July 2019

Kuwait Economic Brief

Second Quarter

GDP growth picks up in 1Q19; domestic credit continued its gradual recovery

National Bank of Kuwait
Economic Research Department

GDP growth picks up in 1Q19; domestic credit continued its gradual recovery

Highlights

- Kuwait's crude oil production will be steady at 2.7 mb/d this year following the extension of supply cuts by OPEC+.
- GDP growth picked up to 2.6% y/y in 1Q19 amid stronger non-oil growth, which we expect to average 2.5% this year.
- The approved FY19/20 budget shows spending up 5% but the projected large deficit is likely to be lower.
- Real estate sales as expected dipped in May during Ramadan, but the trend remains reasonable.
- Broad-based credit growth hit a near-three-year high of 6% y/y in May.
- Kuwaiti equities outperformed Gulf peers in Q2 ahead of the MSCI upgrade announcement.

While concerns over the global economy have risen over the past few months, the performance of the Kuwaiti economy has been mostly steady or slightly improving. Oil prices, although under pressure from the global outlook, rose in 2Q19, on supply cuts by the OPEC+ group of oil producers and geopolitical tensions. Indicators of non-oil activity including consumer spending and credit growth have picked up, and the equity market has outperformed GCC peers helped by another confidence-boosting index upgrade triggering capital inflows. Although the need for macroeconomic and structural reforms to boost long-term non-oil growth and strengthen the public finances persists, in our view the economy is reasonably well-placed to cope with any moderate slowdown in global growth and consequently oil prices over coming quarters.

Oil prices up in Q2 ahead of OPEC+ supply deal

Oil prices started 2Q19 strongly, but then fell back as concerns about the global economic outlook escalated. The price of Kuwait Export Crude peaked at almost $75/bbl in late April amid signs that the oil market was tightening in response to supply cuts by OPEC+, but had fallen to $61 by mid-June before rallying slightly on regional geopolitical tensions to finish the month at $66. On average, prices were 9% higher in 2Q19 than in Q1. Amid downward revisions to oil demand growth and 'large uncertainties' facing the oil market, OPEC+ agreed in early July to extend its expiring supply cuts for nine months until end-March 2020. Kuwait's crude production stood at 2.71 million b/d in May, leaving it 116% compliant with its share of the targeted cuts. This suggests that Kuwait's oil output should be broadly unchanged for the rest of this year and beyond, assuming no change in overall market conditions that could provoke an early OPEC+ policy response. Our expectation remains that a combination of OPEC+ supply restraint and fairly subdued oil demand growth will leave the market broadly balanced ahead, and that Brent oil prices will average $65/bbl both this year and next having averaged $66 year-to-date.

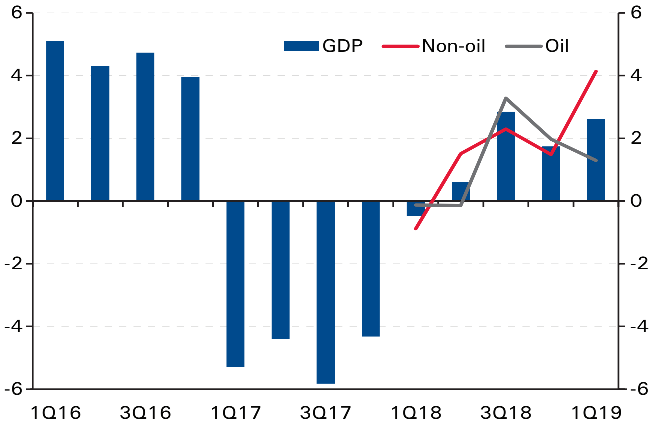
GDP growth rose to 2.6% in 1Q19

Preliminary official data for 1Q19 show that economic growth picked up slightly in the first quarter of this year, despite OPEC-led oil output cuts weighing on overall performance. GDP rose 2.6% y/y in 1Q19, firmer than the 1.7% recorded in 4Q18 (which was revised down from 2.0%). (Chart 1.) Oil GDP – which includes the refining sector – grew 1.3% (2.0% in Q4) which was slightly stronger than the rise in official oil production through the quarter – perhaps helped by a year-on-year rise in refined product output. Of greater surprise however was non-oil growth, which picked up sharply to 4.1% from 1.5% in 4Q18 (revised form 2.0%). But most of this acceleration was due to a change in the taxes and subsidies adjustment used to distinguish market from producer prices. Excluding this, non-oil growth would have been a more modest 2.3% in 1Q19, which is closer to our view of underlying economic performance.

