

In this Report

Credit Facilities growth was sluggish during the first 8 months of 2012 at 4% with an addition of KWD 1 bn to banks' loan portfolios, indicating the ongoing challenges to the business environment for enterprises along with banks' conservative lending policies and the low appetite for credit.

Personal facilities have been following a continuous upward trend over the last 12 months, increasing by 12% since August 2011 to end the month of August 2012 at KWD 9.64 bn, representing around 36% of banks' loan portfolios. During the first 8 months of 2012, personal facilities grew by 7.8%.

Residents' Deposits with local banks, which represent 84% of local Banks' deposit base, added KWD 308 mn or 1.1% to stand at KWD 27.5 bn. During the first 8 months of 2012, bank deposits grew by 7.5% while private sector deposits grew at 2.6%.

M2 snapped a two month losing streak to add KWD 309 mn or 1.1% during August-12 and stand at KWD 28.5 bn.

The oil market set the third consecutive month of gains to bounce back to levels not seen since April.

OPEC Reference Basket, Kuwait Blend Spot Price and European Brent closed the month at USD 110.7/b, USD 110.1/b, and USD 113.4/b, respectively.

World oil demand for 2012 is forecast to grow by 0.9 mb/d to average 88.7 mb/d, broadly unchanged from last month.

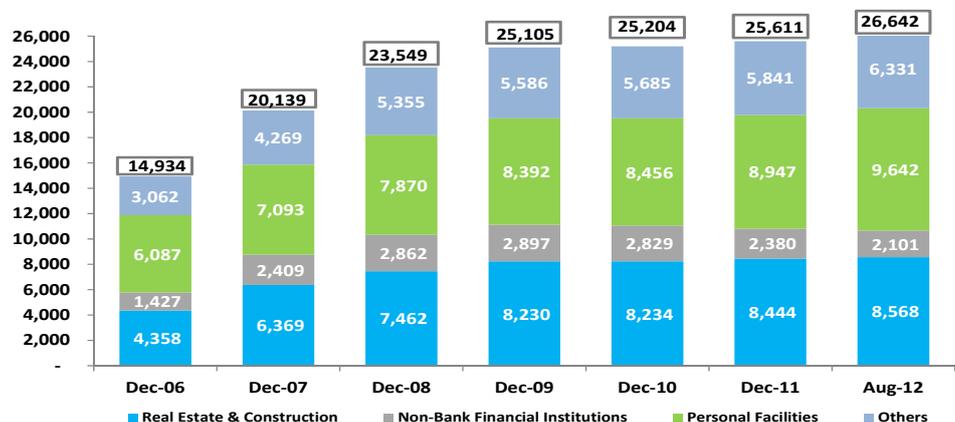
Credit Facilities by Kuwaiti Banks

During August-12, the credit facilities portfolio of local banks remained stagnant at KWD 26.6 bn on the back of low appetite for credit and the continuing restructuring of corporate debt along with the delay in implementing the development plan due to political stagnation. During the first 8 months of 2012, credit growth was sluggish at 4% with an addition of KWD 1 bn to banks' loan portfolios. However, this figure is favourable when compared to FY-2011 when credit saw a marginal increase of 1.6% or KWD 407 mn, indicating the ongoing challenges to the business environment for enterprises along with banks' conservative lending policies and the low appetite for credit. Currently, there is no clear sign of potential revival in credit in the short-term as demand for credit by the private sector is not picking up and the continuous delay in implementing the development plan is having an adverse impact on the credit market by delaying major projects that need financing from banks. The slowdown in credit growth will most likely continue to the second half of the year on the back of tight credit conditions, insolvency problems suffered by local firms, scarce investment opportunities in the local market along with a rise in default risk by distressed and highly indebted firms and the low demand for credit.

Personal facilities, the key growth driver of credit and its major component, has been following a continuous upward trend over the last 12 months, increasing by 12% since Aug-11 to end August 2012 at KWD 9.64 bn, representing 36% of banks' loan portfolios. During the first 8 months of 2012, personal facilities grew by 7.8% fuelled by high consumption and robust growth in the retail sector accompanied with the significant increase in public sector salaries.

Credit facilities for the purchase of securities, which account for 28% of personal facilities, remained stagnant in August-12 at KWD 2.73 bn. Given, the deterioration in the local and int'l equity markets, the structure of credit facilities with the highest percentage of funds channelled into the equity market, has been exposing banks to credit and default risk by individual investors who are heavily invested in the local and regional bourses.

