

# the INVESTOR

Issued by Union of Investment Companies - June - July 2020 - Issue No. 9

## 'KUWAIT'S CENTRAL BANK FINTECH REGULATORY SANDBOX FRAMEWORK'

**SILK CITY,  
DIVERSIFICATION,  
PRIVATIZATION AND  
KUWAIT'S NATIONAL  
DEVELOPMENT  
STRATEGY**

**THIS IS HOW THE  
CORONAVIRUS  
PANDEMIC WILL PUSH  
KUWAIT AND THE  
GLOBAL ECONOMY  
INTO RECESSION IN  
2020**





**اتحاد شركات الاستثمار**  
**UNION OF INVESTMENT COMPANIES**



**WE WORK TO PROMOTE INVESTMENT OPPORTUNITIES AND ACTIVITY IN KUWAIT, STRENGTHEN INVESTMENT POLICY AND REGULATION FOR THE BENEFIT OF THE COUNTRY'S NATIONAL ECONOMY AND FUTURE DEVELOPMENT.**

# Kuwait and FDI: More reform, regulation needed

By Jamie Etheridge

The Investor spoke with Boban Markovic, Senior Analyst at the Institute of International Finance, to hear his views on Kuwait's attractiveness as a destination for foreign direct investment (FDI), challenges remaining and the FDI outlook for the short to midterm.



Boban Markovic



**The Investor:** What are the key factors impacting Kuwait's attractiveness as a destination for foreign direct investment (FDI)?

**Boban Markovic:** FDI inflows to Kuwait continue to be stymied by poor business climate and limited opportunities for investment. Particularly hampering is the fact that foreign companies and individuals who wish to invest or set up businesses in Kuwait

must have a Kuwaiti partnership prescribed by law that holds at least 51% stake. Introduction of the Kuwait Direct Investment Promotion Law, which allows direct investment and 100% foreign ownership in certain sectors, is a positive development but may be insufficient to significantly raise foreign investments. An improvement in the business climate, competitiveness, workforce readiness and policymaking remain prerequisites for higher FDI.

**The Investor: How do foreign investors view Kuwait's investment environment? What are the key sectors or segments of the economy most likely to attract FDI in short to medium term?**

**Markovic:** FDI (as a share to GDP) in Kuwait

*FDI is expected to remain below 0.4 % of GDP as compared with the GCC average of 1.3 % of GDP. Nonetheless, the stock exchange reforms will attract higher equity inflows in the next two years.*

remains the lowest in the GCC. This is not surprising given that Kuwait lags behind other GCC countries in terms of global competitiveness and doing business. Kuwait, like Saudi Arabia, needs to attract adequate FDI outside the energy sector to help diversify the economy away from oil and create a dynamic private sector. The IT, renewable energy and finance sectors could attract the non-oil FDI. However, persistent regulatory and administrative impediments, lack of transparency and slow reforms make Kuwait a less attractive destination compared to other GCC countries.

**The Investor: What are the IIF predictions for private capital inflows to Kuwait for 2019/2020 and beyond? How do these compare to the rest of the GCC?**

**Markovic:** Excluding possible sovereign Euro-bond issuance, capital inflows are relatively small compared to other GCC countries. FDI is expected to remain below 0.4% of GDP as compared with the GCC average of 1.3% of GDP. Nonetheless, the stock exchange reforms, FTSE upgrade and possible MSCI upgrade will attract higher equity inflows in the next two years. However, the limited size of the market and the country's heavy reliance on oil may prevent di-





verified emerging-market portfolio managers from allocating more funds to Kuwait's equities. Inclusion into JP Morgan EMBI index could potentially bring an additional \$2.4 billion in portfolio debt inflows this year. Banking inflows have been positive in the past five years, and we expect this trend to continue unless global investment sentiment deteriorates significantly.

**The Investor: What is the IIF's view of Kuwait's economic outlook in short to medium term?**

**Markovic:** The pickup in credit growth to businesses and households in the past few months is encouraging, and it bodes well for consumer spending. Projected government spending increase of around 5% and the lag effect from the last year's expansionary fiscal stance will support non-oil real GDP growth, which could pick up from 2.6% in 2018 to around 3.0% this year. However, overall growth will remain around 1% due to oil production cuts in the context of OPEC+ agreement. Continuous government spending, strong consumer confidence and a healthy project pipeline will support non-oil growth of around 3.5% over the medium term.

**The Investor: In your view, what do you think are the most important changes or improve-**

**ments Kuwait has made in legislation and reform that will improve its FDI position?**

**Markovic:** Reforms have been limited due to political frictions in the parliament and the lack of administrative capacity to carry out ambitious plans. Under the National Development Plan, the authorities listed 20 international benchmark indexes to track the country's development. Although the goal is to be ranked within the 30th percentile by 2025, Kuwait's position has stagnated since the plan was presented in 2015. As noted before, a law that allows direct investment and 100% foreign ownership in some sectors, and a series of laws related to businesses and public-private partnership are steps in the right direction.

However, constraints such as quotas regarding employment of Kuwaiti nationals are making Kuwait less competitive for FDI as compared with the UAE, for example. The Capital Markets Authority and Boursa Kuwait improved the operational infrastructure of the stock exchange which led to FTSE inclusion. While this won't attract FDI directly, it will put Kuwait on the radar of investment funds and send a positive message to the business community.



The three basic components of the Silk City Project, the Masterplan, the financing and legal frameworks, are all under development.

- Photos by Yasser Al-Zayyat

'The **INVESTOR** speaks with Dr Khaled Mahdi, Secretary General for the Supreme Council for Planning'

# Silk City, diversification, privatization and Kuwait's national development strategy

Interview by Jamie Etheridge

Dr. Khaled Mahdi, Secretary General of the Supreme Council for Planning and Development (SCPD), is a man with a plan. His mandate is to implement the vision of His Highness the Amir Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah as articulated in the New Kuwait 2035 strategic development plan, and oversee the implementation of the country's development vision.

In an hour-long conversation with The Investor, Dr. Mahdi offers insights on the status of Kuwait's historic effort to shift to a diversified, private sector-led economy and shares details about upcoming projects including the Silk City Northern Region project, amendments to the privatization and bankruptcy laws and opportunities for investors, both local and foreign.

**T**he Investor: Please tell us a bit about the role of the Supreme Council for Planning and yours as Secretary General?

