Kuwait: Inflation rises in 3Q19, but housing rents remain soft

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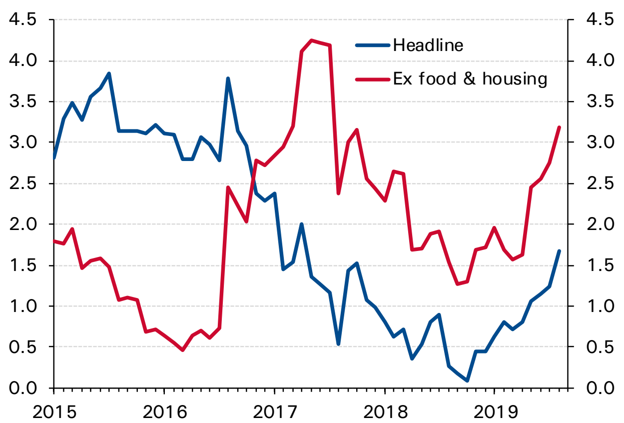
Highlights

- **Inflation rose to a more than two-year high of 1.7% y/y at the end of 3Q19, up from 1.2% the previous quarter.**
- **The increase mostly came from higher 'core' components, though not all of this was due to domestic factors.**
- **Wholesale price inflation remains very low at 0.4%, offering no signal of rising price pressures from suppliers.**
- **Although inflation has climbed more quickly than expected of late, we still expect it to average below 2% next year.**

Inflation rises further in 3Q19

Consumer price inflation rose through 3Q19, ending the quarter at a more than two-year high of 1.7% y/y and up from 1.1% at the end of Q2. (Chart 1.) Although we had expected inflation to pick up this year having bottomed out at just 0.1% last November, the pace of the increase has been somewhat surprising. Our forecast of a year-average figure of 1% for 2019 remains viable, but risks now look slightly to the upside. Meanwhile, the sectoral composition of inflation has shifted, with now stronger 'core' inflation – which rose to 3.2% in September from 2.5% in June – contrasting still-muted pressures from the 'non-core' food and (especially) housing segments.

Chart 1: Consumer price inflation



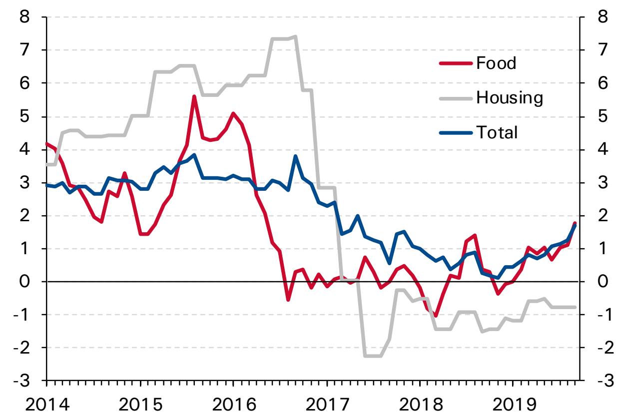
Source: Central Statistical Bureau / NBK

While headline inflation could rise a bit further over coming months, the pace of increase should slow and we currently expect inflation to peak at around 2.5% towards the middle of next year. Some of the recent increase in core inflation may be due to special factors, rather than rising inflationary pressures more broadly (see below). Moreover, while the consumer sector is doing well, other factors – including modest rates of economic and monetary growth, stable oil prices, a strong dinar and soft wholesale prices – still point to subdued price pressures ahead.

Housing rents stable, but still declining year-on-year

The rate of deflation in the housing services component (mostly rents) was -0.8% y/y in September, unchanged from June. (Chart 2.) Prices in this segment – which are recorded only every three months – were flat quarter-on-quarter for the first time since the end of last year. This could indicate some sort of stabilization in the housing sector after a prolonged spell of weakness due to oversupply in the apartment market.

Chart 2: Inflation in food and housing services



Source: Central Statistical Bureau

However given continued reports of vacancies, subdued economic growth and the impact on housing demand from weak growth in expatriate numbers, we are not yet convinced that the rental market has hit a clear turning point – especially after a similar 'false positive' was seen last year before rents resumed their decline in 2019.

Meanwhile inflation in the food and beverage segment – which combined with the housing component is worth half of the CPI basket – picked up to a more than three-year high of 1.8% in September from 0.7% in June. Much of this was due to a sharp rise in inflation in the volatile fish and seafood category to 13% from 2% in June. By contrast international food prices, although also volatile, continue to trend slightly lower, while domestic prices are also affected by various subsidies and price controls.

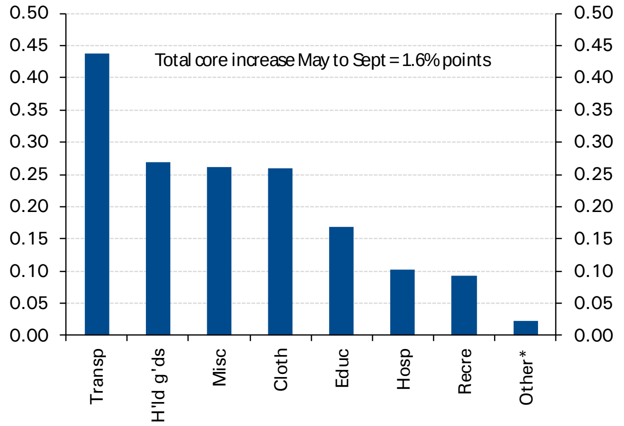
Transport prices have pushed core inflation up this year

Inflation in most of the other core categories of inflation rose compared to June. The strongest rises were in the miscellaneous (up 2.0% to 2.1%), education (up 1.4% to 3.9%), household goods (up 1.4% to 3.3%) and clothing (up 0.9% to 2.3%) segments. Moreover, core inflation has now doubled from a rate of 1.6% recorded as recently as May; this is the fastest pick-up seen since the subsidy cuts-driven rise of 2016.

