August 2022

Kuwait Quarterly Economic Brief

Domestic economic indicators so far solid as global growth worries intensify

National Bank of Kuwait
Economic Research Department

Domestic economic indicators so far solid as global growth worries intensify

Highlights

- **Kuwait's economy has continued to exhibit overall positive signals despite growing concerns about the global outlook.**
- **Oil prices have slipped from their June highs, but at close to $100 should still result in a large domestic fiscal surplus.**
- **Real estate activity reached a multi-year high in Q2, with the investment and commercial sectors now seeing strength.**
- **Inflation remains elevated at 4.4%, but could decelerate in H2 as some global pressures start to ease.**
- **Bank lending growth remains solid, and the economy should be able to absorb ongoing hikes in policy interest rates.**

Kuwait's economy exhibited overall positive signals in the second – and going into the third – quarter of the year, despite growing headwinds facing the global outlook from high inflation, tighter monetary policy and the war in Ukraine, among others. The oil sector continues to provide the key impetus for Kuwait's growth, with both oil production and oil prices posting gains in Q2, though the latter eased back in July amid concerns about weakening global economic growth. Key indicators of non-oil activity are also broadly encouraging, with real estate sales hitting a record level in Q2, bank lending at a 13-year high in May and consumer spending strong and further underpinned by a one-off government payout to retirees in June. The central bank has continued to tighten monetary policy, albeit at a relatively modest pace as it looks to balance control of inflation with ongoing support for economic growth.

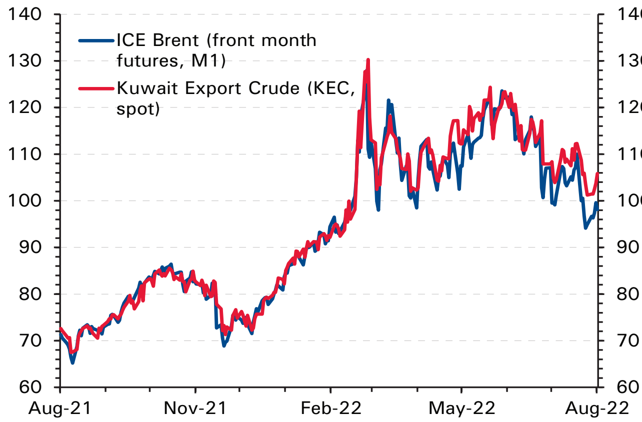
Domestic political developments however are an ongoing source of uncertainty, with persistent government-parliament tensions resulting in the former's resignation in April, reformulation in August under a new Prime Minister, and parliamentary elections now expected later this year. This left the legislative agenda, including approval of the draft budget and potentially several reforms such as the draft debt and mortgage laws, largely stalled. The hope is that the elections will provide a reset that improves political cooperation and kick-starts a period of more decisive progress towards Kuwait's development goals.

Oil prices gain in 2Q22, but were off their highs by July

International benchmark Brent strengthened during the second quarter of the year, averaging $112/bbl—the highest quarterly average since 1Q13. (Chart 1.) Supply-side shortages stemming from sanctions on Russia's oil, outages and dwindling capacity among OPEC+ producers more than offset market fears about the demand impact of extended Covid-19 lockdowns in China, surging global inflation and central bank monetary tightening.

However, since mid-June sentiment has flipped, with global economic growth worries in the ascendancy, especially following aggressive interest rate rises by the US Federal Reserve. Brent stood at around $98/bbl in mid-August, having fallen by more than 20% from its Q2-high of $124/bbl on 8 June. Local marker Kuwait Export Crude followed similar trends, falling 15% from its Q2-high to $106/bbl as of 12 August. Futures markets signal still weaker oil prices ahead with demand worries continuing to dominate: one-year ahead Brent contracts traded at around $90 in mid-August.