**Dr. Khaled Mahdi:** The mandate of the Supreme Council for Planning and Development (SCPD) is to ensure that the State Vision is pursued as envisioned by H.H. the Amir of Kuwait and that it is accomplished by 2035, and so it sets out the country's strategic national development planning framework, oversees its progress and implementation and streamlines planning and development policies. In my role as SCPD's Secretary General, it is my responsibility to facilitate and coordinate the planning and development process starting

from conceptualization throughout to completion, which requires doing extensive research, using quality data. The planning portfolio also focuses on setting goals, targets and indicators and to work out execution plans and timeframes for implementation. Simultaneously, policy research is conducted by local and international specialists, as part of developing evidence-based public policies and supporting sound and informed decision-making process. Concurrently, our national development planning is mapped in alignment with the Sustainable Development Agenda 2030 and the 17 Global Sustainable Development Goals. Finally, the final draft of the national development plan is

submitted to SCPD for review before it is submitted to the Council of Ministers, which, in turn, refers it to the National Assembly for ratification.

**The Investor: What are the key factors that the current planning model uses to ensure success?**

**Dr. Khaled Mahdi:** Our current model uses a holistic approach for development planning. The model is a shift from the top-down, government-centered conventional pattern to a more vertically interactive participatory methodology that engages almost all stakeholders, to include all government and non-government entities, the private sector, academia and civil society. Basically, our model is 'human capital-centered'. It leverages our most



*Dr. Khaled Mahdi is the Secretary General for the Supreme Council for Planning and Development (GSS-CPD) of the State of Kuwait and is the Director of Kuwait's Country Cooperation Program with the UNDP. He is also a member on several high-level government boards and committees, such as the Public Authority for the Industry, Kuwait Institute for Scientific Research, Public Housing Authority, the Economic and Fiscal Reform Committee and the Kuwait Masterplan 2040, among others. Dr. Mahdi was an Associate Professor in the College of Engineering and Petroleum at Kuwait University. He also served as an Advisor to the Kuwait University Strategic Office and the Office of the Minister of Planning and Development. Dr. Mahdi is a B.Sc. graduate of the University of Toronto, CANADA and holds a Ph. D. in Chemical Engineering from Northwestern University, USA.*

sustainable resource, our human capital, in synergizing an all-inclusive position to national development. We recognize that Kuwait's real wealth is our young and older technocrats who are professionally competent, capable and they are willing to share their energies, knowledge and expertise with us. So, we created local 'communities of practice' comprising of local experts from all specializations and we're working closely to build up a body of knowledge and expertise which is the core of the knowledge-based economy that is currently evolving as the country's sustainable development model. Technically, we have also developed various tools and almost every government entity now has its own set of Key Performance Indicators (KPIs) to apply for monitoring and reporting. Planning and development wouldn't be possible without the use of technology, and we have developed several computer programs to support economic modelling and future forecasting.

Indeed, our national planning, as we see it, gives ownership to all stakeholders and we can only see a real impact when non-government entities participate in the process, share their opinions, have their voices heard and their needs met.

**The Investor: What are the major challenges you are facing in implementing this strategy?**

**Dr. Khaled Mahdi:** We have taken every key challenge into consideration when designing the development plan. The most pressing challenge is that most of our national workforce are employed by the government. The youth makes up the largest part of this country's population and most of them work for the public sector.

The second challenge is the skill gap; the human capital gap and the basic yet pressing mismatch between the needs of the labor market and the educational outcomes of tertiary education. There are many other challenges, such as inefficient public administration practices, the slow if not absent digitalization of public services, in addition to the issue of corruption.

**The Investor: Could you elaborate on how Kuwait's national development plan shall implement the New Kuwait Vision 2035?**

**Dr. Khaled Mahdi:** The KNDP is essentially designed so it can translate HH the Amir's Vision of a New Kuwait by 2035. The Vision was first conceptualized in 2006 based on four main components and was later articulated in 2010 as the first five-year national plans.

Basically, the theme of the KNDP is about reviving Kuwait's leading role as a regional trading hub

by means of (a) changing the role of the government, which is essentially a policymaker, from an operator of the national economy to a regulator of economic activities, while encouraging the private sector to take a more leading role in the country's economic development; and (b) building and developing Kuwait's individual and institutional human capital that is strong and capable enough to support the transformation to a private sector-led economy.

In order to achieve this, the principal goal would be to have a diversified sustainable economy and that requires extensive modifications and alterations to the current economic systems so to allow and encourage the private sector to take a leadership role to diversify economic activities, promoting entrepreneurship and facilitating funding and investing in commercial and business projects. And to achieve diversification, four main economic enablers are mobilized:

## The Silk City Vision

The New Kuwait Vision 2035 is built on seven pillars intended to address Kuwait's long-term development and global standing: the economy, infrastructure, human capital, public administration, healthcare, global position and living environment. A centerpiece of this development is the Silk City (Medeenat Al-Hareer) region which is expected to include the five islands and most of the northern territory of Kuwait in a special economic zone. The area will serve as a key trading and transit hub, part of China's Silk Road Economic Belt and Road Initiative and will have a special zone, major port on Bubiyan Island (currently under construction), airport, Olympic-size stadium, housing for 700,000 people, a central business district, schools, public facilities and entertainment areas. Access to the area will be linked to Kuwait City via the newly built \$2.3 billion Sheikh Jaber Al Ahmed causeway.



(a) promoting Foreign Direct Investments (FDIs), and this is enabled under the KDIPA law which treats the whole country as a free zone allowing FDIs 100% ownership, and we've seen more than \$2 billion in FDIs through KDIPA come in under this law from major investors, like Microsoft, GE, Huawei, Limak and others. Under the FDI law, investors are required to provide knowledge transfer and job creation for national labor force. (b) the SME National Fund is another mechanism that the government has created to attract Kuwaitis away from public sector employment by enabling funding of small and medium enterprises. The fund has been endowed by HH the Amir and is the largest such fund in the world with a paid-up capital of around \$7 billion, and it basically targets Kuwaiti entrepreneurs and provides them with funding and ca-



*Investors are invited to invest in facility management and operations in the healthcare sector and in the petrochemical sector.*

capacity development; (c) the third enabler is the PPPs that empowers private sector engagement through the Kuwait Authority for Partnership Projects (KAPP), which is responsible for forming a tripartite partnership between the public sector, private sector companies and the people (as incumbent shareholders). The beauty of this model is that it fosters the participation of Kuwaitis in funding and benefiting from strategic development projects; (d) the fourth enabler is the model for the privatization of public entities, which, let me explain, is not similar to commonly known privatization models. What is 'privatized' here is the management component of a government-owned entity and the Supreme Council for Privatization has already identified 38 such entities as potential privatization units that will be corporatized then privatized.

**The Investor: Are you talking about where the government will sell off pieces of government bodies?**

**Dr. Khaled Mahdi:** Our Privatization Model includes several mechanisms and it is not about selling off pieces of the government. For example, one mechanism is to leverage private sector's operational management expertise to manage certain public services. For example, Sheikh Jaber Hospital will be run by a company that the government will establish, called Al-Enaya Hospital Management Company, to manage the operations of the entire hospital. There are around 38 other projects that are considered for privatization over the coming 20 years, mainly, the Northern Shuaiba Power Station and Kuwait's landlines, fiber optics and DSL services.

