



## Facing Financial Risks Associated with Oil Price Volatility—the role of Macroprudential Policies in Arab Countries

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June 27, 2016

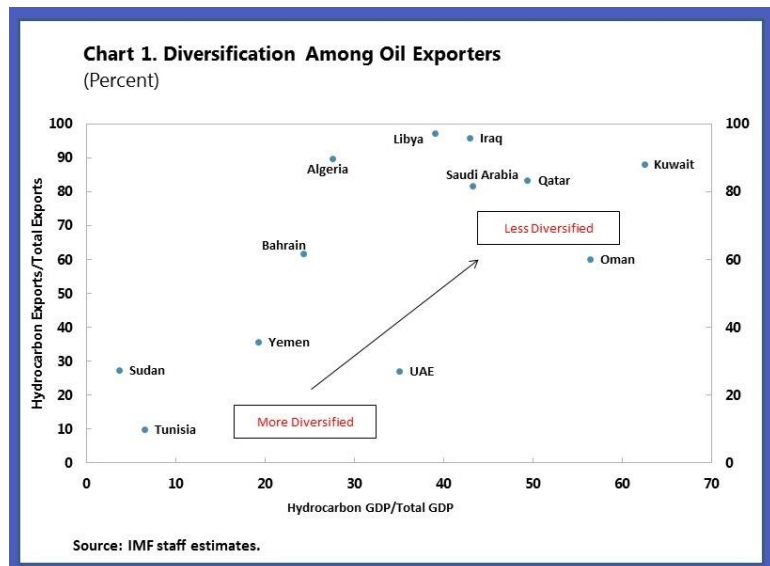
Oil dependency makes Arab countries especially vulnerable to swings in global macroeconomic conditions as volatility in the hydrocarbon sector has a direct impact on the rest of the economy. Macroprudential policies have a key role to play to limit systemic risks. Central banks from Arab countries, especially in the Gulf Cooperation Council countries, have been using macroprudential instruments over many years to mitigate risks against exposures to real estate, credit and concentration risks. However, these measures often came late in the credit boom and have not been implemented in a very systematic way. Our [research](#) shows that there is room for improving the policy framework to streamline the use and reap the benefits of macroprudential policies to strengthen financial stability.

### Risks faced by oil exporters

Countries deeply dependent on the extractive sector for fiscal revenues and export earnings are much more exposed to shocks (see Chart 1). In addition, the financial sector operates as a shock amplifier as banks tend to have high US dollar and energy sector exposure, and credit growth is characterized by a buildup of large exposures in oil-related and real estate sectors. Monetary policy independence is constrained due to fixed exchange arrangements while monetary operations are characterized by the absence of liquidity forecasting, the shallow nature of money markets and financial markets.

### Risks faced by oil importers

Despite more flexible exchange rate regimes in some cases, and thus greater independence in monetary policy, Arab oil-importing countries are also heavily exposed to global economic shocks. The



transmission occurs either through their gross domestic product or through oil prices which heavily affect their fiscal and external balances in a context of small policy buffers (see Chart 2) and in some cases weak policy frameworks. Furthermore, bank liquidity strains may severely affect the provision of credit while excessive concentration on some risky exposures like the real estate sector may contribute to the building-up of systemic risks.

### **Even if not a silver bullet, macroprudential policies can help**

Given the vulnerabilities faced by the region to credit and asset price cycles and the risk of pro-cyclical fiscal policy, the limited monetary policy independence under the fixed exchange rate regimes, and the absence of fiscal and external buffers especially in oil importers, macroprudential policies have an important role to play to limit systemic risks in the financial system. However, macroprudential policy cannot be a substitute for structural reforms –including financial sector reforms –needed to reduce medium and long term vulnerabilities and imbalances.

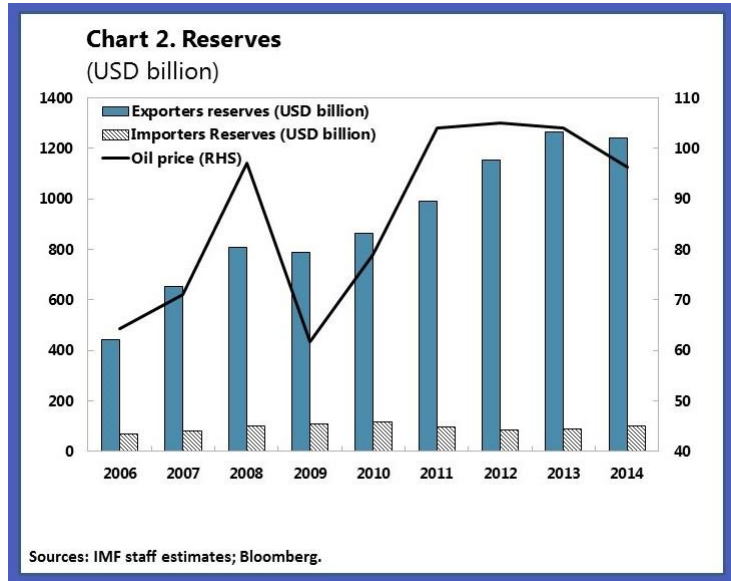
### **Arab countries have a history of using several macroprudential instruments**

Central banks and monetary agencies from Arab countries have been using several macroprudential instruments over the past to mitigate risks in an effective way. Certain macroprudential tools that were already part of the regulatory toolkit before the global financial crisis, helped to weather the global financial crisis relatively well. Some of the measures implemented included capital, provisioning and liquidity requirements for banks, ceilings on personal loans, loan to deposit ratios and limits on forex currency positions and real estate exposures.

### **Towards more effective macroprudential policy framework in the Arab region**

Notwithstanding the above, there is scope for the Arab countries to better understand, identify and mitigate spillovers throughout the financial sector and to build up appropriate cushions by strengthening the design of the macroprudential policy framework. Main policy recommendations include:

- Strengthening the institutional framework. One of the main shortcomings for many countries in the region is the absence of formalized legal and institutional frameworks for financial stability, which limited its effectiveness.
- Expanding the range of instruments and refining the existing ones as needed. In particular, countries should focus on implementing Basel III regulations, implementing counter cyclical and sector specific capital buffers and instruments for dealing with domestic systemically important institutions.
- Strengthening the effectiveness of macroprudential tools by establishing effective early warning system and regular assessments of systemic risks. Improving the data availability is



also key to close major gaps in the information available to the authorities to monitor systemic risks.

- Ensuring effective policy coordination and sharing of cross-sectional country experience

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