

WORLD / MIDDLE EAST / KUWAIT

# Kuwaiti banks reap the rewards of economic boom year

**Hassan Jivraj** | 27/03/2023 8:52 am

*Big deal: KFH is on course to become the second largest Islamic lender in the world by assets.*

**KFH's long-trailed acquisition of Bahrain's AUB has further concentrated banking in the hands of the country's two largest institutions, writes Hassan Jivraj.**



Two years after recording its worst performance since the first Gulf War, Kuwait's economy rebounded and then some in 2022, reaping the benefit of a surge in oil prices following Russia's invasion of Ukraine.

The economic windfall provided a boon for the country's lenders, which recorded their strongest credit growth since 2015, alongside healthy deposit rises and strong profitability.

Activity is set to cool slightly for 2023 on the back of lower oil revenues following cuts to production agreed by OPEC+ (a group comprising the Organization of the Petroleum Exporting Countries, along with 10 other major oil producing countries — notably including Russia), with an anticipated further uptick in interest rates and ongoing political gridlock set to dampen credit growth for the year ahead.

While the Covid-19 pandemic and accompanying slump in oil prices put the brakes on lending growth in 2020, activity has steadily increased since then, rising by 6.3% in 2021 and 7.7% in 2022, according

to data from the National Bank of Kuwait (NBK). The bank — Kuwait's largest by assets — reported that credit growth had begun to slow towards the end of the year, in a trend that is set to continue into 2023.

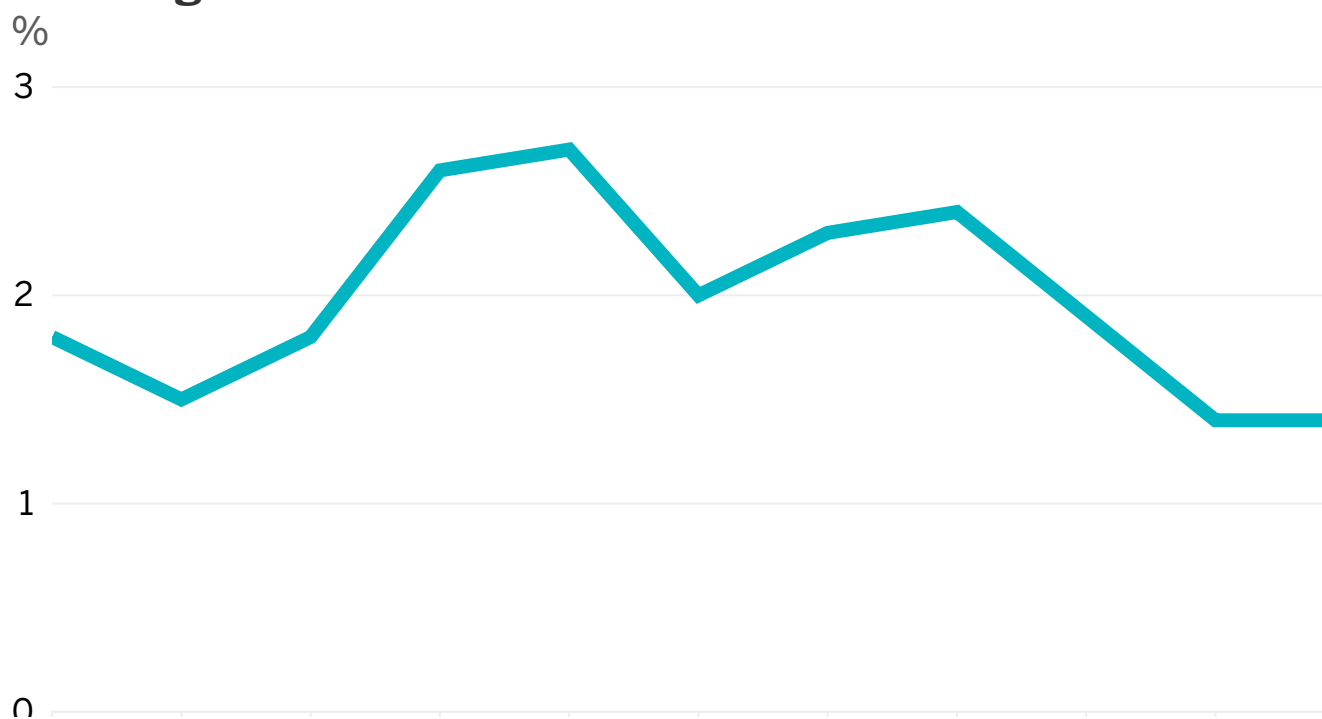
“There's some uncertainty on credit growth following the resignation of the government [in January], although we still expect credit growth to be around 5% for 2023,” says Ashraf Madani, a vice-president and senior credit officer at Moody's, noting that lower oil prices were the main downside risk for the banking system.

“[However] we expect key solvency indicators to remain largely stable and there to be no pressure on funding or liquidity.”

