June 2022

Kuwait Quarterly Economic Brief

Kuwait's economic outlook boosted as oil prices surge and pandemic pressures fade

National Bank of Kuwait
Economic Research Department

Kuwait's economic outlook boosted as oil prices surge and pandemic pressures fade

Highlights

- Kuwait's economic prospects have improved despite shocks to the world economy from the Ukraine war and lockdowns in China.
- Oil prices have surged to multi-year highs. Together with rising oil production, we now see GDP growth of 8.5% this year.
- Strong oil revenues will generate a first fiscal surplus since 2014, and substantially ease recent government liquidity pressures.
- Inflation increased to 4.4% at end-March amid strong demand and continued global supply chain disruptions.
- Following the US Fed's lead in March, the CBK began raising interest rates, by a total of 50 bps as of end-May.
- A busy legislative agenda awaits the new government, including approval of the draft budget and debt laws.

Despite fresh shocks to the global economy from the Ukraine war and Covid-linked lockdowns in China, Kuwait's economic performance and outlook has looked on a stronger footing in recent months. Oil prices have surged, crude oil production is rising, bank lending growth is at a more than decade high and consumer demand remains strong, helping to underpin the non-oil sector's post-pandemic recovery. Importantly too, domestic Covid restrictions have essentially been lifted, with reporting of Covid-19 cases all but ceasing amid a precipitous decline in the confirmed infection rate to below a hundred a day.

Meanwhile, Kuwait's public finances have benefitted immensely from the climb in oil prices. This year, the government can look forward to its first fiscal surplus since 2014, of 8.8% of GDP. The turnaround will enable the authorities to start recapitalizing the General Reserve Fund, which had been close to depletion. The improvement in fundamentals – especially across the oil sector – has also resulted in an upgrade to our GDP growth forecasts. Headline growth is now expected at 8.5% in 2022, up from our previous forecast of 7.0% and an estimated 1.1% in 2021.

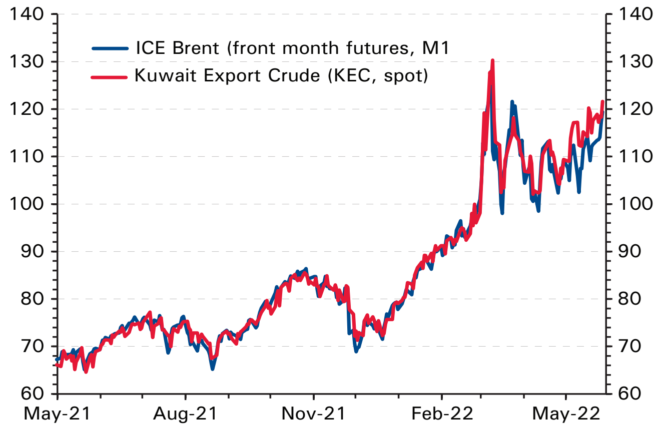
At the same time, however, downside risks are also more prominent. The global economic backdrop is extremely uncertain and volatile. Elevated inflation and monetary tightening have eroded purchasing power and raised borrowing costs. Businesses also face ongoing supply chain pressures, disrupting output. Moreover, the domestic political situation remains in a state of flux. The new government, once it is formed, will have a long list of issues to address, not least speeding up the pace of reforms to boost the economy's long-term growth rate and address declining private sector employment of nationals.

Oil prices surge to multi-year highs amid supply concerns

Russia's invasion of Ukraine in late February propelled crude oil benchmark Brent to $128/bbl, its highest level in twelve years. (Chart 1.) Prices had already been firming prior to the conflict amid tight oil supplies and robust demand, but the severity of sanctions, mostly self-imposed, that the US and its allies began imposing on Russian oil and natural gas exports, threatened a global energy crisis. Despite easing back on concerns over Chinese demand and slowing global economic growth, Brent remained on an upward trend, trading at around $122/bbl by end-May (+57% YTD), amid fears about substantial Russian oil supply losses and lagging OPEC+ production contributing to an already tight market. Local marker, Kuwait Export Crude topped $121/bbl at end-May (+54% YTD).

