

## Oil & Money Market Report July-2012 Issue

### In this Report

**Credit Facilities growth was sluggish during the first 5 months of 2012 at 3% with an addition of KWD 750 mn 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 10.8% since June 2011 to end the month of June 2012 at KWD 9.42 bn, representing around 36% of banks' loan portfolios. During 1H-12, personal facilities grew by 5.3%.**

**Residents' Deposits with local banks, which represent 88% of local Banks' deposit base, dropped by KWD 128 mn or 0.5% to stand at KWD 28.1 bn. During 1H-12, bank deposits grew by 6.2% while private sector deposits grew at 5%.**

**M2 reversed last month's increase, to fall by KWD 121 mn or 0.4% during June-12 to stand at KWD 29.2 bn.**

**In the oil market, snapped a 3 month downward trend to bounce back from some of the lowest levels so far this year.**

**OPEC Reference Basket, Kuwait Blend Spot Price and European Brent closed the month at USD 106.6/b, USD 102.2/b, and USD 100.5/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.**

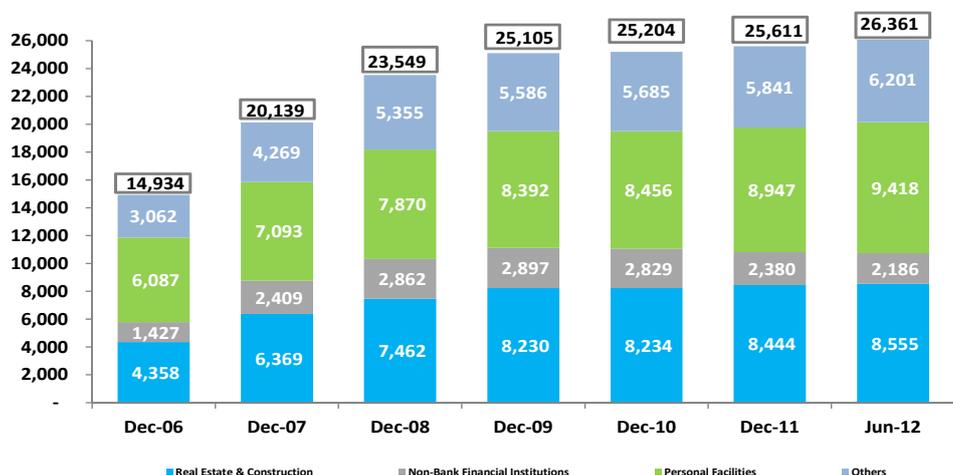
### Credit Facilities by Kuwaiti Banks

During June-12, the credit facilities portfolio of local banks remained stagnant at KWD 26.4 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 1H-2012, credit growth was sluggish at 3% with an addition of KWD 750 mn 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 10.8% since Jun-11 to end June 2012 at KWD 9.42 bn, representing 36% of banks' loan portfolios. During 1H-12, personal facilities grew by 5.3% 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 29% of personal facilities, remained stagnant in June-12 at KWD 2.71 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

