

## COVER STORY

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28<sup>th</sup> October 2020 (Volume 17 Issue 43)

## Kuwait: A compelling proposition

IFN returned once again to Kuwait last week for yet another lively, positive and progressive forum discussing the latest achievements and enormous future potential of the Kingdom within the Islamic finance arena. Already an important market for Islamic finance and with a long-standing commitment to Shariah compliant banking, recent regulatory progress in Kuwait has paved the way for yet further growth, allowing the country to stretch its wings as a pioneer within the Islamic finance industry. LAUREN MCAUGHTRY writes.



Issam

The opportunities for Islamic finance to flourish in the state. Moderated by Issam Al Tawari, the founder and managing partner at Newbury Consulting, the panel debated how Islamic finance in Kuwait could contribute to the country's growth and development while still supporting sustainable and socially responsible finance and investment strategies.

The wide-ranging conversation also discussed the complexities of bank consolidation in the country and evaluated the best course of action for the domestic Islamic banking industry, attempting to create a new roadmap for success across the retail, wholesale and capital markets.

There is no denying that Kuwait in 2020 has faced some challenges, and it has been an exceptional year from all angles. Oil prices started the year at US\$60 and dropped to as low as US\$11. Kuwait's budget is based on a price of about US\$55 and it is currently sitting at about US\$41, making the situation obviously uncomfortable. Kuwait entered the year with a deficit of around KWD9.4 billion (US\$30.66 billion), and this is expected to go up to KWD13-14 billion (US\$42.41-45.67 billion), so the public



debt law and the possibility of Sukuk comes at a timely point — but what can the Kingdom's economy expect over the coming year? Kuwait saw the longest lockdown in the world, and along with the oil price shock the COVID-19 crisis has also shaken its economy — particularly with the deferral of consumer loan payments, which has cost the Kuwaiti banking system an estimated US\$1 billion and seen the potential postponement of the long-awaited Kuwait Finance House (KFH)/Ahli United Bank (AUB) merger. Moody's Investors Service downgraded the sovereign for the first time in September, a month that also saw the tragic passing of Emir Sheikh Sabah Al-Ahmed Al-Sabah.

The implication of all of these elements will be drastic on both the Kuwaiti economy and the Kuwaiti financial system. But can the Kingdom's Islamic banking system weather the storm? On the whole, the panelists were optimistic.

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**The inaugural IFN Non-Banking Financial Institutions Poll is NOW open!**

**CLOSING DATE: 31<sup>st</sup> October 2020**



## Kuwait: A compelling proposition

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Dr Jamshaid Anwar Chattha, the former assistant secretary-general of the IFSB, was matter-of-fact about the situation. "Kuwait's major source of revenue is in trouble. So Kuwait is absolutely in trouble. The only question is the magnitude of the trouble, and what efforts are taken to get out of this trouble," he stated. "The banking sector entered the crisis from a position of considerable strength, but the health crisis and the oil price crash is going to make things very difficult for them and we will see that coming through in the 2021 results.



Dr Jamshaid

very conservative, even compared to its peers in the region, and that has helped it weather this storm quite well. But going forward, it will need to become more entrepreneurial and come up with some more ideas to energize the sector going forward."

Nitish Bhojnagarwala, the vice-president and senior credit officer at Moody's Investors Service, gave some valuable context. "Despite the unique position of Kuwait due to its reliance on oil prices, from an economic standpoint we expect non-oil GDP, which is where most of the Islamic banks and financial institutions do their business, to see a 4.5% decline in 2020, but we expect that to recover in 2021 with growth of 2.2%, and then a further 2+% growth in 2022.

So growth and the economic activity will come back. From a macro standpoint there are no unique headwinds, and some emerging markets have declined much more than Kuwait. And from a banking and financial institutions' perspective, they are coming into this from a position of strength, and the system is one of the most resilient in the region — which has much to do with the way the central bank has been running things, and its focus on building up high provisions. There is certainly a recovery in the pipeline."

In fact, the outlook is surprisingly optimistic, despite the headwinds. "While the medium- to long-term prospects are good, in the short term there are some challenges ahead, primarily driven by COVID-19," admitted Cassim Docrat, a director at DDCAP. "But in the wholesale market on the liquidity management side, we have found quite a resilient climate with liquidity being managed very well.

In terms of new business there hasn't been a lot of activity, but in terms of resilience, most of the Islamic institutions we deal with have not seen much fallout yet,

especially when compared to other markets in the region. That resilience is interesting."



Nitish

"Islamic banks have been extremely resilient and in our assessment we feel they have the right buffers in terms of capital and loan-loss reserves that will help them navigate future challenges," agreed Nitish.

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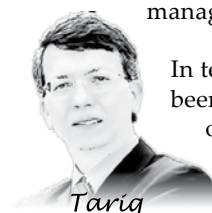
Mohammed Bader Al-Jouan, a senior advisor of investments at Ahli Capital Investment Company, agreed.

