July 2020

Kuwait Banking Sector Outlook 2020 – Incorporating COVID-19 assumptions

Research Highlights:

Analyzing the impact of COVID-19 on Kuwait's banking sector in 2020

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Executive Summary

Key Highlights

- **Credit demand** is expected to contract by 22% in Q2 2020 compared to the previous quarter due to the fall in economic output. Supply-side constraints like labor force shortfalls in expat dominated sectors are also expected to keep economic activity subdued.
- **Deposit growth** is expected to stay muted at 0.8% for CY 2020. Possible job losses and lower interest rates for deposits are expected to drive the contraction. Further interest rate cuts to stimulate economic growth will have negative outcomes in deposit mobilization.
- Defaults are likely to be more in sectors such as real estate, where the financial leverage of some borrowers may be relatively large. **Gross NPLs** are expected to shoot up to 11.9% in CY 2020, up from 1.8% in 2019. However, Kuwaiti banks have the highest **loan loss allowances** of all GCC countries, which provides good buffers for the banks to absorb higher and unexpected losses.
- **Profitability** for 2020 is expected to fall, with net income reducing from KD 660 million in 2019 to KD 17 million in 2020, due to lower operating income consequent to shrinking **Net Interest Margins** (down from 2.9% in 2019 to 2.4% in 2020) and lower non-interest income due to lower reduced business activity.
- The pandemic would be a driver for greater **digitization** in the banking sector. More customers will start demanding contactless payments, branchless account opening and digitized lending. Banks might have to partner with smaller fintech firms in the short term to avail digital services that the new-age banking customer demands.

Kuwait's financial system is known to be one of the strongest in the region, supported by a robust banking system. However, the spread of COVID-19 has and will continue to adversely affect economies around the world in the next few quarters. The impact on an economy tends to have large repercussions on the banking sector as bank operations are dependent on the health of other sectors of the economy which are the source of the banks' business. The performance and health of the different economic sectors also determine the timely fulfillment of interest and principal obligations of banking clients belonging to these sectors. Low oil prices, fall in oil demand and lockdowns imposed to restrict the spread of the virus, continue to result in severe operational and consequently financial stress to many businesses in Kuwait.

Like other GCC Central Banks, Central Bank of Kuwait (CBK) has also announced monetary measures to stimulate the economy that includes postponement of interest and principal for six months for retail borrowers as well as for business clients under financial stress. Under the instructions of CBK, Kuwaiti Banks have also agreed to provide concessions like waiver of bank's commissions and fees on debit card/credit card/ATM card transactions. Banks have also been asked to provide additional funding to the SME sector jointly with the SME Fund. CBK has reduced the risk weight for SME loans and increase limit on loans to the real estate sector as part of the COVID -19 monetary stimulus.

The Central Bank of Kuwait (CBK) has acted swiftly to weather the negative impact of the current crisis on the economy. It cut its discount rate (benchmark rate for Kuwaiti Dinar lending) twice in March by a cumulative 125bp to a historical low of 1.5% in order to reduce the cost of lending and support domestic growth. The CBK does not automatically follow the Fed's rates changes: in 2017 and 2018, the CBK increased its discount rate only twice (by 25bp each time) there were seven Fed-rate increases. The current CBK measures, therefore, reflect the severity of the current crisis and the authorities' high willingness to support the economy.

To facilitate bank lending under the current COVID -19 crisis, CBK has reduced various regulatory requirements like allowing a lower Liquidity Coverage Ratio (LCR) of 80% and lower Capital Adequacy Ratio (CAR) of 10.5%, as well as lower Regulatory Coverage ratio of 15%. Kuwait banks, post global financial crisis of 2009, have strengthened their financial position by exercising greater control over their credit administration policies, standards and procedures and have over the years since then made provisions for loan losses, in excess of the value of Gross Non-Performing loans (GNPL) on their books. The LCR and CAR maintained by Kuwaiti banks is far in excess of the regulatory requirements of CBK and this has placed the Kuwaiti banks in a robust position, which is expected to see them through COVID-19 crisis impact on Kuwaiti economy and businesses and deliver the goals of monetary stimulus measures announced by the government.

Banks are also to delay loan payments from companies affected by the shock. The Central Bank also decreased the risk weights for SMEs (from 75 percent to 25 percent) in determining capital adequacy; reduced banks' capital adequacy requirements by 2.5 percentage points, to 10.5%. CBK has committed to provide liquidity if needed; set up a KD 10 million ($31.9 million) fund, financed by Kuwaiti banks, to support government's efforts in combating the virus.

The COVID 19 impact on the Kuwait banking sector, based on aggregate data for all these banks as provided by CBK (the aggregate data of the banks as per this source is lower than the total for all the listed banks in Kuwait as per information available from Reuters) , has been analyzed in terms of how it will impact:

- Credit growth
- Deposit growth
- Net Interest Margins
- Non-Performing Assets and
- Net Income

Table 1.1: Kuwait Banking Key Metrics

Period	2019	2020 (F)
Credit Demand Growth (YoY)	4.3%	-4.3%
Deposit growth (YoY)	4.8%	0.8%
Net Interest Margin (NIM)	2.9%	2.4%
GNPL to Gross Loans (%)	1.8%	11.9%
NNPL to Gross Loans (%)	1.2%	9.9%
Loan Loss Provisions (% of Gross Loans)	4.1%	5.9%
Cost to Income ratio	46.6%***	57.3%
Capital Adequacy ratio	17.6%	15.8%
Liquidity Coverage Ratio	166%	139%
Total Loans (KD million)	43,545	45,897
Total Deposits (KD million)	43,628	43,977
Total Assets (KD million)	71,021	76,084
Net Income (KD million)	660	17