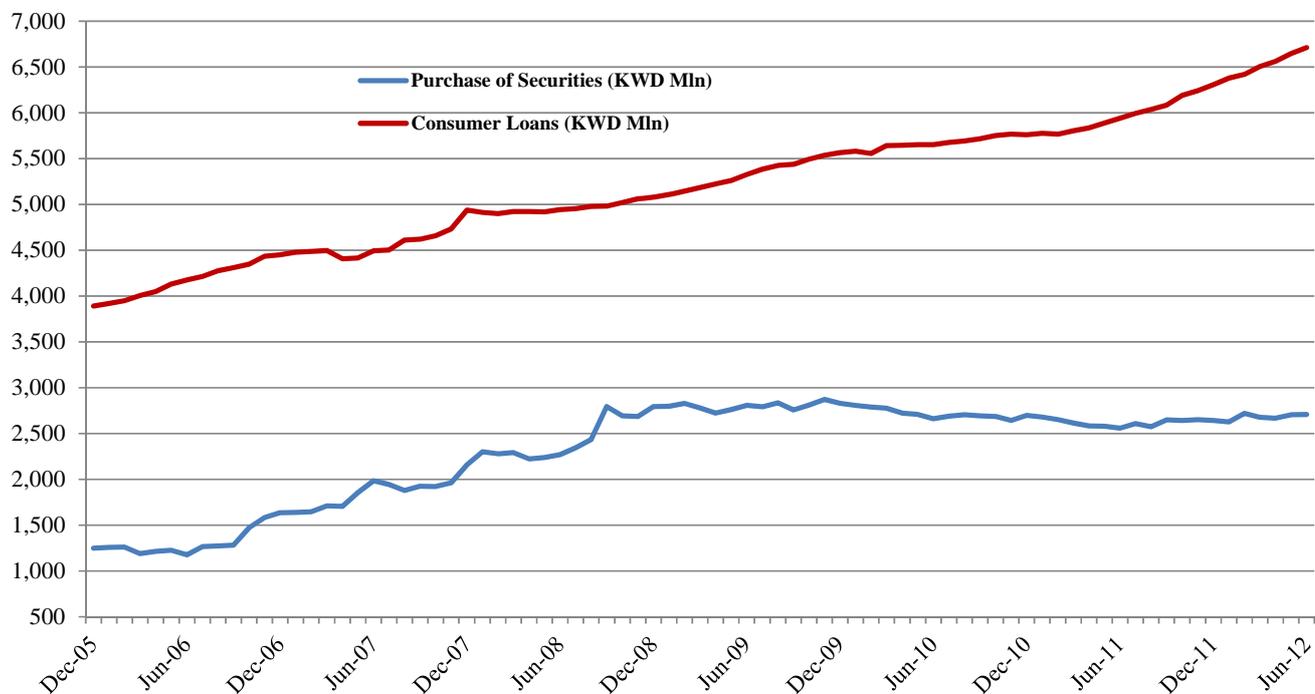
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During 2011, credit to purchase of securities fell by 2% or KWD 56 mn in large part due to the deleveraging amid high market risk and volatility in local and international markets. This made banks shift their lending policy by extending credit to households 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 1H-12, consumer loans grew at 6.4% to KWD 6.71 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 1H-12, credit to purchase securities grew by 2.5% to stand at KWD 2.71 bn.

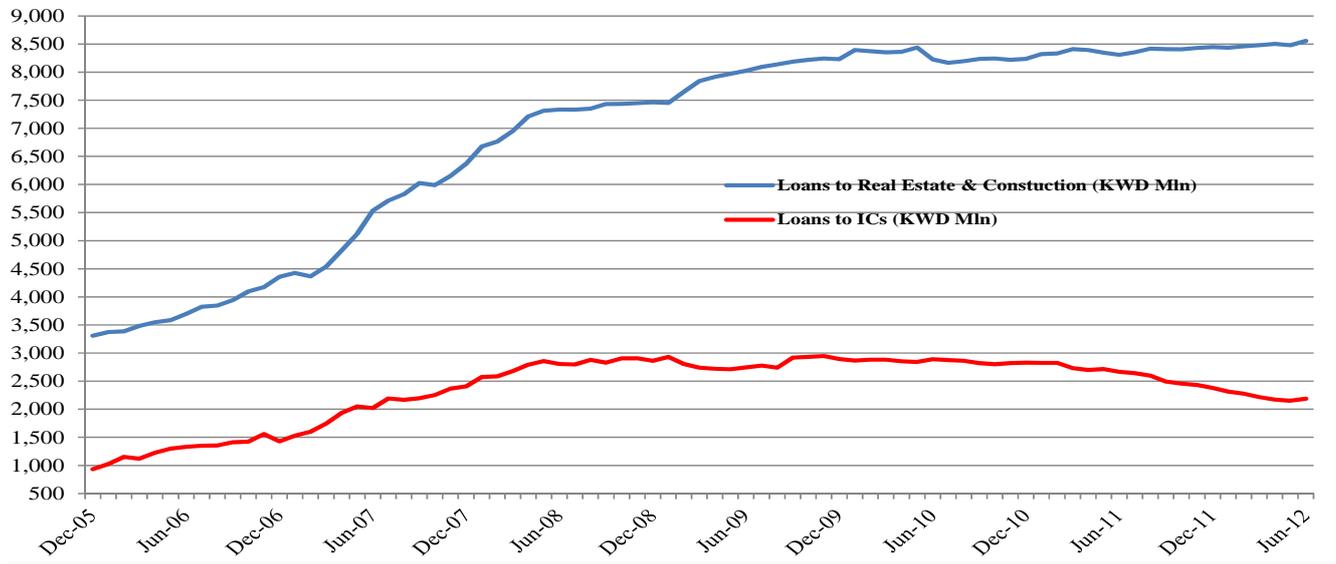
**Chart 2. Evolution of Credit Facilities for Purchase of Securities versus Consumer Loans since Dec-05**



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, grew by KWD 79 mn during June-12 to reach KWD 8.6 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.

