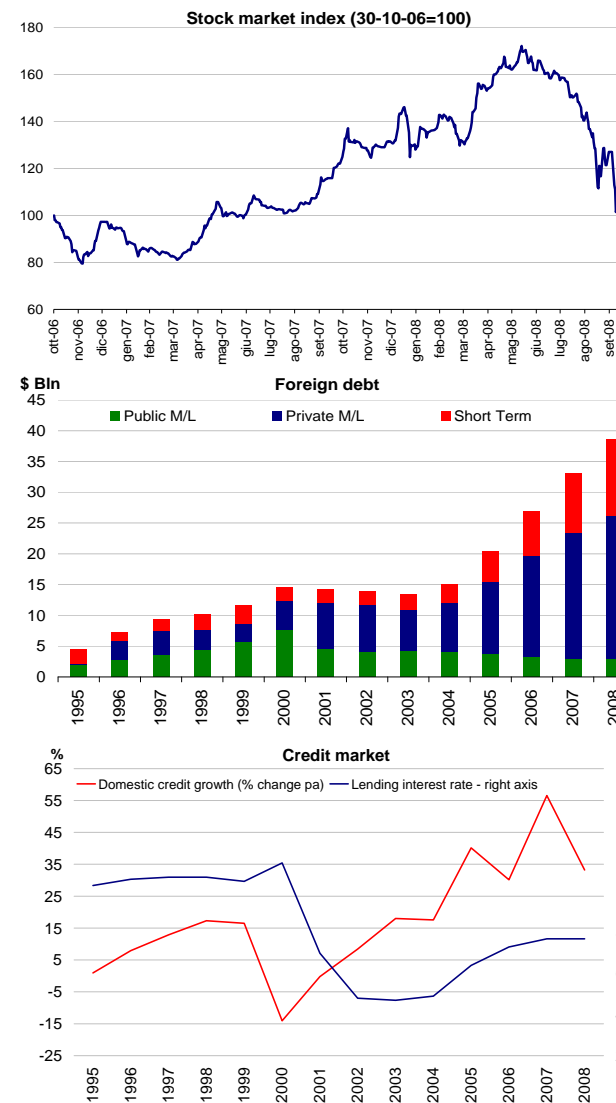
Oman

- Since 2003, **Oman** has been aggressively repaying its foreign debt, whose weight on GDP has been going down from 12.3% in 2003 to an expected 2.4% at the end of the current year
- This obviously bodes very well, especially ahead of a prolonged recession that is likely to drive oil prices and oil demand down quite substantially, thus impacting on the country's ability to generate and mobilize financial resource;
- This is all the more true, given that the very strong dependence of Oman upon the oil and gas sector, whose slowing down will impact negatively on the country's growth rate and fiscal and foreign positions
- In our view, the major risk Oman is facing is that of an increasing weight of short term debt related to the still heavy imports from abroad, however we do not see any risk of sharp deterioration and downgrading, despite the impressive recent losses on the stock market
- The banking sector, despite the regulatory constraints on interest rates and credit ceilings, remains stable, but inflation may be hard to fight given the peg of the local currency to the USD