Chart 1: Oil prices

($/bbl)

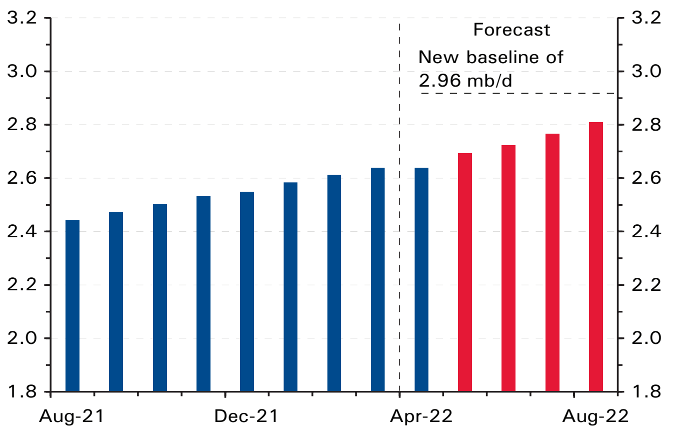


Source: Refinitiv, KPC

The OPEC+ group—keen to avoid antagonizing Russia and preserve the group's hard-won unity—persevered with its schedule of incremental monthly output gains, seemingly unmoved by calls from the Biden administration and others to lift supply more quickly to bring crude prices down. The group ratified at its April meeting an aggregate monthly production increase of 432 kb/d and higher reference baselines for regional oil exporters effective from May. Just recently, at their 2 June meeting, the group agreed to accelerate resupplying the market, by bringing forward September's monthly output increase quota and spreading it evenly across July and August, bringing the aggregate monthly increase in those two months to 648 kb/d. For Kuwait, the rate of monthly output increases will go up from May and June's 29 kb/d to around 43 kb/d in both July and August. By September, all Kuwait and OPEC+ production should have recovered to the pre-pandemic level of 2.81 mb/d. It remains to be seen if, or when, and even how, the reference baseline increase of 150 kb/d to 2.96 mb/d for Kuwait that was agreed to in 2021 will operate, but it will almost certainly involve higher output from the Neutral Zone shared with Saudi Arabia. Crude production was 2.64 mb/d at end-April, up from 2.55 mb/d at the end of 2021. (Chart 2.)

Chart 2: Kuwait crude oil production schedule

(mb/d)



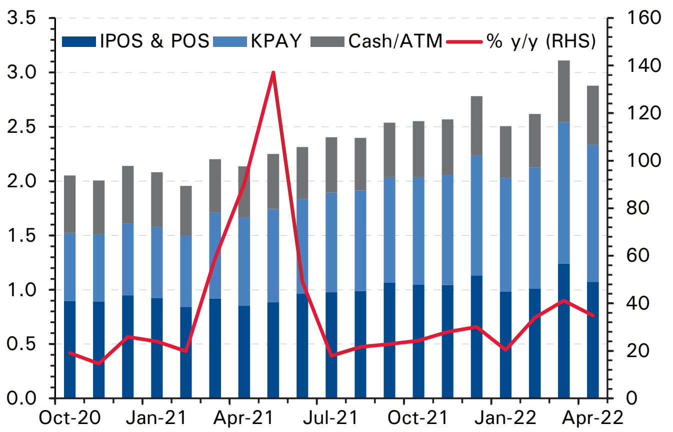
Source: OPEC, JODI

Consumer spending robust amid rising inflation

Strong private consumption continues to support the recovery in the non-oil sector. According to Knet data, consumer spending rose 4.2% q/q in 1Q22 and 32% y/y. (Chart. 3.)