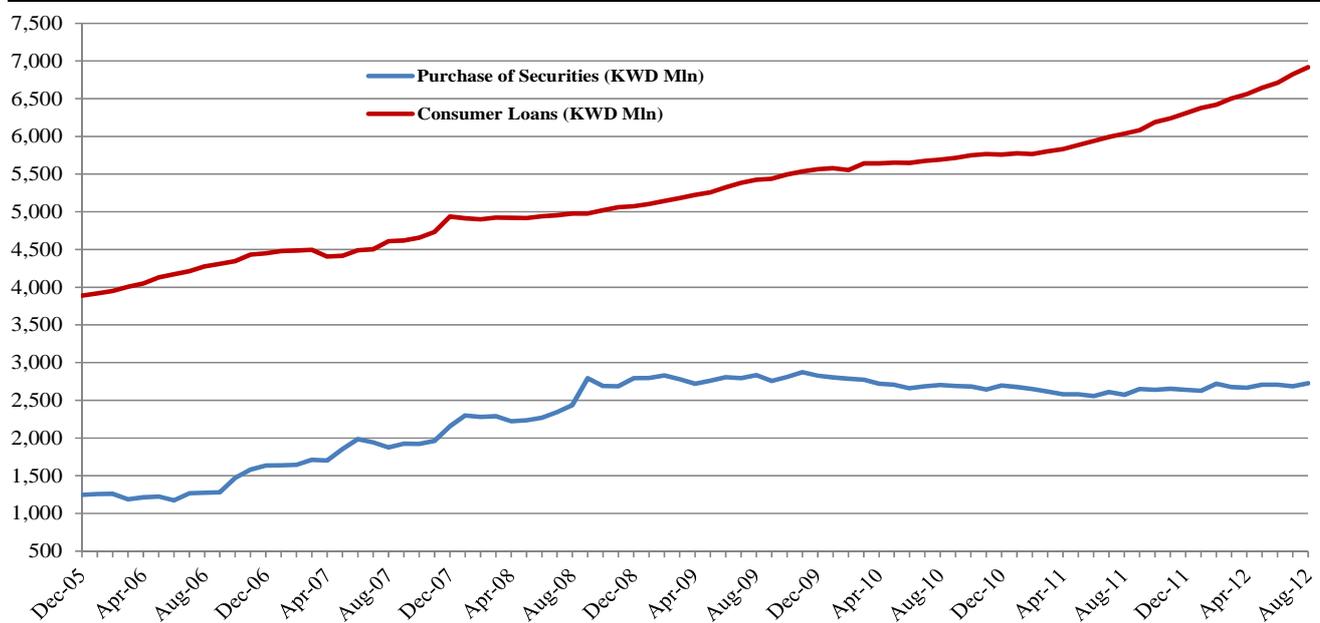
Chart 1. Development in Credit Facilities since December 2006



Source: KAMCO Research & Central Bank of Kuwait

During 2011, credit to purchase of securities fell by 2% or KWD 56 mn in large part due to the deleveraging amid high market risk and volatility in local and international markets. This made banks shift their lending policy by extending credit to households and the productive economic sectors guaranteed by sustainable cash flows. Chart 2 shows the sustainable growth in consumer loans (excluding purchases of securities) since Dec-05 indicating a robust growth amid increase in consumption and purchasing power fuelled by increase in salaries. Consumer loans grew at a 6-year CAGR of 8.4% since 2005 up from KWD 3.9 bn to KWD 6.3 bn in Dec-11. During the first 8 months of 2012, consumer loans grew at 9.7% to KWD 6.92 bn fuelled by rise in salaries and banks focus on diversifying loan portfolios. On the other hand, following 5 consecutive years of strong growth rates over the period 2004-2008 with a CAGR of 34.5% fuelled by buoyant market and ample liquidity, growth in credit to the purchase of securities slowed down significantly during 2009 to 1% and then followed a downtrend in 2010 and 2011 with a yearly contraction of 5% and 2% respectively. However in the first 8 months of 2012, credit to purchase of securities grew by 3.2% to stand at KWD 2.73 bn.

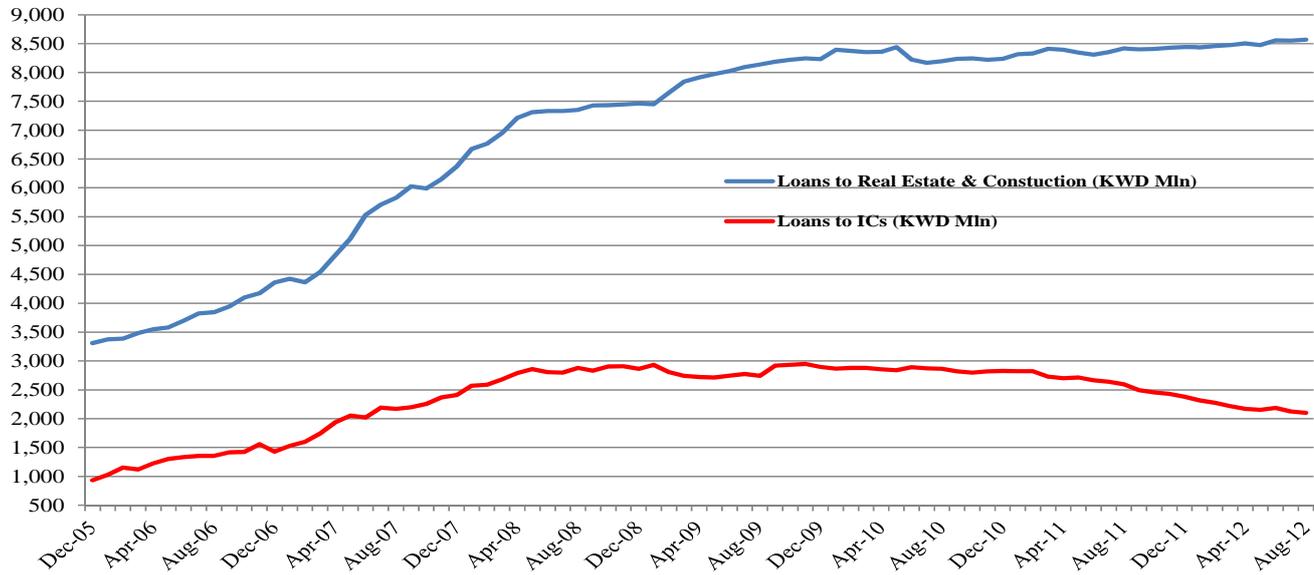
Chart 2. Evolution of Credit Facilities for Purchase of Securities versus Consumer Loans since Dec-05