The quarterly official data pointed to growth last year of 1.2% and 1.1% for total GDP and non-oil GDP, respectively, but these figures may be revised when more comprehensive annual data are released in coming weeks. We have left our (stronger) estimates of growth last year unchanged, and expect non-oil growth of 2.5% this year and slightly higher in 2020.

Chart 1: Real GDP*

(% y/y)



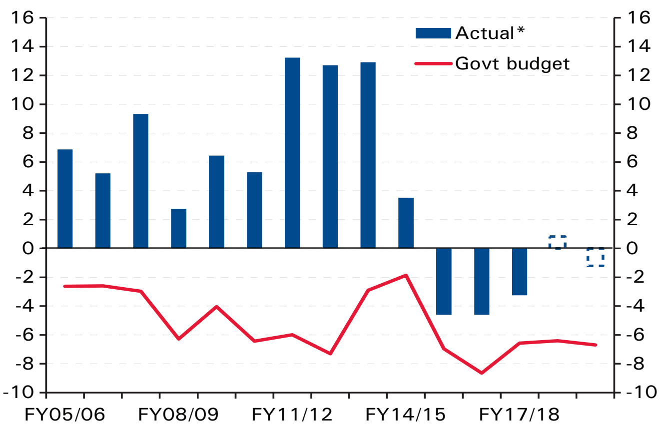
Source: Central Statistical Bureau; * Oil/non-oil breakdown not available before 1Q18 due to series break

Larger deficits in FY19/20

The government's budget for FY2019/20 was approved by parliament, with overall spending unchanged from the draft budget at KD22.5 billion, a 5% rise on the budget for the previous year. Although final details have not yet been released, the draft budget showed (construction-related) capital expenditure little changed at KD3.3 billion and at a relatively high 15% of total spending. Revenues however were revised down from the draft to KD15.8 billion due to lower oil receipts and with the oil price assumption left at $55/bbl, this revision was likely due to lower projected oil output on OPEC supply cuts. The figures imply a budget deficit of KD6.7 billion, or 17% of GDP, before transfers to the Reserve Fund for Future Generations. (Chart 2.)

Chart 2: Fiscal balance

(% of full year budget targets, year-to-date)



Source: Ministry of Finance

Due to a combination of conservative oil price assumptions and underspending (particularly on capital spending), the government's deficit projections are usually far too pessimistic; based upon a $65/bbl Brent oil price assumption and another underspend we project a much smaller deficit of KD1.2 billion, or 3% of GDP this year. Final figures for FY2018/19 have not yet been released but we estimate a surplus of KD0.8 billion (2% of GDP) based on the provisional data for the first 11 months. However, our estimate could be optimistic as large spending could take place in the final month to settle budgetary commitments before closing the accounts for the fiscal year.

Project awards lower than initial projections in Q219

Project awards slowed to only KD377 million in 2Q19, down from a better-than-expected KD700 billion in 1Q19. Total awards for 1H19 therefore stood at KD1.1 billion, pointing, pro rata, to a slightly better performance this year than the KD1.7 billion awarded in 2018. Awards in 1H19 were dominated by the construction (KD523 million) and transport (KD360 million) sectors, mostly for housing and roads.

