CBK held its Inaugural Financial Stability Report Symposium "Resilience in the face of Adversity"

The Central Bank of Kuwait (CBK) held a symposium launching the 9th Financial Stability Report for 2020 on Monday 26 July 2021 at 10:00 a.m. at the CBK headquarters as well as through online channels. The planned event intended to address the major economic developments at both domestic and international levels, and presented an overview on the financial sector in the State of Kuwait. The event hosted prominent economists as panelists and discussants from locally and globally renowned institutions.

Dr. Mohammad Y. Al-Hashel, Governor of the Central Bank of Kuwait, inaugurated the event stating that the Financial Stability Report 2020 gave both a broad and focused examination of financial stability in Kuwait in a year of unprecedented challenges. The covid-19 pandemic prompted many countries to introduce preventive measures including partial and full lockdowns leading to a halt in economic activity, as constraints materialized on both supply and demand leading to unprecedented impact on both lives and livelihoods.

Dr. Al-Hashel added that given the widespread and accelerated transmission, including multiple waves of the virus and consequent impact on the economy, the economic outlook was clouded to an unprecedented degree, exceeding levels seen during the Global Financial Crisis. This in turn led to frequent revisions of GDP projections by international economic bodies, including the International Monetary Fund. Such uncertainty made it difficult for the fiscal, monetary and economic policymakers to make effective decisions and develop plans to mitigate the crisis-induced repercussions, economic deterioration, and drastic job losses. The contraction in global GDP was unparalleled in scale and speed, estimated to be around 3.3%, five times worse than during the Global Financial Crisis. These effects were also reflected through job loss, with the US unemployment rate dramatically surging to 14.7%.

The Governor added that Kuwait faced a dual crisis, where it needed increased medical and strategic spending to mitigate the lockdown implications and support vulnerable sectors of the economy, while simultaneously grappling with an all-time high estimated budget deficit of KD 10.8 billion for 2020/2021, i.e., 29% of GDP, attributable to the plunge in Kuwaiti crude oil prices. Weakness in oil markets was best demonstrated by WTI future contracts, which fell in April 2020 into negative territory for the first time in history. This highlights Kuwait's heavy dependence on oil revenues and the deep-rooted financial, economic and structural imbalances that need to be addressed immediately.

The Governor also explained the CBK's role and proactive measures taken since March 2020 to counter the fallout of the covid-19 pandemic. Such measures included, but were not limited to, cutting the discount rate to a historic low of 1.5% and releasing the capital conservation buffers. This led to a reduction in financing costs and induced banks to lend more by increasing their maximum lending limits, thus empowering them to continue to fulfill their intermediation role in tighter economic conditions. The exceptional nature of this crisis emphasized the CBK's role as the government's financial advisor, which was showcased when CBK spearheaded efforts in the domestic economic recovery, implementing a slew of relief measures announced under the Council of Ministers Resolution No. 455, forming a Higher Steering Committee for Economic Stimulus chaired by the Governor of the Central Bank of Kuwait. The mandate of said committee, included, among others, the implementation of stimulus for the local economy in the report produced by the economic team comprising various public and private entities, and was entrusted to provide its insights to address the coronavirus-induced economic and social impacts. The Committee presented proposals and measures, including:

- Support of the national workforce in the private sector by doubling the allowance extended to the national labor registered under the Third and Fifth Chapters for six months, i.e. 72,000 employees[1].

- Drafting a set of labor and rent laws, and supporting and guaranteeing financing to incentivize the banking sector to lend, based on which the Law No. 2 of 2021 on the Rescue of Small and Medium Enterprises (SMEs) Impacted by the Repercussions of Covid-19 Crisis became issued on 18 April 2021.

To this end, and in line with its sense of social responsibility, the CBK in collaboration with a number of banks took several initiatives, chief among them were the following:

- Return to work protocols for the banking sector in collaboration with an international consultant to ensure the safety of banks' customers and staff.

[1] Chapter Three refers to Kuwaitis registered with the Public Institution for Social Security as working for a private sector employer. Chapter Five refers to Kuwaitis registered with the Public Institution for Social Security as self-employed.

- KD 10 million fund placed at the disposal of the Cabinet.

The Governor mentioned that these measures build on decade-long efforts by the CBK to reinforce both monetary stability and financial stability by adopting prudential policies that enhance the resilience of the Kuwaiti banking system, which allowed it to enter the crisis from a position of strength.

