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الوطني
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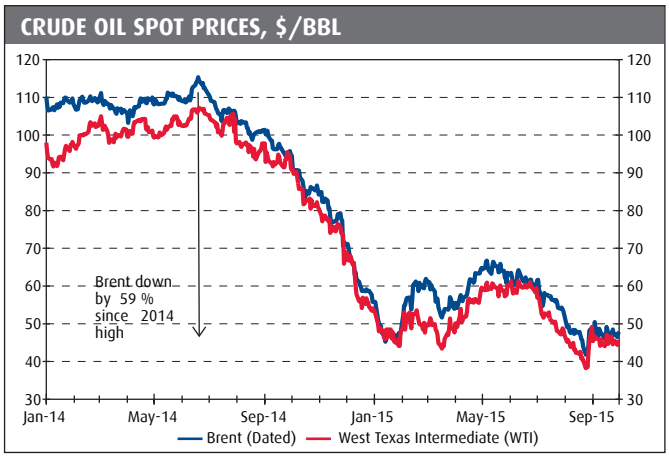
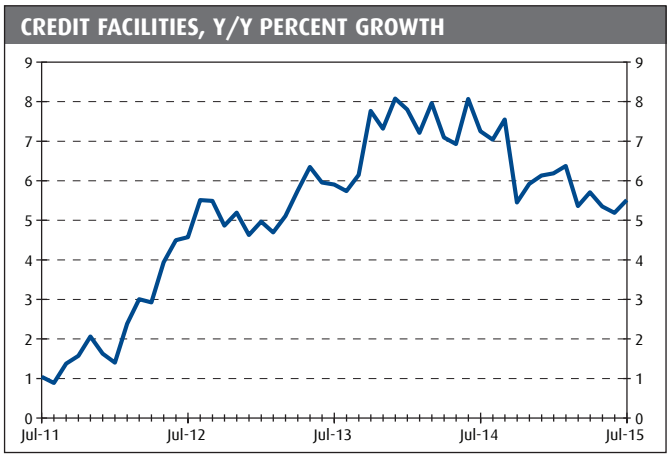
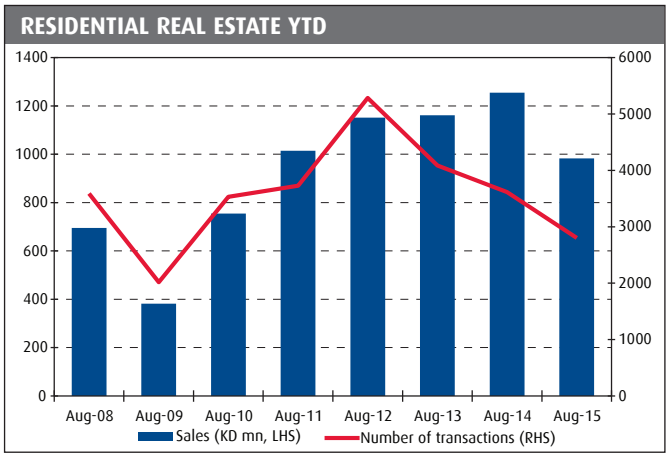
Nonoil growth is expected to pick up in 2015... supply glut keeps oil prices low... consumer remains robust... credit growth accelerates to 5.5%

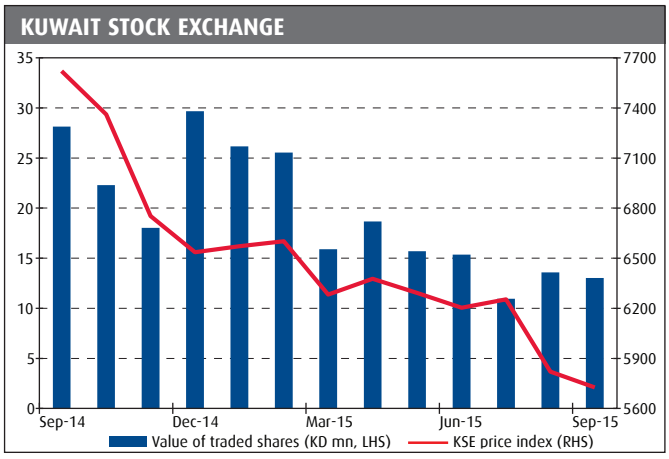
An update of recent developments in select sectors in Kuwait published by Economic Research at NBK