Source: KAMCO Research & Central Bank of Kuwait

Loans to the real estate and construction sectors, which have together comprised an average of 32% of banks' loan portfolios since Dec-04, rose by KWD 17 mn during August-12 to reach KWD 8.57 bn. During 2011, real estate loans grew 2.5% following stagnant growth in 2010. Chart 3 shows that since 2008, growth in the real estate loans has started to lose momentum driven by the slowdown in property market and the depreciation in asset prices. Following a 3-year CAGR of 40% over the period 2004-2007, growth in loans to the real estate & construction sectors dropped sharply to 17% in 2008 then to 10% in 2009 and remained flat in 2010. Given the slowdown in the real estate market and the challenging business environment faced by real estate companies and contractors in Kuwait, high exposure to this sector by banks indicates that further correction in the real estate market might expose local banks to higher credit risk and weigh down on asset quality.

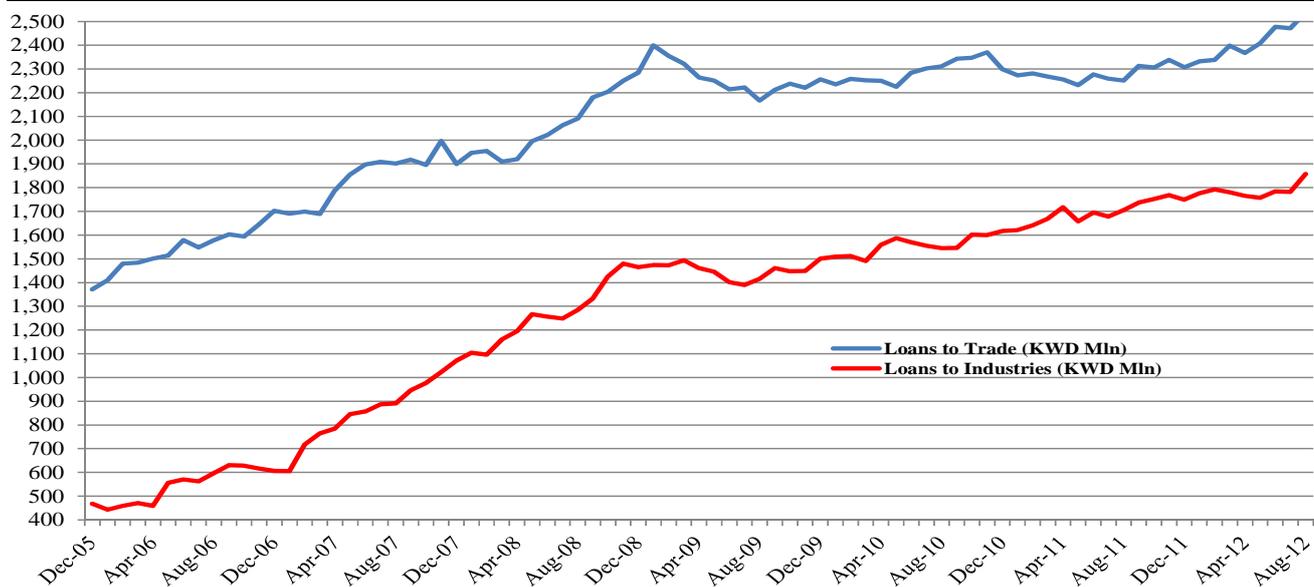
Chart 3. Evolution of Loans to the Real Estate & Construction versus those to Investment Companies



Source: KAMCO Research & Central Bank of Kuwait

The most adverse impact of the credit crisis was on loans to non-bank financial institutions (Investment Companies- ICs); banks suddenly stopped lending to ICs in the last quarter of 2008 following easy credit in the pre-crisis period when loans to ICs grew at a CAGR of 55% over the period 2004-2007. Since then, credit slowed down to 19% in 2008 and 1.2% in 2009 and then followed a steep downward trend in the years that followed dropping by 16% in 2011. Banks remain cautious in extending additional credit to ICs given the challenging business environment and the deterioration in their financial standing and credit profile; accordingly, credit facilities to ICs fell in the first 8 months of 2012 by 11.7% to KWD 2.1 bn, representing 7.9% of banks' loan portfolios down from a percentage contribution of 12% before the crisis. We believe that banks' non-performing loans of ICs will most likely increase and as a result additional impact on banks' financial standing will be priced-in in the current year while current market conditions and possible deterioration in IC's financial standing along with delay in implementing restructuring plans could result in booking further provisions by banks.