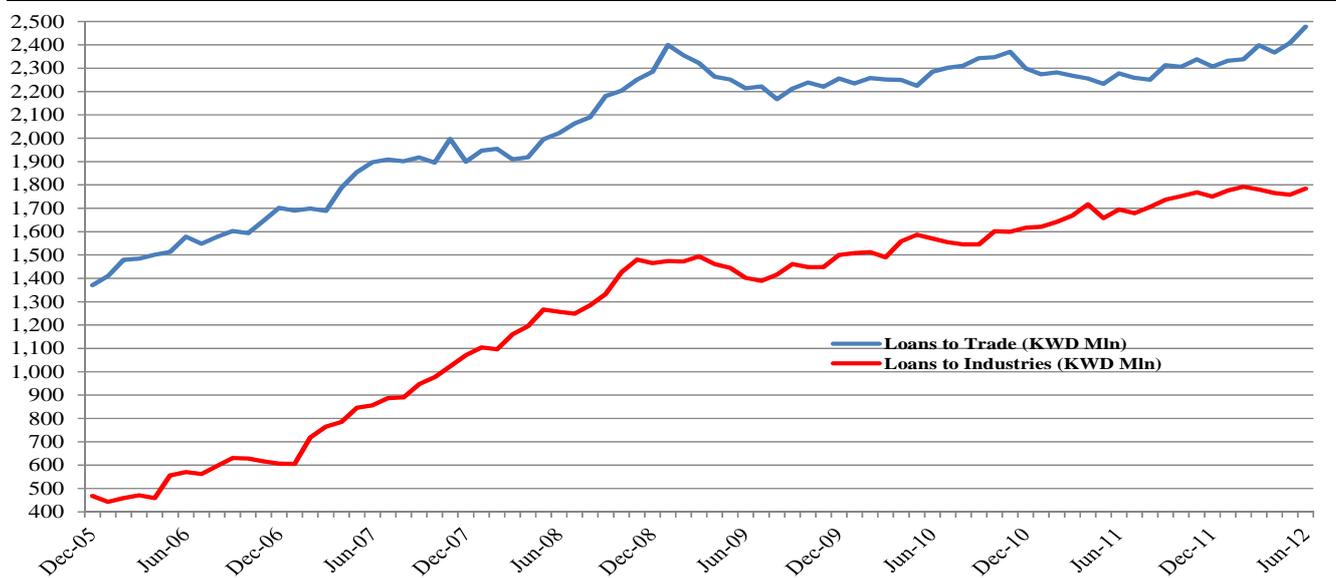
**Chart 3. Evolution of Loans to the Real Estate & Construction versus those to Investment Companies**



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 1H-12 by 8.1% to KWD 2.19 bn, representing 8.3% 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**

