

Kuwait: Coronavirus expected to impact commercial and investment sectors in 2Q20

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Highlights

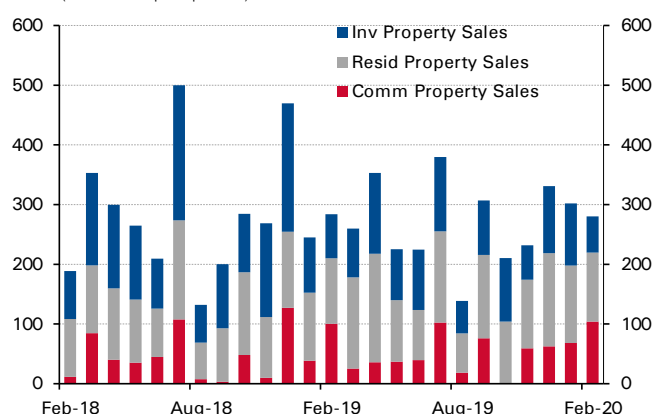
- Real estate sales totaled a solid KD280 million in February 2020, down by 1.2 y/y and 7% m/m.
- Investment and commercial sectors expected to be most impacted by the lockdown and expat unemployment in 2Q20.
- The residential sector, while also affected, could be more resilient due to strong fundamentals and local demand base.
- The easing of business restrictions and the end of the total lockdown mean a recovery may be on the horizon, naturally dependent on the longevity of the pandemic.

Lockdown will impact sales and prices in 2Q20

Real estate sales totaled a solid KD280 million in February 2020, down by 1.2% y/y and 7% m/m. (Chart 1.) This follows sales of KD302 million in January, marking a strong start to the year. The monthly decline in total sales was driven by a notable drop in residential and investment sales which more than offset a strong rise in commercial sales. With respect to prices, our residential real estate price index rose 9% y/y as of January, while investment prices remained soft, on relatively weak demand and high apartment vacancy rates.

Chart 1: Real estate sales

(KD million per quarter)



Source: Ministry of Justice/ NBK

Looking back at 4Q19, sales were moderate at KD773 million, although down 6% q/q and 24% y/y, wrapping up a relatively strong year overall for real estate. Sales in 2019 exceeded KD3 billion, maintaining the recovery seen in 2018 which saw a similar level of activity. Sales were driven by solid volumes in the residential sector (+8%) encouraged by strong confidence,

improving market conditions, and lower prices at the onset of 2019.

No data is yet available post February due to the total lockdown. However we expect the real estate market, especially the commercial and investment sectors and to a lesser extent the residential sector to be impacted in 2Q20 by the coronavirus and the related precautionary measures, namely the lockdown and business restrictions which have led to weaker business conditions and job losses especially among the expatriate population. Real estate shares in Boursa Kuwait have indeed shown signs of distress, with the real estate index down a steep 19% (as of June 14) since late February, though recovering from a low of nearly 30% in April in line with a general equity market pick-up helped by the easing of lockdown restrictions and rising oil prices. Longer-term market pressures could also arise from newly proposed policies to correct the demographic imbalance by reducing eventually the expat population share to 30% from the current 70%. Returns could also be affected by a recently-proposed law to waive rents for six months and reduce rents by 60% in the six months thereafter in times of crisis.

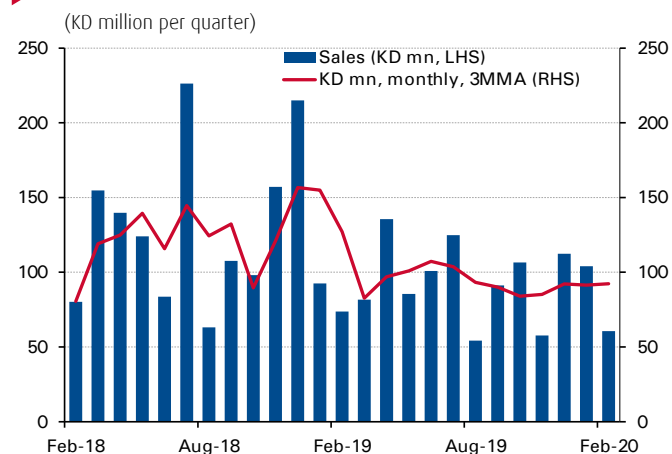
Investment sector may suffer due to higher vacancies

Investment sector sales fell 42% m/m and 18% y/y to KD62 million in February. (Chart 2.) Looking back at 4Q19, sales were roughly in line with the 2019 quarterly average, at KD277 million. The monthly drop was driven by a decline in prices, number of transactions and average transaction size.

Meanwhile prices remained relatively soft in this sector, which has been burdened by weak fundamentals since early 2017, partly reflecting softer demand from the expatriate segment but also continued oversupply. Building and apartment prices as of January were down 3% and 5% y/y respectively. (Chart 3.)