Source: CBK data for local banks, Marmore Research

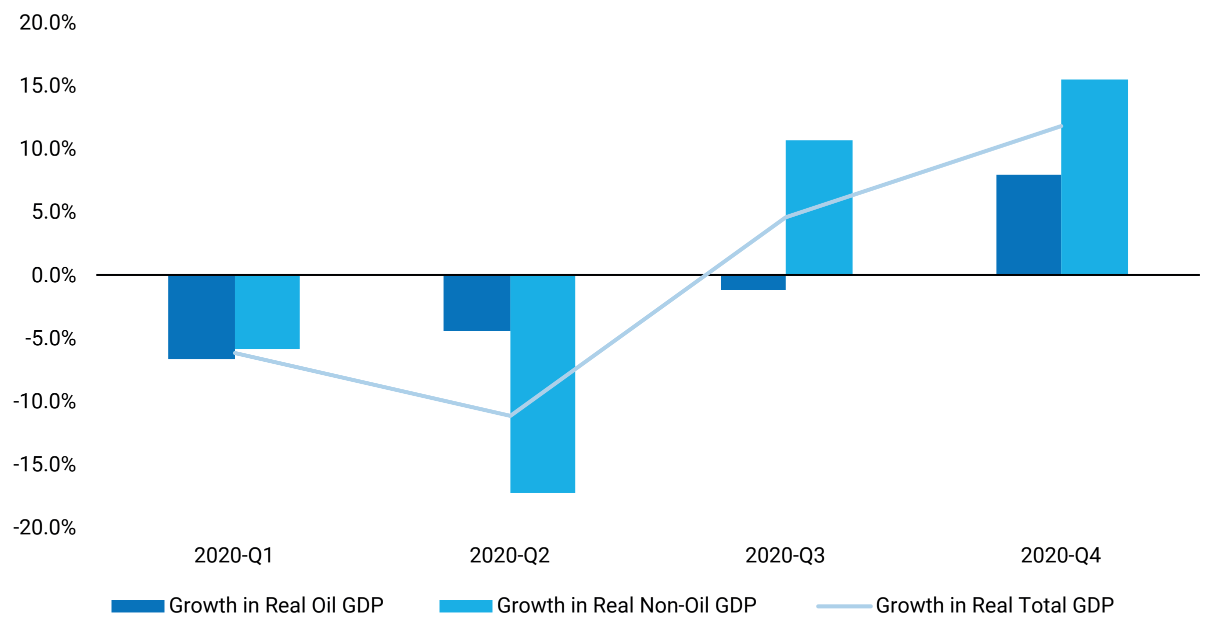
*Note: * Gross Non-Performing Loans (GNPL), ** Net Non-Performing Loans (NNPL), *** Cost to Income Ratio is higher than that for listed banks due to lower estimated non-interest income of 24.7% as per CBK statistics versus 29.5% for listed banks using data from Reuters.*

Chapter 2

Credit Growth

Credit demand is expected to contract particularly during 2020Q1 and 2020Q2due to the fall in economic activity and output caused by the restrictions laid by the government. Even as restrictions are eased by the government, consumer demand is expected to stay muted until 2020Q4 or maybe into 2021. Supply-side constraints like labor force shortfalls in expat dominated sectors are also expected to keep economic activity subdued in the next two quarters. Economic activity in Kuwait navigates in tandem with oil prices. When prices are low, economic activity across sectors are usually muted.

Figure 2.1: Kuwait Real GDP growth (quarter-on-quarter)



Source: National accounts, Marmore analysis

Marmore estimates Kuwait's real GDP at Basic prices (which is before deducting subsidies and taxes to arrive to GDP at market prices) to contract by 9.5% in CY 2020 when compared to the previous year. The real oil GDP is expected to witness degrowth of 8.5% while real non-oil GDP growth is expected to contract by 10.4% over the same period. On a sectoral level, the output from oil and related sectors is expected to face the biggest impact, falling by 41% in CY 2020 compared to CY 2019. The Real GDP at market prices is expected to contract by 7.1%. These estimates are currently moving targets and as the understanding of the pace and shape of recovery in different sectors improves, the estimates can change.

Table 2.1: Breakdown of GDP by economic activity

(in KD Millions)	CY 2019e	Q1 2020	Q2 2020	Q3 2020	Q4 2020	CY 2020
Agriculture and fishing	177	43	40	42	45	170
Extraction of crude petroleum and natural gas and service activities incidental to oil and gas	14,844	2,710	1,508	1,838	2,583	8,636
Manufacturing	2,755	619	528	552	663	2,363
Electricity, gas and water	887	236	223	246	254	959
Construction	1,164	254	178	216	288	935
Wholesale and retail trade	1,571	347	246	300	392	1,284
Hotels and restaurants	373	81	56	68	92	297
Transport, storage and communications	2,367	560	449	526	672	2,205
Financial intermediation Insurance	3,474	791	680	620	751	2,844
Real estate, Renting and business services	3,581	816	589	714	869	2,988
Community, social and personal services	9,158	2,190	1,845	2,067	2,230	8,334
Total GDP at basic prices	**40,350**	**8,648**	**6,342**	**7,188**	**8,839**	**31,016**