Kuwait **Economic** Brief









Gross Domestic Product

Nonoil growth at 2.1% in 2014, to pick up in 2015 on project execution

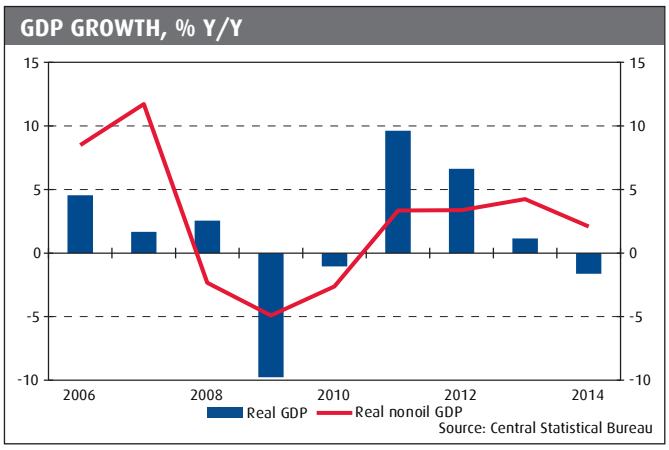
Growth in Kuwait's nonoil economy slowed to 2.1% in real terms in 2014, according to preliminary data recently published by the Central Statistical Bureau (CSB). Real growth in overall GDP declined by 1.6%, pulled down by the oil sector. Growth in domestic demand also slowed during the year, though to a still very decent 4.4%. There was a notable slowdown in investment expenditures, though this is likely to be temporary. Private consumption growth also slowed for a second consecutive year, as the sector has been moderating.

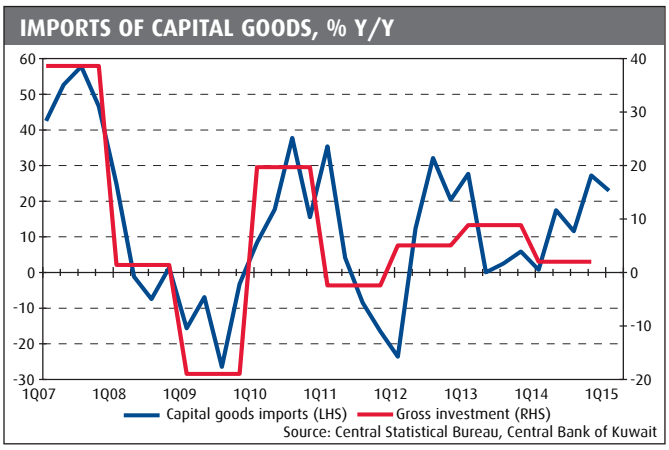
The oil sector, which includes crude and oil refining, shrank by 1.7% during 2014. The decline, which follows a similar decrease the year before, was due in part to a similar drop in crude oil production, which fell to an average of 2.88 million barrels per day. Oil output has been declining gradually since 2012, after seeing a large increase in 2011. Meanwhile, a larger 16% decline was recorded in refining activity during 2014. While 2014 saw oil prices plunge, this is not reflected in the real GDP figures, which are computed at constant 2010 prices. Oil GDP in nominal terms was down by 10.6% during 2014, most of it a result of the decline in the price of oil.

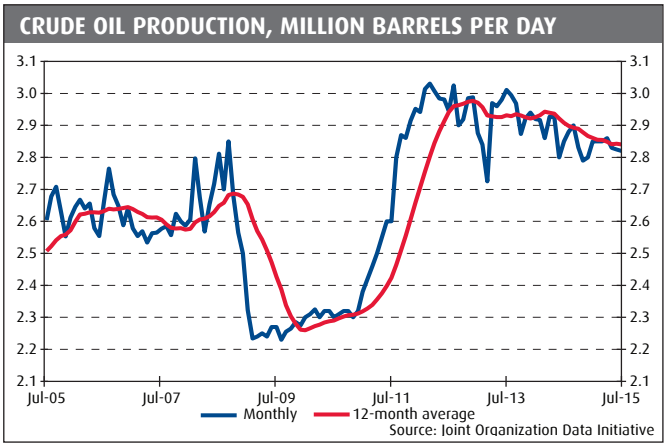
The surprise was in the nonoil sector, where growth slowed to 2.1% from 4.2% the year before. The largest decline was in the government-dominated "public administration and defense" sector, whose growth slowed to 3.2% from double digit growth the year before. Weakness also came from "transport, storage and communication", education, "wholesale and retail trade", and "health and social work", all of which saw growth slow notably. By contrast, "financial institutions and insurance" and "real estate and business services" were among the few sectors to see an acceleration in growth, with the former seeing real growth accelerate to 5.3%.