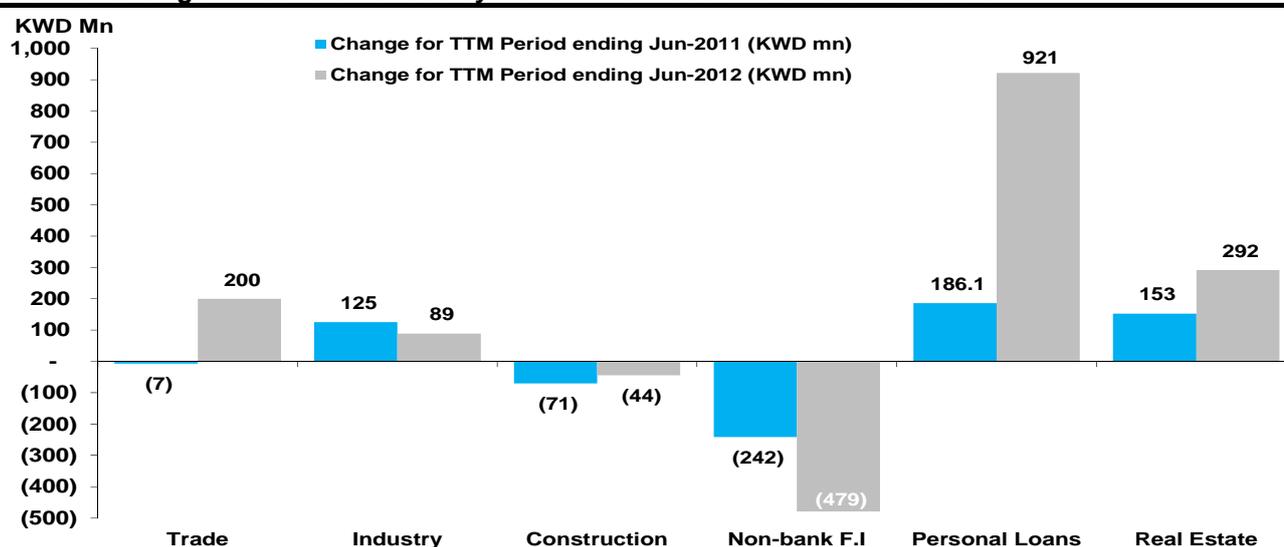


Source: KAMCO Research & Central Bank of Kuwait

After gaining in May to KWD 2.41 bn, loans to trade added KWD 69 mn in June for the second consecutive month to reach KWD 2.48 bn while loans to industry snapped a three month losing streak and gained by KWD 26.5 mn to KWD 1.78 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 June-12 and June-11, reflects a considerable growth in personal loans and credit to real estate and industrial sectors 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 June-12, credit to the real estate sector grew by KWD 292 mn, while growth in personal facilities showed significant improvement to KWD 921 mn. On the other hand, credit to ICs contracted by KWD 479 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.

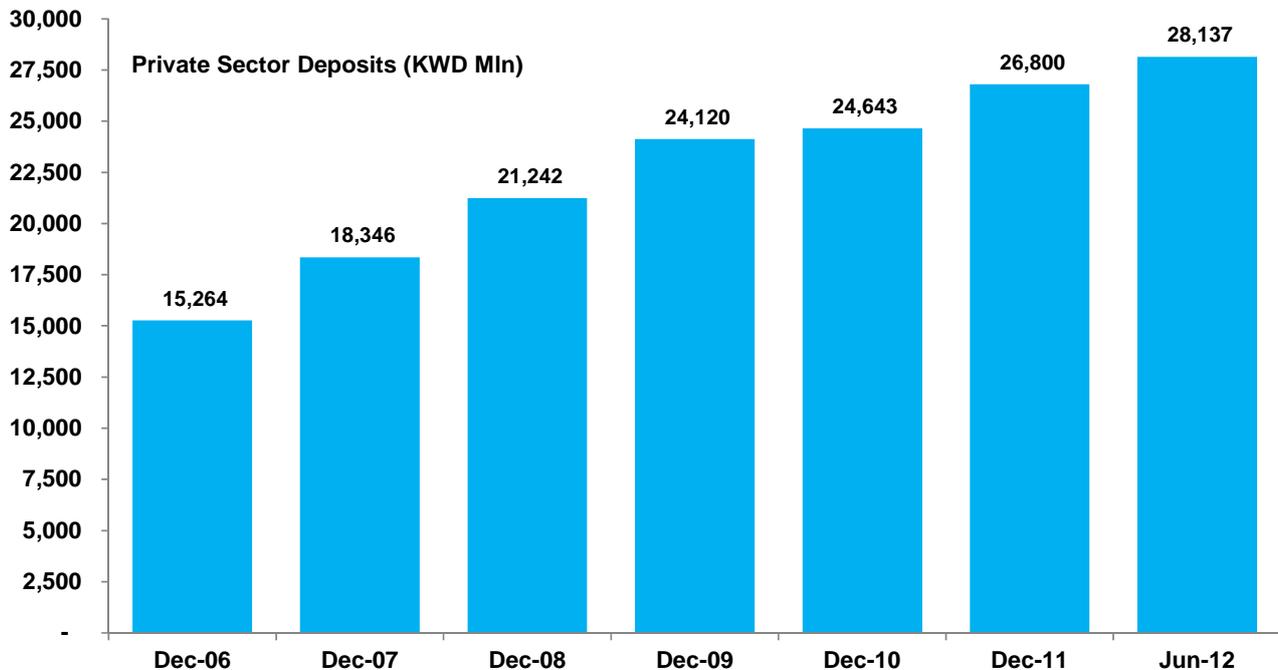
Personal facilities added KWD 921 mn over the last 12 months fuelled by the increase in consumption and the reassessment of banks strategies that became retail-oriented. The Industrial sector has gained a new credit of KWD 89 mn, however less than the KWD 125 mn witnessed during the comparable period 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) grew in June-12 by KWD 203 mn to KWD 32.5 bn. Private sector deposits, which represent 87% of local Banks' deposit base, fell by KWD 128 mn or 0.5% to stand at KWD 28.1 bn. During 1H-12, banks' total deposits grew by 6.2% while private sector deposits were up 5%. 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)**