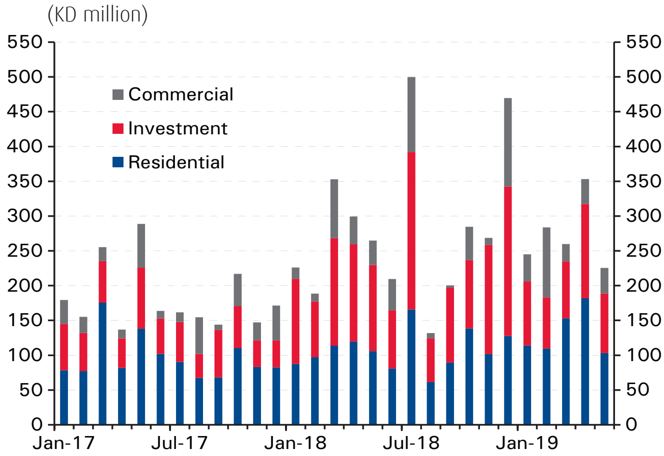
Delayed projects have been rolled over to 2H19, when a large KD4 billion in awards are now provisionally scheduled. These include large projects in transport and power, such as phase 1 of the Mubarak al Kabeer seaport, the Dibdibah solor power plant and the Kabd solid waste project. If these major awards are delayed, H2 performance will be substantially weaker. Based upon historical trends, we expect a more conservative award figure of around KD2-2.5 billion for 2019 overall, which would still be an improvement on last year.

Real estate sector on a positive trend

Real estate sales stood at KD 225 million in May, declining 36% m/m after a robust April and also down 25% y/y. (Chart 3.) The fall is likely to have had a seasonal element, with trading typically slower during the month of Ramadan, which fell mostly in May. Slower sales were due to a drop in the number of transactions in the investment (i.e. apartment) and residential sectors (-46% m/m, -20%). Commercial sector activity on the other hand surged more than three-fold m/m to a record 120 transactions, possibly due to the sale of small commercial properties in the new areas of southern Kuwait. Sales are still up 3% y/y to May amid a solid rise in residential sales but apartment sales are down following a buoyant 2018. We think the market is in a reasonably stable phase overall.

Prices were mostly positive in May on a month-on-month basis, except for home prices which saw a mild 0.6% decline. However on an annual basis prices in most market segments are stable-to-rising, with residential home prices for example up 7% y/y despite May's monthly drop. Single apartment prices are the notable exception, with prices down 1.3% y/y in May. This reinforces our previous view that the property market overall appears to be reasonably healthy, but the investment sector may still be vulnerable amid oversupply and relatively weak demand reflected by ongoing vacancies; housing rents in the CPI have also recently seen a small decline.

Chart 3: Real estate sales

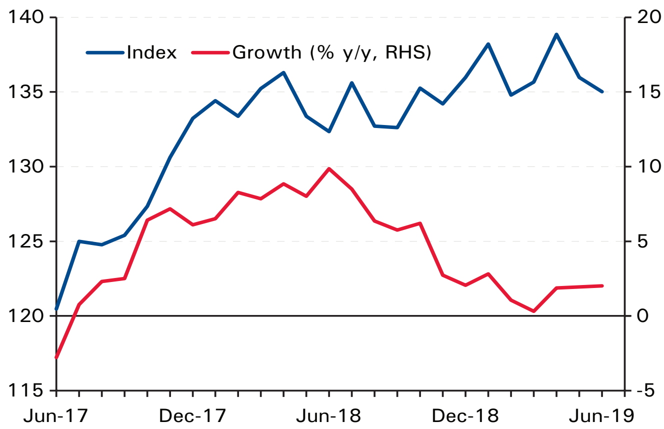


Source: Ministry of Justice

Consumer spending growth picks up in Q2

After trending lower in 1Q19, consumer spending growth appears to have improved in 2Q19, albeit mildly. According to the NBK consumer spending index, spending rose 1.9% y/y in 2Q19 up from 1.4% in 1Q19, as growth in services outlays held firm at 5.8% and durable goods purchases picked-up 1.9% from 0.4% the previous quarter. (Chart 4.) Non-durable sales growth however, remained in decline, falling by a sharper 7.0% versus a 5.7% drop the previous quarter, as clothing, cosmetics and general store sales remained weak.