Chart 1: Oil prices

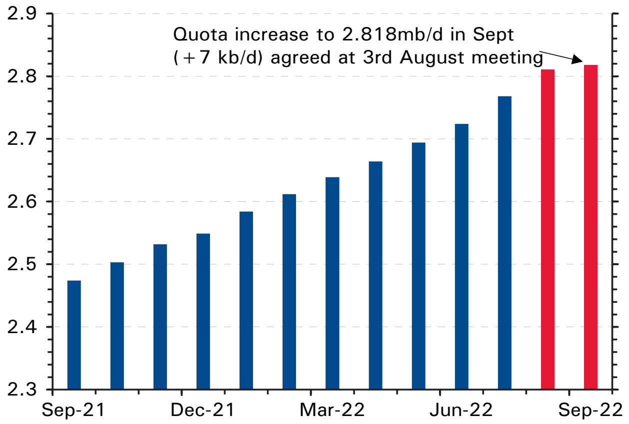


Source: Refinitiv, KPC

Meanwhile, Kuwait's crude oil production continued to increase during 2Q22 by the amount specified in the OPEC+ agreement, (+27 kb/d per month), reaching 2.72 mb/d in June (+3.2% q/q). Output then climbed by a larger 44 kb/d in July, in line with the accelerated supply ramp-up schedule agreed at the June OPEC+ meeting and which extends to August. For September, Kuwait's output is expected to rise by a further 7 kb/d to 2.818 mb/d after the oil producers' group signed off on an additional, albeit modest 100 kb/d group-level output increase at their August meeting. (Chart 2.)

Chart 2: Kuwait crude oil production schedule

(mb/d)

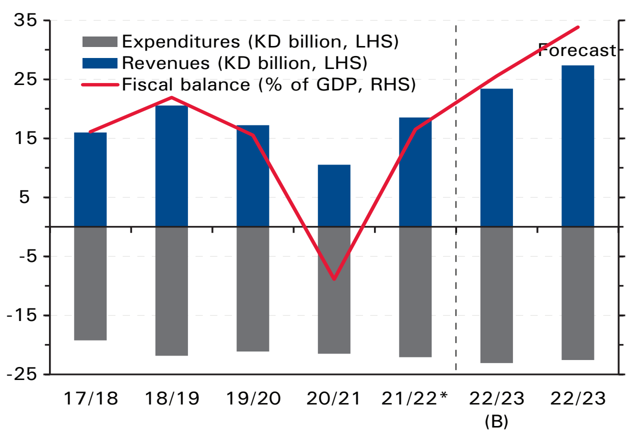


Source: OPEC, JODI

High oil prices may lead to budget revisions

The dramatic recovery in oil prices from their pandemic lows has boosted the public finances. According to press reports, the government recorded a fiscal deficit of only KD3.6 billion for FY21/22 (8.5% of estimated GDP), a big improvement on the KD12.1 billion deficit projected in the budget and on the KD10.8 billion deficit recorded in FY20/21. (Chart 3.) This has helped to alleviate earlier liquidity pressures. However, the improving fiscal picture and strong oil prices so far in FY22/23 have led to calls from certain quarters to increase spending. Indeed, the parliamentary budget and closing accounts committee proposed boosting spending by 5% (to KD23.1 billion) versus the draft budget presented in January, in effect reversing the government's plan to curb spending. The rise partly reflects extra subsidy payouts to offset higher food and commodity prices. The revised budget is set to be signed off by parliament in September/October.

Chart 3: Fiscal balance



Source: Ministry of Finance / NBK / press reports

The parliamentary committee also raised its oil price assumption to $80/bbl from $65/bbl in the January draft, resulting in a projected budget surplus of KD0.3 billion. Still, with oil prices averaging $112 in the current fiscal year (to 12 August), even this projected surplus looks too pessimistic. Based upon our own oil price forecast of $100/bbl, we expect a surplus of KD4.8 billion (8.8% of GDP), which would be the government's first surplus since 2014.