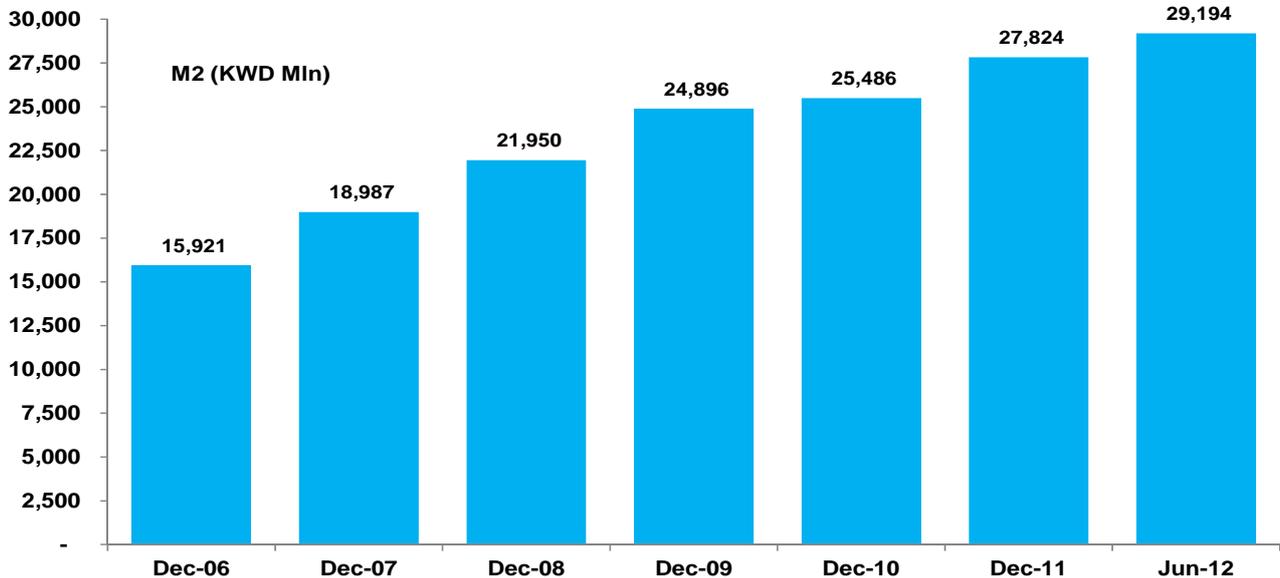
Source: KAMCO Research & Central Bank of Kuwait

Government deposits, which account for 13.4% of banks' deposit base, increased by 8.3% or KWD 331 mn during June to record KWD 4.3 bn; however during 1H-12, government deposits were up 14.6% or KWD 552 mn. 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) once again fell in June, to lose KWD 121 mn or 0.4% to stand at KWD 29.2 bn. During 1H-12, M2 grew 4.9% compared to a growth of 3.8% in the comparable period of 2011. The rise in M2 is mainly attributed to the increase in sight deposits by 13% or KWD 741 mn to stand at KWD 6.3 bn.