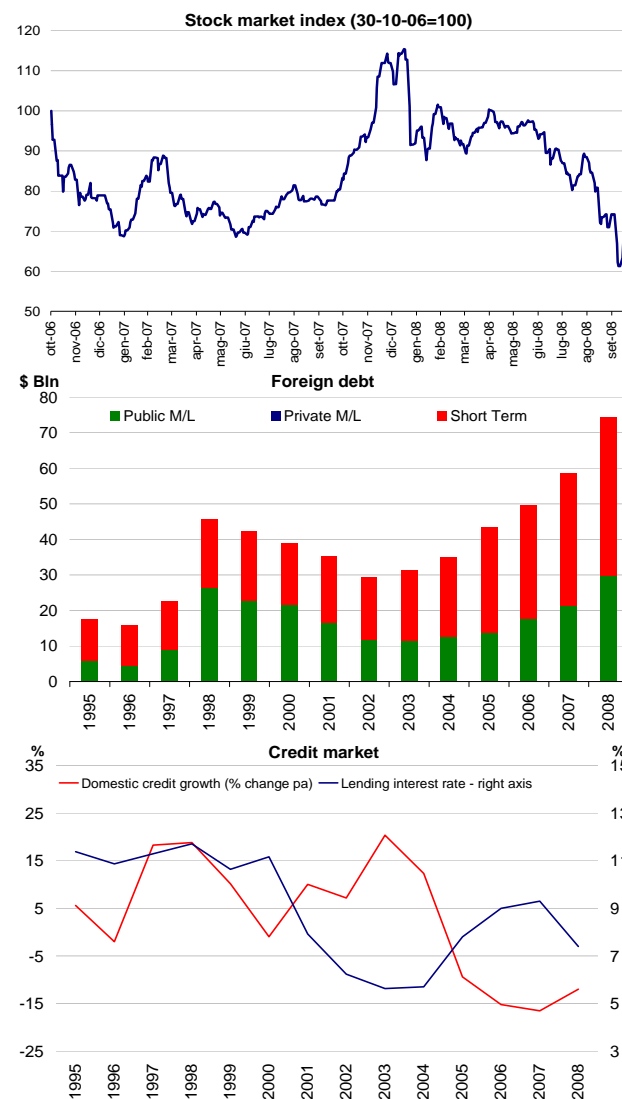
Qatar

- Contrary to what has happen with Oman, **Qatar** has been increasing utilizing debt to finance new liquefied gas and petrochemical facilities, bringing its debt up to above 35 USD bln., from around 20 USD bln. in 2005
- However, given the extremely favourable current account surplus, mainly driven by the trade surplus, the external position of the country does not raise any major doubts about its sustainability
- Growth is expected to remain lively, although this does not bode well for inflation that is likely to remain high for the regional standards – above 15% in 2008 – pushed also by the expansionary fiscal policy, the aggressive investment policies and the very fast growth of credit (above 40%)
- The recent strengthening of the USD has somewhat eased the need of revaluation for the local currency and the concerns about imported inflation, even if there is little doubt about the need to agree sooner than later on a single currency and a common monetary policy in the Gulf area