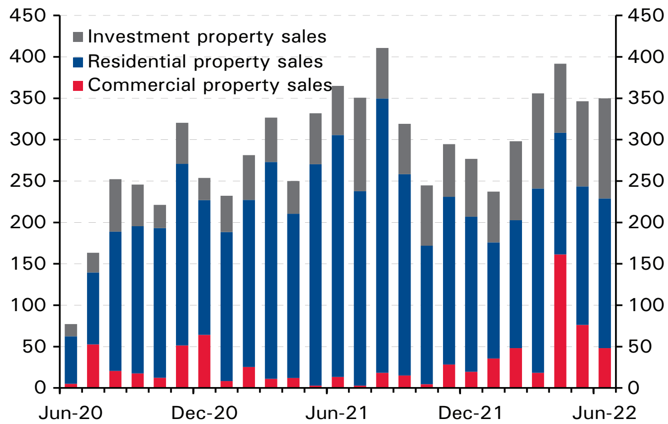
The government is also focusing on recapitalizing the General Reserve Fund (GRF), which was approaching depletion after cumulative withdrawals of KD19.8 billion over the previous four years (FY17/18 to FY20/21). Net assets were reported to be at KD5.6 billion at the end of FY20/21, and cash reserves are reported to have since increased, according to local media. The transfer of KD0.5 billion in retained earnings to the government from state-owned Kuwait Petroleum Corporation (as part of an agreed mechanism to repay a stated total of KD7 billion) has also helped. It was also reported that transfers to the Future Generations Fund (FGF) that would normally be activated when the state records a surplus, would be suspended this fiscal year, should one materialize. The priority instead will be ensuring the restoration of suitable liquidity in the GRF. FGF buffers remain large at around $700 billion, or four times' GDP.

Real estate activity reaches multi-year record

Real estate activity in 2Q22 surpassed the previous quarter's results, with total sales reaching a multi-year high of KD1,088 million. This compares with KD891 million in 1Q22. (Chart 4.) Cumulative sales for the first half of the year stood at KD1.98 billion (+11% y/y). Demand for investment and commercial sector properties has increased considerably, taking over from demand for residential units that was so prominent in 2021.

Chart 4: Real estate sales

(KD million)



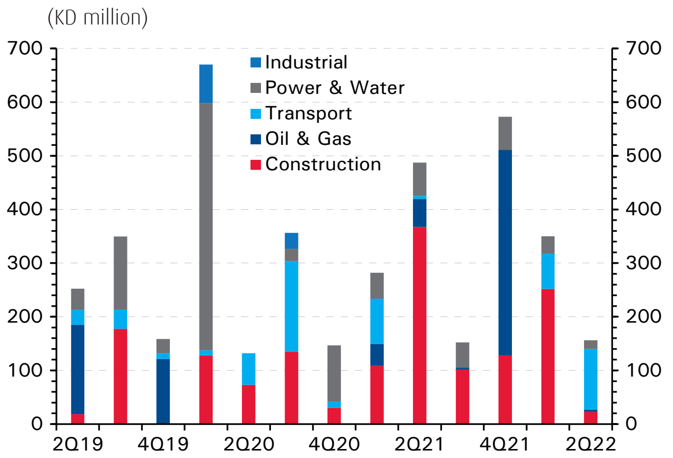
Source: Ministry of Justice

The improving post-pandemic business environment and attractive valuations are possibly behind the uptick, while increasingly higher-valued property prices in the residential market allied to soaring construction costs have likely deterred demand in that sector. A proposed regulatory amendment that allows for greater utilization of residential space in residential areas (in an effort to alleviate the growing housing shortage) may provide some support to the attractiveness of this type of property in the future, though potentially also push prices higher.

Project awards dip in 2Q22

Project activity in Kuwait dipped substantially in 2Q22, according to data from MEED Projects. The total value of awarded projects fell 55% q/q to KD156 million, with one project—the Public Authority for Industry's Shaddadiya Industrial Area Infrastructure Package—accounting for more than half of that at KD84 million. (Chart 5.) This figure is far short of the KD1 billion of awards that MEED had originally earmarked for Q2, and is likely a reflection of continued delays in approvals signoff (perhaps exacerbated by the resignation of the government), and high costs in the procurement process. MEED expects KD3.1 billion worth of awards in total this year, up from KD1.5 billion in 2021, but this is now looking very unlikely.