Chart 3: Consumer spending (Knet)

(KD billion)



Source: Knet

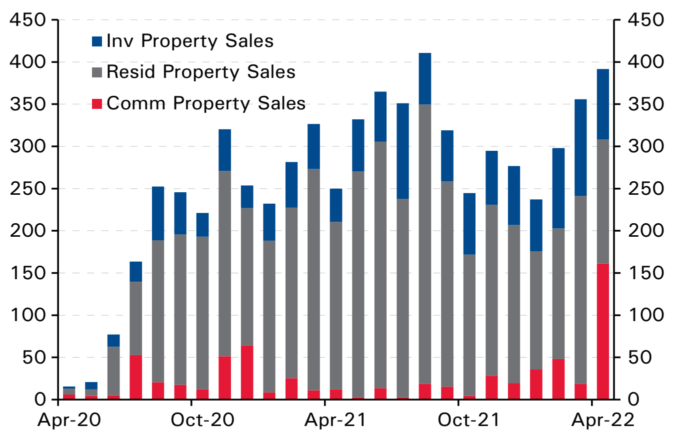
This was followed by a dip in April perhaps due to volatility in spending patterns linked to the holy month of Ramadan. However, growth still accelerated to 35% y/y, despite headwinds from rising inflation and higher borrowing costs (a 25 bp hike to interest rates by the Central Bank).

Investment, commercial sectors lift real estate activity

Recovering demand for investment and commercial real estate has helped drive real estate sales growth this year, following a lackluster 2021. By the end of 1Q22, sales reached KD891 million (+9.0% q/q; +6.1% y/y). (Chart 4.) The value of investment and commercial real estate transactions increased by 79% and 128% y/y, respectively, in 1Q22, a positive trend that also continued into April, where KD 391 million (+57% y/y) in total real estate sales was clocked. Meanwhile, residential sector sales in 1Q22 eased for the second consecutive quarter (-7.1% q/q; -19.6% y/y). Activity remained relatively subdued in April as well, a far cry from 2021 when the residential sector led the post-pandemic rebound. The softness could be a reflection of buyers rotating out of a sector that has become increasingly overvalued and towards investment and commercial properties where property valuations are lower and economic prospects are improving. Buyers may also be more sensitive to headwinds from rising borrowing costs and access to capital.

Chart 4: Real estate sales

(KD million)

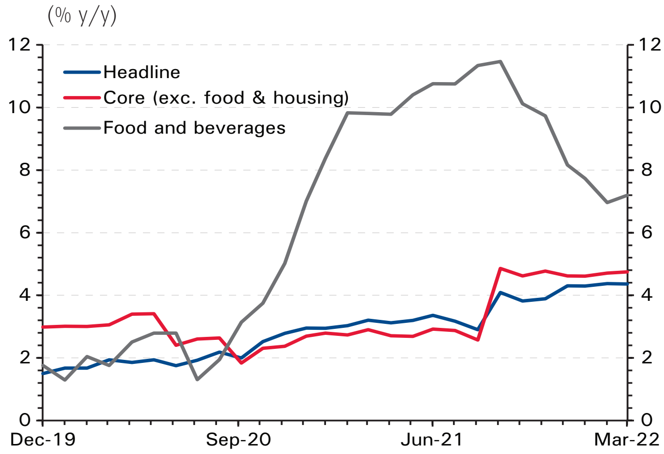


Source: Ministry of Justice

Inflation exacerbated by Russia-Ukraine war

Inflation continued its upward trend in 1Q22, reaching 4.4% y/y in March from 4.3% in December 2021, pushed higher by robust demand, persistent supply chain constraints and pass-through from higher international food and commodity prices. (Chart 5.) Some of these pressures have been exacerbated by both the ongoing Russia-Ukraine conflict and the zero-Covid-19 lockdown policy in China. Food and beverage prices have been especially hard-hit—the FAO price index reached an all-time high of 159.7 (+34% y/y) in March—with inflation in this component in Kuwait still up at 7.2%. Nevertheless, price rises have been broad-based and not limited to just food or housing (+2.3% y/y), with costs in the furnishing, transport, education and communication sectors all combining to push core inflation (excluding food and housing) to 4.7%, above the headline rate. With inflationary impulses likely to persist in 2022, we expect the average headline rate to increase to 4.3% this year from 3.4% in 2021.