Capital adequacy ratios for the sector slipped from 19.1% at end-June 2021 to 18.4% a year later, according to the latest data from the Central Bank of Kuwait (CBK), although this figure remains comfortably higher than the bank-mandated pre-Covid minimum level of 13%, as well as the 10.5% threshold recommended under Basel III standards.

Sector-wide gross non-performing loans (NPLs) remain at comfortably low levels even as interest rates begin to rise, standing at 1.5% at end-June (compared with 2.8% for the year previous period), with NPL coverage in excess of 300%.

## Kuwait gross NPLs to total loans



Source: Central Bank of Kuwait

“We believe that higher interest rates [could] pose a challenge for sectors including real estate, but ... lending to the construction sector is expected to remain elevated in the near term,” says Junaid Ansari, head of investment strategy and research at Kamco Invest, a local asset management firm.

After dipping in 2021 — the first time since 1999 — overall banking deposits bounced back in 2022, rising by 5.3% to Kd46.9bn (\$152.8bn) thanks to an 18.2% rise in government deposits, even as deposits from public institutions fell by 6.3% for the year.

## M&A activity

Beyond the all-round strong performance from lenders in 2022, the year marked the closure of Kuwait Finance House's (KFH's) \$11.6bn acquisition of Bahrain's Ahli United Bank (AUB). The deal represents a rare cross-border deal within the Gulf Co-operation Council (GCC), and cements KFH — Kuwait's second-largest bank — as the latest in a group of regional megalenders formed via mergers and acquisitions (M&As) in the past seven years.

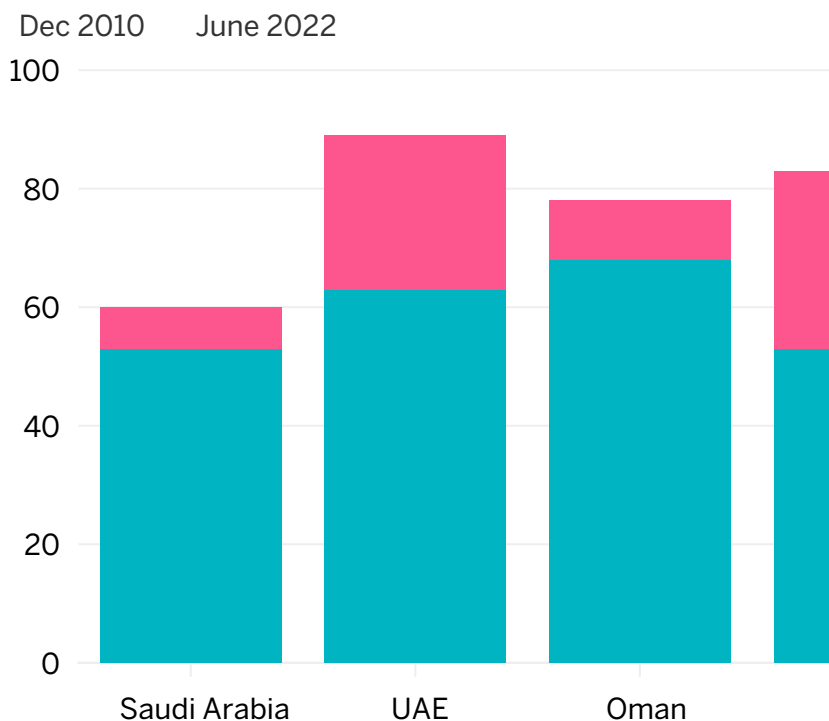
KFH first began studying a possible merger with AUB in July 2017, although the deal faced a series of delays, with the CBK asking KFH to reassess the deal in March 2020 at the outset of the Covid pandemic. The central bank finally gave its blessing to the deal in July 2022, paving the way for its completion three months later.

KFH's post-acquisition strategy includes conversion of AUB Bahrain and its subsidiaries into sharia-compliant businesses, as well as converting AUB Kuwait into a digital bank. Once this process is complete, the acquisition will make KFH the second-largest Islamic lender in the world by assets (behind Saudi Arabia's Al Rajhi Bank), creating a lender with assets of around \$121bn.

By absorbing AUB's Kuwaiti operations, KFH's market share of domestic assets has increased from around 22% to 28%, according to calculations by Fitch, helping to close the gap with NBK, which holds a market share of 33% (including its subsidiary Boubyan), while also boosting KFH's international footprint.

## Top five banks' market shares by loans

%



“The successful completion of KFH's acquisition of AUB [has] enhanced KFH's regional footprint with access to new markets (including the UK and Egypt),” says Abdulwahab Iesa Al Rushood, acting group CEO of KFH.

The increased dominance of NBK and KFH has once again raised the prospect of further consolidation in the market among the country's smaller lenders.

“After the acquisition of AUB, KFH and NBK have more than 50% market share in Kuwait (based on assets), placing them in a strong position compared to their competitors,” says MR Raghu, CEO of Marmore Mena Intelligence, a subsidiary of Kuwaiti asset management firm Markaz.

“Considering the increasing competition, we can expect further consolidation moving ahead.”

