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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.*

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