Chart 4. Evolution of Loans to Trade versus Industrial Loans

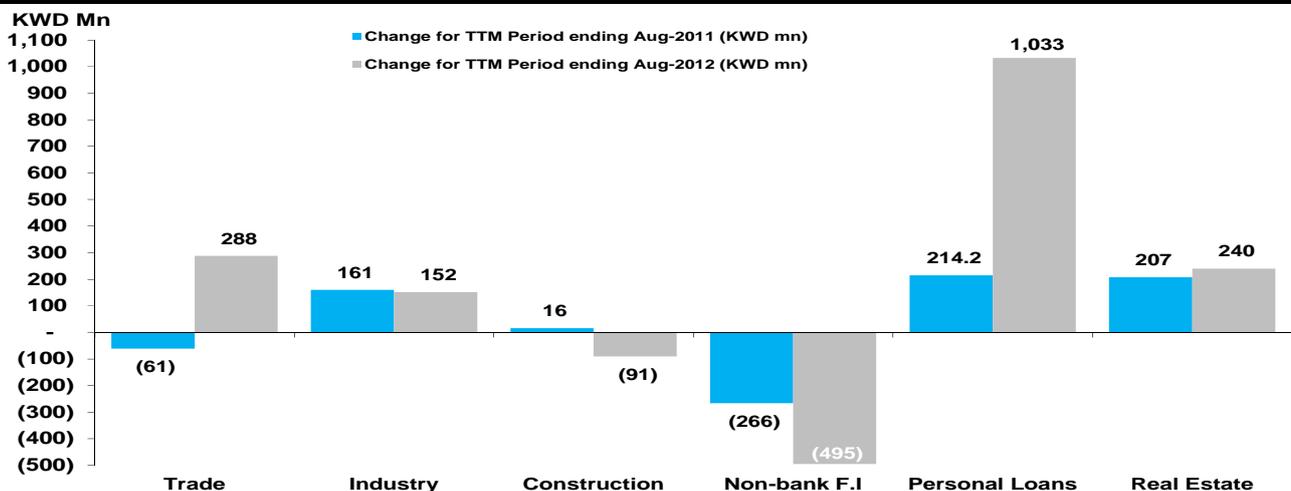


Source: KAMCO Research & Central Bank of Kuwait

After falling in July to KWD 2.47 bn, loans to trade added KWD 67 mn in August to reach KWD 2.54 bn while loans to industry gained KWD 74.6 mn to KWD 1.86 bn. Although loans to trade began 2012 on a positive note, the stagnant growth in loans to trade during the past three years was due to tight credit conditions. Meanwhile, industrial loans jumped KWD 132.5 mn in 2011 following a KWD 116.7 mn increase registered in 2010. The growth in industrial loans is part of an upward trend that began in 2007 as banks strategy shifted towards extending more funds to the productive economic sectors that are backed by real cash flows

Chart 5, which depicts the change in outstanding loans across the major economic sectors during the TTM period ending August-12 and August-11, reflects a considerable growth in personal loans and credit to real estate and industrial sectors and trade along with shrinking credit to ICs due to the strict lending policies followed by local banks and the deleveraging strategy followed by most of the ICs.

Chart 5. Change in Loans extended by Kuwaiti Banks across different Sectors



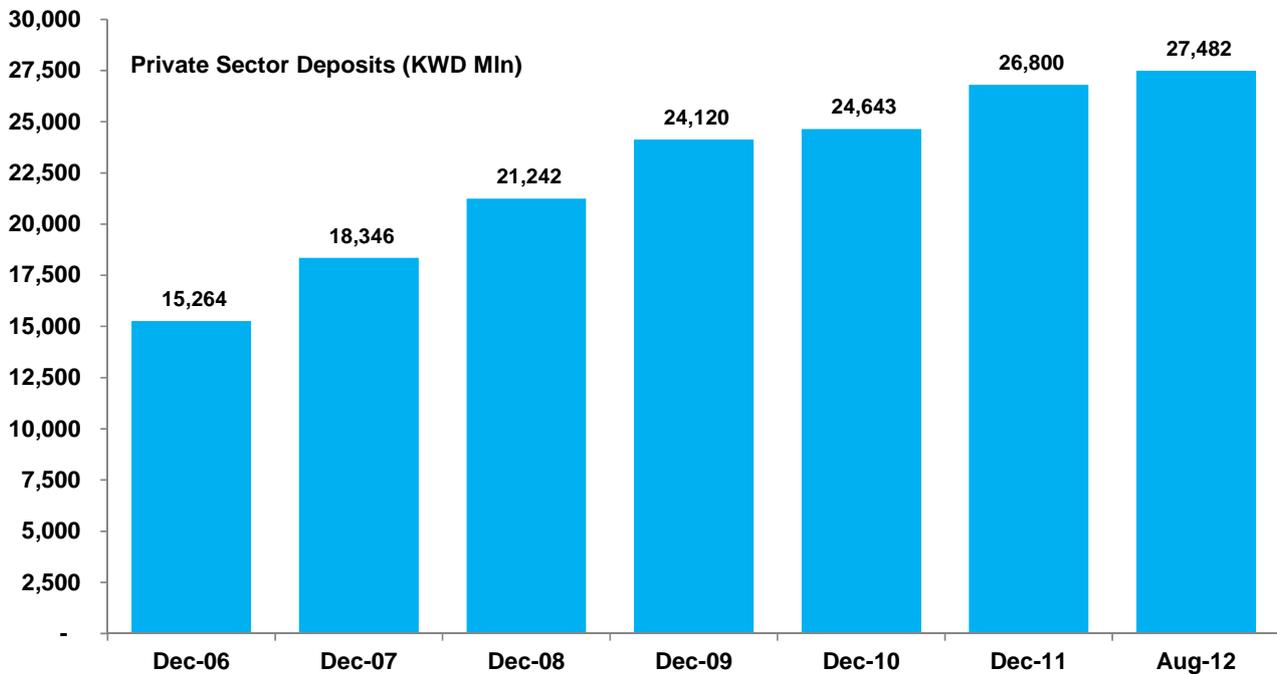
Source: KAMCO Research & Central Bank of Kuwait