Source: National accounts, Marmore analysis

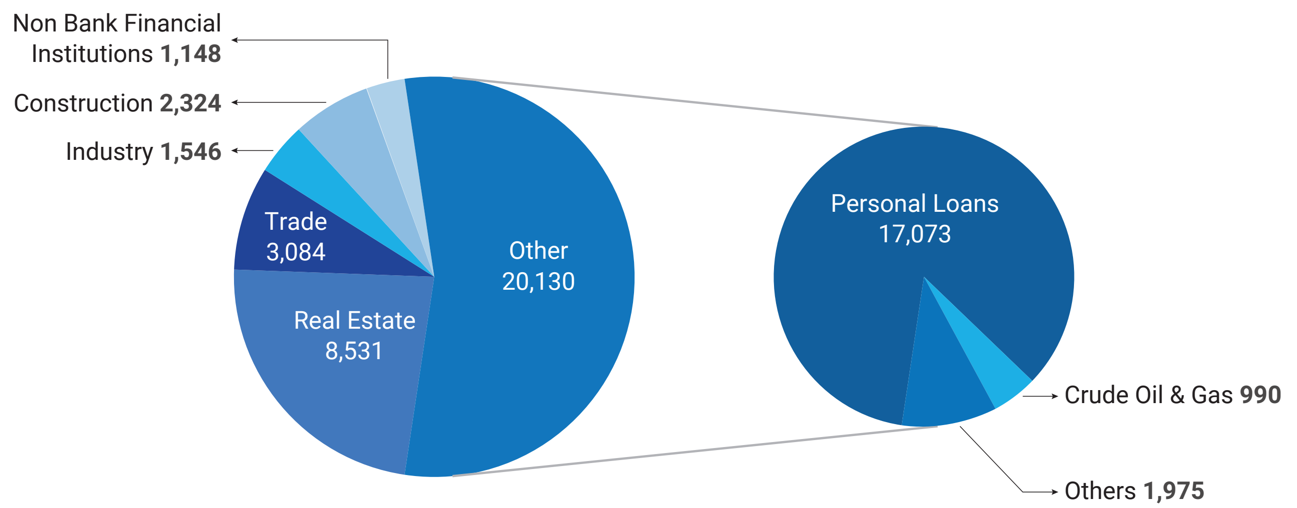
Change in economic output is expected to dictate the credit demand in the coming quarters as well. Based on our economic forecast given credit demand has been forecast taking three scenarios into account. Overall credit demand for CY 2020 is expected to decline by 4.3% compared to the previous year as per our base case assumption. If economic activity recovers smoothly, on an optimistic scenario we predict a mild growth credit demand of 0.6% in CY 2020. However, if restrictions continue to add stress on the economic activity and we see the extension of lockdown regulations, we predict credit growth to decline by 10.7% in 2020, compared to CY 2019 (pessimistic scenario).

Table 2.2: Credit Demand in Kuwait

	CY 2019 (A)	Q1'20 (A)	Q2 '20 (F)	Q3'20 (F)	Q4'20 (F)	CY'20 (F)
Credit Demand (KD Mn)						
Base Case	38,428	39,080	30,482	32,708	36,777	36,777
Pessimistic Case	38,428	39,080	28,806	30,778	34,307	34,307
Optimistic case	38,428	39,080	31,776	34,197	38,662	38,662
Credit Demand Growth (quarter-on-quarter %)						
Base Case	4.3%	1.7%	-22.0%	7.3%	12.4%	-4.3%
Pessimistic Case	4.3%	1.7%	-26.3%	6.8%	11.5%	-10.7%
Optimistic case	4.3%	1.7%	-17.3%	7.6%	13.1%	0.6%

Source: CBK Statistics, Marmore Analysis

Figure 2.2: Credit demand in 2020 by type



Source: Marmore Analysis

For the average case, among the different sectors, the maximum contraction is expected in the Crude Oil & Gas sector. Other sectors are expected to see contraction levels close to the overall average. Construction sector despite having a decline in Q2 2020, is expected to exhibit growth in subsequent quarters and will end with expansion for the full year. This is because though its GDP is lower the sector's average historical Debt to GDP ratio which is used in the forecast is higher than ratio for 2019.

Table 2.3: Sector-wise Credit Growth for Average case

	CY 2019 (A)	Q1'20 (A)	Q2 '20 (F)	Q3'20(F)	Q4'20(F)	CY'20 (F)
Real estate	9.3%	2.1%	-34.9%	19.2%	20.8%	-4.3%
Trade	-2.7%	7.7%	-43.4%	20.3%	30.5%	-4.4%
Industry	1.8%	2.9%	-36.3%	1.8%	14.8%	-23.3%
Construction	-4.1%	-1.5%	-25.5%	19.9%	33.4%	17.4%
Agriculture & Fishing	10.4%	-0.5%	-31.1%	5.0%	5.3%	-24.3%
Financial Institutions	9.1%	-3.3%	-7.5%	-10.8%	21.9%	-2.7%
Personal Loans	3.9%	-0.2%	1.2%	1.3%	1.5%	3.9%
Crude Oil & Gas	2.1%	10.7%	-69.3%	20.2%	40.5%	-42.6%
Public services	-1.8%	17.3%	-41.7%	7.5%	11.4%	-18.1%
Others	7.7%	1.9%	-48.5%	10.3%	21.4%	-29.8%
Total demand	**4.3%**	**1.7%**	**-22.0%**	**7.3%**	**12.4%**	**-4.3%**

Source: Marmore analysis; Represents quarter on quarter growth

Deposit Growth

Growth in banking sector deposits is expected to slow down because of lower incomes levels due to stalling of economic activity. Possible job losses and lower interest rates for deposits are also likely to aggravate the contraction of bank deposits. Further cuts in interest rates by Central Bank of Kuwait to stimulate economic growth, will have negative outcomes in deposit mobilization. A flight in deposits to alternative asset classes such as stocks can also happen given the lower deposit rates or flight to investments in other asset classes like government securities or bonds issued in other emerging market economies where better yields continue to prevail.

Taking into account the GDP forecast for remaining three quarters of 2020 and the deposit growth rates experienced in Kuwait in previous economic contractions during the global financial crisis in 2009, the deposit growth is estimated to be 0.8% for full year of 2020. Private sector deposits are expected to contract by 0.1% while government deposits are expected to grow at 5.2% during the same period.