Chart 4: NBK consumer spending index



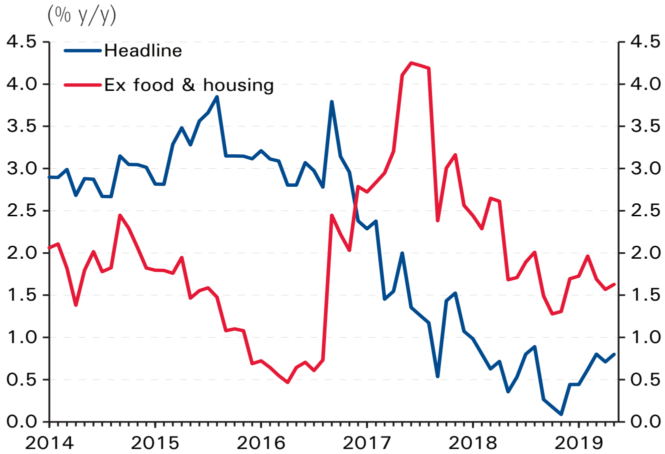
Source: NBK

These figures correspond to broad trends in data on POS sales and ATM withdrawals by the central bank, where growth slipped to a more than two-year low of 4% y/y in 1Q19. Based upon the NBK index, some pick-up might be expected when data is released for 2Q19. We expect spending growth to be steady or improve slightly in 2H19 given the stable macroeconomic climate, oil prices at $60-70/bbl maintaining confidence, an expansionary government budget (including on wages and salaries) and reasonable employment growth. Moreover, the decision by the central bank to loosen consumer loan limits (now up to KD25,000 from KD15,000 previously) in December has since led to a notable rise in consumer borrowing – though the magnitude is quite small relative to the level of consumer spending overall.

Inflation remains low

Consumer price inflation edged up to 0.8% y/y in May from 0.7% in April. (Chart 5.) The rise was driven mainly by higher food inflation (1.0% from 0.8% in April) and slightly slower deflation in the housing segment (-0.5% from -0.6% in April) due to a rise in maintenance costs, but more significantly higher inflation in the communications segment. Core inflation, which excludes food and housing, was unchanged at 1.6%. The pick-up in food prices came mostly from seafood and meat items (unsubsidized), likely stemming from higher demand during the holy month of Ramadan which fell largely in May.

Chart 5: Consumer price inflation



Source: Thomson Reuters Datastream / NBK

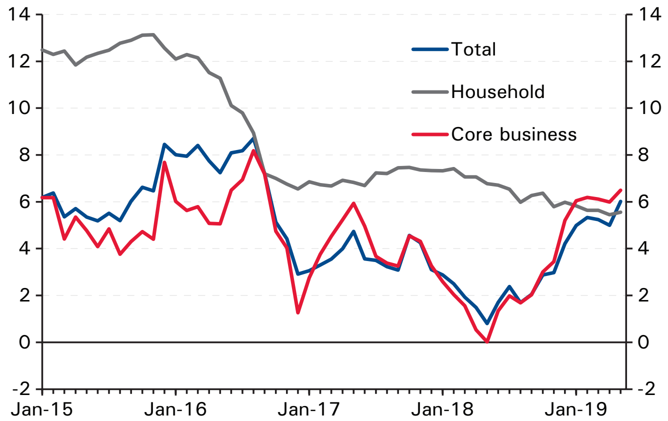
Inflation has drifted slightly higher so far this year having ended 2018 at 0.4%, but nevertheless remains at very low levels. Moreover, much of the recent rise reflects base effects following price falls a year ago. We therefore expect inflation to see only a modest rise overall this year, averaging 1% compared to 0.6% in 2018, and another sub-1% figure is possible given recent signs of continued softness in housing rents. Core inflation could be at or below 2% versus 1.9% last year, reflecting moderate economic growth, a strong dinar with respect to trade partner currencies, and the unlikely implementation of taxes (VAT, Excise) or subsidy cuts this year.

Credit growth continued its gradual recovery

Credit growth has continued the gradual recovery seen since late 2018, accelerating to an almost three-year high of 6% y/y in May from 5% in April and 5.2% in March. (Chart 6.) This improvement was supported by an increase in lending to both businesses and households. In fact, lending to businesses grew at a near three-year high of 6.5% in May, helped by the real estate sector (+7.5%) and industry (+5.9%), while household credit (excluding for security purchase) remained reasonably steady at 5.6%, despite housing loans decelerating (4.3%). As per consumer loans, its growth continues to benefit from the central bank's loosening of lending restrictions last December, reaching 14.2% in May. We expect overall credit growth to end 2019 at around 5% y/y, supported by the stable macro climate, a slight pick-up in project awards and growing employment market.