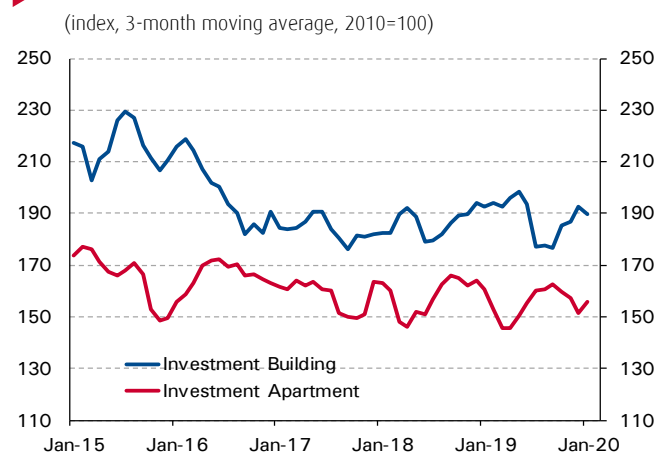
Prices and sales in the investment sector will likely be negatively impacted by the coronavirus, especially given that the bulk of rental demand for such properties typically stems from the expat labor force, which has certainly been affected by the lockdown and business closures. Further, with oil prices and economic growth expected to recover but remain moderate next year, slow progress on policy reforms, and investors increasingly turning to the residential sector for opportunities, it may take some time for demand and prices to recover to pre-2017 levels. Additionally, according to the consumer price index, residential rents (mostly apartments) remain in deflationary territory (-0.3% y/y) though have been stable over the past ten months, but are expected to resume a downtrend on reportedly higher vacancies, with recent reports of rent cuts and/or no rent for 1-2 months as landlords attempt to attract new tenants.

Chart 2: Investment sector sales



Source: Ministry of Justice / NBK

Chart 3: Investment sector price indices



Source: Ministry of Justice / NBK estimates

Residential sector expected to show greater resilience

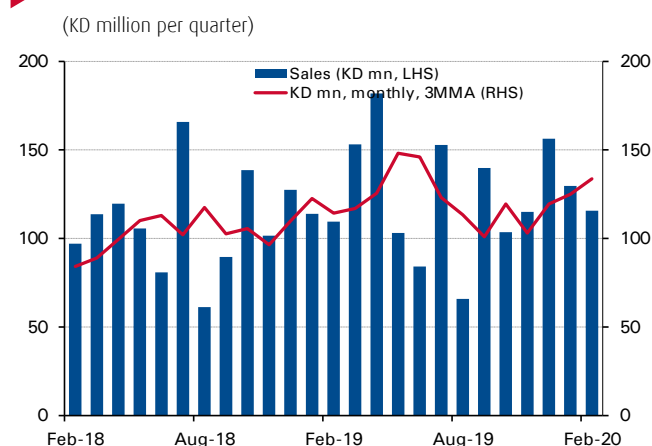
Residential sales eased to KD116 million in February from KD130 million in January (-11% m/m, -5.6% y/y). (Chart 4.) The lower sales came on the back of a notable drop in the average size of

transactions, which fell by 14% m/m.

Meanwhile prices maintained the positive trajectory observed through 2019, with home and land prices up 8% and 13% y/y respectively in January, supported by strong demand. (Chart 5.)

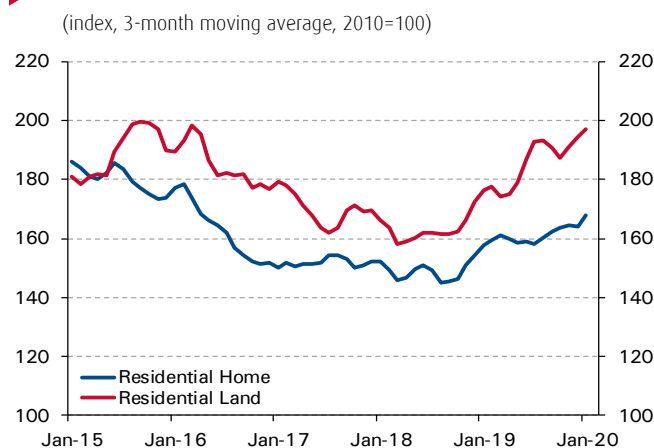
While other sectors will likely be affected by coronavirus restrictions and lockdowns, the residential sector has typically been more resilient to such shocks, as the demand base stems from the local population with mostly stable jobs, and supply is somewhat limited, especially in prime areas.