"The country's macroeconomics is not healthy, no. But the environment for doing business in Kuwait before COVID-19 was on a slow growth track, and I believe it will go back to that."

"Kuwait is facing a fiscal crisis, but it is not unique — the entire region is facing a crisis," pointed out Tariq Al-Rifai, CEO of the Quorum Centre for Strategic Studies. "The Kuwaiti central bank is



Mohammed Bader



Tariq



Cassim

Within the central bank, the inclusion of a higher Shariah authority could be a new beginning, suggested Cassim, that could push Islamic banking forward in Kuwait. In addition, the inter-country merger between KFH and Bahrain's AUB could be immensely important, on the scale of the Abu Dhabi Commercial Bank–Union National Bank–Al Hilal Bank merger in Dubai, when it comes to creating an influential player with real clout in the Islamic space.

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“The banks will get over this crisis,” stressed Dr Jamshaid. “Sovereign issuance is also going to be inevitable, but Sukuk should not just be due to fiscal deficit. They should issue on a regular basis if they want to develop a robust capital market with the confidence of investors.”

### Finding the funding

The second day took the conversation to a whole new level, drilling deep into the real opportunities that exist in Kuwait and how these can realistically be funded.



Abdul kader

Led by veteran Islamic finance expert and SHAPE Group CEO Abdul kader Thomas, it discussed the viability of Sukuk as an option for Kuwaiti banks to enhance their liquidity and explored the benefits that technology could bring to the table for banks seeking to diversify their funding sources.

**“ Our market is in love with two asset classes: it’s always either equities or real estate ”**

Never shy of touching on controversial topics, the panel also debated honestly and openly the requirement for ongoing regulatory change to help address the ongoing challenges in the real economy and mobilize Islamic finance to provide much-needed support during the current COVID-19 crisis.

Finally, it also examined the country’s infrastructure requirements in the coming years, asking what could perhaps be funded through Islamic

facilities, how could that risk be effectively managed and whether public-private partnerships offered a viable opportunity to do so.



Noura

“Our market is in love with two asset classes: it’s always either equities or real estate,” elaborated Noura Alabdulkareem, the head of the markets sector at Bourse Kuwait. “The flow of liquidity between these two asset classes is not ideal, whether it terms of portfolio allocation or risk mitigation. This brings us to bonds and Sukuk — how can such a global asset class be of such negligible value in our market?”

The knowledge of such an asset class locally is largely reserved for treasury desks within banks, and some investment firms that offer some type of fixed income funds. Last time I checked the central bank website, the total issuances of the government were around KWD4.5 billion (US\$14.68 billion), the majority focusing on short-term maturities. Part of our initiative here at Bourse Kuwait is to create a platform for actually trading fixed income and Sukuk. As we try to bridge that gap, we realized our market is fragmented in terms of types and means of trading.

**“ But in 2020–21, Islamic banks will focus more on improving asset quality, and focus less on business growth ”**

We have the backing of the Capital Markets Authority, and we are making great efforts to advance the fixed income asset class by creating more robust rules and creating this platform for trading. But will that bring in investors who will adopt? We have a non-existent

yield curve, a relatively small value of corporate issuances, a scarcity of trading between banks and a lack of detailed knowledge of the asset class.

The main driver of the Kuwaiti capital market is the retail investors, and we need to get them involved and raise awareness about the importance of bonds and Sukuk. We should phase out the CBK [Central Bank of Kuwait] full guarantee of deposits, so that people invest in CBK issuances rather than locking their money up in guaranteed deposits.”

“Kuwait has officially recorded a budget deficit, and they need to issue public debt,” pointed out Dr Hessah Al-Motairi, an assistant professor in the Department of Mathematics at Kuwait University. “The public debt law, that would allow the government to issue bonds and Sukuk, hasn’t been approved yet but we are waiting for it to launch and it should be imminent.”



Dr Hessah

MR Raghu, the executive vice-president and managing director at Marmore Mena Intelligence, pointed out that Islamic banks still entered the current pandemic in a very good position in terms of asset quality, profitability and capitalization. “This is probably what is sustaining us now. But in 2020–21, Islamic banks will focus more on improving asset quality, and focus less on business growth. So we need to be mindful of the big picture.”



MR Raghu

Finally Ajai Thomas, CFO at Kuwait International Bank, was articulate on the importance of sustainable and socially responsible finance, particularly through the UN Sustainable Development Goals and how these correlate to real asset-based, ethical Islamic finance objectives.



Ajai

To hear the full conversation and learn more about the detailed opportunities, challenges and outlook for Islamic finance in Kuwait, download or listen to the whole event for free at [redmoneyevents.com](http://redmoneyevents.com). ☺