

Financial Stability and Economic Resilience in challenging times¹

Your Excellency, the Deputy Prime Minister and Minister of Finance,
Distinguished Guests,
Sabah-al-khair and a very good morning.

I am delighted to return to this forum for the fifth consecutive year. And thank you Mr. Banks for your kind introduction and for inviting me to speak before this august audience.

The conference this year is centered on “Financial Challenges and Financing Opportunities”, a topic very relevant to the core mandate of the Central Bank of Kuwait. CBK, both as the monetary and regulatory authority, has a distinct role to play in ensuring a smooth flow of national savings to productive investments.

That is why we see our mandate to preserve monetary and financial stability not as the final objective in itself, but a mean towards an end - the end being robust economic growth and shared prosperity where financial sector plays its due role.

Probably we should remind ourselves of the implications when regulatory bodies fail to effectively deliver on their mandates. Incidentally, this year marks the 10th anniversary of global financial crisis, which originated as a subprime mortgage crisis in the US but soon engulfed a major part of the global financial system. The financial meltdown that followed had serious economic consequences; global output sharply declined, growth significantly slowed down and unemployment soared across the world, particularly in advanced economies. By some estimates, cumulative output loss since the GFC has been a hefty 25% of the world’s GDP; these estimates don’t include the social costs associated with high unemployment and lost output.

Equally significant for the financial services industry was the loss of public trust. Ethical drift and poor incentive structures led to a range of violations that undermined the public confidence in the financial sector and caused a huge reputational loss.

Given that experience, how can we avoid the repeat of a similar crisis? As Soren Kierkegaard, a Danish philosopher once put it, ‘life must be understood backwards, but it must be lived forward’. It is in this spirit that the global regulatory community,

¹ Keynote Speech delivered by His Excellency Dr. Mohammad Y. Al-Hashel, Governor, Central Bank of Kuwait at the Euromoney Conference held on 26th September, 2017, Kuwait City

by learning from the experience of GFC, has put in place significant safeguards to mitigate the risk of a similar crisis in the future.

While the banking system in Kuwait remained unscathed during the GFC, CBK has continued to refine its existing regulations and has also introduced a host of new measures, in line with the best global practices.

Ensuring a robust regulatory regime

Let me first highlight a few of the steps that CBK has taken on the regulatory front and how our banks fare against the new measures.

First, we have enhanced our capital adequacy regime by setting out higher and better quality capital. As highlighted in our flagship *Financial Stability Report* for 2016, CAR of the banking industry stands at 18.6%, well above the Basel benchmark. We have also put up additional capital requirements, upto 2%, for our systemically important banks. Furthermore, our additional *capital conservation buffer* and *countercyclical capital buffer* requirements aim to help banks to maintain additional cushion and limit the buildup of systemic risk.

Second, we have also put in place a simple *leverage ratio* as a backstop to CAR. Again, Kuwaiti banks stand at 10.1%, substantially higher than the 3% global benchmark.

Third, we have further strengthened banks' capacity to withstand liquidity stress and to make their funding structure more stable by implementing *Liquidity Coverage Ratio* and *Net Stable Funding Ratio*. Admirably, in both ratios, our banks are already well above the minimum benchmark.

Fourth, asset quality has also visibly improved, with banks' non-performing loan ratio steadily declining to reach 2.2%, a historically low level. We have also ensured, based on thorough analyses, the justified buildup of sufficient provisions; consequently, coverage ratio has climbed to a record high of 237%. And while the banks in many advanced economies are struggling to remain profitable, growth in our banks' net income has remained healthy.

What these indicators collectively signify is the ability of Kuwaiti banks to play their role in credit intermediation with an ultimate aim to support economic growth. We believe that the soundness of our banking system has not only helped them weather a challenging macro environment but has also enhanced their capacity to deliver on their primary objective.

It is pertinent to emphasize that CBK doesn't follow a 'higher-the-better' rule to regulations. We aim to be prudent but in a balanced way, carefully weighing the costs of each measure against its benefits. In the end, we don't want to be just resilient. We want to be '*efficiently resilient*'. We aim to design and build a

regulatory regime that, at best, helps avoid any financial turmoil and at least limits the very potential of even the buildup of a crisis.

We also need to appreciate that such a degree of resilience in our banking sector is not by some accident; CBK, along with the banking community, has worked diligently to achieve this, by proactively building buffers and by being prudent despite the pressures to ease up.

Addressing emerging risks

I have just described a few of the regulatory tools we have introduced during the last few years. However, a constantly changing business environment and a dynamically adapting banking system require us to remain vigilant for the upcoming risks.

A key driver of this change, as we all know, is the growing footprint of latest technologies in our lives. Obviously, financial sector is not immune to these developments; rather it is at the center stage of such progress, evident from the increasing role of financial technology firms or fintechs in the finance value chain.

The influence of financial technologies is now ubiquitous. The use of mobile network operators and digital IDs are enabling payments, savings, credit and insurance products which were not feasible a decade back. Technology is also supporting the outreach of formal financial services to the millions of otherwise unbanked customers. And hosts of other innovations, like mobile wallets, crowd-funding and robo-advisors are reshaping the way we transfer money, pay bills, obtain credit or make investments.

A delicate balance for central banks is to determine how far to go in embracing fintechs without compromising safety and stability of our systems. On the one hand, President of the Deutsche Bundesbank has suggested that central banks may consider issuing their own digital currencies. Yet on the other hand, incidents like a recent cyber-attack on credit reporting firm Equifax that compromised the personal information of 143 million US customers highlight the risks involved.

To address this dilemma, CBK has adopted a 'regulatory sandbox' approach to provide a testing ground for innovative products or services. Our approach to regulate innovations is both *enabling* and *proportionate*, as we aim to use a tiered process of introducing rules in accordance with the risks involved.

To make this process a success, we are bringing all stakeholders on board, which not only include financial institutions but also the fintechs behind innovative products. Our collaborative efforts are meant to provide new entrants with innovative solutions a level playing field to operate but without exposing the entire financial system during the early stages of exploration and development.

Achieving macroeconomic resilience

In the final part of my speech, let me say a few words about the broader economic context we operate in. As I pointed out at the outset, financial system is a conduit between savers and investors, thus playing a central role in allocating scarce resources and supporting economic growth and employment.

Given the close link of the financial system to the broader economy, it is easy to imagine how a weak economic environment can undermine the stability of a financial system. So far, our banking sector has weathered the low oil price environment fairly well. For over three years into these challenging conditions, our banks have not only remained sound and stable but have also enhanced their capabilities and resilience. However, I must emphasize that banks' capacity to remain resilient must not be taken for granted; a weak economic environment would ultimately put an otherwise stable banking system under stress.

On a positive note, the government has taken some difficult yet necessary steps to enhance macroeconomic resilience and strengthen fiscal sustainability. Still, progress on many structural fronts is needed; further rationalizing expenditures, increasing non-oil revenues, reforming labor market, increasing private sector role and in general diversifying the economy are some key areas that would continue to require unremitting attention. Our high fiscal buffers provide us some breathing space; that means we can gradually introduce economic reforms provided the momentum is sustained.

To conclude, we at the CBK have made strenuous efforts in maintaining monetary and financial stability in these testing times. Yet a sound banking sector is only a pillar that is necessary but not sufficient to maintain the stability of the overall economic architecture; equally essential are requisite economic and structural reforms to preserve macroeconomic sustainability.

On our part, at the CBK, we will remain, as Churchill said, 'awake to the tips of our fingers'.

Thank you for your attention.

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