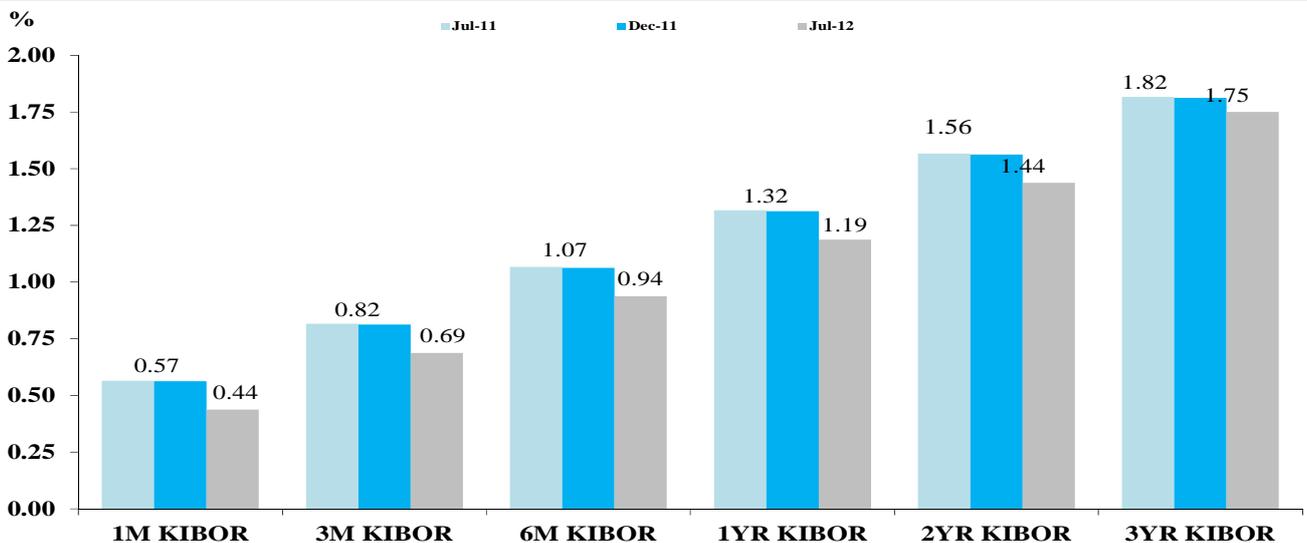
However, in an analysis of the evolution in money supply and its effect on credit facilities, it is evident that the significant expansion seen in money supply following the year 2008 failed to spur growth in the credit market as banks became more cautious in their lending policies.

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

Source: KAMCO Research & Central Bank of Kuwait

## Interest Rates

Kuwait Inter-bank Offered Rates (KIBOR) 3-year maturities remained unchanged during July, while 2-year maturities and 1-year maturities dropped by 6.25 basis points to 1.4375 and 1.1875, respectively; furthermore, maturities under one year remained unchanged. The 1-month KIBOR remained at 0.44% while the 3-month KIBOR rate stands at 0.69% and the 6-month and 1-year record 1.19% and 1.50%, respectively. Meanwhile, London Interbank Offered Rate (LIBOR) that banks charge each other for 3-month loans decreased by 1.8 bps to average 0.45% in July-12; likewise, the 6-month and 12-month LIBOR decreased by 0.8 bps and 1.4 bps averaging around 0.73% and 1.07%, respectively. Meanwhile, the spread between the 3M KIBOR and 3M LIBOR increased to 49 bps.

