Poised for a new era of growth

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Kuwaiti banks' cautious approach has paid off, with several posting strong returns for the third quarter of 2012

The underlying strength of the Kuwaiti economy has allowed the country to weather the global financial crisis: estimates for GDP growth this year are 4.5 per cent, an annual rate the IMF says Kuwait will maintain until at least 2015. At the same time, its stock market has continued to perform well, and it has benefitted from sustained high oil prices. This year produced an unprecedented budget surplus – 27 per cent of GDP – coupled with increased investment funds to safeguard future generations. That said, there have been rising public service costs, decade lows in capital spend, and continued dependence on the oil sector. That said, this year's budget, which includes a 9 per cent increase for capital investment – provides the opportunity to deepen economic reform, privatisation and diversification, along with implementation of the National Development Plan, as well as increased investment in the UK. The Government has recently approved raising the allocation to the Reserve Fund for Future Generations, making some £15.4bn available for investment through the Kuwait Investment Authority (KIA), much of which is likely to be administered by its London office.

Prior to the global financial crisis, most sectors of the economy were registering strong growth, specially the real estate, banking, and investment sectors.

The Central Bank of Kuwait (CBK) used a combination of monetary and fiscal policies to contain the negative effects of the financial crisis and provide stability to the economy. The steps taken by the CBK have improved the overall market conditions and brought in much needed stability.

Financial sector

The Kuwaiti financial system is large and sophisticated, with a growing number of financial companies and investment funds, as well as an active stock exchange and a fast-expanding insurance sector. The financial sector was among the sectors most affected by the crisis.

The KSE is the second largest bourse in the Middle East after Saudi Arabia's. At the beginning of 2012, the Government announced that the KSE would be privatised, with HSBC adjudicated to supervise a process that will involve tightening up trading regulations and implementing tougher reporting and transparency requirements.

In 2010, the Kuwaiti Parliament passed legislation setting up the Capital Markets Authority (CMA), Kuwait's first independent stock market regulator, as part of a larger regulatory framework for the country's capital markets. The CMA regulates the Kuwait Stock Exchange (KSE), supervises public and private subscriptions and oversees mergers and acquisitions. The new authority has increased competition and led to greater direct foreign investment into Kuwait.

The crisis hit liquidity, prompting insolvency among many investment companies, some of which are still financed by large amounts of debt. A number of companies defaulted in paying back their debts to local banks, turning to foreign financial institutions for more funding. The Central Bank imposed new regulations on the investment companies to enhance liquidity and leverage in June 2010, giving them until June 2012 to comply.

Kuwait's banking sector is made up of the Central Bank of Kuwait, 11 local banks and a handful of foreign banks. In terms of both assets and capital, the market is dominated by the National Bank of Kuwait (NBK). NBK is listed in the world's 50 safest banks as ranked by US-based Global Finance. There are five sharia-compliant lenders. Foreign banks include HSBC, BNP Paribas, Citigroup, National Bank of Abu Dhabi and Qatar National Bank.

Many banks used the crisis as an opportunity to clean up their balance sheets and reduce their risk exposure by setting aside high provisions to cover bad loans. The capital adequacy ratio of local banks is around 17 per cent: higher than the 12 per cent minimum ratio required by the central bank and the 8 per cent ratio recommended by the Basel committee.

Kuwaiti banks' cautious approach has paid off, with several posting strong returns for the third quarter of 2012, and several reporting double-digit quarterly increases in net profits for the period.

In April, ratings agency Moody's said it expected the banking sector to remain stable over the next 18 months. The agency predicts that high oil earnings will boost government spending and provide stimulus to the non-oil private sector economy, creating greater demand for banking services in the process.

One factor that could stimulate demand for bank credit, at least in Kuwait, is the implementation of the National Development Plan (NDP), a four-year economic programme that was approved by the Kuwaiti Parliament in February 2010. The NDP calls for several hundred projects and initiatives in areas such as housing, healthcare and transport, with total spending projected to reach an estimated US$108bn and about half the amount to be financed by banks. However, the implementation of the development programme has been slower than expected.

In its strategy to promote and support increased private sector participation in infrastructure development, the Government of Kuwait has established a Public-Private Partnership programme providing significant investment and financing opportunities for the private sector. The healthcare and education infrastructure schemes in particular will be developed using UK models. Great potential also exists, therefore, for the UK financial services industry to provide advisory services and expertise on PPP/PFI infrastructure development in Kuwait.

To facilitate the activities of UK businesses in the PPP programme, in 2011 the UK and Kuwaiti governments signed an MOU on Trade and Technical Co-operation which covers the area of provision of advisory and consultancy services allied to Kuwait's rolling cycle of 5 year development programmes.

Property sector bounces back

With close links to the banking sector, property was hit hard by the global markets crisis. Prices were extremely inflated prior to the crash, producing a real estate bubble. Many property investors were in default, and therefore they were not able to commit to their debt obligations with the financial institutions. But at the beginning of the year, the National Bank of Kuwait announced a 64 per cent, year-on-year increase in real estate sales.

Again, the government's development plan has been the catalyst for renewed confidence in the construction and property sectors.

So-called Megaprojects include the US$77bn Silk City project, which will create a 25,000 hectare metropolis close to Kuwait City. The project, which is expected to be completed by 2023, also includes plans for the world's tallest tower at 1001 metres. A 22.5 kilometre bridge will connect Silk City, Kuwait City and the US$1.1 billion Bubiyan Port. A $25 billion railway project has also been announced.

The construction and property sectors are also benefiting from an upturn in retail. Kuwait's largest mall and shopping centre, The Avenues, has just undergone a US$500m extension.

Other recent major developments include the Al Harma Luxury Centre, part of the 412-metre-tall Al Harma tower that was completed in January.

Global real estate firm CB Richard Ellis ranks Kuwait 13th as international retail market, and most-popular retail city. The National Bank of Kuwait said in February 2012 that the nation's economic growth this year would in large part be "driven by positive performance in Kuwait's consumer sector."

Kuwait's young and wealthy population, combined with an almost 2 per cent annual population growth rate bodes well for the future of the retail sector. GDP per capita is predicted to grow to some US$64,027 by 2015, up from US$40,700 in 2011, according to the IMF.

UK brand Marks & Spencer has said it could double its number of stores in Kuwait from two to four if business continues to do well.

Moving away from oil dependence

Kuwait's economic dependence on oil continues to increase, with 66 per cent of GDP generated directly from hydrocarbons – the highest percentage since 1980. A sustained decline in oil price would relegate Kuwait to one of the worst performing economies in the GCC, says the IMF. This problem is potentially exacerbated by Kuwait's ever increasing internal energy consumption, which – if unabated – will result in it needing 20 per cent of oil production capacity for energy generation by 2017. All this highlights the importance of economic reforms, diversification of the economy, strengthening the private sector, boosting incentives for Foreign Direct Investment and the importance of Kuwait implementing its National Development Plan.

The need for an oil-rich country to diversify away from its biggest source of profit is not as far-fetched as it might seem. In fact, most other countries in the GCC are already thinking of the next generations when oil will become a scarce commodity. Dubai and Qatar, for example, are promoting tourism and developing their non-oil sector by investing in their infrastructure.

At the same time further reforms are needed to enhance the business environment, says the IMF, for example, upgrading the education system to better attune it to the needs of the business sector, streamlining business procedures, legislating for a larger share of independent members on boards.

Kuwait is poised for a new cycle of growth that if managed skilfully, has every potential to increase the country's competitiveness through the emergence of a dynamic, diversified private sector. F

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