During the trailing 12 month period ending Aug-12, credit to the real estate sector grew by KWD 240 mn, while growth in personal facilities showed significant improvement to KWD 1.03 bn. On the other hand, credit to ICs contracted by KWD 495 mn, indicating the deterioration in operating environment, weak financial standing of some major players along with the restructuring of some highly leveraged firms and the significant losses incurred by the sector originated mainly from drop in the prices of equities and real estate.

Personal facilities added KWD 1.03 bn over the last 12 months fuelled by the increase in consumption and the reassessment of banks strategies that became retail-oriented. The Industrial sector has gained a new credit of KWD 152 mn, however less than the KWD 161 mn witnessed during the comparable period in 2011. The sustainable growth in credit to the industrial sector since 2009 is mainly driven by the banks' new strategy to direct more funds to the productive economic sectors that are backed by real cash flows.

Deposits with Kuwaiti Banks

Banks' deposit base (public and private) added in Aug-12 around KWD 509 mn to KWD 32.9 bn driven by low risk appetite in the local market that has been prevailing since 2009. Private sector deposits, which represent 84% of local Banks' deposit base, added KWD 308 mn or 1.1% to stand at KWD 27.5 bn. During the first 8 months of 2012, banks' total deposits grew by 7.5% while private sector deposits were up 2.6%. Growth in private sector deposits has accelerated during 2011 to record 8.8% compared to 2.2% in 2010. This growth was mainly fuelled by the Amiri grant which took place in February 2011 when private sector deposits increased by KWD 1.22 bn in addition to the volatility in financial markets which resulted in flight to safety.

Chart 6. Private Sector Deposits (KWD Mln)

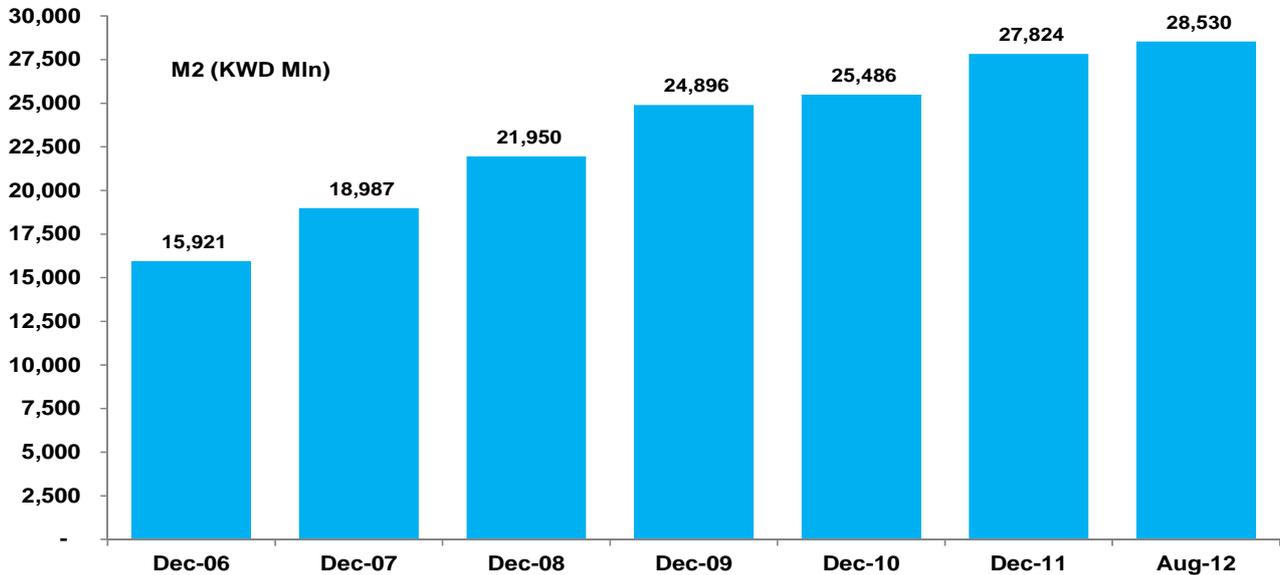
Source: KAMCO Research & Central Bank of Kuwait

Government deposits, which account for 16% of banks' deposit base, increased by 3.9% or KWD 201 mn during August to record KWD 5.4 bn; however during the first 8 months of 2012, government deposits were up 42.6% or KWD 1.6 bn. After recording a significant increase of KWD 449 mn in 2009 driven by the government intervention in the banking system, government deposits during 2010 dropped by 4% or KWD 163 mn amid easing concerns about the financial standing of local banks; this was carried-over in 2011, seeing government deposits losing 1% or KWD 38.8 mn. Injecting public money to the banking system has maintained confidence in local banks and improved liquidity, however, it failed to stimulate credit growth as local banks remained reluctant in extending credit to some sectors, namely financial and real estate.