**The Investor: Is there a public list of these 38 entities?**

**Dr. Khaled Mahdi:** The list of projects has already been approved, and the Supreme Council for Privatization will start to gradually issue the projects for privatization once they are ready.

**The Investor: Can you tell us more about the Supreme Council for Privatization?**

**Dr. Khaled Mahdi:** The Supreme Council for Privatization steers the country's privatization policies and plans, in the same manner that the SME National Fund is in charge of SMEs, the KDIPA is in charge of FDI and the Kuwait Public Private Partnership Authority is responsible for PPP projects. Every economic enabler has its own authority that operates within a legal framework. Kuwait believes in the institutionalized model of long-term development.

**The Investor: What are the upcoming opportunities for investors (both local and foreign?)**

**Dr. Khaled Mahdi:** There is a wide range of opportunities available in the form of public-private partnership projects, such as power stations, wastewater treatment and solid waste management plants, to name just a few. The new amendments to the privatization law provide a broader concept of privatization that is not limited to the transfer of assets, but it extends to the transfer of management as well as to leasing. There are different forms of privatization, focusing mainly on the management of operations of the health sector and the railroads, as well. In other words, the government establishes the infrastructure, but the operations of the project will be managed by the private sector. So, yes, there are a lot of opportunities coming up.

**The Investor: You mentioned shifting the leadership of the economy to the private sector but at the same time we've seen an increase in purchasing and taking over of projects by the Amiri Diwan (Shaheed Park, Sheikh Jaber Cultural Center, Sheikh Salem Cultural Center, and now Entertainment City), which seems at odds with the plans mentioned. What do you think?**

**Dr. Khaled Mahdi:** The private sector will take over the management, operation and financing of the Entertainment City project. As for the other projects, these are all national cultural centers and their operations will be privatized. In the Vision of HH the Amir and its national development plans, private sector institutions aren't perceived as contractors but as partners and investors.

**The Investor: What are the opportunities for investment companies and how can they participate in the New Kuwait 2035 vision?**

**Dr. Khaled Mahdi:** Investment companies are invited to look for PPP projects that are offered by the PPP Authority, such as power stations, wastewater management and others. These are key development projects and more in the pipeline. Investors are invited to invest in facility management and operations in the health-care sector and in the petrochemical sector, such as the Al-Zour refinery, which will be coupled with a petrochemical plant. PPP projects provide excellent investment opportunities for the private sector at the vertical level including support services and industry.

**The Investor: The New Kuwait 2035 vision envisions the development of the Silk City, an entire economic zone in the northern part of Kuwait. What is the status of this plan/project? What**



*Government plans to privatize "total of 38 projects in the next 20 years".*

**steps will take place in 2019/2020 to move this forward and what can investors expect in terms of opportunities or things to watch out for? And what about establishing or working with investment companies to open funds related to projects like Silk City?**

**Dr. Khaled Mahdi:** There are three components to the Silk City project that are considered as main prerequisites for the success of the Special Economic Zone or Northern Region project - known locally as the Silk City project. (a) the masterplan which is currently in progress and is being finalized by the consultants who are also working out the project's feasibility, zoning and implementation; (b) the financing model which will be developed once the masterplan has been articulated to allow 100% financing by the private sector. Until now, the engagement of the public sector hasn't yet been addressed; and (c) the legislative framework, and, in fact, a draft of the new legislation has recently been submitted to the National Assembly for review.

**The Investor: What is the status and where we are over the different components and what do you expect to happen within the next year?**

**Dr. Khaled Mahdi:** Kuwait is a country that takes pride in its constitution and institutions, and there is a different government entity responsible for the execution of the different components. I, myself, am following up on their progress as they have already initiated the process, especially that the draft law has been submitted (as mentioned). Regarding the financing, several models are being considered.

**The Investor: To move forward with the development of the Silk Region project, the draft law must be approved by parliament. What is your view on how long this might take and is there consensus and support for the proposal?**

**Dr. Khaled Mahdi:** I expect it'll take some negotiations to pass this law, which, when promulgated, the legal framework will support the project in a more efficient and practical manner. It will be much more effective to work according to the law for faster and better results allowing a bigger leading role of the private sector.

**The Investor: Who holds the decision making for these? And under which authority?**

**Dr. Khaled Mahdi:** The Silk City Authority (Medinat Al-Hareer Authority) oversees the project; previously, it was under the authority of the Council of Ministers. Now, it is under the authority of the Deputy Prime Minister Sheikh Nasser Al-Sabah.

**The Investor: Let me go back. Clearly, the human capital is vital in all the national development efforts. Can you give an example of what you mean by educational reform?**

**Dr. Khaled Mahdi:** The "Human Capital" is another strategic pillar in the national plan, which requires introducing educational reforms that can narrow the gap between the needs of the economy and educational outcomes. The Human Capital Pillar also extends to include women's empowerment, persons with special needs and the youth. The concept of the educational reforms would be to move to a more STEM-based syllabus in public schools that is science and math intensive. The reforms will also introduce an accreditation program of schoolteachers in the private sector, and to ensure that the whole education system is operated by licensed teachers.

**The Investor: And do you foresee more involvement by the private sector in the public education field?**

**Dr. Khaled Mahdi:** Yes, I do, based on the views of the Supreme Council for Planning and Development. It will be considered when the new amended privatization law is passed to permit the private sector to manage and operate public entities. As I said, privatization is no longer about the transfer of assets, but it entails leasing and transfer of management. The new draft of the privatization law was originally issued in 2010. The National Assembly is currently reviewing the amendments that the government has submitted a year ago.

**The Investor: What do you foresee as opportunities for investors – local and foreign – coming up in the next one or two years?**

**Dr. Khaled Mahdi:** It'll be in the short to medium terms and will focus on the management of operations of strategic projects that, when complete, will require international and local expertise of private companies for managing these facilities efficiently and effectively. For instance, the bed capacity of almost all the hospitals in the country are doubled and this will need management arrangements with the support of the private sector. Investors will certainly find potential opportunities and they need to move aggressively to push the government to stay away from operations and let the private sector actively engage.