A March report from Moody's forecasts that M&A activity is set to continue across the wider GCC banking sector, with consolidation helping lenders expand revenues and achieve cost synergies in the medium term. The trend is set to increase the dominance of the region's biggest players within their markets (see figure).

“We still believe there is more room for consolidation in the [Kuwaiti banking] system. The competition is high and the impact is noticeable, especially on the consumer side where margins face extreme pressure,” said Mr Madani. “Two banks are already discussing M&A options and may see a deal concluded in 2023. Overall pressure on the smaller banks is higher than larger ones, but shareholder expectations remain high.”

In August 2022, Al Ahli Bank of Kuwait (ABK) and its smaller retailed-focused Gulf Bank inked a memorandum of understanding (MoU) on a proposed acquisition of one of the two banks over the other, with the possibility of converting one of them into a sharia-compliant bank.

Beyond this deal, however, further consolidation in Kuwait may well prove unlikely, given the relief brought by higher oil revenues.

“We don't expect to see any further consolidation in the sector in the near term in Kuwait, given a balanced market, and healthy credit profiles and profits growth for most banks in the country,” says Kamco Invest's Mr Ansari.

## Going green

In November 2022, at COP27, Kuwait pledged its commitment to achieve carbon neutrality in its oil and gas sector by 2050 and in other sectors by 2060.

“Climate change has been on the radar for Kuwait for longer than some of its regional peers, in part because of the participation by the sovereign wealth fund the Kuwait Investment Authority (KIA) in the One Planet Sovereign Wealth Fund (SWF) Working Group which just released its five-year report,” says **Blake Goud**, CEO of the RFI Foundation, a sustainable finance think tank.

In the One Planet SWF Network Companion Document 2022, Ghanem Al Ghenaiman, managing director of KIA, said that process of transitioning towards 100% environmental, social and governance (ESG) compliance for the entire portfolio is an ongoing process. He added that KIA's external asset managers are implementing the One Planet SWF Framework whenever and wherever possible.

“Currently, the action by the SWF has begun to spill over into development of some forms of regulatory enablement for climate change mitigation domestically. But there are some big gaps that, if filled, would open up some substantial opportunities for the financial sector,” says Mr Goud.

In November 2022, the CBK issued a circular on guidelines for sustainable finance for local banks. The guidelines adhere to the Kuwait Vision 2035 as well as the UN's Sustainable Development Goals (SDGs). The guidelines contain 13 points that aim to provide a framework for Kuwaiti banks on sustainable financing and sustainability factors. Alongside the sustainable finance circular, the CBK also issued a statement that it will give priority to fintechs in its regulatory sandbox to testing products and services that support sustainability standards.

## KFH IS THE FIRST BANK IN KUWAIT TO RECEIVE GLOBAL SUSTAINABILITY ASSESSMENT SYSTEM GOLD-LEVEL CERTIFICATION

### Abdulwahab Iesa Al Rushood

NBK has pledged to reduce gross operational emissions by 25% by the year 2025. It also plans to use various technologies and research and development opportunities to expand its usage of renewable energy beyond 2025 with an intention to become net zero operationally by 2035. To support its net-zero efforts, NBK established its sustainable financial framework in February 2022.

NBK's sustainable finance framework complies with the International Capital Market Association (ICMA) and Loan Market Association principles, namely: use of proceeds, process for project evaluation and selection, and management of proceeds and reporting. It is also aligned with the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines published in June 2021 by ICMA.

Similarly, Mr Al Rushood said that KFH signed a MoU with the UN Development Programme to support the body's SDGs. He notes that KFH has an environment-friendly auto showroom (KFH Auto), which is fully compatible with the standards of green buildings and global sustainability.

"KFH is the first bank in Kuwait to receive Global Sustainability Assessment System Gold-Level certification for its KFH Auto," says Mr Al Rushood. "KFH is also active on the sustainability front through the issuing of green sukuk.

"In addition, KFH launched the 'Keep it Green' campaign and published a comprehensive report on sustainability highlighting the leading role of the bank on that front."

KFH has also been involved in sustainable financing as an arranger. For example, in October 2021, KFH Capital was an arranger for a \$350m Tier 2 sustainability sukuk issuance transaction for its Turkish subsidiary, KFH-Turkey (Kuveyt Turk). The sustainability sukuk issuance is considered as the first of its kind to be issued by an Islamic bank, as well as the first Tier 2 sustainability sukuk issuance transaction globally.

At time of writing, no Kuwaiti banks or financial institutions have issued green or sustainable bonds or sukuk in the international market. But Alex Roussos, managing partner of Dentons' Dubai office, and co-head of the Middle East banking and finance practice, believes that it is a matter of time.

"ESG is increasingly important for the banking sector, and we are aware of initiatives amongst the Kuwaiti banks to prepare their ESG finance frameworks, procure second party opinions and incorporate relevant ESG mechanics in their debt issuance programmes," he says.

"A couple of the banks have published their frameworks and we will hopefully see the first green or social bond out of Kuwait soon."

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