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

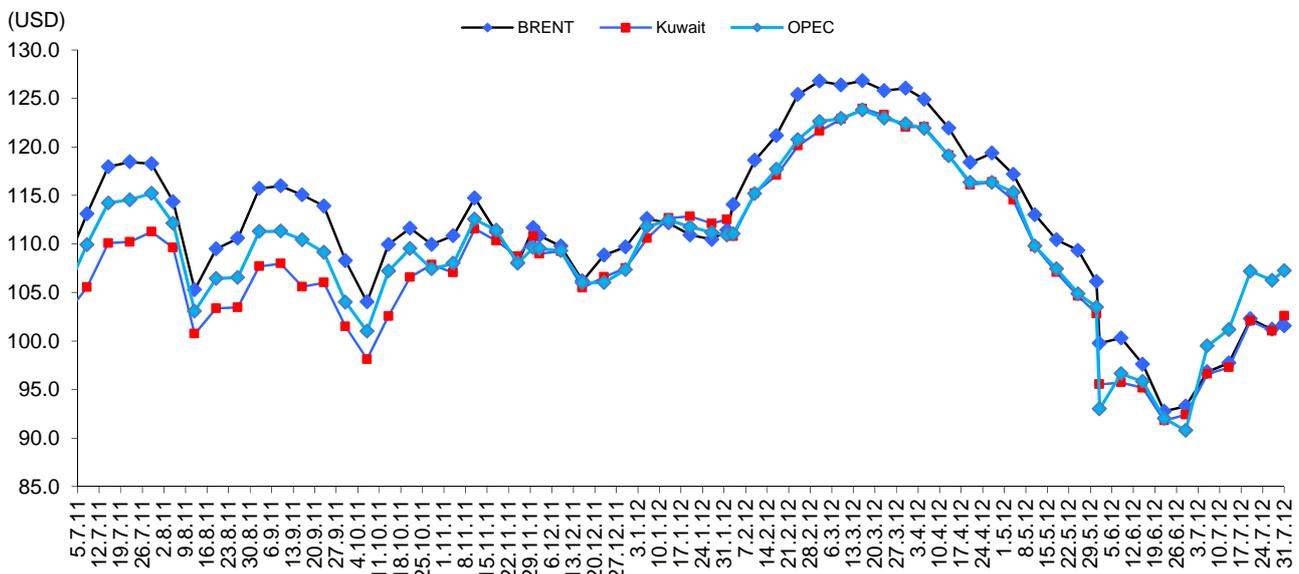
Source: KAMCO Research & Bloomberg

## Oil Market

Oil prices snapped a three month downward trend, to bounce back to close at the highest levels in seven weeks. Prices gained on confidence that European policymakers will deliver new measures to get a grip on the debt crisis and save the Euro. Oil market had a sharp bounce on improved confidence after the ECB chief announced that the bank would do whatever it takes to keep the euro common currency intact; the comment was followed by similar strong remarks from the leaders of Germany and France. The rebound in oil prices was further supported by positive economic indicators from China as factory data showed that manufacturing is getting stronger, while lower inflation reinforced expectations for more stimulus measures to boost waning economic growth. Price volatility remained elevated during the month with OPEC basket moving within a range of USD 97.1-109.7/b during July-12.

On a monthly basis, OPEC oil prices averaged USD 103.9/b during July-12, an increase of around 10.5% from last month's average of USD 94/b and closed the month at USD 106.6/b. Nevertheless, the average YTD-12 price reached USD 110.9/b compared to an average of USD 107.4b for the same period 2011, while the average price in 2010's comparable period was at USD 75.4/b. On the other hand, Kuwait Blend Spot Price FOB averaged USD 99.6/b, and closed the month at USD 102.2/b, up from USD 96.7/b recorded at the end of June-2012. As well, European Brent Blend Spot Price FOB averaged around USD 99.7/b, up by around 3.7% from an average of USD 96.2/b recorded during June-2012, to close the month at USD 100.5/b.

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



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

## World Oil Demand - Supply

World oil demand growth in 2012 now stands at 0.89 mb/d, broadly unchanged from the last month, to average 88.68 mb/d. Global economic developments are almost offsetting each other. US demand is weakening due to the sluggish economy, while European economic turbulence is suppressing the continent's demand; on the other hand, the shutdown of Japanese nuclear power plants led to the excessive use of crude and fuel oil burning. World oil demand growth has, at least for the short-term, stopped its declining trend to show some growth; as well, oil demand in non-OECD countries is also indicating a slight improvement.

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

	2011	Q1-12	Q2-12	Q3-12	Q4-12	2012
North America	23.51	23.08	23.21	23.69	23.49	23.37
Western Europe	14.28	13.72	13.74	14.41	13.87	13.94
OECD Pacific	7.85	8.82	7.56	7.84	8.37	8.15
<b>Total OECD</b>	<b>45.64</b>	<b>45.62</b>	<b>44.51</b>	<b>45.94</b>	<b>45.73</b>	<b>45.45</b>
Other Asia	10.46	10.51	10.72	10.66	10.8	10.67
Latin America	6.37	6.28	6.5	6.71	6.66	6.54
Middle East	7.56	7.64	7.61	8.02	7.68	7.74
Africa	3.36	3.37	3.4	3.28	3.43	3.37
<b>T. Dev. Countries</b>	<b>27.75</b>	<b>27.8</b>	<b>28.23</b>	<b>28.67</b>	<b>28.57</b>	<b>28.32</b>
FSU	4.29	4.24	4.09	4.51	4.75	4.4
Other Europe	0.7	0.69	0.65	0.69	0.77	0.7
China	9.41	9.45	9.98	9.81	9.99	9.81
<b>T. Other Regions</b>	<b>14.4</b>	<b>14.38</b>	<b>14.72</b>	<b>15.01</b>	<b>15.52</b>	<b>14.91</b>
<b>Total World</b>	<b>87.79</b>	<b>87.8</b>	<b>87.46</b>	<b>89.62</b>	<b>89.81</b>	<b>88.68</b>

FSU: Former Soviet Union

Source: OPEC Monthly Oil Market Report (July 2012)

Non-OPEC supply is expected to increase by 0.67 mb/d in 2012 to average 53.06 mb/d, representing an upward revision of 10 tb/d from last month's estimate. The adjustment to this year's growth was mainly due to the release of preliminary 1H-12 data for actual production, particularly for the US. 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 53.24 mb/d, 52.76 mb/d, 52.86 mb/d and 53.38 mb/d respectively.