**The Investor: This is different, however, from PPP or privatization?**

**Dr. Khaled Mahdi:** The PPP or privatization schemes use other investment arrangements than mere capital. In fact, the management of operations of facilities is a much more lucrative investment because it's almost risk-free. It is a partnership between the government which builds the



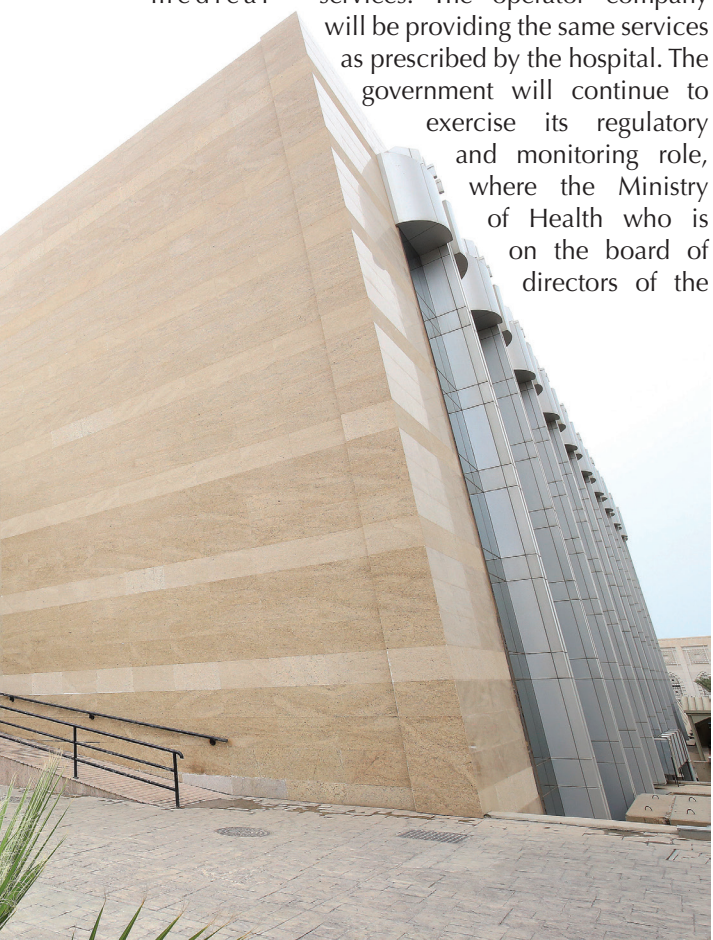
infrastructure and the investor as the operator of the facility. After all, the government needs to operate and manage the facility, and this is where the private sector manages the facility not as a contractor but as an operator. For example, the government builds a hospital then invites the private sector to manage its operations and generates its own revenue. This is different from acting as a contractor that receives its payments from the government, but instead, it'll act as an operator providing services.

**The Investor: How will this work in public hospitals, like Jaber Hospital, when the hospital is for Kuwaitis only and healthcare is free for citizens.**

**Dr. Khaled Mahdi:** Per the operating model approved, if you are a non-Kuwaiti who has insurance, then you can go to Jaber Hospital. Although the operation of the hospital is privatized, but we don't have full privatization in Kuwait. The model doesn't cater for full privatization; it's a public private and people partnership.

**The Investor: Then in a government hospital, the government will be paying for citizens?**

**Dr. Khaled Mahdi:** The government will cover all medical services. The operator company will be providing the same services as prescribed by the hospital. The government will continue to exercise its regulatory and monitoring role, where the Ministry of Health who is on the board of directors of the



Sheikh Jaber Al-Ahmad Hospital will continue to monitor and regulate the operations. We believe that if the private sector will be able to manage these mega development projects effectively and efficiently, while acting in their investment capacity, they will also have to attend to the operations, equipment, establishing infrastructures and systems for operations.

**The Investor: Taking government services and privatizing them?**

**Dr. Khaled Mahdi:** Yes. This will be achieved gradually but not all at once. The transforming of the role of the government from an operator of the economy to its regulatory role takes time. If we look at the Kuwait Boursa project, we see how it has developed on an operator-investor model. We've just started but there is one success story after another. Another success story is the North Al-Zour power station, developed under public-private-partnership, had been set up entirely in 22 months and the government will buy the electricity and water from the operator. The government didn't pay one cent for the building and the construction of the facility. It's owned by a company under the PPP arrangement at present, we're looking at this same model for investment options in the two islands.

**The Investor: As Secretary General of the Supreme Council for Planning, what do you foresee for the Kuwait economy in 2019/2020? Where do you expect growth and development and what are the Council's main concerns for Kuwait's short- and medium-term economic future?**

**Dr. Khaled Mahdi:** Our main aim is to gradually achieve deviation from dependency on crude oil being the main source of national income and this can be possible through diversification which in itself is an enabler; moreover, and as I mentioned earlier, advancing privatization and expanding the SMEs portfolio, as well as improving the ease of doing business should holistically make investing in mega projects attractive to foreign and local investors.

**The Investor: Speaking of that, do you have any insight or knowledge about possible changes or updates to Kuwait's bankruptcy laws?**

**Dr. Khaled Mahdi:** There is a package of laws that are considered to be revised for amendments as part of improving the ease of doing business environment, including the new draft bankruptcy law which is nearly ready for submission to the National Assembly. The plan is to have them ready by 2020 for implementation.



Encouraging innovation

# ‘Kuwait’s Central Bank fintech regulatory sandbox framework’



**S**andbox is one of the most common words in the fintech universe. In the financial industry, the term refers to a mechanism for developing regulation that keeps up with the fast pace of innovation. The word sandbox originally referred to the small box filled with sand where children play and experiment in a controlled environment. But little by little, the term has acquired new meanings. In the digital economy landscape, it is mostly used to refer to regulatory sandboxes: testing grounds for new business models that are not protected by current regula-

tion, or supervised by regulatory institutions.

The purpose of the sandbox is to adapt compliance with strict financial regulations to the growth and pace of the most innovative companies, in a way that doesn't smother the fintech sector with rules, but also doesn't diminish consumer protection.

In line with its vision and aim to encourage and adopt innovation in fintech, the Central Bank of Kuwait (CBK) has issued the Regulatory Sandbox Framework document which encourages both companies and



individuals looking to provide innovative products and services, that are built on or associated with electronic payment of funds and that utilize new technologies or existing technologies in an innovative way, to test their innovations within a methodology that ensures the safety and soundness of the financial and banking sector.

The Regulatory Sandbox Framework includes four stages to be completed within one year at the most. The Regulatory Sandbox starts with the application stage of the proposed product or service, then the evaluation stage where thorough evaluation, which covers technical, security, and regulatory aspects, of the application will take place, followed by the experimentation stage of the proposed product or service in a testing environment, and finally the accreditation stage, where CBK grants its approval (or rejection) to deploy the proposed product or service in the local market.

For full details, visit: <http://www.cbk.gov.kw/en/legislation-and-regulation/regulatory-sandbox/general-framework.jsp>

## FAQS

### **Who are the target audience for the Regulatory Sandbox?**

The Regulatory Sandbox targets both companies and individuals looking to provide innovative FinTech products and services that are built on or associated with electronic payment of funds, using new technologies or existing technologies in an innovative way.

