Macroeconomic outlook

Kuwait: Nonoil growth steady at 5%, despite lower oil prices

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Overview and outlook

- **Nonoil growth to maintain a healthy pace as project implementation improves; nonoil growth expected at 5% in 2015 and 2016.**
- **Lower oil prices likely to push fiscal balance into deficit in FY15/16, but fiscal and external buffers remain more than adequate.**
- **Consumer sector growth to remain solid, but to moderate its pace.**
- **Inflation is likely to end 2015 up slightly, but remains contained thanks to a stronger dinar and low global inflation.**

Kuwait's economic growth is set to maintain a healthy pace despite last year's collapse in oil prices. Growth, which picked up since 2013, is being supported by the accelerated implementation of the government's development plan and a robust consumer sector. Ambitious capital spending targets have boosted aggregate investment and should continue to do so in 2015 and 2016.

The parliament's recent approval of the five-year development plan for 2015-2020 as well as the FY15/16 capital spending budget confirm the commitment to the ambitious investment spending targets. We think the capital spending outlook will remain unchanged in the current low oil price environment.

While lower oil prices have had a significant impact on Kuwait's fiscal and external positions, the country continues to enjoy substantial buffers that allow it to stay the course in the medium term. Indeed, Kuwait is expected to register a deficit in FY15/16, its first in over a decade. However, a sovereign wealth fund estimated at over 300% of GDP ($550 billion), among the highest in the region, will allow Kuwait to easily finance a deficit without having to make deep cuts in spending.

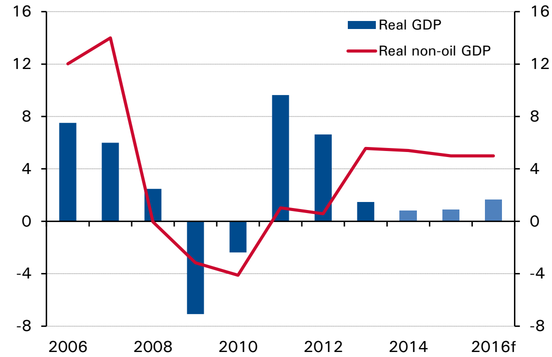
Still, lower oil prices have highlighted the longer term sustainability challenges for Kuwait. As such, the government has rekindled efforts to introduce vital fiscal reform. Those include a broader corporate income tax and a value added tax (VAT), though neither is likely before 2019. A new subsidy reform initiative is also expected, which could include a cash transfer to lower income households. The parliament is also currently deliberating on an ambitious wage bill reform initiative which aims to

Table 1: Key economic indicators

		2013	2014e	2015f	2016f
Nominal GDP	KD bn	49.9	47.8	35.4	40.1
Nominal GDP	USD bn	176	168	118	134
Real GDP growth	% y/y	1.5	0.8	0.9	1.6
Oil	% y/y	-0.8	-1.9	-1.7	-0.6
Non-oil	% y/y	5.6	5.4	5.0	5.0
Inflation	% y/y	2.7	3.0	3.5	3.5
Budget balance	% of GDP	25.9	8.1	-4.8	0.2

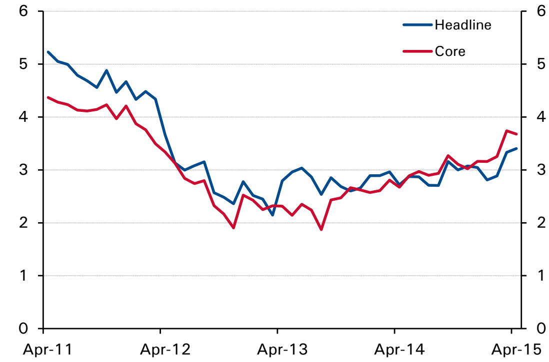
Source: Central Bank of Kuwait, Ministry of Finance, Central Statistical Bureau, NBK estimates

Chart 1: Real GDP
(% y/y)



