## *Impact of the Gulf Crisis on Gulf and Arab Financial Markets* [1]

Allow me at the outset of my speech to express my sincere thanks to the Arab Bankers Association for its impressive hospitality. I have been asked to shed some light on a subject of great importance to all of us, which is "The Impact of the Gulf Crisis on Gulf and Arab Financial Markets".

In order to place the impact of the Iraqi invasion of Kuwait on our financial sector in its proper context, it is necessary to briefly outline the situation prior to August 2, 1990.

By the summer of 1990, the Kuwaiti banks and financial institutions, with the guidance of the Central Bank, had covered a lot of ground in overcoming the adverse effects of the stock market crash of the early 1980s through the implementation of the Difficult Credit Facilities Settlement Programme, which was introduced on

---

(1) Delivered on January 10, 1991 in London, UK, on the occasion of the Arab Bankers Association luncheon.

the 10th of August, 1986. In addition, most different kinds of financial institutions were already brought under the supervision of the Central Bank, i.e. investment companies and exchange companies. Moreover, the Central Bank of Kuwait closely monitored developments in the international financial markets and the rapid changes in Europe and in other regions, with the aim of reforming the financial services sector of Kuwait and making it more competitive. With that goal in mind, the Central Bank had started in recent years to review and amend the supervisory standards used in Kuwait, in order to bring them into line with the international trend toward convergence of these standards. Moreover, there was close coordination among the monetary authorities in the GCC countries on the matter of supervisory standards in the preceding three years.

Our banking and financial institutions have always had close relations with international institutions, which was a natural result of the openness of our economy and its integration into international trade and financial systems. Our data indicate that by the end of May 1990, foreign assets formed about 25.5% of the total assets of Kuwaiti banks. In recent years, some of our banks and other financial institutions had deepened their international presence by opening branches and representative offices in major centers and by establishing subsidiaries and joint companies. These moves were largely triggered by the various directives issued by the European Commission defining the framework of the unified European market in financial services after 1992.

As you know, the Iraqi aggression against Kuwait had serious consequences for the Kuwaiti financial system, consequences which encompass both the short and long term. The immediate, obvious effects have included:

1- loss of headquarters and equipment. The extent of damage to buildings and loss of equipment cannot be estimated at this stage;

2- loss of contact with the outside world;

3- loss of data and records of outstanding transactions. This loss created a special problem for the attempts by Kuwaiti banks and financial institutions to regroup outside;

4- dispersal of manpower, especially those with managerial and technical skills;

5- the decision by the authorities to block or freeze all Kuwaiti assets and in effect cut off our banks and financial institutions from their assets. It was, without question, a helpful decision because it protected Kuwaiti assets from falling into the hands of Iraqi occupation authorities. The negative effects of the freeze were ameliorated as information was gathered about the assets and liabilities of our institutions, and about the control and supervision of these institutions.

Therefore, the immediate impact on the financial system was a total cessation of banking operations and financial transactions, in addition to loss of records and loss of access to assets.

While the immediate impact of the invasion on our financial institutions was reduced gradually through the reconstruction of records and the cooperation of the authorities in various countries, there are other effects which have produced more lasting drawbacks on the Kuwaiti economy and its financial system. These effects can be summarized as follows:

1- the Iraqi invasion of Kuwait had an immediate, direct impact on economic activity and on property values, leading to a sharp decline in banks' domestic assets;

2- the invasion had a devastating impact on the assets and short-term earning prospects of Kuwaiti companies. Consequently, there was much uncertainty about the value of the shares of these companies. Before the invasion, there were 50 companies and 14 brokers registered on Kuwait's official stock exchange. Trading was suspended and the stock exchange closed after the invasion. I believe that the reopening of the stock exchange will take a longer period, perhaps several months. This step will be connected with a market assessment of the value of shares and of future prospects for various Kuwaiti companies;

3- another damaging effect in the long run has been the changed international outlook about the stability, and therefore the credibility, of our financial sector.

