

## **A Bright Future For Islamic Finance**

*With a fertile ground for growth, Islamic finance is bucking a regional trend in Kuwait where it is trying to be at par with the conventional banks.*

Similar to the conventional banking sector in Kuwait, the last couple of years have been challenging for Kuwait's Islamic finance industry as the weaker oil price led to lower economic growth and reduced business and consumer confidence. The Kuwait government also adopted more deliberate cost containment measures towards subsidy grants, such as the partial subsidy lifting of fuel prices. It raised electricity charges on residential and commercial properties in order to improve the general budget. However, Kuwait still possesses strong fiscal reserves and, despite lower GDP growth since 2014, the domestic economy has continued to increase.

Growth is being driven by the Kuwait government's development plan, which has sustained an improved pace of implementation over the last few years. More recently, pickup in business activity has improved as the government awarded and executed mega projects. Ambitious capital spending targets have boosted investment and this should continue for 2017. The government launched a road map for fiscal and structural reforms last year and this will bolster fiscal sustainability and economic growth in the medium to long-term. Overall, economic activity is expected to improve in 2017, helping to underpin the Islamic finance industry's performance.

The Islamic finance sector in Kuwait now represents around 50% of total financing and banking sector assets. Its growth over the past five years has outpaced that of conventional banking in Kuwait. Islamic financial sector institutions in Kuwait have acknowledged the need to innovate, to design and introduce new products to the market which add value and to develop new processes to gain clients and market share. Total credit growth in Kuwait was around 3% in 2016 and Islamic financing companies and banks grew by a slightly higher amount. Growth in financing has been higher in the retail sector, particularly in instalment financing and personal financing.

### **Real estate sector remains challenging**

The real estate sector is important for Kuwait Islamic institutions. The Kuwaiti real estate sector recorded a mixed performance in 2016; while investment and residential segments witnessed declining sales, the commercial sector experienced strong growth, rising by 29%. Slower activity in the real estate market was primarily on account of investors' caution amid low oil prices. Moreover, sales in the residential segment were affected because of the greater distribution of subsidized housing units, which reduced the demand-supply gap. During 2016, Public Authority for Housing Welfare was able to distribute over 12,000 plots, in addition to 15,240 apartments, homes and plots in 2015. Sales were also lower in the investment segment amid greater supply of investment buildings and relatively slower growth of expat labor.

Total sales amounted to KD2.55 billion during 2016, 74.2% of total sales in 2015. The

number of deals reached 4610, 77.4% of 2015 figures. Overall, total sales dropped by 25% compared to 2015. On average, the prices of residential properties have slumped 15% since the beginning of 2016, while investment properties fell 10%.

## **Kuwait Finance House**

Not all of Kuwait's Islamic financial sector players are focused solely on the small domestic market. Kuwait's flagship Islamic financial institution, and indeed one of the main Islamic institutions globally, Kuwait Finance House (KFH), has followed an international expansion strategy over the years. As well as a dominant franchise domestically, KFH has a presence in Malaysia, Saudi Arabia, Bahrain and Turkey. Its subsidiary in Turkey has opened an Islamic bank in Germany, KT Bank. KFH's net profit in 2016 declined by 15% to \$529 million due to losses from discontinued operations. Profit from continued operations recorded good improvement however. KFH financed a number of major projects in Kuwait in 2016 including the clean fuel project for Kuwait National Petroleum Company which was the largest banking syndication transaction in the history of Kuwait.

KFH is seeking to simplify its credit procedures in order to boost financing to the SME sector in Kuwait. This sector is considered as one of the promising sectors in Kuwait. KFH, along with other Islamic financing institutions, have been increasing their branch networks in Kuwait in order to boost market positions. They have been increasing their ATM networks and strengthening digital banking services through mobile phone banking and online banking. Islamic financial institutions need to do this in order to maintain their competitiveness with conventional banks. KFH is also focusing increasingly on the wealth management and private banking side.

Boubyan Bank, the Islamic bank in which the National Bank of Kuwait holds majority shares, recorded a rise of 16% in net profit in 2016, and an increase of 17% in the first quarter of 2017. The bank's market share in financing increased to approximately 7.4%, while the share of the retail finance increased to 10.5%.

Warba Bank had an outstanding year in 2016, with net profit more than doubling to KD2.6 million. The bank's financing portfolio rose by 52% in 2016 with a growing market share in the domestic Islamic banking industry. During 2016 the demand for Sharia compliant financial services in Kuwait grew at a faster pace than the demand for conventional banking services. Whilst this is a positive trend, the market remained competitive and challenging.

## **Retail and corporate banking—Key segments**

Warba's Islamic retail banking group is seeking to expand the bank's branch network. It recently successfully issued its maiden \$250 million sukuk and has embarked on a new strategy for the bank which runs to 2021. This new strategy is based on Warba to be the leading Islamic bank in Kuwait for corporate and investment banking as well as digital retail business by boosting its digital infrastructure capabilities. The bank plans to acquire a CMA license for asset management and investment advisory activities in 2017. The consumer finance portfolio has shown significant growth. Of particular note has been its progress in the auto finance market. Forming alliances with the major auto dealers, Warba has been able to bring innovative offerings to the market that have driven an increasing volume of sales. In addition, its traditional consumer financing activities have been expanded through alliances with major players in both the medical and educational sectors.

Kuwait International Bank achieved growth of 14% in net profit in 2016, to KD18.2 million.

International banking operations continue to contribute to the growth strategy of the bank, including trade finance, multinational corporations and infrastructure project finance. Domestically, it is following a similar pattern to others, increasing its branch network and ATMs but also increasing its digital banking services. KIB has vast experience in the Kuwaiti real estate market as it was formerly a specialized real estate bank. Based on the bank's aim to expand its real estate customer base, a real estate services strategy has been developed.

The Central Bank of Kuwait is supportive to the growth of Islamic financing in Kuwait. To this end, it has recently issued new governance rules for Islamic banks, including requirements for external sharia audits, as regulators seek more transparency and accountability in the sector, and further raising customer confidence in Islamic banking by strengthening both internal and external oversight. Islamic financing in Kuwait is expected to register further robust growth going forward, and growth in 2017 is at least likely to match that of conventional banks.

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