Table 3.1: Domestic Deposit Growth of Banks

	CY 2019 (Actuals)	Q1 2020 (Actuals)	Q2 2020 (Forecasts)	Q3 2020 (Forecasts)	Q4 2020 (Forecasts)	CY 2020 (Forecasts)
Deposits (in KD million)						
Private Sector Deposits	36,240	35,897	35,984	36,083	36,205	36,205
Government Deposits	7,388	7,560	7,620	7,688	7,772	7,772
Total Deposits	**43,628**	**43,457**	**43,605**	**43,771**	**43,977**	**43,977**
Growth in Deposits (Quarter on Quarter growth)						
Private Sector deposits	3.5%	-0.9%	0.2%	0.3%	0.3%	**-0.1%**
Government Deposits	11.6%	2.3%	0.8%	0.9%	1.1%	**5.2%**
Overall Deposit growth	4.8%	-0.4%	0.3%	0.4%	0.5%	**0.8%**

Source: Marmore analysis

Chapter 4

Net Interest margins (NIM)

The net interest income measures what the banks earn by way of interest income on the loans extended by them to their clients after deducting the interest expense on the deposits and loans borrowed by them to fund their loans to clients. The Net Interest Margin (NIM) is derived from the ratio of Net Interest Income to the Outstanding Loans of the Banks. The Net Interest margin during 2019 stood at 2.9%. NIM is expected to shrink to 2.4% in 2020CY, as interest income is expected to reduce due to lower lending rates and fall in interest bearing assets due to lower credit offtake particularly in 2020Q2 which is more than the gain from the reduction in deposit rates. Loans are repriced quickly due to the competitive nature of markets. Also, interest expense would fall albeit with a lag, as the repricing of deposits would take place at maturity.

Table 4.1: Forecast of Net Interest Margin

(in KD Millions)	CY 2019 (Actuals)	Q1 2020 (Actuals)	Q2 2020 (Forecasts)	Q3 2020 (Forecasts)	Q4 2020 (Forecasts)	CY 2020 (Forecasts)
Total Interest expense (KD Mn)	664	88	46	89	88	311
Total Interest Income (KD Mn)	2,175	421	381	350	381	1,533
Net Interest Income (KD Mn)	1,512	333	335	261	293	1,222
Net Interest Margin (%)	2.9%	2.5%	2.8%	2.3%	2.4%	**2.4%**

Source: Refinitiv, Marmore

Chapter 5

Non-Performing Assets

The deterioration in economic conditions is expected to cause financial stress to borrowers in all economic sectors, resulting in a spike in Non-performing Assets (NPAs) for banks. Defaults are likely to be more in sectors such as Real estate, where the financial leverage of some borrowers may be relatively large, leading to difficulty in weathering stress from contraction in business due to fall in economic output. Smaller businesses and sectors like restaurants and hotels are the next largest economic sector in which banks can be expected to see high NPAs. Borrowers in other segments like trade, industry and construction are also expected to face financial stress resulting in NPAs for the banks.

Kuwaiti banks have the highest loan loss allowances of all GCC countries, owing to precautionary reserves (representing about 50% of total loan loss allowances) as imposed by the CBK over and above the specific and collective loan loss allowances. These provide good buffers for the banks to absorb higher and unexpected losses from the current crisis without consuming their capital. Loan loss provisioning, measured as available provisions to gross non-performing loan, that stood at 38.5% during Global Financial Crisis is now at 229%. Presence of adequate provisions during the good times could buttress the fall in profitability to an extent.

Effective exposure of Kuwait Banks to real estate sectors stands at 58% of total loans. Kuwaiti banks are highly exposed to real estate (about 23% of loans in Kuwait at end-2019), construction (about 5%) and personal instalment loans (31% of total loans), which are all likely to be under pressure in the current crisis. Mortgages in Kuwait, which stands at 31% of total loans, are provided to salaried people – majorly Kuwaitis whose salaries largely are guaranteed (government jobs). Additionally, CBK has been prudent and had set a limit regarding borrowing limit, wherein monthly interest payments should not exceed 40% of salary level. Thus, mortgages segment would not be impacted in Kuwait.

Given the impact of COVID-19 that has led to sharp fall in economic activity for a quarter of the year and added to this effect of sharply lower oil GDP, it is expected that the present financial stress for borrowers maybe more than that during the Global Financial Crisis in 2009. For estimation of the likely defaults and consequent NPAs, we used the financial indicators of listed companies in Kuwait and the GCC as proxy for the larger universe of businesses in Kuwait's economy.

The current crisis, which is partly due to forced clampdown for many businesses, may mean that relative competitive position of businesses may not change and hence post lockdown many businesses can be expected to regain their previous competitive positions and consequently regain previous profitability, except for some businesses in some sectors that may face permanent or continued damage. In the case of traditional economic crisis like the global financial crisis of 2008-09, the economic drop takes time to recover due to structural economic deficiencies that take time to rectify and hence NPAs caused by such crisis are long lasting requiring larger provisioning. Also, NPAs generally arise in the case of businesses that face a fall in competitive positions and profitability due to company specific factors that are difficult to overcome due to competitive pressures and hence will remain NPAs permanently or for long periods, requiring greater provisioning by banks to provide for estimated losses, unlike the NPAs caused by omnibus falls like the current one that may recover quickly and hence may require lower provisioning.

Table 5.1: Forecast of NPAs for Banks

(in KD Millions)	CY 2019 (Actuals)	Q1 2020 (Actuals)	Q2 2020 (Forecasts)	Q3 2020 (Forecasts)	Q4 2020 (Forecasts)	CY 2020 (Forecasts)
Gross Non-Performing Loans (GNPL)	784	784	4,753	12,879	5,474	5,474
Less: Provisions	(95)	(24)	(539)	(918)	813	(668)
Net Non-Performing Loans (NNPL)	523	499	3,929	11,138	4,545	4,545
GNPL to Gross Loans (%)	1.8%	1.7%	12.1%	30.9%	11.9%	11.9%
NNPL to Gross Loans (%)	1.2%	1.1%	10.0%	26.7%	9.9%	9.9%

Source: Marmore Analysis

Due to the absence of granular business data like financial indicators for bank borrowers, the Gross NPAs for Kuwaiti banking sector are estimated based on available data and behavior during previous crisis. Gross NPAs to gross loans is expected to increase to 11.9% for 2020, rising from 1.8% in 2019.

Net Income

The Net Income forecast builds on the Net Income Margin and the credit demand estimate to forecast the Net Interest Income. The Non-interest Income of the banks that represents income from fees and services for a host of banking services is expected to be impacted by the lower economic output forecast for the remaining three quarters of 2020 and is estimated based on the expected nominal output for this period.