Chart 6: Bank credit

(% y/y)



Source: Thomson Reuters Datastreamt

Meanwhile, Meanwhile, deposit growth edged up in May but remained soft at 1.5% y/y versus 1.3% in April. The rise was due to a surge in government deposits, while private deposit growth decelerated to just 0.1% from 2.2% in April.

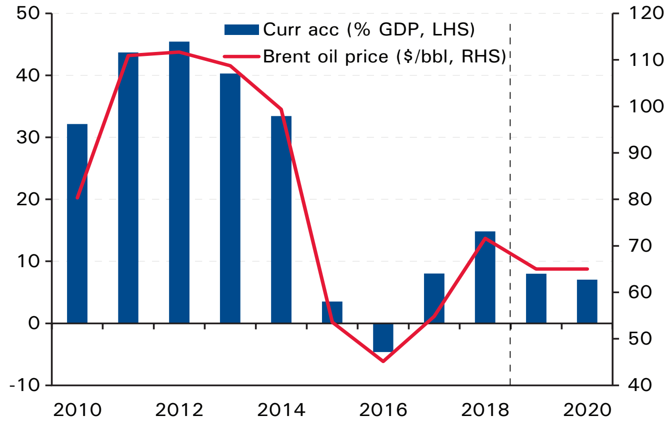
Current account surplus doubled in 2018

The current account position strengthened in 2018, recording a surplus for the second consecutive year since 2016, when the country posted its first deficit in more than twenty five years. The surplus in 2018 increased to KD6.2 billion (14.8% of GDP), more than double 2017's figure of KD2.9 billion (8% of GDP). (Chart 7.) This was primarily due to a 31% rise in oil export revenues thanks to higher oil prices and also record foreign investment income of KD6.4 billion. The latter is mainly a reflection of higher returns on the government's overseas investments. Growth in goods imports was a moderate 6%, reflecting somewhat subdued growth in the broader non-oil economy last year.

Meanwhile the capital and financial account balance – the main counterpart to the current account and reflecting movements of capital into and out of the country – saw net outflows increase to KD7.4 billion from KD5.4 billion in 2017. FDI inflows stood at KD104 million (0.3% of GDP), which is the second lowest level in ten years. However, net portfolio investment turned positive at KD726 million, as Kuwaiti residents sold their foreign bond holdings and as foreign investors bought Kuwaiti bonds and equities, the latter stimulated by the country's inclusion in the FTSE Russell Emerging Markets Index.

Chart 7: Bank credit

(% y/y)



Source: Thomson Reuters Datastreamt

Equity market outperforms Gulf peers in 2Q19

Boursa Kuwait's All-Share index gained 1.9% m/m in June, slightly underperforming the MSCI-GCC (2.1%) which was lifted by Saudi Arabia and Qatar. Liquidity was relatively high, with an average daily turnover of KD38 million. Price gains were led by the consumer goods and banking sectors which rose 12% and 3% m/m, respectively. Net foreign inflows in June were well down from the exceptional peak of KD141 million in March, but remained relatively healthy at KD35 million. For the second quarter as a whole, the Kuwait market's performance was strong relative to peers, up 3.8% versus 0.5% for the GCC.

Good sentiment this year has been supported by favorable stock re-weightings by the FTSE in March and good corporate earnings, coupled with the anticipation of the MSCI Emerging Market inclusion announcement which took place officially on June 25, to be implemented in May 2020 once confirmed in December. This is expected to generate further passive inflows in the range of $2.3–$2.8 billion, plus large active inflows. Regional markets however face various downside risks: we have already seen a marked deceleration in Q2 performance versus Q1 amid escalating geopolitical tensions, faltering trade talks, lower oil prices and slower global growth.