### **How to apply to the Regulatory Sandbox?**

To apply to the Regulatory Sandbox, the applicant is required to complete and submit the application form by following the instructions specified in the Regulatory Sandbox Framework page available on the Central Bank of Kuwait website.

### **What is the duration of the Regulatory Sandbox?**

The maximum duration of the regulatory sandbox is one year, with the possibility of an extension based on the Central Bank of Kuwait discretion.

**Are there any participation fees?**

There are currently no fees to participate in the Regulatory Sandbox.

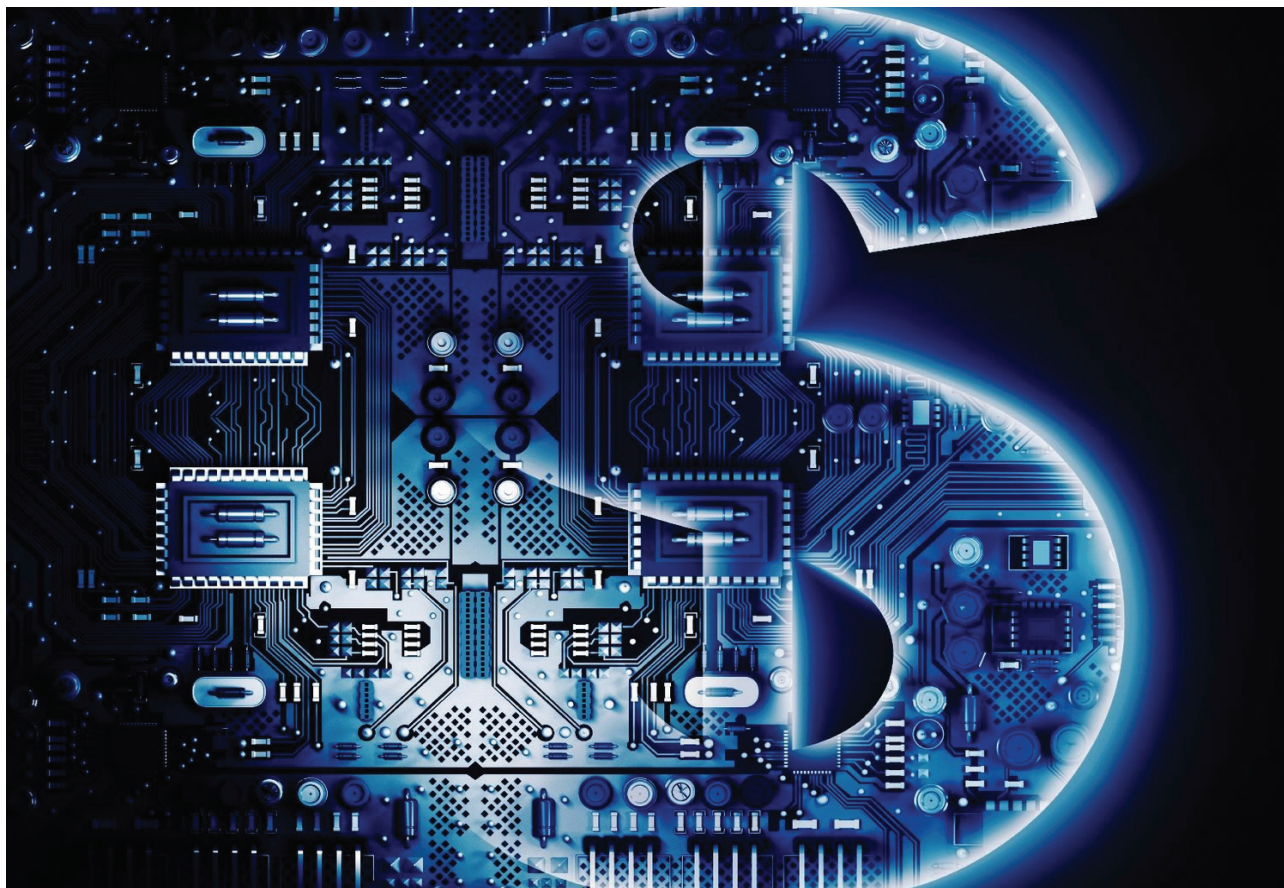
**Are participants able to leave the Regulatory Sandbox prior to completing the stages? Are there any consequences in doing so?**

Participants are required to notify the Central Bank of Kuwait via email [sandbox@cbk.gov.kw](mailto:sandbox@cbk.gov.kw) with the necessary justifications and clarifications in order to be able to leave the Regulatory Sandbox at any stage. In such case, based on its discretion, the Central Bank of Kuwait has the right not to accept any subsequent applications to participate in the Regulatory Sandbox for a period of one year from the date of notification.

**What is the level of development required of the proposed product or service in order to be eligible to participate in the Regulatory Sandbox?**

The proposed product or service must be in an advanced stage of development, deeming it ready for testing.

*The purpose of the sandbox is to adapt compliance with strict financial regulations to the growth and pace of the most innovative companies, in a way that doesn't smother the fintech sector with rules, but also doesn't diminish consumer protection.*



A supply shock followed  
by a demand shock:

## This is how the coronavirus pandemic will push Kuwait and the global economy into recession in 2020

By Tariq Al-Rifai

Markets around the world kicked off 2020 with a lot of optimism. Not only was it the beginning of a new decade, it was also the start of what is hoped would be another great year for stock markets around the world. This was unlike 2019, which kicked off with rising worries on a global economic slowdown, Brexit concerns and a trade war between the US and China.

This new year optimism, however, quickly faded as the coronavirus outbreak in China spread around the world leading the World Health Organizations (WHO) to declare this a pandemic on 11 March 2020. World leaders, international organization such as the International Monetary Fund (IMF) and leading economists expect this pandemic to have a short-term effect on the global economy and have adjusted their forecasts slightly downwards for the rest of the year. They believe that this pandemic will be short-lived and the global economy will quickly recover. There is mounting evidence, however, that their outlook for 2020 is too optimistic.

### Global economic slowdown in 2019

In early 2019, several leading agencies, including the IMF, World Bank, European Central Bank (ECB) and US Federal Reserve, voiced their concerns over a global economic slowdown that began in 2018 and spilled over into 2019. Both the Federal Reserve and the ECB were forced to lend additional support to their respective markets. The Federal Reserve lowered interest rates for the first time in 12 years while



the ECB reaffirmed its commitment to continue with its asset purchase program.

Though the global economy began slowing down before the US-China trade war began in early 2018, central banks were concerned that the trade war coupled with uncertainty over Brexit would accelerate the slowdown. Gross domestic product (GDP) growth in the US, EU and China have been consistently slowing down from 2018 to this day. Other



major economies have reported anemic growth in 2019, including the UK, Japan, Singapore and South Korea.