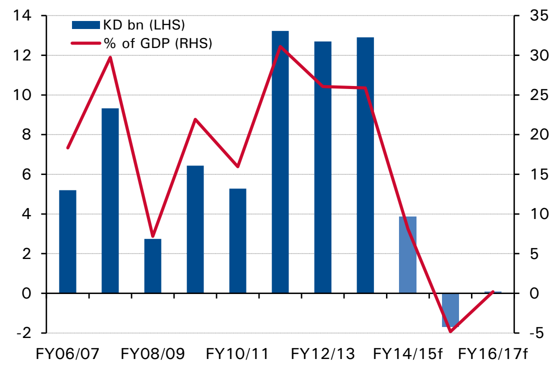
Source: Central Statistical Bureau, NBK estimates

Chart 2: Consumer price inflation
(% y/y)



Source: Central Statistical Bureau

Chart 3: Budget balance



Source: Ministry of Finance, Central Statistical Bureau, NBK estimates standardize pay across the public sector and to increase central control over the government's wage bill. We think authorities are serious about addressing the long term fiscal challenges facing the country and doing so in a gradual manner that does not derail the pace of growth.

Nonoil growth at 5%, supported by public investment drive

The nonoil economy has registered a healthy growth rate since 2013, and we expect it to maintain growth around 5% in 2015 and 2016. The most recent available official data on GDP growth indicates that Kuwait's nonoil economy grew by 5.6% in 2013. We think that pace of growth was largely maintained in 2014, supported by an accelerating pace of project implementation and a robust consumer sector.

There are signs that nonoil activity may have eased slightly in Q1 from the strong pace seen in 2013 and early 2014, though this trend appears temporary and should be short-lived. Private credit growth was lower in 2014 thus far in 2015, following several years of accelerating growth. Private credit grew by 5.7% y/y through April 2015, down from growth of 8.1% in 2013 and 6.2% in 2014. Business credit (excluding personal facilities and the nonbank financial sector) alone slowed to 5% y/y from 7.9% in 2013. The lower figures are largely due to the write-off of Family Fund loans by banks and to the pay-down of legacy debt by some corporates in 2014. Adjusting for these factors, we think growth has been relatively steady through April 2015 at around 8% y/y where it should close the year.

Investment boosted by government development plan

The solid pace of growth has been driven and supported by investment spending, itself due to improved implementation of the government development plan. The plan calls for both government and private investment in a host of large infrastructure projects. Following some delay in prior years, 2014 saw a pickup in the pace of implementation, with project awards rising notably in 2014. Further progress should be seen in the coming period following the legislative approval earlier in 2015 of the broad investment plan for the coming five years (2015-2020), as well as the FY15/16 capital spending budget.

The 2015-2020 development plan targets around KD 34 billion in new project spending in various sectors including oil, power generation, transportation and housing. Most of the projects in the plan have already been approved individually and have been on the government's drawing board for several years.

The government also seeks to improve the business environment and to boost private sector participation in the economy. This will be done largely through the public-private partnership (PPP) investment model. Legislation passed in 2014 should lead to better regulation of the PPP initiatives. The new law replaced the Partnerships Technical Bureau (PTB) with the Kuwait Authority for Partnership Projects (KAPP). The new body has greater independence and executive powers and should manage PPP initiatives more effectively.

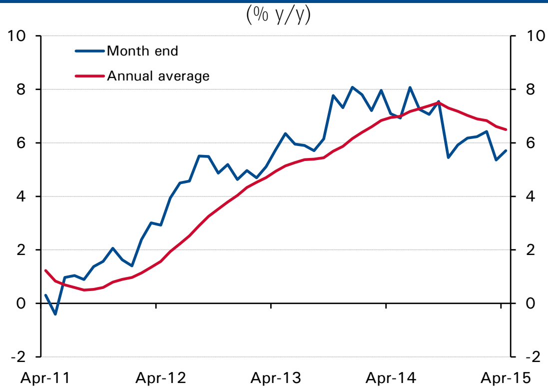
Consumer sector set to continue to moderate

Growth in the consumer sector has been resilient and consistent, though we expect growth to continue to moderate. The sector will remain a key driver of the nonoil economy. Household income growth has remained supportive, with hiring among Kuwaitis and skilled expats steady. As a result, consumer spending and household borrowing growth have been healthy despite some moderation over the last year.

