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### Gulf dispatch: Sovereign funds turn to home

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Before the credit crunch began to bite, the developed world got hot under the collar about the rising economic power of sovereign wealth funds, opaque investment vehicles that were snapping up trophy assets worldwide.

Then came the gratitude that these investment vehicles were willing to carry on buying.

They might even become the lenders of last resort for the global financial system.

Now, the sovereign wealth funds of the oil-rich Gulf are increasingly seen as the potential saviours of the region, as they turn their attention back home to help sustain the Middle East's growth spurt through the global downturn.

The Gulf states have built up vast assets during the recent five-year oil boom.

The cumulative current account surplus since 2003 has risen to $2,000bn, with the Gulf Co-operation Council's official reserves rising to about $1,100bn by the end of this year.

The separate assets of the region's sovereign wealth funds come in even higher.

The banking system has dried up, leaving hundreds of billions of projects exposed. Global credit markets remain frozen over, putting the local banking system under pressure.

"As elsewhere, credit is still difficult to come by here, and if government liquidity isn't freeing credit markets, the only other way is for sovereign wealth funds to become direct lenders," says Mohsin Khan, regional director for the International Monetary Fund. "But they aren't going to do that. If they do anything at all, it will be via the banks to make them more liquid. Sovereign wealth funds could come in to recapitalise the banks by buying shares."

Governments across the Gulf have already moved individually to ease conditions, partly relying on the help of sovereign wealth funds.

The Kuwait Investment Authority, the oldest and most domestically proactive fund, invested in the stock market, as it sought to put a bottom under plunging equities.

The Qatar Investment Authority, meanwhile, has said it will help build national banks' balance sheets by raising its stake in listed banks to between 10 and 20 per cent by buying shares.

Qatar, has already said that it will step in to buy up local banking shares, which have been pummelled by the precipitous declines across the Gulf since the summer.

The equity injection is also likely to shore up the banks' balance sheets, allowing them in theory to lend more freely.

The QIA could also extend this policy further, say people aware of the authority's thinking.

The United Arab Emirates, meanwhile, has injected Dh25bn ($6.8bn) into national banks and guaranteed all deposits.

Dubai, which has built up debt as it grows into the region's business hub, is already looking to more "creative means" to finance its economy, as it looks to refinance debt in the region of $20bn over the next six months.

While most officials say its assets are strong with generous cash flow, other analysts predict that the emirate could be forced to seek special financing arrangements from its big brother in Abu Dhabi, the senior member of the seven emirates in the UAE federation.

Banks, whose loans to deposit ratios have soared above 100 per cent in the UAE, are increasingly looking maxed out in their real estate loan allocations.

Capital markets are also off-limits to companies.

The much lauded Islamic bond, or *sukuk*, market has dried up, with year-to-date issuance declining by 44 per cent.

The booming regional IPO market is also set to decline.

While the market has been buoyant so far this year, nearly doubling on the same period last year, market conditions have turned and research from companies such as Ernst & Young predicts that the size and frequency of issuance will slow well into next year.

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Bankers say that this will lead to more innovative forms of company finance.

Karim Souaid, managing partner of regional buy-out firm GrowthGate Capital, says that companies in the region could get strong interest from cash-rich investors if they add an equity kicker into debt offerings.

Government-linked companies will have no problem issuing pure debt, as was seen earlier this year in the issues from quasi-government energy companies such as Saudi's **Sabic** and **Taqa** of Abu Dhabi.

The private sector, however, will need to lure those investors spooked by the slump in international and local markets with a little something extra.

Like Warren Buffett's investment in Goldman Sachs, convertible preferred share deals –which offer a strong yield to investors but also an option to convert into equity at a good price – are already being looked at in the region, says Mr Souaid.

"Big pools of money such as the sovereign wealth funds will want to extract a pound of flesh. They want to ride the wave if it goes up and in meantime get a nice yield," he says.