Mariam R. Abdulsalam, CBK Deputy Manager of the Financial Stability Office, gave an overview on the development of the banking sector's financial position and key soundness indicators. She explained that the Financial Stability Report analyses the Kuwaiti banks on a consolidated basis. She pointed out that, unlike the previous crises during which banks needed support and sometimes propagated the initial shocks, banks played a vital role during the pandemic towards economic recovery. Thanks to the support by the prudential oversight over the last decade and the pre-emptive measures for liquidity and capital that increased the lending limits, the banking sector was able to continue to fulfill its intermediation role and extend credit to the various economic sectors during the crisis. Despite the pandemic-driven contraction in nominal GDP, the banking sector maintained a positive trajectory with total assets up 2.9% YOY, reaching KD 85.4 billion. Deposits witnessed an increase of 4.1%, even with the historically low discount rate, to reach an all-time high of KD 61.1 billion, of which 78.1% were sourced locally. The increase reflects individuals' confidence in local banks. The banking sector, on a consolidated basis, achieved a net increase of KD 2.5 billion in the credit portfolio at 4.8%, which is considered a good sign given the severe crisis, lack of consumer confidence, and overall material uncertainty.

Abdulsalam mentioned that the banking sector's Non-Performing Loans Ratio remained healthy at 2%. As provisions were utilized for write-offs, and coupled with the slight increase in non-performing loans, the coverage ratio declined, yet remained sturdy at 222%. Moreover, banks remain flush with liquidity as reflected by the Net Stable Funding Ratio and Liquidity Coverage Ratio, at 115% and 184% respectively (against the required minimum of 100%), while the regulatory liquidity levels reached 27.5% against the required minimum of 18%. She concluded her statement by providing assurance that, unlike many countries that faced a liquidity crunch and required central bank intervention, the CBK, being the local monetary authority, opted to absorb rather than to inject surplus liquidity as is customary in times of crises.

Haya B. Al-Humaidi, CBK Manager of the Financial Stability Office, said that despite the unprecedented operating challenges, e.g., partial and total lockdowns, curfews, halt in economic activity and slump in real estate sector, which impacted banking customers and resulted in increased defaults, loan moratoriums and all-time low interest rates, banks still managed to register healthy net income attributable to shareholders, at KD 455 million. In addition, banks collectively maintained a higher capital adequacy ratio of 19% at year-end, and did not need to use their capital conservation buffers. They were able to continually operate and contribute to the domestic economy.

She added that the pandemic was a true test of the resilience of the banking sector. Despite the banking sector successfully navigating the first year of the crisis, the CBK continues to ensure that such achievements revolving around the integrity and resilience of the sector are sustained well into the future. Thus, the CBK conducts quarterly stress tests. Last year, the CBK, in cooperation with a global consulting firm, updated the stress-testing framework to fit the shifting economic landscape of the crisis. The new framework is highly dynamic and enables flexible scenario setting that incorporates macro and micro economic variables. This stress-testing tool enables the CBK to identify vulnerabilities of individual banks so that, if necessary, it can take corrective actions to address any potential issues.

Al-Humaidi further explained that the new stress testing framework involves three main phases, where phase one entails hypothetical sectoral shocks (e.g. defaults in loan portfolios, changes in interest rates, and a drop in stock prices and real estate prices). In phase two, the direct and subsequent impacts of shocks on the sector are measured. The direct impact involves higher credit and market risks resulting from deterioration in asset quality, and pressure on the interest margin. This is followed by a subsequent shock in the form of a liquidity crunch, which would result from expected deposit withdrawals and higher cost of funds, ultimately transforming into a solvency issue if not adequately addressed. Phase three involves analyzing the effect of the shocks on the sector’s financial position and on the key indicators of financial soundness, allowing the CBK to take appropriate prudential action at a sectoral or individual bank level.

She added that the framework is 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 on the country-level. The third scenario hypothesizes a wide-ranging global crisis. She concluded that the stress tests revealed the resilience of the Kuwaiti banking sector, which maintained a CAR higher than the BCBS minimum requirement of 8% - even under the harshest scenario.

In the last section of the presentation, the Governor discussed the outlook amidst the unprecedented uncertainty that the crisis has caused globally. He stated that the economic turbulence that the world is experiencing, at its core, is an unfortunate health crisis, which should be remedied first and foremost. He confirmed that the COVID-19 pandemic is the defining global health crisis of our time and should be addressed by expanding vaccine rollouts and guaranteeing equitable access to vaccines to achieve herd immunity. However, only 12% of the world population is fully vaccinated, and more efforts should be expended to ensure that more people are inoculated.