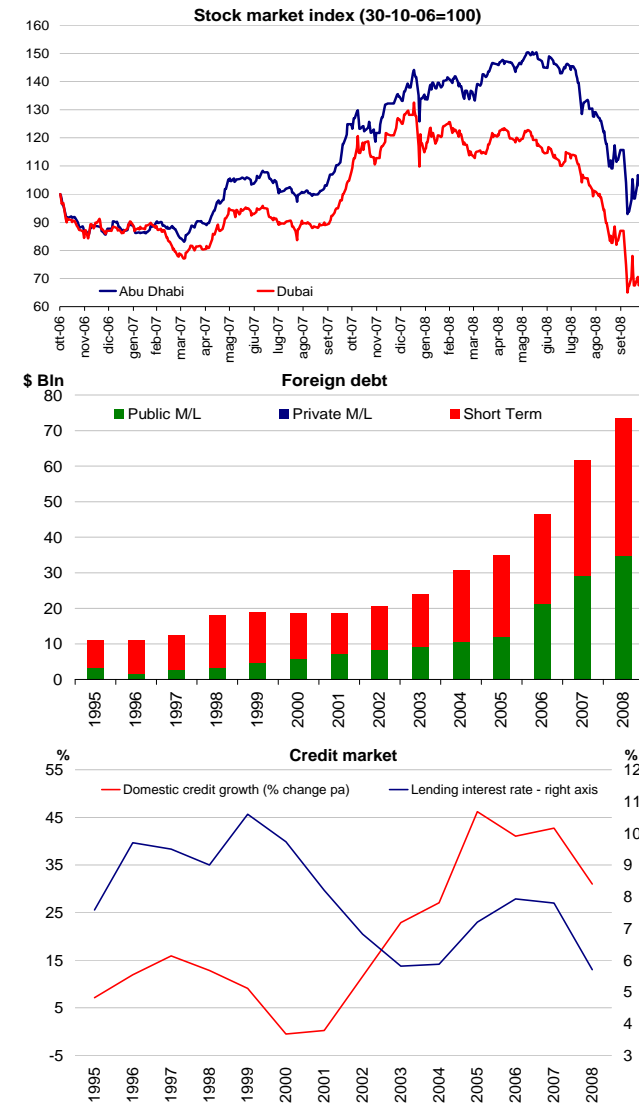
Saudi Arabia

- Following very closely Kuwait's reaction, also Saudi Arabia has acted very promptly in response to the global crisis, by injecting liquidity into the local banks in the form of deposits and following the FED by trimming rates by 50 bps. to 5% - the first cut since March 2004 - and reducing cash reserve requirements from 13% to 10%
- These measures were extremely necessary given the deep losses of the stock market (see picture) and after the prolonged period – since November 2007 – in which the monetary authority has been trying to reduce – **successfully indeed** – the rapid credit expansion of the early 2000's
- Despite the growth of the foreign debt utilised for financing local investments that is heading above 70 USD bln., the structural strength of the Saudi economy is not in jeopardy, thanks also to the very low cost of oil extraction
- The major concerns for the Saudi economic and financial system seems to be that of inflation without “free” monetary policy on one side and that of a weak net foreign assets position of local banks, probably induced by foreign banks holding local currency deposits with Saudi banks, betting on a possible (but in our view unlikely) ryal revaluation



UAE

- The sharp decline of **UAE** stock markets has prompted the authorities' intervention in the form of three-year deposit guarantee, even in support of foreign banks with "significant operations" in the Emirates and in the injection of liquidity (in case of need)
- The major concern in the case of UAE is its debt, which has been moving on a steep upward trend since 2003 and is now hovering above 70 USD bln
- The picture, however is far from clear. As a matter of facts the debt that might prove to be hard to refinance in the current circumstances (the sovereign spread of Dubai closed last week above 800 basis points) is caused by highly leveraged Dubai's economy, that is only one part of the larger Emirates system, characterised by the financial strength of Abu Dhabi, which, by the way, accounts for virtually the entire Emirates oil production
- The vulnerability of Dubai to global turmoil is also caused by its deep involvement in the real estate sector development



Annex – Vulnerability Indicator

- In order to provide a quick and effective measure of sovereign vulnerability, we have constructed a simple indicator, spanning from 0 (no vulnerability) to 1 (highest vulnerability), that captures how much a sovereign is vulnerable to the present crisis
- In order to do that, we have put together macro indicators (such as the internal rating and the corresponding PD) with other typically financial indicators (such as the loss of the stock exchange), that capture the loss of confidence of investors, and the depreciation of the local currency, that captures the capital outflows and the pressure that the locally currency is facing under the current circumstances
- We have also considered the likelihood that a country is forced into a lower rating class, characterized by a higher probability of default
- This is still a work in progress under discussion, its results should not be considered as definite in a very difficult junction like the one we are currently going through

Annex – Vulnerability Indicator

■ VARIABLES

- **Internal Rating** : Intesa Sanpaolo Internal Rating as of March 08
- **PD**: probability of default associated with the internal rating
- **MIR PD**: Probability of default associated with the current market perception captured by Market Implied Ratings by Moody's
- **Delta MIR PD**: Difference in MIR PD between 22 July 08 and 22 October 08 – a positive number means increase in market perception of sovereign default
- **Currency depreciation (vs. Euro and US Dollar)**: Measure of local currency depreciation in the last three months - in percentage terms - considered only in case that it has been greater than 5%, which in the current situation could be considered as a good threshold to separate a depreciation consistent with the current portfolio re-allocation and flight to quality and depreciation due to a confidence crisis - USD measure are computed in excess of the 20% USD appreciation vis a vis all other currencies
- **Extra stock market collapse**: Measure of possible boom & bust dynamic - percentage measure of the three months collapse in the local stock market index, reported in case it is higher than the average collapse registered by developed markets (USA, UK, Germany, Japan, Italy and France)