In spite of all the adverse effects, I believe we have tried our best to help our banks and financial institutions regroup outside Kuwait, reconstruct their accounts and meet their more urgent interbank and foreign exchange obligations. I believe this was a unique experience for a country occupied by enemy forces. I have to add here that this was achieved with the understanding of our friends all over the world.

The Iraqi occupation of Kuwait not only adversely affected the financial market of Kuwait and its various institutions through its impact on domestic assets; it also created much uncertainty in world financial markets. That was demonstrated by the continuously downward tendencies of the financial markets, which has weakened the values of foreign assets of different Kuwaiti and non-Kuwaiti entities.

The immediate impact on the Arab financial markets was the breaking of all links and transactions with Kuwait. This was partly a result of the cessation of trade, remittances by expatriates, and the flow of funds between Kuwait and these centres. A second impact has been a perception among international banks of lack of stability and credibility in the Arab region. The Iraqi aggression undid, in a few hours, the years of work to build up stability and credibility in our financial markets. As you all know, political and economic stability are essential elements for the development of a credible financial sector.

Another negative impact of the Iraqi invasion was the disruption of an important part of the Arab regional financial network; that is, the Kuwaiti financial sector, which was a major set-back for the hopes of developing a viable and stable inter-Arab financial system.

There is no doubt now that international perception of Arab financial systems has been shaken by the crisis, and we must accept that it will take some time, and much work, to undo the damage, especially for Arab countries with external payments problems. It is difficult to measure such damage, but it can be reflected in the short term on interbank transactions, and over a longer period on the classification of Arab institutions and their ratings by international markets. Consequently, this issue will be a problem for all Arab banks and financial institutions for quite some time.

**Future Prospects:**

I see the future development of the Kuwaiti financial sector as going through several phases, with the earliest or post-liberation phase, a period of immediate relief programmes for the population, followed by a period of reconstruction of the damaged infrastructure. The destruction and disruption of the past few months means huge costs for rebuilding, in addition to lost production.

However, the important thing now is to try to identify alternative paths of action that are available to us. I foresee a chance for us, not only in Kuwait but also in other Gulf financial markets, to re-establish and strengthen our institutions and reinforce the international outlook. Such a goal would require a review of the overall structure of the financial system.

Such a review would include a serious consideration of amending existing laws and regulations wherever needed, and examining the institutional framework of the banking and financial systems with a view to implementing any restructuring or mergers that may be needed.

With these prospects in mind, the Central Bank of Kuwait is preparing a multi-stage plan for reviving, then restructuring, the financial services sector of Kuwait. The broad elements of the plan would consist of the following elements:

1- a short-term plan for re-opening the banks and financial institutions, authenticating their various assets and liabilities, restoring basic functions, and taking care of immediate depositor claims;

2- a review of the various tools of monetary policy and implementing policies that would add more stability to the market. In the short run, the emphasis will be on the appropriate interest and exchange rates for the Kuwaiti Dinar. This will be done with a view towards more coordination and harmonization between monetary and fiscal policies to ensure policy effectiveness and stability;

3- a medium-term plan that involves assessing our banking and financial system, and developing or establishing strong institutions capable of competition. This will be a crucial step, if we are to consider allowing entry of foreign banks and financial institutions into Kuwait, with all that entails in terms of revising our supervisory framework.

It has been the view of the Central Bank, a view accepted by the higher authorities of Kuwait, that there is a need to assess and evaluate our financial system in view of its past performance and international trends. That process had started before the invasion and the Central Bank is continuing along the same path, with modifications and adaptations caused by the impact of the Iraqi invasion.

However, it must be clear that the main responsibility to adapt to the new situation, and to take advantage of its opportunities and reduce its risks, lies with the banks and financial institutions themselves, which must prepare their own individual plans, for it will be a period of self-reliance, competition, and integration with international markets. The Central Bank will provide the monetary and supervisory framework for stability and competition, but the banks and financial institutions will have to prove their ability to adjust and survive.