Chart 5: Consumer price inflation

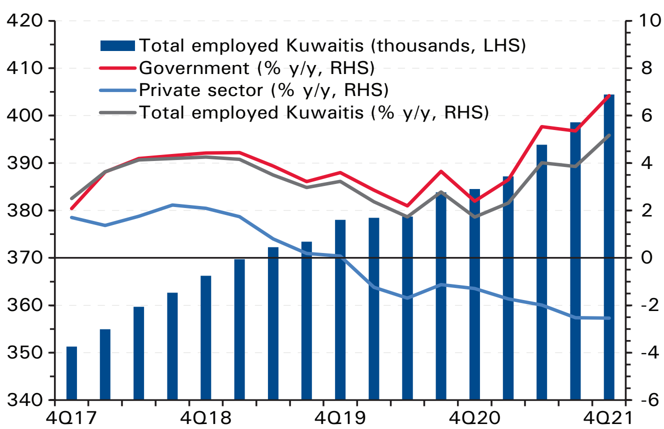


Source: CSB

Government sector drives Kuwaiti employment gains

Kuwaiti employment growth accelerated in 4Q21, according to data released by the Public Institute for Social Security. The total number of employed Kuwaitis rose by 5,833 q/q to 404,448 in 4Q21 (+5.2% y/y), with the government sector accounting for 91% of employment gains. (Chart 6.) Indeed, public sector employment growth in 4Q21, at 6.8% y/y, was the fastest in at least twelve years, bringing the total number of government employees to 313.5k. The private sector, meanwhile, continued to suffer attrition, losing 184 Kuwaitis q/q to bring the total number employed down to 52.6k (-2.5% y/y), or 13% of the employed Kuwaiti base. Private sector employment has now contracted for eight consecutive quarters. While separately-classified self-employment edged up, (+1.3% y/y to 16.8k) overall weakness in private sector hiring of nationals is a trend that the authorities will be keen to reverse including to ease the pressure on the public sector payroll and underpin the longer-term economic diversification agenda.

Chart 6: Kuwaiti employment



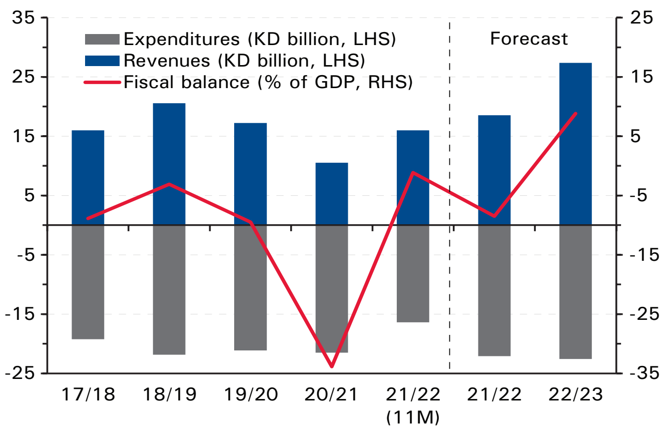
Source: Public Institute for Social Security (PIFSS)

Improving public finances to see a first surplus in 8 years

Data for the 11 months of FY21/22 (April-February) show the government's fiscal position benefitting greatly from the high oil price environment. The deficit shrank to KD0.4 billion, a significant improvement on the KD6 billion shortfall recorded over the same period in the previous fiscal year. (Chart 7.) Oil and non-oil revenues increased by 87% y/y (to KD14.3bn) and 41% (to KD1.7bn), respectively. The latter was supported by the final Gulf war reparations payments by the UN Compensation Commission, totaling more than KD0.6 billion.

Expenditures, meanwhile, increased by 10.5% y/y to KD16.4 billion, on the back of double-digit increases in current spending components compensation of employees, subsidies and social subsidies. Capital spending, though up 33% y/y, remained low in absolute terms at KD1.4 billion—only 54% of the full-year budget. These figures, especially on the spending side, are expected to increase substantially once the full year results are in, owing to the habit of recording payments in the final month of the year. According to a recent media report quoting official sources, a preliminary fiscal deficit of KD3.6 billion is expected for FY21/22. This would be in line with our forecast of KD3.5 billion (-8.5% of GDP), and down from the government's own deficit forecast of KD12.1 billion in the budget.