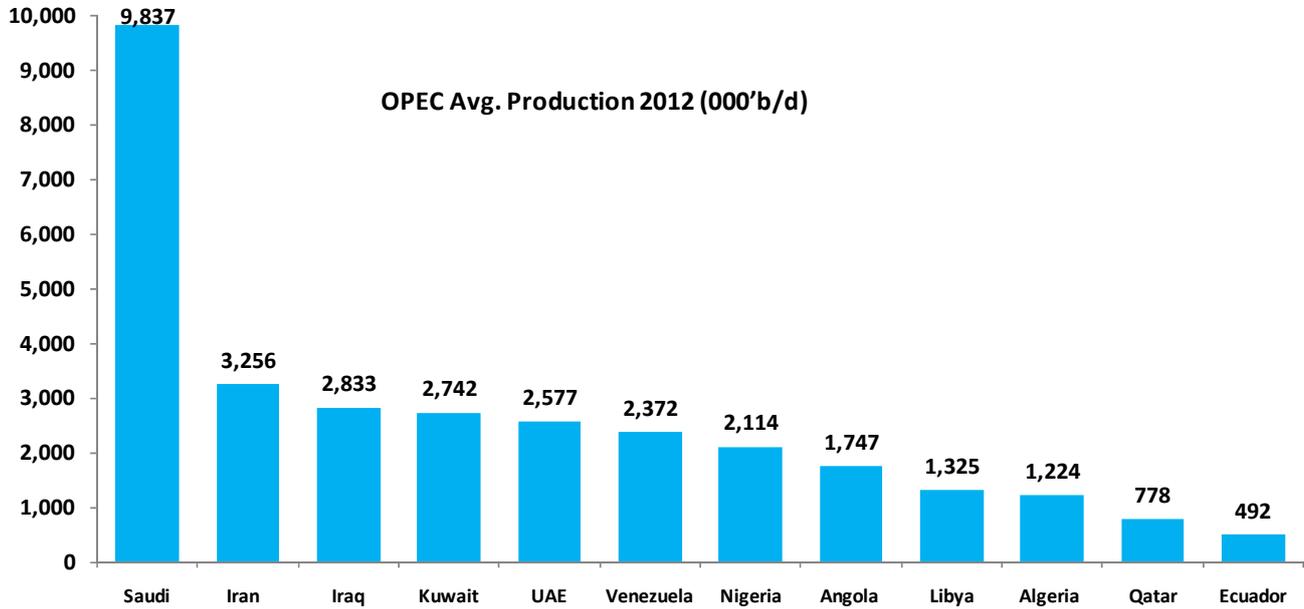
Total OPEC crude oil production averaged 31.36 mb/d in June-12, indicating a decrease of 0.17 mb/d from the previous month. Iran and Angola crude oil production led the decline in June while Kuwait, Iraq and Libya experienced the largest increases in June. OPEC crude oil production, excluding Iraq, stood at 28.38 mb/d in June, down 170 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
<b>World Oil Demand</b>	<b>87.79</b>	<b>87.8</b>	<b>87.46</b>	<b>89.62</b>	<b>89.81</b>	<b>88.68</b>
<b>Non-OPEC Supply</b>	<b>52.39</b>	<b>53.24</b>	<b>52.76</b>	<b>52.86</b>	<b>53.38</b>	<b>53.06</b>
OPEC NGL & non-conv.	5.32	5.49	5.60	5.73	5.86	5.67
<b>Supply Excl. OPEC Crude</b>	<b>57.71</b>	<b>58.73</b>	<b>58.36</b>	<b>58.59</b>	<b>59.24</b>	<b>58.73</b>
<b>Difference</b>	<b>30.08</b>	<b>29.07</b>	<b>29.1</b>	<b>31.03</b>	<b>30.57</b>	<b>29.95</b>

Source: OPEC Monthly Oil Market Report (July 2012)

Preliminary figures indicate that global oil supply experienced a decrease of 100 tb/d in June-12 compared to the previous month, to average 89.72 mb/d. This was due to a 10 tb/d increase in non-OPEC supply as well as a 106 tb/d decline in OPEC crude production. The share of OPEC crude oil in global production decreased to 35% in July.

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

Source: OPEC Monthly Oil Market Report (July 2012)

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