Chart 5: Project awards



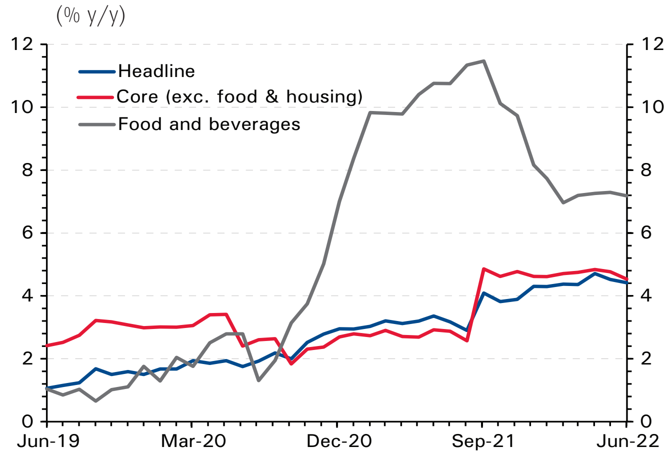
Source: MEED Projects

Inflation edges up, though may have peaked

Consumer price inflation remained elevated in the second quarter, standing at 4.4% y/y in June, unchanged from March though softening versus April and May. The food component continues to be a key inflation driver, increasing by 8.0% y/y in June from 7.2% in March, mostly reflecting trends in international food prices. (Chart 6.) Meanwhile, inflation in housing services (largely rents) was mostly steady through Q2 at 2.2%, with the accelerating trend seen through 2H21 seemingly having abated. Core inflation, which excludes both food and housing, edged down through Q2, reaching 4.5% by June. Within core, annual price rises were fastest in the education (+19% y/y) and clothing & footwear (+6%) categories, with all others in the 2-4% range.

While inflation remains quite high by the standard of previous years, the pace of increase appears to have slowed in recent months, and indeed both core and headline rates are barely changed versus end-2021 levels. It is also noteworthy that inflationary pressures remain more concentrated in a small number of CPI sub-components including the aforementioned food and education; prices in most other segments are rising more slowly. Both these factors offer hope that inflation may have peaked (or be close to a peak), so long as the exceptional recent strength in the food and education components does not persist, as we expect to be the case, and inflation in housing rents does not pick up significantly. Moreover, a combination of tighter monetary policy, a strong Kuwaiti dinar (related to the strength of the US dollar, and helping to lower import prices) and potentially a gradual easing in global supply chain disruptions should help to lean against inflationary forces going forward. We expect inflation to average 4.3% in 2022, up from 3.4% last year, easing back in 2023.

Chart 6: Consumer price inflation

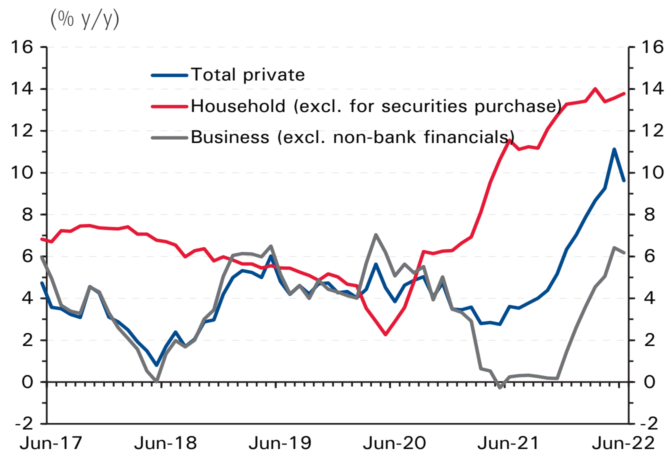


Source: CSB / Haver

Credit and deposit growth strong as policy rates rise

Domestic credit strengthened in 2022, accelerating every month through May, where annual growth reached 11.1% y/y, the fastest in 13 years, before softening slightly to 9.6% in June. (Chart 7.) Lending to businesses has picked up this year (+6.2% in June), and is increasing its contribution to total credit growth as firms benefit from the normalization of the operating environment post-Covid-19 and from strong consumer demand by furthering their own expansion and development plans through project financing.