It is true that the US and China reached a Phase 1 trade deal and elections in the UK gave some certainty to investors that it will be leaving the EU, but it did not change the fact the global economy was still slowing down as we entered 2020.

In spite of this negative economic news, stock markets around the world had a stellar year in 2019, with many markets recording new record highs. In 2019, for example, the S&P gained 28% reaching a new record high. Germany's DAX Index and France's CAC40 index both were up 25%. Other top performing markets in 2019 were Greece's blue-chip index up 50%, Japan's Nikkei up 18% and the UK's FTSE 100 up 12% despite all the Brexit worries.



### **China's economic health has been deteriorating for years**

China has been a concern for many years. Its double-digit economic growth ended a decade ago. Since then, its economy has been consistently slowing down year after year. While many economists would point out that its latest GDP growth figures of 6% is well-above most other countries, it is a major problem for China.

The main reason this is a problem for China is because this GDP slowdown over the past 10 years coincides with a record rise in debt across all sectors; government, corporate and consumer (Figure 1). According to McKinsey Global Institute, the country's debt to GDP ratio is approaching 300%, and is mainly corporate debt.

Following the Global Financial Crisis, China stimulated its economy by encouraging its companies, led by its exporters, to take on more and more debt for growth and expansion. The hope was to drive up economic growth as it did in the previous decade. This time, however, it was not working. Companies took on more debt but it did not lead to higher economic growth.

While global growth remained lower than historic averages following the financial crisis, China focused inward to build up its consumer base. The country invested heavily in building local infrastructure and in creating a more consumer-driven economy. This too has failed to yield the desired results. Fixed asset investments and

retail sales have been steadily falling for the past 10 years (Figure 2).

### **Coronavirus pandemic and its effect on the economy**

What we have learned from history is that market optimism can quickly change, especially when an unknown risk suddenly sparks a global panic, or in today's case, a pandemic. The coronavirus outbreak was first identified in China in December 2019, but it did not raise international concern until January this year when it began to spread rapidly across the country.

This brings us to today's dilemma; not only is China facing a major health crisis, but in fact, the world is now facing a once in a lifetime health crisis, the effects of which will be felt around the world for many years to come. From an economic perspective, the coronavirus is shaping up to be the perfect storm to hit the global economy.

The Chinese government's swift reaction to contain the spread of the virus seems to be working, but has caused a global supply shock. As the virus spreads around the world, other countries will be forced to follow China's stringent containment measures. In doing so, this will create a demand shock. The world economy is not prepared for either shock and now it must face both simultaneously.

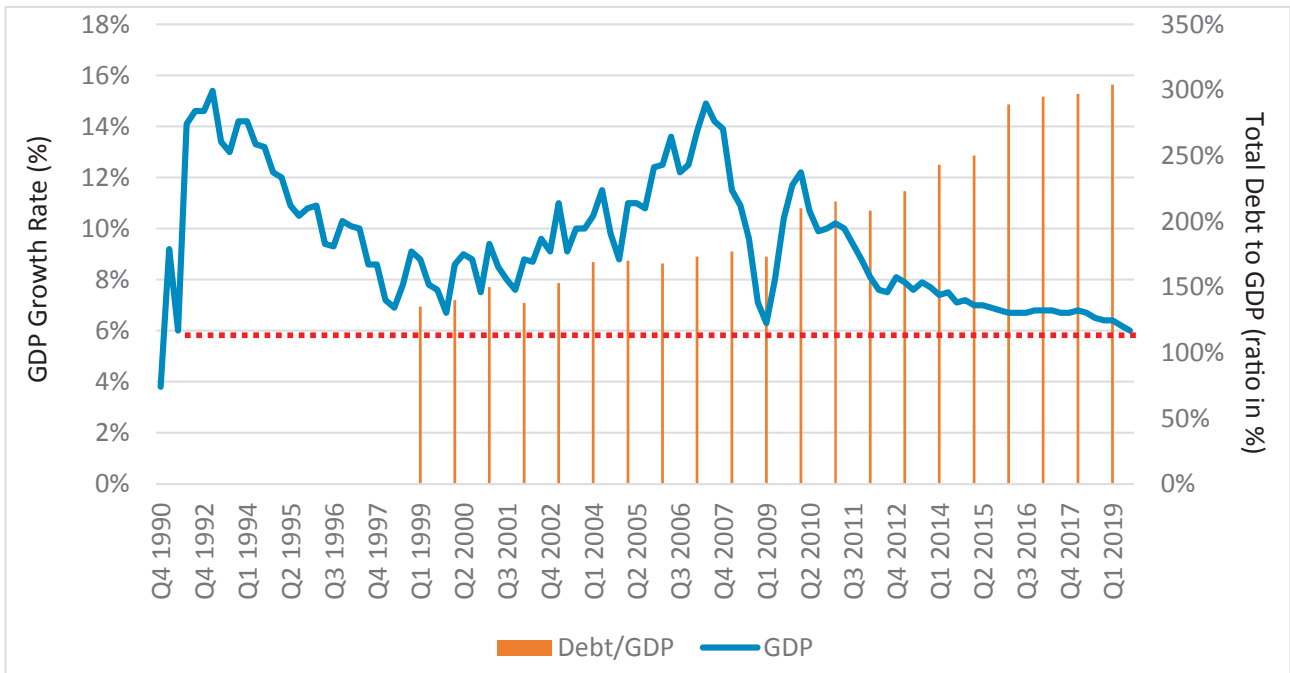


Figure 1: China's GDP growth from 1990 to 2019 compared to total debt to GDP ratio. Data source: Trading Economics and McKinsey Global Institute.