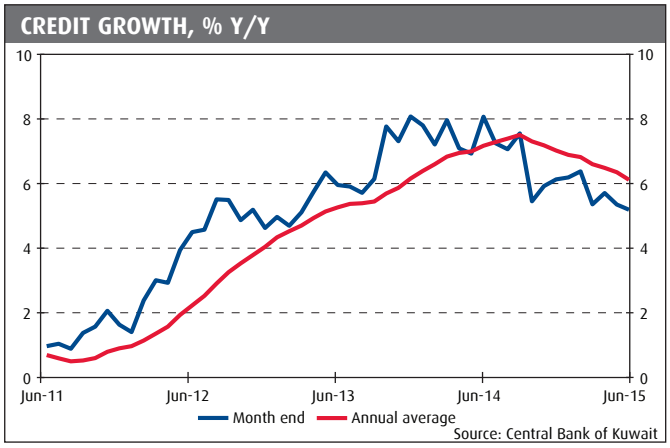
Growth in domestic demand moderated for a second consecutive year in 2014, but maintained a healthy pace. Domestic demand, which includes final consumption by households and government as well as investment, grew by 4.4% compared to 6.4% the year before. The slowdown was largely due to slower growth in investment spending. Gross investment grew by only 2.1% in real terms during the year; this compares to growth of 8.9% the year before. There was also a deceleration in consumer spending growth, which eased to 2.8% from 4.9% the year before.

The cooling off in investment spending growth during 2014 appears to be temporary and should turn around in 2015. The preliminary data, which contradicts indications that implementation of the government's Development Plan projects is picking up pace, appears to reflect a lull in capital spending during late 2013 and early 2014. This is particularly visible in quarterly capital goods imports, which saw growth slow to 2.3% y/y in 1Q14 from 23% y/y a year before. Growth has since picked up pace rising to 20% y/y in 1Q15.





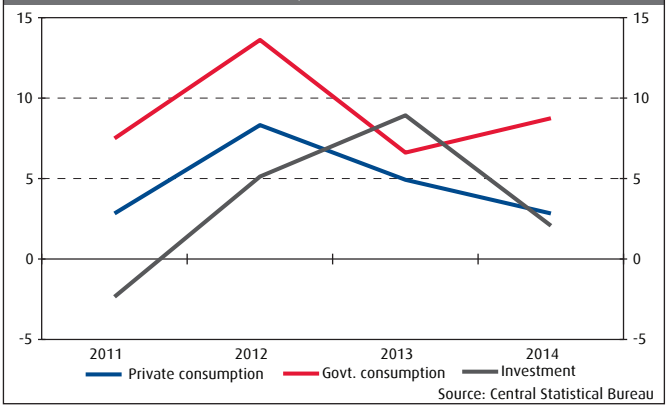




Slower nonoil growth in 2014 also coincided with a slowdown in credit during that year. After ending 2013 with growth of 8.1%, growth slipped to 6.1% by the end of 2014. Growth has shown signs of recovery in recent months, with annualized growth in 2Q15 rising to 8.9% q/q following three quarters of weaker growth.

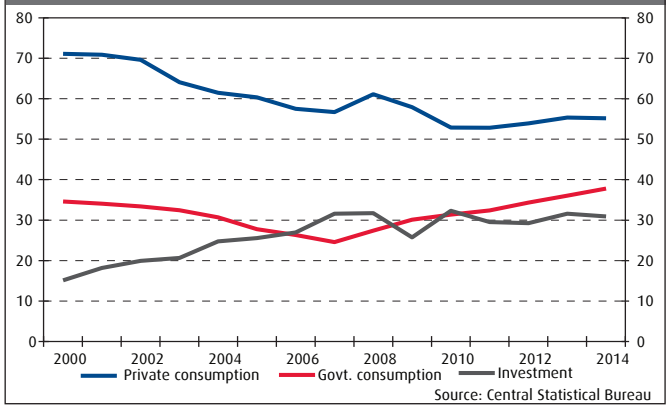
Nonoil activity growth is expected to pick up once again towards 4-5% in 2015 and 2016. Growth should receive a boost from increasing investment spending with the government's Development Plan implementation continuing to improve. Capital investment activity has been picking up pace, as reflected in the progress in government project awards. Kuwait's authorities are expected to continue to push ahead with strategic projects worth upwards of KD 30 billion over 5 years despite concerns that oil prices could remain low in the coming year or two, especially since the country has very comfortable fiscal buffers.