The operating expense forecast considers the likely job reductions in the banking sector due to lower volume of banking services. The salaries approximately account for 40% of banks operating expenses[1] and the remaining expenses may see some belt tightening by banks but the effects thereof being currently difficult to estimate have not been considered. Ultimately, the estimated provisions assumed in estimating the Net Income for the banks for 2020CY. Cumulative net income of banks for the year 2020CY is expected to be a small profit of KD 17 million, down from a profit of KD 870 million in 2019. The net losses is expected due to lower operating income consequent to lower Net Interest Margin and also lower non-interest income due to lower reduced activity of business operations due to business disruptions caused mainly by lockdown, while, the operating expenses are not expected to reduce much. The loss estimates have limitations about likely variations in the level of permanent NPA increase and required provision estimates as well as difficulty in predicting the pace and shape of economic recovery in 20020Q3 and 2020Q4.

Table 6.1: Net Income Forecasts

(in KD Millions)	CY 2019 (Actuals)	Q1 2020 (Actuals)	Q2 2020 (Forecasts)	Q3 2020 (Forecasts)	Q4 2020 (Forecasts)	CY 2020 (Forecasts)
Net Interest Income	1,512	333	335	261	293	1,222
Non-Interest Income	496	106	78	88	110	382
Total Income	2,008	439	413	349	403	1,604
Operating Expenses	(936)	(232)	(230)	(227)	(230)	**(919)**
Operating Income before Provisions	1,072	207	183	122	173	685
Income before Tax	977	183	(356)	(796)	986	17
Net income	870	183	(356)	(796)	986	17

Source: Marmore Analysis

[1] Refinitv

Chapter 7

Key Banking Metrics

Kuwait Banks remain well capitalized at a total capital adequacy ratio of 17.6% for 2019. Bank liquidity also remains strong as it did during times of lower oil prices (unlike in most other GCC countries), supported by large and stable deposits from government-related entities (GRE). In the past five years, GRE deposits on an average accounted for about 25% to 30% of total customer deposits.

CBK has also cut the repo rates by 125bps (to 1% for overnight repos; 1.25% for one-week repos; 1.75% for one-month repos) to support bank liquidity and funding costs, if necessary. Kuwait interbank offered rates were also cut, which will support local interbank borrowing, but this remains a secondary funding source. Additionally, CBK has relaxed the Liquidity Coverage Ratio (LCR) and Capital Adequacy Ratio (CAR), which will enable the banks to release their liquid assets to be utilized for extending borrowings and meeting funding deficit arising from postponement of payments and incremental credit demand. Thus, bond issuance may not be required to meet their financing needs. However, Kuwait banks could take advantage of the low interest environment and surplus liquidity in global markets to shore up their balance sheets.

The high CAR ratios enjoyed by Kuwaiti Banks prior to COVID-19 are expected to be eroded to lower levels particularly for some of the banks. Therefore, a special fund to strengthen and improve the Capital Base of the banks through investment in Tier-2 Capital requires to be thought of in order to prepare the Kuwaiti banks see growth in the next few years.

Liquidity Coverage ratio (LCR) and Capital Adequacy Ratio (CAR) for the banks are expected to be far above the minimum regulatory levels, showing the robust health of Kuwaiti Banking Sector despite the impact of COVID-19.

Table 7.1: Operating Ratios for Kuwaiti Banks

(in KD Millions)	CY 2019 (Actuals)	Q1 2020 (Actuals)	Q2 2020 (Forecasts)	Q3 2020 (Forecasts)	Q4 2020 (Forecasts)	CY 2020 (Forecasts)
Liquidity Coverage ratio	166%	150%	192%	164%	139%	139%
Capital Adequacy ratio	17.6%	16.8%	18.8%	16.0%	15.8%	15.8%
Loan Loss Provisions (% of Gross Loans)	0.6%	0.6%	2.1%	4.2%	2.0%	2.0%
Interest Income (% of Outstanding Interest Bearing assets)	4.2%	3.2%	3.1%	3.1%	3.1%	3.1%
Interest Expense (% of Outstanding Deposits)	1.7%	0.9%	0.5%	0.9%	0.9%	0.9%
Cost to Income ratio (%)	46.6%	52.9%	55.8%	64.9%	57.0%	57.3%
Non-Interest Income to Operating Income (%)	24.7%	24.1%	18.9%	25.2%	27.4%	23.8%

Source: Marmore Analysis

Digitization trends

Mitigation measures taken to prevent the spread of COVID-19 are likely to spur demand for digital banking services in Kuwait. Consumer behavior will undergo a transformation that is likely to sustain beyond the suppression of the pandemic. The shift towards a cashless society will gain further momentum, with digital modes of payments becoming the norm over cash and check payments. Traditional Banks with legacy system will start revamping their core IT systems to incorporate newer technology such as cloud-based systems, analytics, automation etc. to future-proof their technological infrastructure for the long-term. In the short-term, there will be more collaborations between banks and fintech players to serve the growing digital-friendly customer base.

Kuwait's cash usage has been diminishing in recent times, with more and more customers switching to digital forms of payments. However, there is still a large portion of payments that are done through cash and checks. As per the guidelines of the World Health Organization, currency notes could be a medium for the spread of coronavirus. Therefore, the organization recommended the usage of contactless payments as much as possible. Several online retailers are also encouraging the use of online payment channels to their customers. These changes will quicken the adoption of cashless modes of payment for several customers who have preferred to use traditional forms of payments. In terms of infrastructure, many Kuwaiti banks have been launching several contactless payment services such as Tap to pay, NFC-enabled pay, Apple Pay, Fitbit Pay etc. With the new COVID-19 restrictions kicking in, consumers will start using these services more. Banks that do not offer these services might be forced to provide these services due to the risk of customers switching to competitors who provide them.

