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Middle East and Africa

Regulation Will Influence the Future of Banking

The future of banking was one of the topics discussed at the first Middle East Speaker Series hosted by Credit Suisse in Dubai in May. The increased importance of the Arab world within the global economy was another subject presented to clients, investors and professionals from the region's financial community.

Robert Aliber, professor emeritus of International Economics and Finance, University of Chicago Booth School of Business

The last 40 years have been the most turbulent in 300 years of monetary history, with four waves of financial crisis sweeping through the financial system during this short period of time, said Robert Aliber, professor emeritus of International Economics and Finance at the University of Chicago Booth School of Business, during his speech. The first wave took place in 1982 when the MBA countries – Mexico, Brazil and Argentina – and other developing countries were the worst affected, the second in the early 90's with Japanese, Swedish, Norwegian and Finnish banks in the spotlight, the third in 1997 with Asian banks being most hit, and the fourth is the most recent crisis that the world is emerging from at the moment. "Each of these crises was preceded by a credit bubble and in some cases also by an asset bubble," Aliber noted. Virtually all countries that had a credit bubble experienced a massive inflow of money from abroad, which led to unsustainable growth in the credit supply, this in turn triggered unsustainable growth in asset prices – usually real estate prices. "A large number of financial institutions went bankrupt during these periods of turmoil, not because of strategic mistakes or the existence of complex financial instruments, but because they misread the financial environment."

Tougher Regulations Ahead

These recent crises have triggered major changes within the financial industry: the number of banks headquartered in countries such as the US, Japan, the UK and Germany has declined as result of mergers or bankruptcies. Other fundamental changes are the increase in the global activities of many banks and a sharp rise in the number of products and services offered to clients. "Many banks have turned into financial department stores and do not focus on their core business, deposits, any longer," Aliber stressed. To reduce the likelihood of further financial bubbles and the failure of large financial institutions, the political response is to strengthen regulations. Political leaders are trying to limit the activities of banks, by separating narrow banking activities (typically deposits) from other activities such as trading and underwriting. "The cost of such regulations can be seen as a tax on deposits. They reduce the rate of return that banks can pay on their deposits and are just likely to make banks move to the legal jurisdictions with the least severe regulations," Aliber underlined. I am rather ambivalent about the development of tougher financial regulation. We've had 200 years of financial regulations and still have financial crisis occurring at regular intervals."

Marvin Zonis, professor emeritus of Business Administration, University of Chicago Booth School of Business

New Role for the Middle East

The Middle East has suffered from the curse of "free money," said Marvin Zonis, professor emeritus of Business Administration at the University of Chicago Booth School of Business during his presentation. It is difficult to get people to work and to get entrepreneurial activity going when oil money is available. The region does however have the capacity to play a far greater role in the global economy as well as in other emerging markets. "The Arab world is encouraged to take a more activist role within the global economy. I believe this will occur, though not in the Middle East itself. The funds will tend to flow out of the region in the coming years. Large amounts of investments will move from the Middle East to emerging markets such as Brazil, India, China, Indonesia (BICI) and Africa." According to Zonis, these four BICI countries all have extremely impressive growth stories. Investors should however not bet on Russia, as its gas dominance will decline over time, now that unconventional gas types such as stale gas are gaining in importance.