Kuwaiti Banks' 2020 Financial Statements Analysis Results

CBK: Banking Sector Successfully Weathers First Year of Crisis

The Central Bank of Kuwait (CBK) announced that it conducted a comprehensive review of the financial statements of Kuwaiti banks for the year 2020. This was done as part of its ongoing efforts to bolster the financial stability of the banking sector, considered central to the State's financial system, and ensure its continuous and efficient supply of services to the economy amid highly stressed operating conditions. Thus, the CBK stressed its diligent and proactive monitoring of developments that could affect financial stability. Despite the ramifications of the Covid-19 pandemic on local and international economic conditions, the overall conclusion was that the sector had successfully weathered the first year of the crisis.

His Excellency, Governor Dr. Mohammad Y. Al-Hashel, in a statement, said that in addition to being a health crisis, last year's global pandemic-induced economic crisis was unprecedented in its scope, depth, and impact on economic and financial conditions. The austere lockdown measures shocked both supply and demand, sending global economies into recession and causing a surge in unemployment. Governments intervened as central banks maintained highly accommodative monetary policies to contain the crisis.

CBK preemptively mitigates pandemic's ramifications on the banking sector with over 30 measures.

The CBK proactively pursued accommodative monetary and macroprudential policies geared towards increasing lending and financing capacities for banks to counter the effects of the pandemic on the economic and banking system, all within an integrated scheme of measures that protects the banking and financial sector. This is in line with the main mandates of the CBK to maintain both monetary stability and financial stability.

Dr. Al-Hashel remarked that the banking sector's success in weathering the first year of the crisis was a result of CBK's diligent efforts over the past decade and its preemptive approach to supporting the positions of the country's monetary and banking system's units. This approach comes within a regulatory framework aimed at bolstering financial stability through both microprudential and macroprudential tools to curb systemic risk and maintain financial stability.

Macro-prudential policies helped the banking sector weather crises over the past decade through enhancing risk management, strengthening capital bases, setting up precautionary provisions, and implementing Basel III reforms.

Foremost among the pillars of the CBK's macroprudential policy and instruments in recent years, and within its preemptive, forward-looking measures, was enhancing risk management in the banking sector, bolstering the capital bases, and building precautionary provisions. This is in addition to implementing the Basel III standards that serve as a comprehensive and integrated package to enhance banks' financial soundness indicators, strengthen their positions, and further ensure conditions needed to maintain financial stability through increasing both capital adequacy and quality, enabling greater shock absorbing abilities. The Basel reforms package also urges diverse additional capital buffers, and liquidity standards to enhance banks' ability to counter liquidity pressures and enhance the stability of their financing structures. This is to be added to other standards related to enhanced governance and reduction of risky exposures to financial and real estate markets.

Despite the challenging operating environment, the Governor stated that analysis of Kuwaiti banks' financial statements for the year ending in December 2020 demonstrated the sector's strength and resilience of its financial soundness indicators amid a devastating crisis that is wreaking havoc on global economies.

Despite the crisis that is wreaking havoc on world economies, analysis of Kuwaiti banks' financial statements indicate they are in a position of strength.

Such was also the result of the financial stress tests, which demonstrated banks' strength as they countered shocks and continued operations amid difficult conditions. These tests, Dr. Al-Hashel added, were based on scenarios designed according to the newly implemented CBK stress testing framework and covered aspects of the Covid-19 pandemic and its diverse implications on the banking sector's solvency, liquidity, and profitability.

Banking Sector Demonstrates Strong Financial Soundness Indicators

Kuwaiti banks continued to show strong financial soundness indicators in terms of capital adequacy and liquidity ratios. At the end of December, the Capital Adequacy Ratio (CAR) was at 19.0%, comfortably above the CBK's mandated minimum of 13.0% and the Basel Committee on Banking Supervision's (BCBS) requirement of 10.5%. Although the CBK had allowed banks to use their capital conservation buffers, they continued to operate without resorting to this option owing to their strong CARs.

Banks continued operations without resorting to their conservation buffers, and even managed to increase Capital Adequacy Ratio and boost Regulatory Capital.

Moreover, CAR improved from 2019's 18.5%, which was mainly a result of banks bolstering their regulatory capital through increased international issuances. These issuances are eligible for inclusion in the calculation of the capital base according to BCBS's standards. This indicates the high level of confidence in Kuwaiti banks internationally.

When it comes to liquidity ratios, the banking sector is still seeing an abundance of liquidity reflected by several indicators, including Liquidity Coverage Ratio, reaching 184.2% against a minimum of 100%. The Net Stable Funding Ratio meanwhile came close to 115.3%, in turn higher than the minimum of 100%, while Regulatory Liquidity reached 27.5% against a minimum of 18%.

The banking sector's abundant liquidity allowed it to properly function.

Banks Maintain Asset Quality

Despite the effects of the pandemic on economic and banking conditions, banks succeeded in maintaining a high degree of asset quality, supported by strong financial soundness indicators that weathered severe conditions and confirmed the banking sector's ability to withstand shocks.

Provisions accumulated over the past decade were used towards bad-debt write-offs and maintaining agile statements.