The cost to world authorities in ensuring that individuals and companies battle through the pandemic amounted to around USD 20 trillion (24% of global GDP) through fiscal, monetary, and macroprudential instruments. However, a significant portion of support was funded by borrowing, with world debt reaching an all-time high of USD 289 trillion, i.e. 360% of the global GDP (an increase of USD 30 trillion in 2020 alone). Asset purchase programs and massive liquidity injections have driven the strong recovery of stock markets. As per the IMF statements, the liquidity injected in 2020 by the central banks exceeded those injected over the last decade.

To explain the effect on the markets, the Governor introduced a comparison with the Global Financial Crisis (GFC) during which the stock market recovered post the initial shock. For example, while MSCI took 1,890 days to return to its pre-crisis level during the GFC, it took only 196 days after the Coronavirus economic shock to not only recover but to increase 88% from its lowest level recorded in March of last year. The direct financial support and pent up demand during the lockdown periods led to a strong rebound of personal consumption exceeding pre-crisis levels. These measures and actions identified certain vulnerabilities that represent a classic concern of dealing with a crisis, which is to risk planting the seeds of another crisis.

The Governor shed light on the concerns of rising inflation and the importance of caution in setting the time for unwinding the support measures, particularly for other economies given the interconnectedness of the global markets. In this regard, the Governor said that any swift and disorderly reduction of financial support by reducing subsidies, loan guarantees, or ceasing payment deferrals may lead to increased bankruptcies. In addition, any prompt action by the monetary authorities to mitigate the asset purchase programs and gradually increase the interest rates would tighten financial conditions and increase the borrowing costs, adversely affecting the ability of individuals and corporates to serve their debts. Similarly, if the regulatory authorities opt not to reduce the capital and liquidity requirements, some banks may curb the extension of credit in order to meet stricter regulatory requirements, and the resultant financial conditions would be tighter.

In addition, Dr. Al-Hashel explained that there are other risks that could stem from cross-border economic contagion. For example, if measures are not retracted in a country, the early tightening of monetary policy by a central bank in any of the major economies, such as the Federal Reserve, would lead to capital outflows in the emerging markets that may have been under pressure. Oil prices and geopolitical challenges are also potential concerns.

Dr. Al-Hashel concluded that Kuwait has a small, but relatively open economy that will inevitably be impacted by developments in major economies, as well as highlighting the present structural imbalances that need deliberate remedies. He assured that CBK, so far, effectively deployed its monetary and macroprudential instruments and tools to ensure monetary and financial stability despite the unprecedented pandemic-induced shocks. The CBK shall continue its close monitoring and early intervention to preserve these achievements. Monetary stability and financial stability on their own are, however, insufficient in ensuring a stable and sustained economy. There is an urgent need for immediate and decisive actions and the consolidated efforts of all stakeholders to adopt effective financial and structural reforms to maintain inclusive sustainable prosperity.

The first discussant was Daniel Kanda, The IMF Mission Chief for Kuwait who joined via a video intervention. At the outset, Kanda thanked the Governor and mentioned that the well-written 2020 Financial Stability Report provides valuable input to policymaking at this critical juncture of economic recovery. It provides an in-depth discussion of the impact of the pandemic on the financial sector, financial sector vulnerabilities and risks, and the performance of the banking sector, real estate and capital markets. He commended the skillful regulatory oversight of the Central Bank of Kuwait and the pre-crisis strong buffers with banks that remained well-capitalized and liquid during the pandemic. He also commended the CBK’s close monitoring of financial sector developments and risks, and pre-emptive and proactive approach to assess and mitigate any unexpected shocks to financial sector resilience. Kanda concluded that credit risks remain given substantial uncertainty on the outlook, and the need to remain vigilant, as this challenge is not unique to Kuwait.

Maxim Rybnikov, EMEA Director, from Standard & Poor’s (S&P) Sovereign Ratings Team participated via a video and mentioned that Kuwait banking sector risks compare favorably with peers not just regionally, but globally, and the Kuwaiti banking system has historically been well-regulated. He added that S&P regularly publishes banking industry country risk assessments, which rank banking sector risks on a scale of 1 to 10, with one being the strongest and 10 the weakest. Kuwait banking sector currently in group 4, on par with banking systems of Ireland, Poland and Spain. Kuwait's banking sector risks are only one category higher in their view than those for Australia, France, Germany, UK and the US that are in group 3. Within the GCC, only Saudi Arabia ranks in group 4, with other banking systems ranking weaker.

The Financial Stability Report 2020 is available on CBK’s website www.cbk.gov.kw.

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