Money Supply

Kuwait's broad measure of money supply (M2) snapped a two month decrease, to increase in August-12 by KWD 309 mn or 1.1% to stand at KWD 28.6 bn. During the first 8 months of 2012, M2 grew 2.5% compared to a growth of 6% in the comparable period of 2011. The rise in M2 is mainly attributed to the increase in sight deposits by 4% or KWD 217 mn to stand at KWD 5.82 bn.

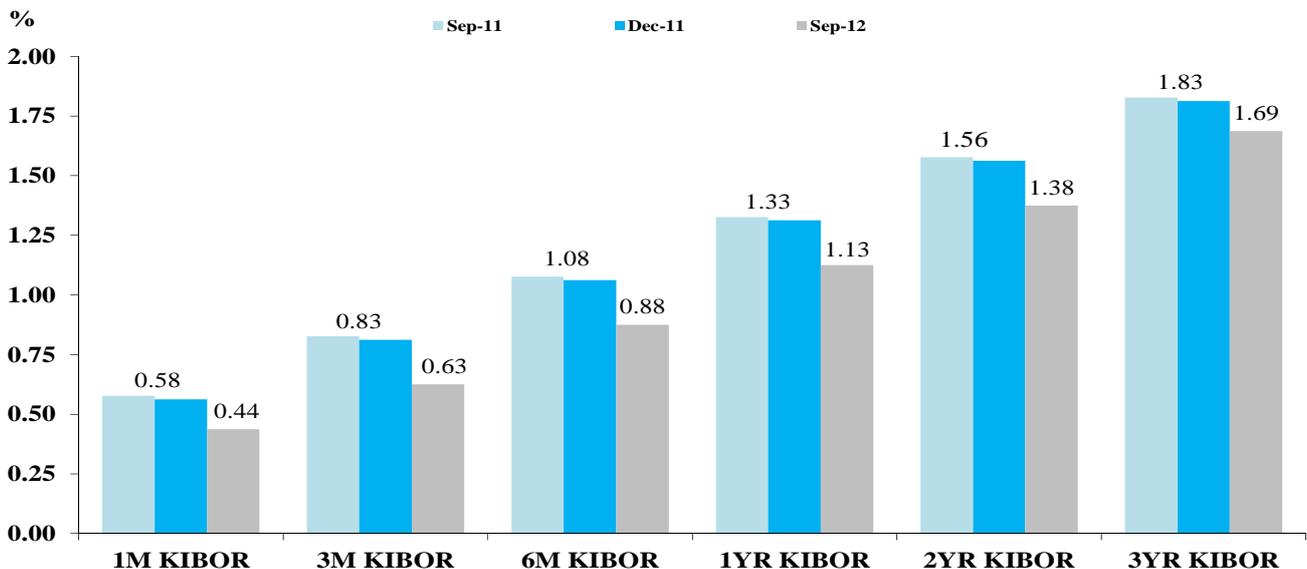
However, in an analysis of the evolution in money supply and its effect on credit facilities, it is evident that the significant expansion seen in money supply following the year 2008 failed to spur growth in the credit market as banks became more cautious in their lending policies.

Chart 7. Money Supply (M2) Since December 2006 (KWD Mln)

Source: KAMCO Research & Central Bank of Kuwait

Interest Rates

Kuwait Inter-bank Offered Rates (KIBOR) 3-year maturities, 2-year maturities and 1-year maturities remained unchanged at 1.687%, 1.375%, and 1.125% respectively; furthermore, 1-month, 3-month and 6-month maturities also remained unchanged at 0.437%, 0.875% and 0.625%, respectively. Meanwhile, London Interbank Offered Rate (LIBOR) that banks charge each other for 3-month loans decreased by 4.7 bps to average 0.39% in September-12; likewise, the 6-month and 12-month LIBOR decreased by 4.6 bps and 4.2 bps averaging around 0.67% and 1.00%, respectively. Meanwhile, the spread between the 3M KIBOR and 3M LIBOR increased to 51 bps.