Card spending growth eased slightly to 12.6% y/y in 1Q15, its slowest

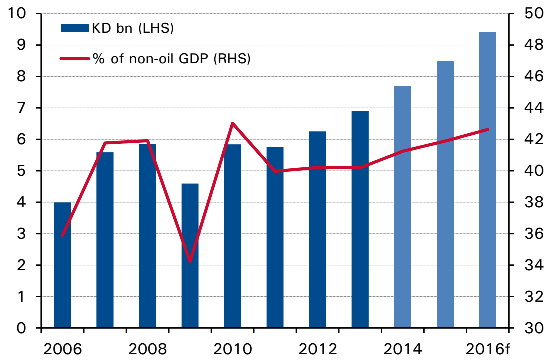
Chart 4: Private credit

(% y/y)



Source: Central Bank of Kuwait

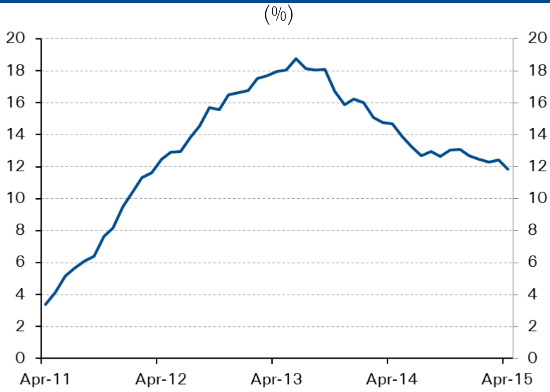
Chart 5: Aggregate investment



Source: Central Statistical Bureau, NBK estimates

Chart 6: Household debt growth

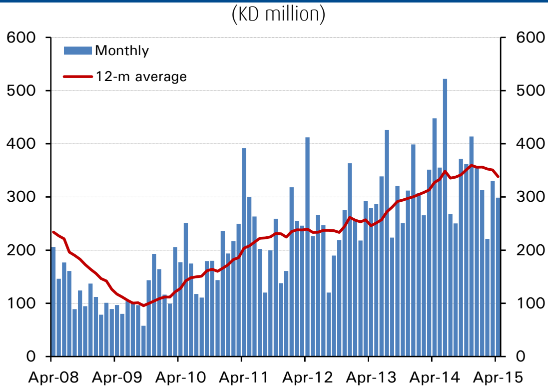
(%)



Source: Central Bank of Kuwait

Chart 7: Real estate sales

(KD million)



Source: Ministry of Justice

pace in three years. The figure points to some slowing in the consumer sector though the pace remains healthy. Personal loan growth also slowed to a three-year low though it remained quite healthy too at 11.8% y/y in April 2015. The positive outlook in other sectors of the economy and continued support from current government spending should help support continued robust growth in the sector.

Real estate market cooled in early 2015

Real estate sales growth cooled thus far in 2015 following strong growth in 2014, though the commercial sector was an exception. The residential and investment sectors both cooled, with sales during the first four months of 2015 shrinking by 15% and 23% compared to the previous year. This followed very strong growth in 2014, with sales of investment properties rising by nearly 30% last year. Meanwhile, the commercial sector continued to register robust gains in sales during the first four months of 2015, as the KD volume of registered transactions was up 21% y/y.

Inflation has picked up on domestic pressures

Inflation continued to pick up with upward pressures coming largely from domestic sources. Headline inflation came in at 3.4% y/y in April 2015, up from 2.7% a year before on stronger housing inflation. "Core" inflation (excluding food) was slightly higher at 3.7% y/y. Consumer price growth has been on a moderate uptrend over the last two years but has remained subdued thanks to low international inflation. We expect inflation to increase to an average of 3.5% by the end of 2015 on accelerating domestic activity. Particularly, we expect housing inflation to cool off later this year.

Fiscal deficit expected in FY15/16 on lower oil prices

Kuwait is expected to record its first deficit in 16 years in FY15/16 as a result of the decline in the price of oil. Though the parliament has yet to approve the budget, government spending is expected to be lower in FY15/16; most of the cuts should be in items that would leave the outlook for the domestic economy unchanged. In particular, investment spending plans will be largely unchanged.

Brent has recovered somewhat since it bottomed early in 2015, averaging $57 per barrel thus far in 2015. Still, the price remains nearly 40% lower than a year ago. Oil revenues are expected to be 38% lower at KD 13.8 billion, producing a deficit of around 4.8% of GDP.