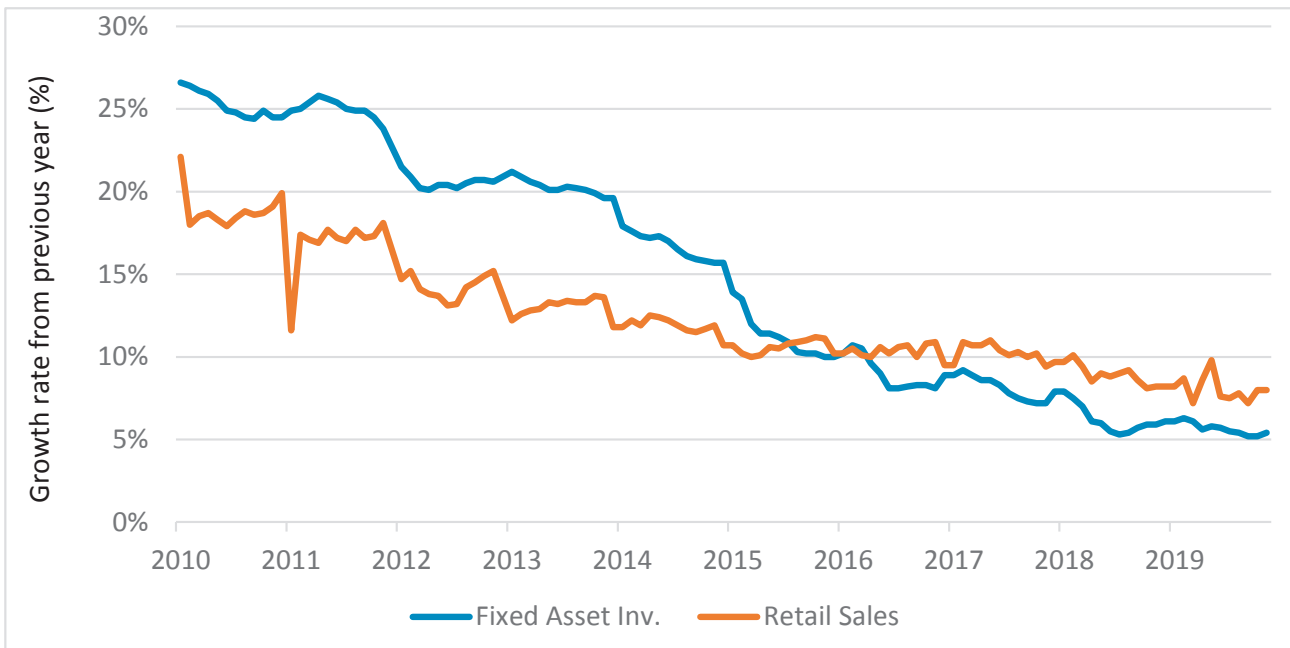


Figure 2: Growth in China's fixed asset investments and retail sales from 2010 to 2019. Data source: Trading Economics.

**Supply shock**

The economic effects of this outbreak will impact the Chinese economy severely this year. The severity of which will not be known for months to come. However, we can see the effects today and how they are beginning to spread throughout the global economy.

In their attempts to halt the spread of this virus, Chinese officials quarantined several major cities, shut down factories and cut off transportation links. Foxconn, for example, the manufacturer of iPhones, has closed its factories in the country along with Samsung. Airbus, General Motors, Toyota and Volkswagen also closed their Chinese factories. Auto manufacturers Hyundai and Kia have

been forced to halt production in their South Korean factories due to supply-chain disruptions with their Chinese auto parts suppliers. This is what is most worrying to the global economy. As factory closures extend for weeks or months, the damage to global supply chains and economic growth will be significant.

Last month, China reported its Manufacturing PMI figures, which is an index that tracks manufacturing activity, as well as the New Orders index, which tracks new orders received in the manufacturing sector, the backbone of China's economy. The reported figures were the worst on record as can be seen in Figure 3. This was a clear sign that China's economy was frozen.

According to a 21 February 2020 Fortune Magazine survey, 94% of Fortune 1,000 companies (the largest companies in the US) are seeing supply chain disruptions from China. Some of the largest companies in the world have already announced factory closures and disruptions outside of China including; Fiat Chrysler, General Motors, Honda, Jaguar Land Rover, Nike, ... and this list goes on.

As soon as Chinese authorities were able to slow the spread of the virus, they ordered their companies to reopen and get back to business as usual as quickly as possible to lessen the damage to the economy. However, a study published by the Institute for Supply Management on 11 March 2020, reveals the virus' supply chain effects. Companies were struggling to get back to business as usual. In the study, manufacturers reported operating at 50% capacity with only 56% of normal staff. This was nearly one month since the government announced the orders

for companies to get back to work (on 13 February).

The world depends on China more than ever. For example, China is currently the world's largest manufacturer of pharmaceuticals and their ingredients. A report published by the Council on Foreign Relations in August 2019, warns about America's dependence on China for pharmaceuticals. The report highlights the fact that 97% of antibiotics sold in the US come from China, while 80% of the active ingredients pharmaceutical companies use to make drugs come from China. India, which is the second largest producer of pharmaceuticals, is also dependent on China as it received 75% of the active ingredients it uses in its industry.

The rapid slowdown in supplies of manufacturer goods coming from China is what is known as a supply shock. The sudden drop in supplies have a ripple effect on other economies as they depend on these goods for their economies to function efficiently.

### Demand Shock

The commodities markets are already sounding the alarm on China. Industrial commodities such as copper, iron, steel and zinc have all fallen since the beginning of the year. However, the most affected commodity to date has been oil. The price of Brent Crude, the benchmark for oil, has fallen by over 50% in January 2020. This collapse in price has been attributed to the drop in demand from China, estimated to be 2 million barrels per day, as well as the start of an oil war between Saudi Arabia and Russia. For oil producing countries like Kuwait, such a drop