The pick-up in core inflation is striking and could in principle be a sign of strong consumer spending conditions – including very robust growth in loans for personal consumption purposes – spilling over into higher retail prices. However, there are also some mitigating factors. Firstly, some of the rise is a rebound from low inflation rates recorded late last year; even after the latest rises, inflation is still by no means high. Secondly, the strong recent rise in the 'miscellaneous' inflation category has been driven by rising jewelry prices. This is almost certainly linked to the surge in the price of gold since the summer, which has since tailed off, rather than domestic inflation drivers.

Chart 3: Contribution to recent increase in core inflation

(% point contribution to the y/y rate, May to September)



Source: Central Statistical Bureau / NBK *Other=cig&tob, health, communications

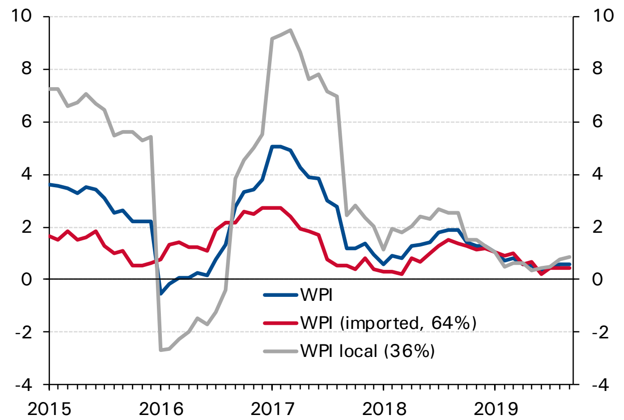
Finally, more than half of the increase in core inflation since May was driven by a one-off jump in prices in June, which appears to have stemmed from a 19% hike in airfares (which also pushed up the recreation category due to higher holiday costs). (Chart 3.) The underlying cause of this unusual rise is not clear, but given seasonal factors affecting travel (June coincided with the Eid al-Fitr holiday and prices are more volatile in the summer), we are reluctant to draw too many firm conclusions at this stage.

Wholesale price inflation remains very low

Also supporting the narrative of modest underlying inflation pressures are trends in wholesale prices. Wholesale price inflation – which measures prices charged between some businesses rather than to consumers – stood at just 0.6% y/y in September, above the 0.3% recorded in June but still very low and less than half the average rate of last year. (Chart 4.) Most of the rise since June came from higher food prices – in particular the same hike in local fish prices recorded in the CPI above – rather than from manufactured goods. The especially low rates of inflation for imported (as opposed to locally-produced) items, at 0.4% in September, confirms the impact of the strong dinar in keeping import price inflation low. Although not a complete measure of businesses' costs, low wholesale price inflation does suggest that retailers are not facing strong pressures from their suppliers to push up prices.

Chart 4: Wholesale price inflation

(% y/y)



Source: Central Statistical Bureau

Inflation to edge up in 2020, but remain moderate

That said, the recent rise in core inflation is worth watching and – although still low – at 1.7% Kuwait's inflation rate is now the highest in the Gulf (most other countries are in deflation territory). Assuming that current downward pressure on housing unwinds only slowly and food price inflation is broadly stable, we expect inflation to average only a little higher at 1.5-2.0% next year, from around 1% in 2019. This will not be a major policy concern for the authorities. Further increases in inflation however could put pressure on real income growth and start to chip away at currently strong conditions in the consumer sector. Meanwhile there are also downside risks to inflation from slower world growth, continued US dollar/dinar strength and extended weakness in the local apartment real estate sector.

Table: Consumer price inflation

CPI component	% y/y annual average		%m/m			% y/y		
	2017	2018	Jul	Aug	Sep	Jul	Aug	Sep
Food & beverages	0.2	0.1	1.2	0.1	0.3	1.0	1.1	1.8
Tobacco & cigarettes	1.3	11.5	0.0	0.0	0.0	1.0	1.0	0.9
Clothing & footwear	1.3	-0.4	0.2	0.4	0.4	1.7	1.7	2.3
Housing services	-0.4	-1.1	0.0	0.0	0.0	-0.8	-0.8	-0.8
Furnishings & household maintenance	3.3	2.0	0.0	0.9	0.8	1.9	2.6	3.3
Healthcare	0.2	1.9	0.0	0.2	0.6	2.2	2.5	2.9
Transportation	10.2	1.4	0.0	-0.1	0.1	4.7	4.4	4.5
Communication	-0.6	3.6	0.2	0.4	1.1	4.8	4.9	5.4
Recreation & culture	3.2	4.2	0.0	-0.2	-0.3	3.9	3.5	3.0
Education	2.8	1.4	0.0	0.0	1.3	2.4	2.4	3.9
Restaurants & hotels	3.1	1.7	0.6	0.0	0.0	1.3	1.3	1.3
Other goods & services	1.7	3.5	0.3	0.6	0.6	0.6	1.4	2.1
General index	**1.5**	**0.6**	**0.3**	**0.2**	**0.3**	**1.1**	**1.2**	**1.7**
*** ex food and housing**	**3.3**	**1.9**	**0.1**	**0.3**	**0.5**	**2.6**	**2.7**	**3.2**

Source: Central Statistical Bureau

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