Mobile wallets will also grow in prominence, with token-based wallet systems starting to be preferred to physical card-based payments. Customer-facing businesses will have to upgrade their payment channels to allow customers to make contactless payments. This could be used as an opportunity for banks to strengthen their merchant network by forming partnerships and providing the necessary infrastructure. Peer-to-peer wallet transactions may also be favored in future with regulators also encouraging the move towards digital payments. Recently, the Central Bank of Kuwait announced that it would be increasing the limit for contactless payments to KD 25 from KD 10.

E-commerce business will also see a surge in customers due to current restrictions in place. As more users would now prefer making online purchases, this presents an opportunity for banks to collaborate with e-commerce players to provide additional benefits to customers. Promotions and discounts would become more attractive advertisement techniques compared to traditional offline methods.

Availing loans through online channels would also increase during these times as customers would not prefer to visit branches. Banks need to use this opportunity to onboard more customers by offering convenient methods of availing loans. Like in the case of payments, partnership with fintech companies that are small but technologically advanced could help banks to encourage digital lending.

The change in customer behavior towards digital channels will warrant banks to ramp up their innovation efforts in order to stay competitive. They will have to adopt more agile and scalable digital technologies such as cloud platforms, Artificial intelligence, and machine learning, which reduce the costs and increase the time to market. The presence of legacy systems and the high cost involved in replacing them will force banks to collaborate with fintech companies instead, to launch digitalized services in the short run.

Another shift that is likely to be seen is that banks would have to focus more on engagement rather than servicing. As customers will spend more time on their banking apps rather than physical branches, selling of products and services will happen more through digital channels in the future. Banks, which have developed banking applications primarily for services like checking balances and making transfers, will also have to use them as primary modes of selling products such as loans, insurance policies etc. This would require banks to build an ecosystem of value-adding services, which will keep the customers engaged with the platform and buy products digitally. Engaging customers by providing multi-faceted services through the banking apps will be the way forward and replace the current servicing models where the apps are primarily used to check balances and doing money transfers.

Adoption of digital banking services appears to be high from a broad level, with all banks providing basic digital services. However, it is observed that customers do not use them for all types of services. According to a McKinsey study, customers lean towards using digital channels for services such as checking account balances and transferring but prefer to raise complaints or open account or take loans by visiting the bank branches. In some cases, regulatory barriers prevent banks from offering services such as opening an account without a branch visit. But for certain services, customers find more comfort in visiting a branch. With restrictions due to COVID-19 shifting consumer behavior, customers are in a way nudged to try out these services through digital channels. Banks need to make entailing these services a hassle-free experience so that customers find comfort in using digital channels in the future as well.

Some of Kuwait's leading banks have already taken steps towards enabling contactless payments for their customers. National Bank of Kuwait (NBK) has already enabled NFC technology, which allows users to make contactless payment, in 86% of its points of sale (POS) network. The bank had plans to increase the coverage to 95% by the end of 2020 even before the outbreak of COVID-19. NBK has also been proactive in supporting other forms of contactless payments such as Fitbit Pay and Garmin Pay, which were launched in the early months of 2020. They allow fitness tracking devices and smartwatches to make contactless payments. After lockdown rules were enforced, NBK introduced an e-dividend facility that provided a convenient option to have their cash dividends directly deposited in their bank accounts. Tap and Pay services are also made available to customers by NBK, Boubyan Bank, Gulf Bank and Al Ahli Bank of Kuwait. Kuwait Finance House (KFH) has its own KFH wallet that helps their customers make digital payments. Banks such as National Bank of Kuwait and Boubyan Bank that have invested heavily in digitalization are in a better position to attract customers in the current situation.

Conclusion

Chapter 9

The Kuwaiti Banking sector is envisaged to continue and sustain its position as a strong and safe repository of public savings as well as maintain its role in meeting the financial needs of the Kuwait's economy. This is despite the adverse impact of COVID-19, which includes the expected sharp fall in Oil GDP in 2020. Credit demand is expected to contract during 2020CY, and an all-round decline is expected across several sectors which will be sharper in Q2 2020CY. However, a recovery is expected in the subsequent two quarters of the year. Deposit growth rate is expected to be muted in 2020 due to economic contraction leading to lower incomes and expected job losses both of which will cut into savings. Reduced interest rates in the economy will also exert pressure on deposit growth as alternative asset classes for savings may pose competition to bank deposits as a savings avenue.

The NPAs of the banks are expected to see a sharp rise in 2020CY due to the deterioration of the financial position of borrowers. However, unlike the previous economic crises which may have led to lasting or prolonged economic damage and financial stress for borrowers, the current crisis can be expected to be short lived for many businesses. This is explained by the omnibus short-term impact of the crisis for many businesses that, however, leaves their long-term competitive position and profitability intact despite stress experienced in the near term. The damage and financial stress to borrowers by COVID-19 has also been mitigated by extensive firefighting monetary stimulus measures extended by the Central Banks for example in developed countries like USA and partly in Kuwait as well. Accordingly, in view of the difficulty in assessing long term impact on businesses at a macro level, the NPAs and the consequent provisions for the banking sector may be difficult to forecast accurately. However, we provide estimates of NPAs for 2020 based on expected economic impact and financial stress of borrowers during the year and also provided provisions forecast using data pertaining to provisions required when high NPA levels arose in the past.

On an optimistic note, the provisions estimated in the report could be lower or they might be amenable to being reversed if borrowers' financial health recovers post COVID-19 in the subsequent period. Ultimately, we expect the Kuwaiti banks to face a reduced and only a meagre profit for 2020CY on a cumulative level. However, the financial soundness of Kuwaiti Banking sector is expected to be unaffected despite COVID-19 impact and the ratios like Liquidity Coverage Ratio and Capital Adequacy Ratio are expected to remain well above regulatory requirements at the end of 2020CY.

Apart from the short-term stress on banking operations, the impact of COVID-19 will be felt in other ways such as changes in consumer behavior, which would have an indirect impact on the banking sector. In our view, the pandemic would be a driver for greater digitization in the banking sector. Marketing and sales of products would start flowing from digital channels, as customers tend to avoid physical visits to bank branches and ATMs. High smartphone penetration and a young demographic profile would help in quicker adoption of digital banking channels. More customers will start demanding contactless payments, branchless account opening and digitized lending, with banks moving towards a customer engagement model as against a servicing model adopted right now. Banks will have to upgrade their legacy systems accordingly to keep up with the advancements in the financial service space and might have to partner with smaller fintech firms in the short term to avail digital services that the new-age banking customer demands.

