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Strategic thoughts:

- Excess liquidity prevented a significant increase in Kuwaiti dinar deposit rates, despite the increase in the Repo rate
- Financing to greenfield businesses is based on assessment of future cash flows, assignment of contracts, ring-fencing of project revenues and direct agreements/step-in rights
- Further delays in approving the debt law will affect the government's ability to borrow to fund new projects

Kuwaiti banks in strong position

How Kuwait's finance sector is tackling market challenges

What are the cost implications of higher levels of liquidity in Kuwait and how will banks benefit?
The local market liquidity in the Kuwait dinar has increased notably over the past two years, driven by three factors.

First, the expiry of the public debt law resulted in a gradual, yet significant, build-up of excess liquidity in the local system following the maturity of local banks' holdings of government bonds (about KD1.8bn). This, however, was partially offset by the Central Bank of Kuwait's (CBK) efforts to increase its liquidity absorption through new issuances of CBK bills (about KD0.5bn in new bills) and via short-term acceptances.

Second, foreign direct investments and the increase in capital flows to the equity market in the wake of upgrading Kuwait's stock market to Emerging Markets status by FTSE and S&P resulted in more purchases of the local currency, thus resulting in an increase in the local currency liquidity.

Third, the lack of credit growth opportunities in the domestic market, especially on the corporate side, on the back of a slowdown in government spending also contributed to the increase in unutilised liquidity.

The resulting increase in local banks' excess liquidity was mostly deployed in short-term low-yielding placements with the CBK or was left idle in non-interest earning accounts, hence resulting in an opportunity loss in comparison with the possibility of placing the excess liquidity in higher-earning longer-term treasury bonds.

On the positive side, excess liquidity prevented a significant increase in Kuwaiti dinar deposit rates, despite the increase in the Repo rate nine times since December 2015. For instance, the spreads paid above the standard counter rates on deposits from high net-worth individuals and large institutions have narrowed quite significantly on the back of the ample liquidity. Moreover, banks are equipped to fund any growth in assets that may come as a result of new government projects.

Has it become less competitive for banks to attract new deposits?
The increase in excess liquidity has reduced the need to compete for deposits in the local market and has subdued market rates, causing banks to turn down expensive deposits more often, which goes in line with the dynamics of supply and demand. However, banks continuously bid for stable and long-term deposits from non-financial sources in order to manage the regulatory ratios and to maintain a robust funding base that would support existing long-term assets and to fund potential future growth.

How much does the bank participate in government project financing and does this impact market share in personal finance?
NBK contributes by a leading share in government project financing. We believe that supporting government projects enables us to have access to auxiliary business such as employee accounts, foreign exchange business and increase our market share in personal finance.

How does the bank provide financing to startups that have no assets?
Financing to greenfield businesses that have limited assets or to businesses whose assets cannot be provided as collateral to the bank for regulatory reasons is done based on rigorous assessment of their future cash flows, assignment of contracts, ring-fencing of project revenues and direct agreements/step-in rights, as applicable.

Are oil price fluctuations causing concern due to ongoing investment spending and the impact on the private sector and its borrowing?
Oil prices have always been volatile as they are not only affected by demand and supply, but also by hard-to-predict geopolitical factors. Budgets are based on an assumed oil price that mostly turns out to be very different from actual prices.

While budgeted public spending depends to some extent on oil price expectations, spending is not directly linked to the actual price. To counteract the typically large swings in oil prices and ensure smooth spending and more stable budget outcome, many oil-producing countries build financial buffers they can resort to when oil prices fall.

In Kuwait, the government has accumulated resources in the General Reserves Fund (resulting from previous budget surpluses and asides savings in the Future Generation Fund) that could be used to maintain public spending and particularly capital when faced with an oil price decline.

Other spending categories, mainly wages and salaries, are recurrent and are not normally affected by oil price fluctuations.

So there are no strong links between ongoing investment spending and oil price fluctuations. In fact, actual spending could fall below the budgeted amount even when the oil price exceeds the budgeted price, and the opposite is true. Actual spending depends on many other factors such as rules and procedures governing project awards, procurement, technical considerations and execution.

On the other hand, oil prices may be thought to have more of an impact on consumer confidence and spending, which tends to be more correlated with oil prices.

While oil price is one factor, there are other reasons affecting credit growth and borrowing, namely, wages, inflation and regulations related to consumer borrowing. For example, the recent relaxation of limits on consumer borrowing by the central bank may have contributed to the pickup in credit growth which reached 5.3 per cent year-on-year in February.

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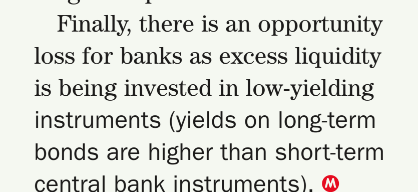
What are the implications of the delayed approval of the new debt law by the Kuwaiti parliament?
The main repercussion of further delays in approving the new debt law is the government's inability to borrow to fund new projects, thus reducing fiscal spending, which in turn could lead to lower economic growth and hence slower growth in banks' balance sheets.

Moreover, the government debt issuances are required to create a benchmark yield curve that helps in developing the capital market and is essential to the financial sector for pricing long-term products.

Finally, there is an opportunity loss for banks as excess liquidity is being invested in low-yielding instruments (yields on long-term bonds are higher than short-term central bank instruments).



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