Chart 7: Fiscal balance



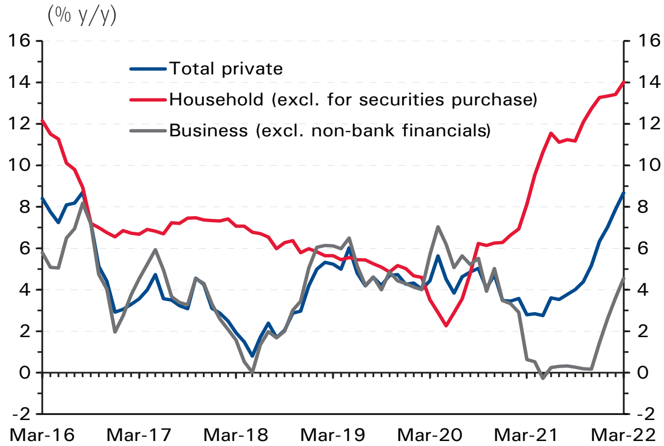
Source: Ministry of Finance (MOF), NBK estimates

The same official sources reported liquidity in the state's General Reserve Fund (GRF) at around KD2.1 billion ($7 billion) at end-March—presumably following the successful repayment of the KD1.1 billion sovereign Eurobond due that month. Based upon a projected average oil price of $100 this year, we see the government registering in FY22/23 its first fiscal surplus in eight years, at 8.8% of GDP. This should enable the authorities to start recapitalizing the GRF, though the delay in forming the new government has injected unnecessary uncertainty into proceedings. The new cabinet's agenda will be full: there is the draft budget to be approved, a new debt law to pass and a new long-term economic and fiscal strategy to unveil, hopefully one that addresses structural reforms. Kuwait's strong balance sheet and ample buffers were recognized by Moody's in its recent affirmation of the country's sovereign credit rating of A1, with a stable outlook. Economic and fiscal reforms would immeasurably help the country's medium to longer-term prospects, however.

Business credit recovers to propel domestic credit growth

Domestic credit started the year on a strong note, increasing by 3.2% q/q through March (+8.7% y/y), on the back of an acceleration in business lending (+3.7% q/q; +4.5% y/y) and continued strength in the household credit sector (+2.2% q/q; +14% y/y). Indeed, the quarterly uptick in business credit in 1Q22 was the fastest in at least 10 years, with the sector finally benefitting from the normalization of economic activities post-pandemic, pent-up corporate demand for capital spending and generally positive sentiment about the economic outlook amid higher oil prices. (Chart 8.)

Chart 8: Private credit to residents



Source: Refinitiv

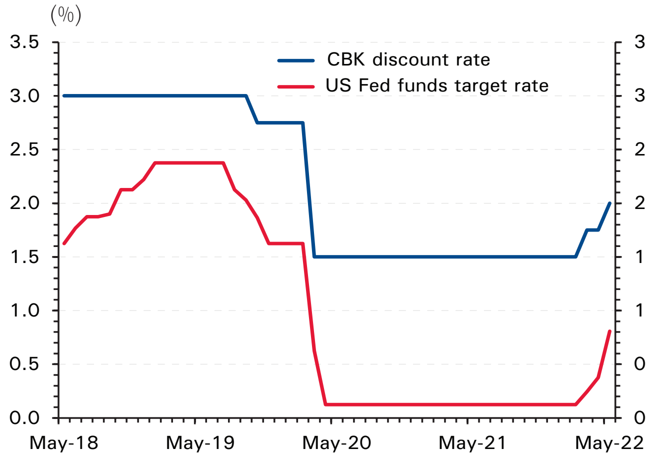
We expect credit growth to continue to be supported by the above factors in our outlook for this year. On the liabilities side, private sector deposits continued to increase, gaining for the third consecutive month in March (+4.4% q/q; +6.0% y/y). The quarterly increase was the fastest in almost two years.