Chart 7: Domestic credit growth

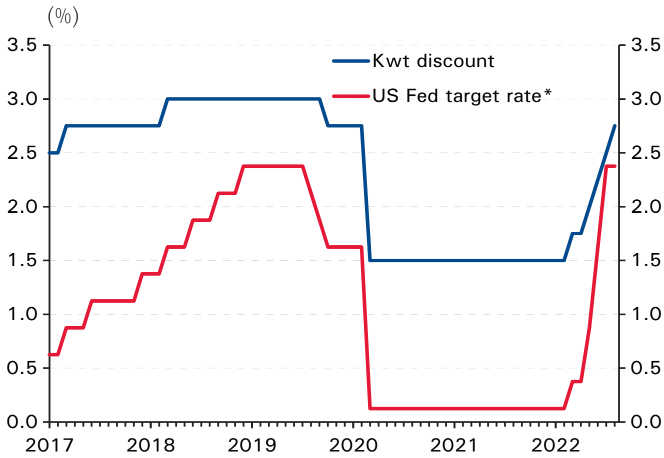


Source: Central Bank of Kuwait / Haver

While growth in lending to the oil & gas and industrial sectors has been strongest over the last year, real estate, the largest component of corporate credit demand by volume (42%), is picking up. Credit to trading and construction forms is also gaining momentum. Household credit, meanwhile, continues to expand (+13.8% y/y in June), with strength across both installment (housing) and consumer durables loans. Looking ahead, domestic credit growth will likely continue to find support from the household and corporate sectors, though we do note that business credit growth tends to be much weaker in the second half of the year compared to the first.

Moreover, while borrowing costs have also risen after the Central Bank of Kuwait (CBK) raised its benchmark discount rate five times since March by a cumulative 125 bps to 2.75% following the US Fed's lead, we don't expect this to dampen lending too much in the near term. Rates in Kuwait are still relatively low and manageable by historical standards. Further rate hikes by the CBK are expected in 2H22, in line with continued Fed policy tightening, although so far, the CBK has tightened policy by less than its US counterpart (225 bps since March), providing additional support for economic growth relative to a scenario where policy was tightened faster. (Chart 8.) Private sector deposits, meanwhile, expanded by 7.1% in June (+7.3% ytd), one of the fastest annual expansions in the past eight years.

Chart 8: Benchmark interest rates



Source: CBK / Haver * Middle of the target range

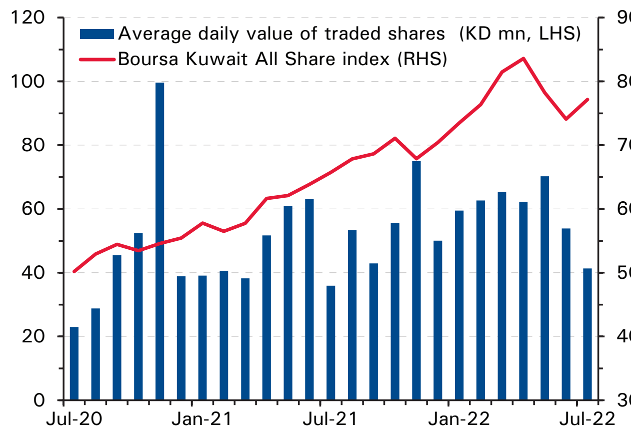
Equities drop in 2Q22 amid higher risk, but bounce in July

After the strong gains in 1Q22 on higher oil prices and a positive economic outlook, Kuwait equities, like their GCC counterparts, suffered steep declines in 2Q22 (MSCI GCC -14% q/q) as global risk factors spilled over into regional economies. Investor confidence was hit by rising inflation, interest rate hikes, and global growth concerns, the latter also weighing heavily on oil prices—a major catalyst for GCC equities. Profit-taking after the strong first quarter was also a factor. However, an improvement in sentiment saw a partial recovery in July, amid hopes that global inflationary pressures may have peaked and that global monetary policy tightening might therefore be less aggressive.

Kuwait's All-Share index lost 9% q/q to close at 7,409 at end-June, though recovered 4.2% in July. Market capitalization in Q2 fell to KD43.6 billion from an all-time high of just under KD50 billion in early May, while turnover slowed to a nine-month low of KD53.6 million/day in June. (Chart 9.) Though losses were broad-based, the steepest declines in Q2 came from the consumer goods (-26%), financial services (-17%) and real estate (-14%) sectors. Net foreign inflows were buoyant at KD221 million over the quarter, while Kuwaiti investors continued to be net sellers.

The downturn in Q2 curbed YTD gains to 9.6% in July from a high of 20% in early May. Looking ahead, equity market performance will continue to be influenced by oil prices, geopolitics and global economic and monetary developments. Oil prices and earnings are expected to remain broadly supportive of equities, though could suffer if the worst worries about slower global growth or a recession are realized.