Appendix

Profile – Conventional Banks

National Bank of Kuwait

National Bank of Kuwait	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	13,551	13,611	14,503	15,503	16,553
Total Deposits (KD Mn)	20,021	20,372	21,740	22,930	24,051
Total Assets (KD Mn)	23,598	24,204	26,035	27,428	29,271
Profitability					
Net Income (KD Mn)	282	295	322	371	401
Operational Efficiency					
Cost to income ratio (%)	39.01	39.70	36.14	35.36	37.08
ROAE (%)	11.73	11.25	11.65	12.92	12.74
ROAA (%)	1.31	1.31	1.36	1.47	1.50
Key Ratios					
Non-performing Loans (% of total loans)	1.34	1.28	1.42	1.38	1.10
Capital Adequacy Ratio	16.80	17.70	17.80	17.20	17.80
Loan Loss Provision (% of Loans)	1.02	0.93	1.24	1.13	0.79
Stock Performance					
Dividend Yield (in %)	3.57	4.29	3.92	3.43	3.12
Share Price (in KWf)	612	535	629	756	1,019

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 824, as of June 30, 2020

Gulf Bank

Gulf Bank	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	3,634	3,446	3,809	3,950	4,225
Total Deposits (KD Mn)	4,825	4,700	4,871	5,155	5,367
Total Assets (KD Mn)	5,438	5,467	5,683	6,016	6,245
Profitability					
Net Income (KD Mn)	39	43	48	57	64
Operational Efficiency					
Cost to income ratio (%)	40.56	49.79	39.80	45.66	40.89
ROAE (%)	7.78	8.09	8.56	9.66	10.31
ROAA (%)	0.72	0.79	0.86	0.97	1.04
Key Ratios					
Non-performing Loans (% of total loans)	2.60	2.40	1.70	1.00	1.10
Capital Adequacy Ratio	15.56	18.49	17.80	17.53	17.10
Loan Loss Provision (% of Loans)	1.77	1.22	1.74	1.31	1.51
Stock Performance					
Dividend Yield (in %)	-	1.67	2.94	3.57	3.30
Share Price (in KWf)	260	240	238	252	303

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 214, as of June 30, 2020

Burgan Bank

Burgan Bank	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	4,088	4,224	4,408	4,263	4,284
Total Deposits (KD Mn)	5,577	5,770	6,013	5,633	5,215
Total Assets (KD Mn)	6,825	7,269	7,415	7,312	7,081
Profitability					
Net Income (KD Mn)	52	68	65	83	85
Operational Efficiency					
Cost to income ratio (%)	49.01	51.31	50.77	43.51	42.73
ROAE (%)	9.35	9.67	9.91	10.76	10.74
ROAA (%)	0.88	0.95	0.94	1.14	1.18
Key Ratios					
Non-performing Loans (% of total loans)	1.4	1.0	2.7	2.7	2.5
Capital Adequacy Ratio	15.60	16.70	16.20	17.40	16.80
Loan Loss Provision (% of Loans)	1.32	1.00	0.96	1.44	1.15
Stock Performance					
Dividend Yield (in %)	3.71	5.90	1.55	2.40	3.76
Share Price (in KWf)	333	263	278	265	304

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 194, as of June 30, 2020

Commercial Bank of Kuwait

Commercial Bank of Kuwait	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	2,297	2,250	2,237	2,253	2,267
Total Deposits (KD Mn)	3,340	3,390	3,534	3,520	3,747
Total Assets (KD Mn)	4,037	4,125	4,395	4,468	4,873
Profitability					
Net Income (KD Mn)	46	50	55	64	-
Operational Efficiency					
Cost to income ratio (%)	29.97	15.02	75.36	31.18	42.77
ROAE (%)	8.55	8.93	9.24	9.64	0.01
ROAA (%)	1.12	1.23	1.30	1.44	0.00
Key Ratios					
Non-performing Loans (% of total loans)	0.9	0.5	0.5	-	-
Capital Adequacy Ratio	-	-	-	-	-
Loan Loss Provision (% of Loans)	2.04	2.93	(0.93)	1.66	4.02
Stock Performance					
Dividend Yield (in %)	3.60	2.99	3.41	3.27	3.44
Share Price (in KWf)	354	308	331	455	529

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 500, as of June 30, 2020

Al Ahli Bank of Kuwait

Al Ahli Bank of Kuwait	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	3,047	3,029	3,075	3,026	3,216
Total Deposits (KD Mn)	3,695	3,635	3,536	3,616	3,920
Total Assets (KD Mn)	3,904	3,692	3,666	3,914	4,351
Profitability					
Net Income (KD Mn)	30	32	36	42	29
Operational Efficiency					
Cost to income ratio (%)	34.34	43.13	39.75	40.38	40.50
ROAE (%)	6.00	6.59	6.98	7.52	4.90
ROAA (%)	0.77	0.75	0.83	0.95	0.61
Key Ratios					
Non-performing Loans (% of total loans)	2.3	2.6	1.7	1.8	1.5
Capital Adequacy Ratio	17.23	17.67	17.23	19.15	18.69
Loan Loss Provision (% of Loans)	2.15	1.67	1.88	1.84	2.28
Stock Performance					
Dividend Yield (in %)	3.47	3.33	3.79	4.07	5.47
Share Price (in KWf)	385	328	301	269	326