Monetary policy in Kuwait began to tighten in March, after the Central Bank of Kuwait (CBK) followed the US Federal Reserve in raising benchmark interest rates by 25 bps. In May, the CBK opted for an increase to the discount rate of 25 bps (to 2.0%), rather than follow the US Fed with its 50 bps rate hike. (Chart 9.) The discount rate is expected to trend up in Kuwait as the Fed continues raising interest rates, though not necessarily in tandem.

Strong gains in equities pared by sharp May sell-off

The Kuwait All-Share index gained a solid 16% q/q in 1Q22, boosted by bullish sentiment linked to high oil prices, good earnings and a positive economic outlook. (Chart 10.) This is in line with the broader trend in the GCC, where the MSCI GCC index registered an increase of 18% over the same period. The rally in equities extended through April (+2.6% m/m), pushing market capitalization to an all-time high of KD49 billion, before heightened uncertainty in global markets and concerns over faltering economic growth pushed prices down in May. Year-to-date gains were pared back to 8.4% as of 27 May.

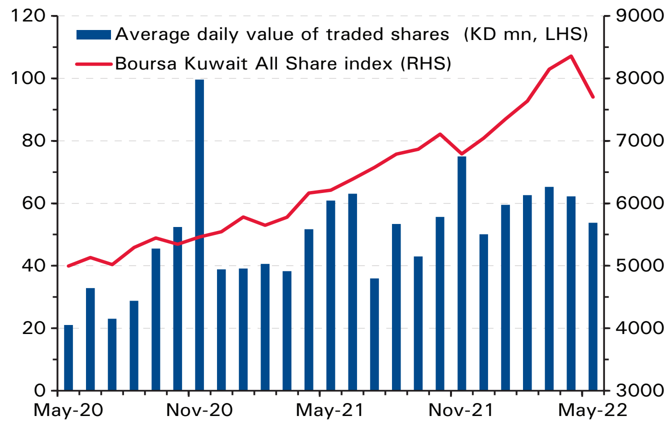
Chart 9: Kuwait and US policy interest rates



Source: Haver

Looking ahead, elevated oil prices and a favorable economic outlook could continue to lend support to Kuwaiti equities, even if global headwinds, from multi-year high inflation, slowing economic growth, partly as fallout from the Russia-Ukraine conflict, and monetary tightening, persist.

Chart 10: Kuwait All-Share Index



Source: Refinitiv

Table 1: Key economic data

	2016	2017	2018	2019	2020	2021	Forecast/estimate 2022	2023
				(KD billion)				
Nominal GDP	33.5	36.6	41.7	41.3	32.4	44.1	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	12.8	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-19	Dec-20	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	April-22
Credit	38.4	39.8	42.1	42.3	42.7	43.2	43.7	...
Growth (% y/y)	4.3	3.5	5.2	6.3	7.0	7.9	8.7	...
Money supply (M2)	38.1	39.1	39.2	39.0	39.7	40.1	40.6	...
Growth (% y/y)	-1.2	2.7	-1.2	-0.5	1.9	3.9	5.7	...
Inflation (% y/y)	1.5	3.0	3.9	4.3	4.3	4.4	4.4	...
ex food and housing	3.0	2.7	4.8	4.6	4.6	4.7	4.7	...
Consumer spending (Knet, % y/y)	5.0	25.9	28.0	30.0	20.4	33.9	41.2	34.8
Consumer confidence (Ara, index)	105	99	105	102	...	114	106	...
Kuwait export crude price ($/bbl, avg)	66	49	81	75	86	94	113	107
Stock market – All Share index (end-mth)	6,282	5,546	6,790	7,043	7,350	7,638	8,147	8,358
Growth (% m/m)	4.5	1.6	-4.5	3.7	4.4	3.9	6.7	2.6

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

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