This can be attributed to the constant allocation of provisions to counter requirements of bad debt write-offs and the accumulation of such provisions, which act as buffers and support banks' financial positions. This, in turn, enables banks to continue serving all sectors of the domestic economy competently and in a balanced manner, taking into account the interests of all concerned parties.

Specifically, loan loss provisions charged on the banks' income statements reached about KD 852 million in 2020, whereas the increase in overall value of banks' available provisions reached KD

403 million, indicating the utilization of the remaining balance towards bad-debt write-offs.

Non-Performing Loans (NPLs) Ratio, which could have spiked due to closures and dampened economic activity both in Kuwait and in countries where Kuwaiti banks operate, increased by 0.5% amid the unprecedented crisis from 1.5% in 2019 to 2.0% in 2020. Furthermore, this figure remains at historically low levels, inspiring even more confidence in the strength of our banking sector.

NPL Ratio showed slight increase only, and remains at historically low levels.

Meanwhile, NPL Coverage Ratio (provisions to NPLs) dropped from 271% to 222% mainly as a result of utilizing these provisions towards the purposes for which they had been created. The ratio remains at healthy levels, boosting asset quality and serving as an additional buffer to counter any potential worsening in the credit portfolio that may arise if the pandemic persists.

Bank Credit Continues to Grow

The measures introduced by the CBK in terms of accommodative monetary policies and of regulatory policies geared to bolster bank credit growth and to promote economic activity amid the pandemic have resulted in the continued positive growth in credit facilities despite last year's markets closures.

The CBK's reduction of the Discount Rate to a historic low of 1.5% was accompanied by an increase in credit facilities.

At the end of December, the Net Credit Facilities Balance, on a consolidated level, amounted to KD 51.8 billion, an increase of 4.3% and KD 2.1 billion from December 2019. This growth in credit facilities started during March 2020, coinciding with the CBK's decision to bring down the Discount Rate to an all-time low of 1.5%.

High Profitability Despite Challenges

Banks continued to be profitable in spite of lockdowns, customers reduced ability in fulfilling their debts, consumer, housing, and credit card debt moratoriums.

As was the case with most other world economies, the pandemic resulted in increased implications on the Kuwaiti banking sector's operating environment. Banks faced challenges in terms of profitability which resulted in their net income slipping from KD 964 million in 2019 to KD 495 million in 2020, a drop of 48.7%.

The drop in net income was partially due to a drop in operating revenues and to the consolidation of provisions, which took into account the direct effects of the pandemic on the economy, and the possibility of further market closures amid uncertainty and new waves of infections. This would detrimentally impact clients' ability to meet their debt obligations and thus requires further provisions to counter any possible increase in NPLs or depreciation of investment assets. Kuwaiti banks' initiative of introducing moratoriums for consumer, housing, and credit card installments also had a hand in weighing down on profitability.

Banks Successfully Pass Stress Tests

The Covid-19 crisis was undoubtedly a true and difficult test for local banks, stressing both their financial position and service continuity. And for added reassurance in the banking sector's ability to counter anticipated shocks, the CBK conducted stress tests based on a newly introduced stress testing framework developed in accordance with the best international practices. The framework, the CBK Governor pointed out, takes into consideration several financial, micro- and macro-economic variables based on three scenarios covering a period spanning three years. The first scenario hypothesizes a strong blow to a single sector in the real economy. The second consists of a wider multi-sectoral shock in the real economy. The third scenario hypothesizes a wide-ranging global crisis triggered by new waves of Coronavirus infections that bring about wider closures and further suspension of economic activity.

The stress tests revealed the banking sectors' soundness and ability to continue operations amid harsh operating conditions.

The stress tests revealed the resilience of the Kuwaiti banking sector which maintained an average CAR of 11.4% by end of 2023, a relatively high level given the severity of the scenarios considered in the tests and in contrast with the BCBS minimum requirement of 10.5%.

It is still premature to declare the end of the crisis. A continued vigilant, composed hedging approach is required along with the cooperation of all parties.

Concluding the statement, His Excellency the Governor of the Central Bank of Kuwait Dr. Mohammad Y. Al-Hashel remarked that the CBK shall maintain its firm supervision of the banking sector while also maintaining vigilance and a composed hedging approach so that banks remain able to provide their services to all segments of the domestic economy efficiently and without disruption. The crisis, he noted, is far from over.

And while it looks to the future with optimism, the CBK shall continue to diligently monitor economic and banking conditions so that the economy safely overcomes this period. It also continues to strive, he said, to bolster monetary stability and financial stability, which are key requirements, though not sufficient on their own, for sustainable economic stability.

The CBK again stresses the importance of comprehensive structural reforms and their speedy implementation to ensure inclusive sustainable prosperity.

Thus, the CBK again stresses the importance of expediting the implementation of comprehensive reforms of the complex and deep-rooted structural imbalances of our economy. We need to cruise forward to defeat the challenge rather than countering its consequences, and treat the disease rather than alleviating the symptoms. So long as oil-based revenues dominate, and current expenditures grow, and effective corrective measures remain absent, the State's general budget will remain under an accumulated financial deficit, and therefore it is of utmost importance to address these challenges before they escalate, so that we may succeed in sustaining prosperity and developing the national economy in order to preserve rights of present and future generations.

24/02/2021