Chart 9: Kuwait All-Share Index



Source: Refinitiv

Table 1: Key economic data

	2016	2017	2018	2019	2020	2021	Forecast 2022	2023
				(KD billion)				
Nominal GDP	33.5	36.6	41.7	41.3	32.4	41.9	54.5	52.4
Oil	12.8	15.4	19.8	18.9	11.2	18.8	29.2	25.7
Non-oil	20.7	21.2	21.9	22.4	21.3	23.1	25.3	26.7
				(percent change)				
Real GDP	3.5	-5.3	2.4	-0.6	-8.9	1.1	8.5	3.3
Oil	3.3	-10.4	2.4	-1.0	-8.9	-1.0	12.7	3.1
Non-oil	3.8	1.5	2.5	-0.1	-8.8	3.5	3.7	3.6
Private credit	2.9	3.1	4.2	4.3	3.5	6.3	...	...
Money supply (M2)	3.6	3.8	3.9	-1.2	2.7	-0.5	...	...
Inflation (% y/y, average)	3.5	1.5	0.6	1.1	2.1	3.4	4.3	3.1
				(percent of GDP)				
Fiscal balance (before FGF transfers)	-13.8	-8.9	-3.1	-9.5	-33.2	-8.5	8.8	2.3
Revenues	39.1	43.7	49.3	41.6	32.4	44.2	50.2	45.8
Oil	34.9	39.0	44.2	37.2	27.1	39.6	46.6	41.8
Non-oil	4.2	4.7	5.1	4.5	5.3	4.6	3.6	4.0
Expenditure	52.8	52.6	52.4	51.1	66.3	52.7	41.4	43.4
Transfers to Future Generations Fund	4.0	4.4	0.0	0.0	0.0	0.0	...	...
Fiscal balance (after transfers to FGF)	-17.7	-13.2	-3.1	-9.5	-33.2	-8.5	8.8	2.3
Investment income*	13.4	12.9	11.3	11.8	32.9	26.2	12.1	13.0
Public debt	18.6	19.0	13.9	9.9	10.7	5.0	3.5	3.3
Current account balance	-4.6	8.0	14.4	24.5	21.1	19.2	32.9	26.1
Goods balance	17.6	21.3	29.7	25.9	14.6	28.5	41.6	35.4
Export	41.9	45.7	52.2	47.5	37.8	48.2	58.5	54.3
Imports	24.3	24.4	22.5	21.6	23.2	19.7	17.0	18.9
Services (net)	-18.1	-16.7	-17.8	-13.1	-9.7	-10.5	-10.5	-11.3
Investment income (net)	11.5	15.6	13.3	26.2	32.8	14.3	12.1	13.0
Worker remittances	-15.6	-12.2	-10.7	-14.6	-16.6	-13.2	-10.3	-10.9
Exchange rate (KD per 1 USD)	0.302	0.303	0.302	0.304	0.307	0.302	...	...
CBK discount rate	2.50	2.75	3.00	2.75	1.50	1.50	...	...
Kuwait export crude price (USD per barrel)	39	51	69	64	41	70	100	85
Oil production (million barrels per day)**	2.95	2.70	2.74	2.68	2.44	2.41	2.72	2.81

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

*Based on estimated figures by CSB and NBK. ** Uses JODI/OPEC direct communication figures.

Table 2: Monthly economic data

(KD billion, unless otherwise indicated)	Dec-20	Dec-21	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22
Credit	39.8	42.3	43.2	43.7	44.1	44.8	44.7	...
Growth (% y/y)	3.5	6.3	7.9	8.7	9.3	11.1	9.6	...
Money supply (M2)	39.1	39.0	40.1	40.6	41.5	41.6	41.7	...
Growth (% y/y)	2.7	-0.5	3.9	5.7	8.5	8.1	6.6	...
Inflation (% y/y)	3.0	4.3	4.4	4.4	4.7	4.5	4.4	...
ex food and housing	2.7	4.6	4.7	4.7	4.8	4.8	4.5	...
Real estate sales (KD million)	253.8	276.7	298.0	355.8	391.6	346.4	349.9	...
Kuwait export crude price ($/bbl, avg)	49	75	94	113	107	117	117	109
Stock market – All Share index (mth-end)	5,546	7,043	7,638	8,147	8,358	7,824	7,409	7,717
Growth (% m/m)	1.6	3.7	3.9	6.7	2.6	-6.4	-5.3	4.2

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

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