Annex – Vulnerability Indicator

■ TRANSFORMATION DUMMIES

- **Lower than BB-:** we assign 1 to countries with internal rating lower than BB-
- **Speculative Grade:** we assign 1 to countries in speculative grade
- **Risk of getting speculative:** we assign 1 to countries in the BBB class (from BBB+ to BBB-), which currently face the risk of downgrade in the speculative grade
- **MIR PD > 5%:** we assign 1 to countries with probability of default implied in the MIR greater than 5%, which indicates countries considered near to default
- **Increase in MIR PD:** we assign 1 to countries whose probability of default implied in MIR has increased in the last three months
- **Currency Risk:** we assign 1 to countries whose currency has gone under down pressure against USD or EUR, as measured by the Currency Crisis variable
- **Corporate Risk:** we assign 1 to countries whose stock market indicator has collapsed in the last three months, as measured by the Extra Stock Market Collapse indicator

■ INDEX CONSTRUCTION

- **countries with internal rating lower than BB- receive 1 no matter other measures or indicators**
- **countries in speculative grade, but with internal rating higher than BB- receive 0,2 plus the average of registered transformation dummies**
- **in all other cases the countries receive the average of registered transformation dummies**

The final risk indicator ranges from 0 (no immediate risk) to 1 (high immediate risk)

Annex – Vulnerability Indicator

Countries with Internal Rating lower than BB- are considered with Risk Indicator equal 1 and are not listed here to avoid redundant information

Countries are sorted according to the Risk Indicator (starting from the highest risk)

Country	Internal Rating	PD	MIR PD	Delta PD	Currency Crisis USD	Currency Crisis EUR	Extra Stock Market Collapse	Risk Indicator
Turkey	BB-	1.57%	1.21%	0.58%	-7.7	-6.4	-5.4	0.914
Indonesia	BB-	1.57%	4.21%	3.58%			-11.4	0.629
Peru	BB+	0.53%	0.63%	0.44%			-16.3	0.629
Brazil	BBB-	0.32%	0.63%	0.44%	-13.2	-11.4	-11.0	0.625
Mexico	BBB	0.18%	0.34%	0.21%	-8.4	-7.0	-1.1	0.625
Hungary	BBB+	0.13%	0.63%	0.44%	-23.2	-19.3	-18.1	0.625
South Africa	BBB	0.18%	0.63%	0.29%	-15.7	-13.0		0.500
Iceland	A-	0.09%	4.21%	3.58%	-24.4	-20.3	-51.6	0.500
Poland	A-	0.09%	0.13%	0.10%	-14.2	-11.8	-5.7	0.500
Czech Republic	A	0.07%	0.13%	0.11%	-12.0	-10.1	-14.6	0.500
Ukraine	BB-	1.57%					-34.6	0.486
Guatemala	BB-	1.57%	0.63%	0.29%				0.486
Egypt	BB+	0.53%	0.63%				-14.0	0.486
Panama	BB+	0.53%	0.63%	0.44%				0.486
Romania	BBB-	0.32%	1.21%	0.87%			-17.1	0.375
Bulgaria	BBB-	0.32%	0.63%	0.29%			-14.4	0.375
Croatia	BBB-	0.32%	0.34%	0.25%			-5.6	0.375
Russian Federation	BBB	0.18%	2.25%	2.12%			-35.8	0.375
Lithuania	BBB+	0.13%	1.21%	1.02%			-9.2	0.375
Korea, South	A	0.07%	0.63%	0.50%	-11.3	-7.9		0.375

Annex – Vulnerability Indicator

Country	Internal Rating	PD	MIR PD	Delta PD	Currency Crisis USD	Currency Crisis EUR	Extra Stock Market Collapse	Risk Indicator
Uruguay	BB-	1.57%	1.21%					0.343
Philippines	BB-	1.57%	0.63%					0.343
Antigua & Barbuda	BB-	1.57%						0.343
Azerbaijan	BB-	1.57%						0.343
Jordan	BB-	1.57%						0.343
Montenegro	BB-	1.57%						0.343
Serbia	BB-	1.57%						0.343
Vietnam	BB	0.93%	1.21%					0.343
Guam	BB	0.93%						0.343
Macedonia	BB	0.93%						0.343
Colombia	BB+	0.53%						0.343
El Salvador	BB+	0.53%	0.63%					0.343
Algeria	BB+	0.53%						0.343
Costa Rica	BB+	0.53%						0.343
Latvia	BBB	0.18%	4.21%	3.58%				0.250
Thailand	BBB	0.18%	0.19%				-6.3	0.250
India	BBB	0.18%					-0.7	0.250
Israel	A-	0.09%	0.13%	0.04%			-0.6	0.250
China	A	0.07%	0.13%	0.08%			-7.6	0.250
Qatar	A+	0.05%	0.13%	0.09%			-7.4	0.250
United Arab Emirates	AA-	0.04%	0.19%	0.15%			-2.7	0.250
Slovenia	AA	0.03%	0.03%	0.02%			-1.8	0.250
Australia	AA+	0.02%	0.01%		-21.3	-17.8		0.250
Norway	AAA	0.01%	0.01%		-12.0	-10.0		0.250
Sweden	AAA	0.01%	0.01%		-6.1	-5.1		0.250