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 178, as of June 30, 2020

Profile – Islamic Banks

Kuwait Finance House

Kuwait Finance House	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	8,095	8,176	9,216	9,385	9,337
Total Deposits (KD Mn)	13,763	13,541	13,845	14,476	15,986
Total Assets (KD Mn)	16,527	16,499	17,358	17,770	19,391
Profitability					
Net Income (KD Mn)	124	203	184	227	251
Operational Efficiency					
Cost to income ratio (%)	53.35	51.59	47.36	49.17	38.71
ROAE (%)	10.68	12.44	13.25	15.41	15.79
ROAA (%)	1.00	1.21	1.27	1.50	1.41
Key Ratios					
Non-performing Loans (% of total loans)	-	-	2.70	1.99	1.88
Capital Adequacy Ratio	16.67	17.88	17.76	17.47	17.67
Loan Loss Provision (% of Loans)	1.73	1.18	1.51	0.97	2.00
Stock Performance					
Dividend Yield (in %)	2.53	2.86	2.68	2.53	2.24
Share Price (in KWf)	335	369	433	505	737

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 612, as of June 30, 2020

Boubyan Bank

Boubyan Bank	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	2,172	2,517	2,877	3,262	3,729
Total Deposits (KD Mn)	2,782	3,021	3,466	3,818	4,584
Total Assets (KD Mn)	3,133	3,482	3,970	4,345	5,301
Profitability					
Net Income (KD Mn)	35	41	48	56	63
Operational Efficiency					
Cost to income ratio (%)	51.38	55.90	54.25	50.17	46.48
ROAE (%)	11.98	11.69	11.47	12.59	11.55
ROAA (%)	1.22	1.25	1.28	1.35	1.30
Key Ratios					
Non-performing Loans (% of total loans)	0.9	0.8	0.8	0.9	0.9
Capital Adequacy Ratio	17.04	21.35	19.41	18.19	20.32
Loan Loss Provision (% of Loans)	0.50	0.23	0.38	0.49	0.50
Stock Performance					
Dividend Yield (in %)	1.08	1.21	1.31	1.19	1.11
Share Price (in KWf)	325	306	355	478	610

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 538, as of June 30, 2020

Warba Bank

Boubyan Bank	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	544	828	1,263	1,608	2,262
Total Deposits (KD Mn)	678	1,025	1,582	1,888	2,659
Total Assets (KD Mn)	776	1,127	1,773	2,193	3,144
Profitability					
Net Income (KD Mn)	1	3	7	13	17
Operational Efficiency					
Cost to income ratio (%)	77.61	66.33	48.18	40.42	38.92
ROAE (%)	1.13	2.84	5.68	6.00	6.13
ROAA (%)	0.15	0.27	0.51	0.64	0.62
Key Ratios					
Non-performing Loans (% of total loans)	2.84	3.01	-	1.39	1.10
Capital Adequacy Ratio	26.07	18.00	-	24.26	18.49
Loan Loss Provision (% of Loans)	0.64	0.74	1.15	1.12	0.99
Stock Performance					
Dividend Yield (in %)	-	-	-	-	-
Share Price (in KWf)	173	196	203	200	262

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 206, as of June 30, 2020

Ahli United Bank Kuwait

Ahli United Bank Kuwait	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	2,680	2,706	2,673	2,800	3,019
Total Deposits (KD Mn)	3,491	3,194	3,135	3,343	3,747
Total Assets (KD Mn)	3,904	3,692	3,666	3,914	4,351
Profitability					
Net Income (KD Mn)	43	40	44	51	55
Operational Efficiency					
Cost to income ratio (%)	44.97	37.48	35.37	31.93	32.31
ROAE (%)	10.81	9.86	10.21	11.18	11.43
ROAA (%)	0.93	0.99	1.21	1.35	1.33
Key Ratios					
Non-performing Loans (% of total loans)	-	-	1.4	1.3	-
Capital Adequacy Ratio	15.51	18.23	18.00	16.55	16.02
Loan Loss Provision (% of Loans)	0.97	1.15	1.21	1.11	0.57
Stock Performance					
Dividend Yield (in %)	1.72	1.11	3.18	4.17	4.18
Share Price (in KWf)	385	328	301	269	326

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 252, as of June 30, 2020

Kuwait International Bank

Kuwait International Bank	2015	2016	2017	2018	2019
Financial Position					
Net Loans (KD Mn)	1,374	1,377	1,401	1,698	2,155
Total Deposits (KD Mn)	1,025	1,136	1,214	1,329	1,487
Total Assets (KD Mn)	1,790	1,846	1,916	2,169	2,688
Profitability					
Net Income (KD Mn)	16	18	18	21	17
Operational Efficiency					
Cost to income ratio (%)	35.40	50.72	55.34	55.60	62.09
ROAE (%)	7.00	7.71	7.29	8.26	5.62
ROAA (%)	0.93	1.00	0.95	1.03	0.71
Key Ratios					
Non-performing Loans (% of total loans)	1.43	1.40	1.40	2.50	1.80
Capital Adequacy Ratio	21.68	20.54	19.05	16.63	19.24
Loan Loss Provision (% of Loans)	2.79	0.88	0.72	0.51	0.41
Stock Performance					
Dividend Yield (in %)	3.98	4.37	4.39	3.79	3.86
Share Price (in KWf)	207	189	209	242	261

Source: Refinitiv, NPL ratios from Company Annual Reports, Note: The current stock price is KWf 176, as of June 30, 2020

Foreign banks in Kuwait

Kuwait International Bank	Headquarters	Services	Branch location
Bank of Bahrain and Kuwait	Bahrain	Conventional	Safat
BNP Paribas	France	Conventional	Safat
HSBC Middle East	UAE	Conventional	Safat
First Abu Dhabi Bank	UAE	Conventional	Safat
Citibank	U.S.A	Conventional	Safat
Qatar National Bank	Qatar	Conventional	Dasman
Doha Bank	Qatar	Conventional	Safat
Mashreq Bank	Qatar	Conventional	Dasman
Al-Rajhi Banking and Investment Corporation	Saudi Arabia	Islamic	Safat
Bank Muscat	Oman	Conventional	Souk Al-Dakhly
Union National Bank	UAE	Conventional	Safat
Industrial and Commercial Bank of China Limited	China	Conventional	Safat

Source: Central Bank of Kuwait

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