The outlook for 2019

A soft oil sector will limit GDP growth this year and next given the extension of OPEC+ agreement to March 2020 and possibly beyond. Non-oil growth will likely be about 2.5% this year, supported by an accommodative monetary policy and a budgeted increase in public spending. In the absence of a debt law, the financing of budget deficit will fall mainly on the General Reserve Fund (GRF) resources. Looking beyond 2019, this calls for adopting fiscal and structural measures to broaden the revenue base (VAT, excise taxes), cut subsidies, and stimulate private sector activities including by creating a friendlier investment environment through improving the ease of doing business and reducing restrictions that would constrain foreign direct investment.

Table 1: Key economic data

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast/estimate	
				(KD billion)				
Nominal GDP	48.7	49.4	46.3	34.5	33.1	36.3	41.5	40.5
Oil	33.2	32.7	29.2	15.7	13.6	16.2	21.3	19.2
Non-oil	21.4	22.4	23.2	23.9	23.9	24.6	25.4	26.3
				(percent change)				
Real GDP	6.6	1.1	0.5	0.6	2.9	-3.5	1.8	1.0
Oil	10.3	-1.8	-2.1	-1.7	3.9	-7.2	1.2	-0.5
Non-oil	3.4	4.2	4.8	0.4	1.6	2.2	2.5	2.5
Private credit	4.6	8.1	6.1	8.5	2.9	3.1	4.2	...
Money supply (M2)	7.7	10	3.4	1.7	3.6	3.8	3.9	...
Inflation (% y/y, average)	3.3	2.7	3.2	3.7	3.5	1.5	0.6	1.0
Inflation (% y/y, e.o.p)	2.8	2.6	3.0	3.1	2.4	1.1	0.4	1.5
				(percent of GDP)				
Fiscal balance (before FGF transfers)	26.1	26.1	7.6	-13.4	-13.9	-9.0	2.0	-3.0
Revenues	65.7	64.4	53.9	39.5	39.6	44.1	49.3	47.9
Oil	61.5	59.3	48.6	35.0	35.4	39.4	44.9	42.4
Non-oil	4.2	5.1	5.2	4.5	4.3	4.7	4.4	5.6
Expenditure	39.6	38.3	46.3	52.9	53.6	53.1	47.3	50.9
Transfers to Future Generations Fund	16.4	16.1	13.5	4.0	4.0	4.4	4.9	4.8
Fiscal balance (after transfers to FGF)	9.6	10.0	-5.9	-17.3	-17.9	-13.4	-3.0	-7.8
Investment income*	5.9	7.0	8.5	12.4	13.4	13.0	11.5	11.9
Public debt	3.2	3.1	3.4	4.6	19.6	20.0	14.8	12.7
Current account balance	45.5	40.3	33.4	3.5	-4.6	8.0	14.8	8.0
Goods balance	54.8	51.8	47.7	24.4	17.8	21.5	29.8	24.7
Export	68.7	66.5	64.2	47.5	42.5	46.2	52.6	49.4
Imports	13.9	14.7	16.6	23.2	24.7	24.7	22.8	24.8
Services (net)	-7.0	-8.5	-11.1	-17.4	-18.3	-16.9	-17.7	-20.0
Investment income (net)	7.3	8.0	9.6	11.1	11.7	15.7	13.5	14.7
Worker remittances	-9.6	-11.0	-12.7	-14.5	-15.8	-12.3	-10.8	-11.4
Exchange rate (KD per 1 USD)	0.280	0.284	0.285	0.301	0.302	0.303	0.302	...
CBK discount rate	2.00	2.00	2.00	2.25	2.50	2.75	3.00	...
Kuwait export crude price (USD per barrel)	109	105	95	48	39	51	69	63
Oil production (million barrels per day)	2.98	2.92	2.87	2.86	2.95	2.70	2.74	2.71

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

*Based on estimated figures by CSB and NBK.