The dinar has strengthened along with the stronger dollar

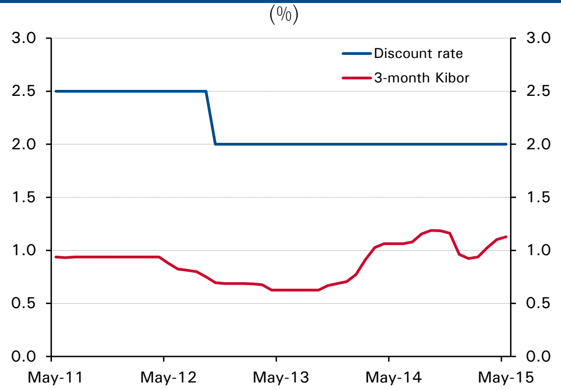
The Kuwaiti dinar (KWD) had strengthened substantially in 2014, as a result of the stronger US dollar; it has since retreated somewhat, though the KWD is still up compared to a year ago. The dinar is pegged to a basket of 4-5 major currencies, with the US dollar having the largest weight among them. The JP Morgan trade-weighted index of the dinar shows the currency up by around 6.2% since May 2014, though it retreated around 2.6% from its peak in March 2015.

Stock market moves sideways so far this year

Kuwait equities have yet to recover following the market's retreat late last year in the wake of weaker oil prices. The market made an initial but short-lived recovery earlier in 2015. The Kuwait Stock Exchange's value-weighted index (IXW) was down by 3.9% year-to-date (ytd) in May. Over the same period, the MSCI total return index is down by 2.5% ytd.

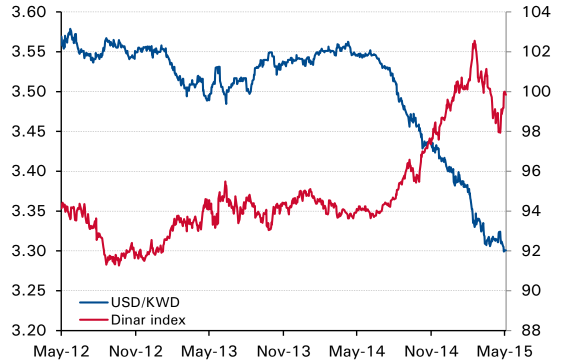
Chart 8: Interest rates

(%)



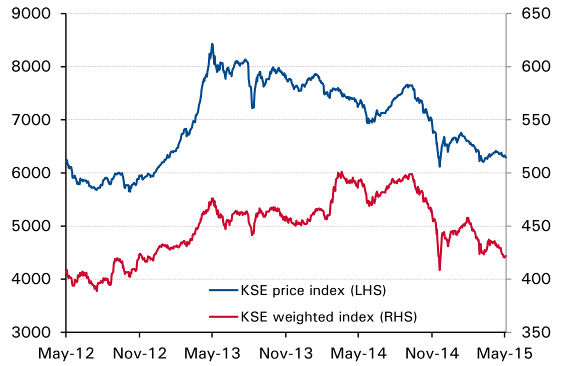
Source: Central Bank of Kuwait, Thomson Reuters Datastream

Chart 9: Exchange rate



Source: JP Morgan, Thomson Reuters Datastream

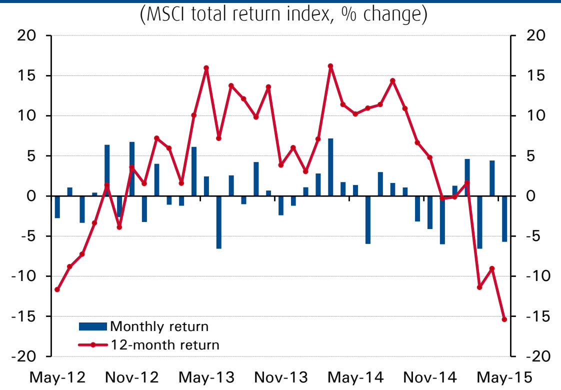
Chart 10: Stock market indices



Source: Kuwait Stock Exchange, Thomson Reuters Datastream

Chart 11: Stock market total returns

(MSCI total return index, % change)



Source: MSCI, Thomson Reuters Datastream

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