Chart 8. Average Daily KIBOR (Sep-11 to Sep-12)

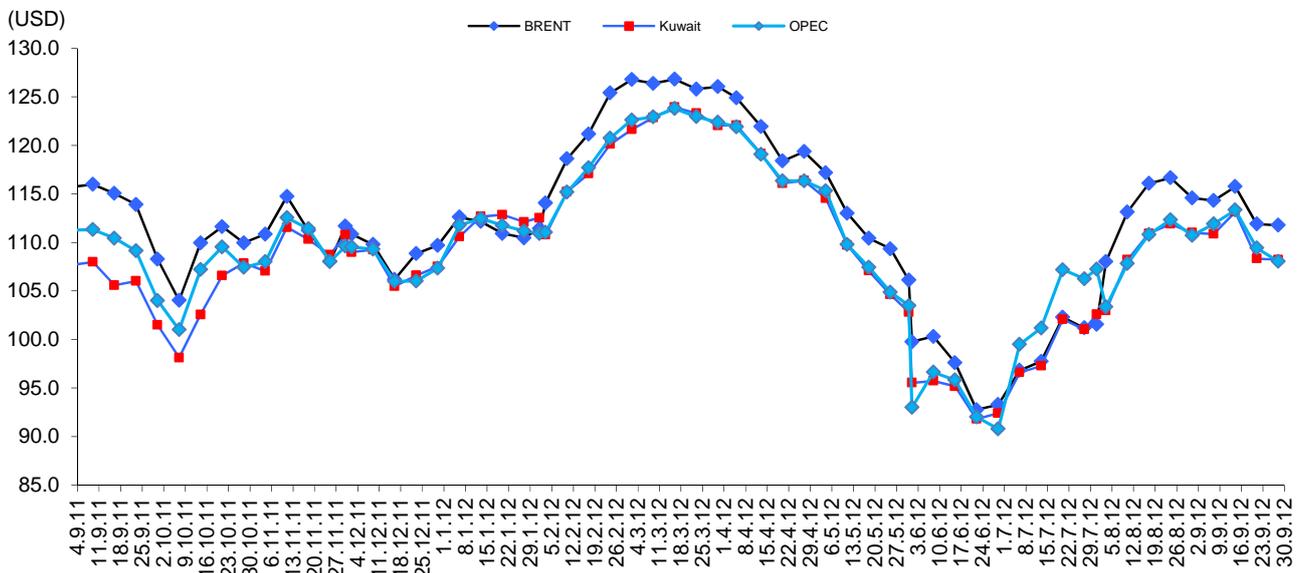
Source: KAMCO Research & Bloomberg

Oil Market

Oil prices were mixed this month as OPEC oil price gained for a third month, but at a slower pace, while Brent oil's price decreased. Worries of a global economic deceleration and a soft landing in China, which could negatively affect demand, dragged on prices. However, the gain in OPEC's price was led by strong growth in consumption in non-OECD countries which has strengthened summer oil consumption seasonality. While US oil consumption grew slightly during the summer, Indian oil demand grew drastically by 9.4% or 0.3 mb/d y-o-y in July. India's jump in consumption is partially attributable to the massive power black-out and summer weather flooding, while the shutting down of most of Japan's nuclear power plants has also added to the excess summer consumption. Due to the strengthening of summer consumption seasonality, third quarter oil demand is increasing and is expected to surpass fourth quarter oil demand within two years. Prices had gained in the preceding months on increased central bank intervention and growth stimulus along with confidence that European policymakers will deliver new measures to get a grip on the debt crisis and save the Euro.

On a monthly basis, OPEC oil prices averaged USD 110.7/b during September-12, an increase of around 1.1% from last month's average of USD 109.4/b, and closed the month at USD 109.7/b. Nevertheless, the average YTD-12 price reached USD 110.7/b compared to an average of USD 107.3/b for the same period in 2011, while the average price in 2010's comparable period was at USD 75.2/b. On the other hand, Kuwait Blend Spot Price FOB averaged USD 110.1/b, and closed the month at USD 109.5/b, up from USD 112.8/b recorded at the end of August-2012. As well, European Brent Blend Spot Price FOB averaged around USD 113.4/b, down by 0.7% from an average of USD 114.2/b recorded during August-2012, to close the month at USD 113.4/b.

Chart 9. Daily Spot Oil Prices for OPEC Basket, Kuwait, and European Brent – Sep 2011 / Sep 2012



Source: KAMCO Research & Energy Info. Administration, US Dep. of Energy

World Oil Demand - Supply

World oil demand growth in 2012 remained at 0.9 mb/d, to average 88.7 mb/d. Despite the economic turbulence in the OECD, oil consumption is following its usual seasonal pattern worldwide. World oil demand has overcome the earlier notion of declining momentum and moved to a more stable trend as oil use in the US, Japan and India has been growing due to various reasons, while non-OECD countries' demand is also gaining some strength; the only exception is European demand which continues its

downward trend. The summer driving season, the heat, the shutdown of Japanese nuclear power plants and the massive electricity shutdown in India has led to an excess of crude and fuel oil burning. Since most of the increase on oil demand has been from incidents or seasonal events, Q4-12 outlook is unclear.

Table 1. World Oil Demand Forecast 2011-2012, mb/d

	2011	Q1-12	Q2-12	Q3-12	Q4-12	2012
North America	23.59	23.15	23.33	23.76	23.57	23.45
Western Europe	14.28	13.69	13.67	14.33	13.87	13.89
OECD Pacific	7.87	8.83	7.73	7.89	8.39	8.21
Total OECD	45.74	45.67	44.73	45.97	45.55	45.55
Other Asia	10.46	10.50	10.74	10.70	10.81	10.69
Latin America	6.37	6.28	6.47	6.68	6.66	6.52
Middle East	7.57	7.64	7.65	8.07	7.70	7.77
Africa	3.36	3.36	3.37	3.28	3.43	3.36
T. Dev. Countries	27.76	27.78	28.23	28.73	28.60	28.34
FSU	4.29	4.24	4.09	4.51	4.74	4.4
Other Europe	0.7	0.69	0.65	0.69	0.77	0.7
China	9.41	9.47	9.86	9.71	9.97	9.75
T. Other Regions	14.4	14.40	14.60	14.92	15.49	14.85
Total World	87.89	87.85	87.56	89.61	89.92	88.74