Chart 4: Residential sector sales



Source: Ministry of Justice / NBK estimates

Chart 5: Residential sector price indices



Source: Ministry of Justice / NBK estimates

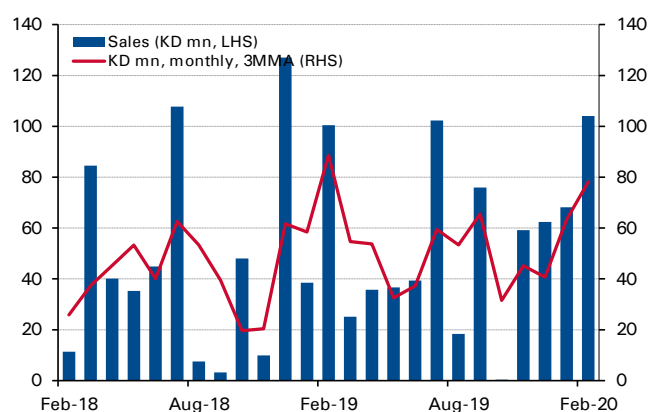
Coronavirus expected to weigh down on commercial sector

Commercial sector sales rose 53% m/m (3.6% y/y) to KD104 million in February, driven by a doubling of the number of transactions, which more than offset an 24% drop in average transaction size, indicating that smaller/ more subprime properties were transacted (Chart 6.). Similarly on a yearly basis, the higher transactions coupled with a drop in average transaction size points to smaller size/less premium property deals having taken place. The commercial sector will almost

certainly be affected by the coronavirus lockdown and its adverse effect on business sales and revenues. There have indeed been various reports of businesses struggling to pay rent for commercial space, leading to rent reductions and deferred payment for various commercial tenants, but mostly for severely impacted retail tenants with high rents in malls.

▶ Chart 6: Commercial Sector sales

(KD million per quarter)



Source: Ministry of Justice / NBK estimates

too early to say how large the economic and property market fallout from both shocks will be, but it is probable that the prices of property – like other key asset classes – will be affected. Virus concerns have already weighed down on immigration, with a weaker job market and various travel bans already in place, which may in turn affect demand for property rentals and weigh on property prices. Additionally, lower oil prices may lead investors and homebuyers to be wearier of market conditions, resulting in postponement of would-be property purchases, though this maybe offset in the near-term by pent-up sales from the lockdown period. Nevertheless, with the recent easing of business restrictions and the end of the total lockdown in May in accordance with a five-phase plan, a recovery may be on the horizon, but the pace of which will naturally depend on the longevity of the pandemic.

Market outlook

Our previous view was for the market to be somewhat steady in 2020 on a relatively softer overall economic climate, but risks are now clearly to the downside. This is in light of a prolonged coronavirus situation and a severe slump in oil prices, which will impact economic growth, sentiment and financial markets. It is

▶ Table 1: Real estate sales

| | Monthly average | | Monthly | | | | Feb. change, % | |
|--|-----------------|--------------|--------------|--------------|--------------|--------------|----------------|-------------|
| | 2018 | 2019 | Nov-19 | Dec-19 | Jan-20 | Feb- 20 | m/m | y/y |
| Sales (KD million) | 283.0 | 265.8 | 231.9 | 331.0 | 301.8 | 280.4 | -7.1 | -1.2 |
| Residential | 107.4 | 123.3 | 115.0 | 156.3 | 129.7 | 115.7 | -10.8 | 5.6 |
| Investment | 131.0 | 93.1 | 57.7 | 112.3 | 104.0 | 60.6 | -41.7 | -17.8 |
| Commercial | 44.6 | 49.5 | 59.2 | 62.4 | 68.2 | 104.0 | 52.6 | 3.6 |
| Number of Transactions | 498.5 | 526.5 | 473 | 582 | 470 | 461 | -1.9 | 3.4 |
| Residential property | 342.3 | 371.3 | 348 | 442 | 333 | 346 | 3.9 | 1.2 |
| Investment | 146.3 | 116.3 | 113 | 118 | 128 | 97 | -24.2 | 0.0 |
| Commercial | 9.8 | 38.9 | 12 | 22 | 9 | 18 | 100.0 | 157.1 |
| Average Transaction Value (KD th) | 561.2 | 505.5 | 490.3 | 568.8 | 642.2 | 608.2 | -5.3 | -4.4 |
| Residential property | 312.8 | 331.3 | 330.5 | 353.7 | 389.5 | 334.5 | -14.1 | 4.4 |
| Investment | 968.6 | 810.1 | 510.7 | 951.9 | 812.4 | 625.2 | -23.0 | -17.8 |
| Commercial | 4150.8 | 2832.9 | 4933.5 | 2834.5 | 7573.2 | 5779.7 | -23.7 | -59.7 |

Source: Ministry of Justice

Note for text: Our proprietary real estate indices database comprises over 65,000 transactions. Each index combines monthly average prices (per sqm when possible) in select, more active, areas of Kuwait; it is then adjusted for volatility. The indices are based in 2010, i.e. 2010 price index equals 100. The indices are not adjusted for seasonality nor for number of business days. They also do not cover the commercial sector.

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