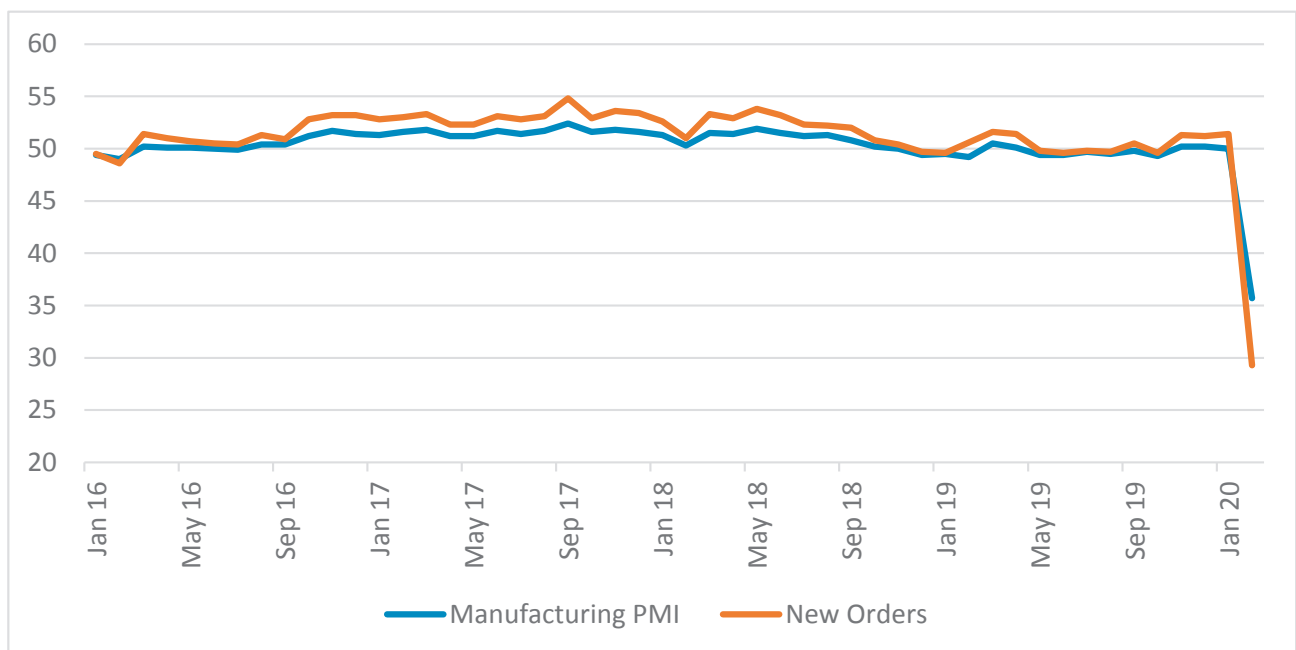


Figure 3: China monthly Manufacturing PMI and New Orders indices from Jan. 2016 to Jan. 2020. Data source: Y-charts and Trading Economics.

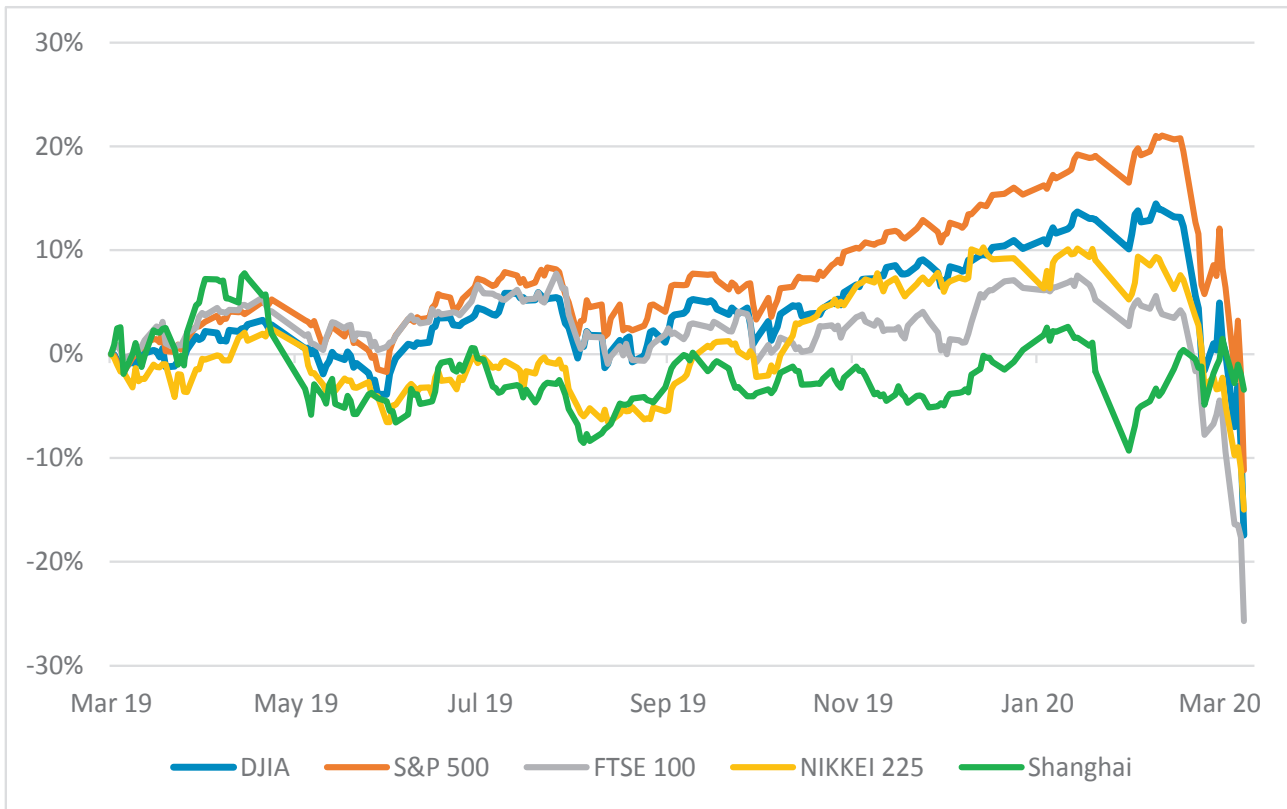


Figure 4: Performance of select stock indices over the past 12 months (12/3/2019 to 12/3/2020). Data source: Trading Economics.

in the price of oil is guaranteed to push the economy into a recession.

Global financial markets, which just one month earlier were dismissing the effects of the supply shock from China, continued to rise despite all indicators pointing to serious problems on the horizon. It was not until the virus began spreading rapidly outside China did financial markets finally take note.

During the last week of February 2020, stock markets around the world crashed (Figure 4). The oil war only added more fuel to the fire. US stock markets, for example, have not witnessed such a crash since 1987.

As the virus spreads around the world, countries will be forced to take on stringent containment measures as in China. This includes, travel bans, school and work closures, and shop and restaurant closures. Though the media has been reporting on the severe impact this is having on global air travel and tourism, it is also having a severe impact on overall consumer spending, the engine of most economies. Thus, the slowdown in spending will erode demand just as China is attempting to repair its supply chains. This is the demand shock.

This demand shock together with the supply shock will impact Kuwait's economy in 2020 and maybe longer. In 2018, 15% of Kuwait's total exports went to China, or

USD 953 million, and 17% of the country's imports came from China, or USD 5.98 billion, making China by far Kuwait's largest trading partner. This is according to the United Nations COMTRADE database on international trade.

**Conclusion**

The impact of the coronavirus pandemic on the global economy will be more severe than international agencies, such as the IMF are predicting. Their expectation of an economic slowdown in the first half of this year followed by a rise in growth is overly-optimistic. The supply shock from China is only now being felt around the world and the demand shock that will follow could be the perfect storm that pushes the global economy into its worst recession since 2008. This could also be the year in which China experiences its first recession since 1974.

Sustained lower oil prices throughout the year are enough to negatively impact the economy in Kuwait and the GCC. Thus, these countries should be prepared to weather this storm by continuing to implement their future development plans as stated. This investment and support of the local economy will ensure a stronger recovery.

Overall, 2020 is shaping up to be the most challenging year not only for Kuwait's economy, but also for the global economy since 2008.



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Published by the Union of Investment Companies Kuwait in cooperation with Kuwait Times Publishing House under the leadership of UIC President Saleh S. Al-Selmi, the Investor Editor-in-Chief Bader N. Al Subaiee and Kuwait Times Editor-in-Chief Abd Al-Rahman Al-Alyan.

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