Annex – Vulnerability Indicator

Country	Internal Rating	PD	MIR PD	Delta PD	Currency Crisis USD	Currency Crisis EUR	Extra Stock Market Collapse	Risk Indicator
Morocco	BBB-	0.32%	0.19%					0.125
Kazakhstan	BBB-	0.32%						0.125
Mauritius	BBB-	0.32%						0.125
Montserrat	BBB-	0.32%						0.125
Tunisia	BBB	0.18%	0.19%					0.125
Trinidad & Tobago	BBB	0.18%	0.09%	-0.04%				0.125
Barbados	BBB	0.18%						0.125
Macau	BBB	0.18%						0.125
Greenland	BBB	0.18%						0.125
Brunei	BBB+	0.13%						0.125
Aruba	BBB+	0.13%						0.125
Estonia	A-	0.09%	1.21%	0.87%				0.125
Chile	A	0.07%	0.13%	0.08%				0.125
Oman	A	0.07%					-12.1	0.125
Saudi Arabia	A	0.07%					-6.2	0.125
Slovak Republic	A+	0.05%	0.09%	0.07%				0.125
Cyprus	A+	0.05%	0.02%				-21.2	0.125
Greece	A+	0.05%	0.05%	0.02%				0.125
Malta	A+	0.05%	0.02%	0.01%				0.125
Kuwait	AA-	0.04%					-2.3	0.125
Taiwan	AA-	0.04%					-6.5	0.125
Italy	AA-	0.04%	0.03%	0.01%				0.125
Hong Kong	AA	0.03%	0.03%				-18.0	0.125
New Zealand	AA+	0.02%	0.02%	0.01%				0.125
Japan	AA+	0.02%	0.01%				-5.9	0.125
Germany	AAA	0.01%	0.01%				-2.2	0.125
Ireland	AAA	0.01%	0.03%	0.02%				0.125

Annex – Vulnerability Indicator

Country	Internal Rating	PD	MIR PD	Delta PD	Currency Crisis USD	Currency Crisis EUR	Extra Stock Market Collapse	Risk Indicator
Botswana	A-	0.09%						0.000
Malaysia	A-	0.09%	0.19%					0.000
Bahamas	A-	0.09%						0.000
Bahrain	A	0.07%	0.19%					0.000
Vatican City	AA-	0.04%						0.000
Cayman Islands	AA-	0.04%						0.000
Portugal	AA	0.03%	0.02%					0.000
San Marino	AA	0.03%						0.000
Andorra	AA	0.03%						0.000
Bermuda	AA	0.03%						0.000
Spain	AA+	0.02%	0.02%					0.000
Belgium	AA+	0.02%	0.01%					0.000
Melilla	AA+	0.02%						0.000
Austria	AAA	0.01%	0.01%					0.000
Finland	AAA	0.01%	0.01%					0.000
France	AAA	0.01%	0.01%					0.000
Netherlands	AAA	0.01%	0.01%					0.000
Denmark	AAA	0.01%	0.01%					0.000
United Kingdom	AAA	0.01%	0.01%					0.000
United States	AAA	0.01%	0.01%					0.000
Luxembourg	AAA	0.01%						0.000
Monaco	AAA	0.01%						0.000
Canada	AAA	0.01%						0.000
Isle of Man	AAA	0.01%						0.000
Liechtenstein	AAA	0.01%						0.000
Singapore	AAA	0.01%						0.000
Switzerland	AAA	0.01%						0.000