FSU: Former Soviet Union

Source: OPEC Monthly Oil Market Report (September 2012)

Non-OPEC supply is expected to increase by 0.70 mb/d in 2012 to average 53.15 mb/d, representing a downward revision of 30 tb/d from last month's average, while growth experienced a minor upward revision of 20 tb/d. A historical revision in 2011 to the oil supply estimate, saw Africa revised the most followed by North America, OECD Pacific and the Middle East. The overall supply forecast remains relatively stable, with North and Latin America expected to have the highest growth, followed by the FSU and China, while supply in Africa, the Middle East and OECD Western Europe is projected to decline. On a quarterly basis, non-OPEC supply is seen to average 53.30 mb/d, 52.81 mb/d, 52.94 mb/d and 53.55 mb/d respectively.

Total OPEC crude oil production averaged 31.41 mb/d in August-12, an increase of 0.25 mb/d from the previous month. Angola, Nigeria, Libya and Iraq crude oil production led the increase in August while UAE and Iran led declines in August. OPEC crude oil production, excluding Iraq, stood at 28.30 mb/d in August, up 254 tb/d from the previous month.

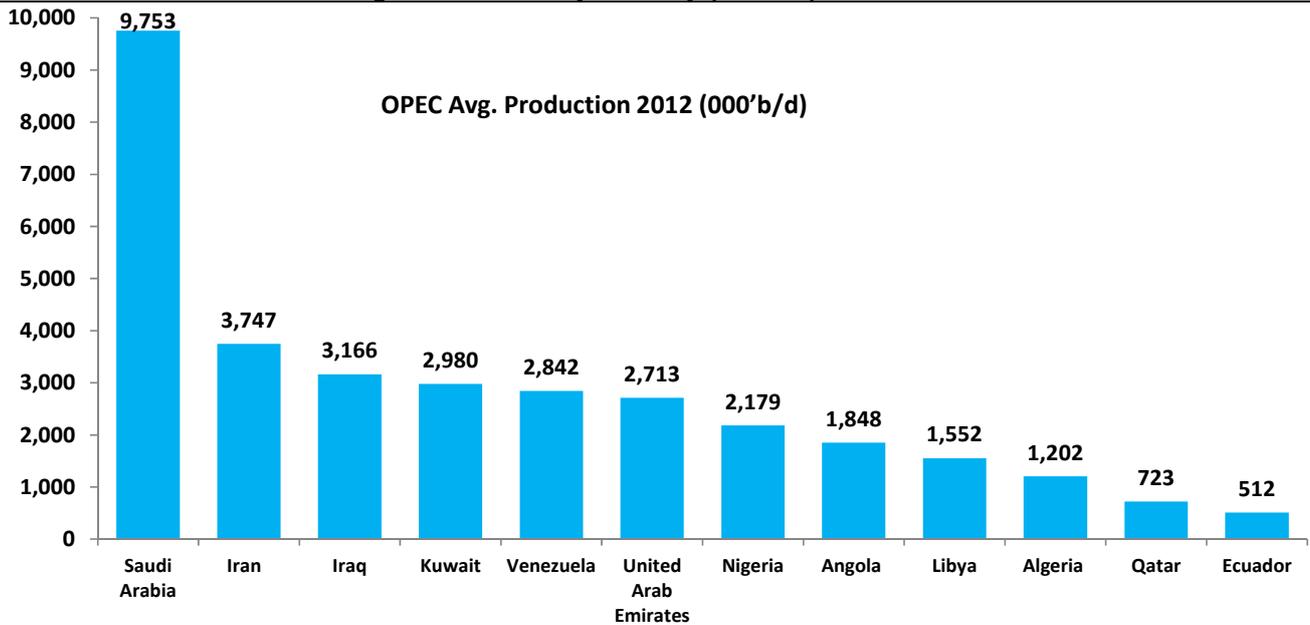
Table 2. World Oil Supply/Demand Balance, mb/d

	2011	Q1 12	Q2 12	Q3 12	Q4 12	2012
World Oil Demand	87.89	87.85	87.56	89.61	89.92	88.74
Non-OPEC Supply	52.44	53.30	52.81	52.94	53.55	53.15
OPEC NGL & non-conv.	5.32	5.49	5.60	5.73	5.86	5.67
Supply Excl. OPEC Crude	57.76	58.79	58.41	58.67	59.41	58.82
Difference	30.13	29.06	29.15	30.94	30.51	29.92

Source: OPEC Monthly Oil Market Report (September 2012)

Preliminary figures indicate that global oil supply increased by of 0.3 mb/d in August-12 compared to the previous month, to average 89.8 mb/d. OPEC crude is estimated to have a 35% share in global supply, a minor increase from the previous month.

Chart 10. OPEC YTD-12 Average Production by Country (000'b/d)



Source: OPEC Monthly Oil Market Report (September 2012)

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