Table 2: Monthly economic data

(KD billion, unless otherwise indicated)	Dec-17	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
Credit	35.4	36.9	37.0	37.1	37.4	37.2	37.6	...
Growth (% y/y)	3.1	4.3	5.0	5.3	5.2	5.0	6.0	...
Money supply (M2)	37.1	38.6	38.6	38.7	38.9	38.8	38.2	...
Growth (% y/y)	3.8	4.0	5.2	4.7	5.0	2.6	0.6	...
Inflation (% y/y)	1.1	0.4	0.4	0.6	0.8	0.7	0.8	...
ex food and housing (% y/y)	2.6	1.7	1.7	2.0	1.7	1.6	1.6	...
Real estate sales (KD million)	171	470	245	284	260	353	225	...
Growth (12-month average, % y/y)	-6.9	56.1	53.7	55.6	45.2	37.9	37.7	...
Real estate price indices:								
Residential homes	152	156	158	159	161	160	159	...
Residential plots	174	176	178	176	172	170	175	...
Investment buildings	181	194	192	190	187	190	194	...
Consumer confidence (index)	110	110	103	108	103	...	...	...
Kuwait export crude price (USD per barrel)	61	57	58	64	67	71	70	63
Stock market - All Share index (e.o.p)	4,830	5,080	5,206	5,232	5,618	5,630	5,726	5,832
Growth (% y/y)	...	-0.6	2.5	0.5	7.4	0.2	1.7	1.9

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

Table 3: Quarterly economic data

(KD billion, unless otherwise indicated)	4Q15	4Q16	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
GDP growth (% y/y)	1.7	4.0	-4.3	-0.5	0.6	2.9	1.7	2.6
Oil	0.9	2.2	-5.8	-0.1	-0.1	3.3	2.0	1.3
Non-oil	0.3	2.7	1.6	-0.9	1.5	2.3	1.5	4.1
Point-of-sale card spending	2.1	2.3	2.6	2.7	3.0	3.0	2.9	2.9
Growth (% y/y)	10.0	9.1	11.4	15.8	16.6	14.1	10.9	7.8
Current account balance	-0.1	0.6	1.2	1.9	2.7	0.9	1.6	...
Exports	3.6	4.1	4.7	5.7	6.2	6.0	5.4	...
Imports	2.1	2.1	2.4	2.3	2.4	2.5	2.3	...

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, NBK estimates * Series break: due to classification changes, growth rates in the oil and non-oil sectors before 1Q18 are not comparable with those thereafter.

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAK
Bahrain Branch
GB Corp Tower, Block 346
Road 4626, Building 1411
P.O.Box 5290
Manama, Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAK
Dubai Branch,
Latifa Tower
Sheikh Zayed Road
P.O. Box. 9293
Dubai UAE
Tel: +971 4 3161600
Fax: +971 4 3888588

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office, 13 George Street
London W1U 3QJ
United Kingdom
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

Jordan
National Bank of Kuwait SAK
Head Office, Al Hajj Mohd Abdul
Rahim Street, Hijazi Plaza,
Building # 70, P.O Box 941297
Amman 11194
Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

National Bank of Kuwait SAK
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom Road (Old Airport
Road), P.O. Box 113567
Abu Dhabi, U.A.E
Tel: +971 2 4199555
Fax: +971 2 2222477

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

Saudi Arabia
National Bank of Kuwait SAK
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

United States of America
National Bank of Kuwait SAK
New York Branch
299 Park Avenue
New York 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

China
National Bank of Kuwait SAKP
Suite 1501-1502,
AZIA Center 1233
Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 8036 0800
Fax: +86 21 8036 0801

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building
Justinien Street
P.O. Box 11-5727, Riyad El Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Singapore
National Bank of Kuwait SAK
Singapore Branch
9 Raffles Place # 24-02
Republic Plaza,
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center
First Sector 5th Settlement
New Cairo
Egypt
P.O Box 229 Cairo 11835
Tel: + 20 2 26149300
Fax: + 20 2 26133978

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Élysée
75008 Paris, France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Associates
Turkey
Turkish Bank
Valikonagi Avenue No. 1
P.O. Box 34371
Nisantasi, Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building,
Block 6, Shuhada'a Street, Sharq
P.O. Box 4950, Safat 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial
Center, Sheikh Zayed Road
P.O. Box 506506, Dubai, UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805