GDP BY EXPENDITURE, % Y/Y



Source: Central Statistical Bureau

GDP BY EXPENDITURE, % OF NONOIL GDP



Source: Central Statistical Bureau

GROSS DOMESTIC PRODUCT

	2014	Real growth 2012	2013	2014
	KD bn nominal	% y/y real	% y/y real	% y/y real
Oil sector	**29.22**	**10.3**	**-1.8**	**-1.7**
Crude oil & gas extraction	28.06	10.0	-1.8	-0.9
Refining	1.16	16.0	-1.7	-15.8
Nonoil sector	**23.82**	**3.4**	**4.2**	**2.1**
Public administration and defense	3.56	1.0	12.5	3.2
Financial institutions and insurance	3.08	0.0	1.7	5.3
Real estate and business services	2.97	0.7	0.0	1.6
Transport, storage and communication	2.47	7.8	2.7	-1.2
Education	1.62	3.4	5.0	2.5
Wholesale and retail trade	1.40	-0.2	4.0	1.6
Manufacturing (excl. refining)	1.40	23.2	-0.9	0.9
Health and social work	0.87	2.5	4.1	2.3
Construction	0.81	3.4	2.0	2.7
Electricity, gas and water	0.80	-5.2	11.5	2.3
Other sectors	1.57	6.3	5.3	0.5
GDP at producer prices	**53.04**	**7.2**	**0.8**	**0.0**
minus: imputed bank service	1.98	-	-	-
plus: taxes less subsidies on products	-4.50	-	-	-
GDP at market prices	**46.56**	**6.6**	**1.1**	**-1.6**
By type of expenditure:				
Private consumption (C)	13.15	8.3	4.9	2.8
Government consumption (G)	9.01	13.6	6.6	8.8
Gross investment (I)	7.36	5.1	8.9	2.1
Domestic demand (C+G+I)	**29.52**	**9.0**	**6.4**	**4.4**
Exports	31.60	7.7	-4.0	-3.1
Imports	14.56	14.0	-0.1	7.7

Source: Central Statistical Bureau, NBK estimates

Oil Markets

Oil glut and concerns about emerging market growth weigh on prices

- Oil prices remained near six-and-a-half-year lows for most of September; Brent and WTI closed the month at $47.2/bbl and $45.1/bbl, respectively.
- Markets continue to be affected by concerns over a slowdown in emerging markets and the persistence of the crude supply overhang.
- OPEC crude oil production declined slightly in August to 31.9 mb/d on lower output from Saudi Arabia, the UAE and Angola in particular.
- The IEA expects the oil supply glut to gradually ease in 2016 as oil demand remains firm and non-OPEC supply growth, especially US shale production, slows due to cutbacks in capital expenditure brought about by low oil prices.

Less volatility in September but oil prices remain depressed on worries over an emerging markets slowdown and continued crude supply overhang

The volatility that characterized oil markets in late August gave way to a more settled period in September, with benchmark crudes, Brent and West Texas Intermediate (WTI), trading within the $46-49.0 per barrel (bbl) and $44-46.0/bbl ranges, respectively, for most of the month. At September's close, Brent settled at $47.2/bbl while WTI reached $45.1/bbl. Both crudes were still down near six-and-a-half-year lows, however, depressed by continued worries about economic growth in emerging markets, particularly China's, and by the persistence of the crude oil supply glut. The US Federal Reserve's decision to hold interest rates steady was partly an implicit acknowledgment of the former, while the supply overhang dynamic was further evident in the rise to record levels of OECD commercial oil stocks and continued price discounting by regional oil producers Kuwait and Iran. The current discount of Kuwaiti export crude (KEC) against Saudi Arabia's benchmark Arab Light for Asian customers is the largest in 10 years as efforts intensify even among OPEC members to retain market share.

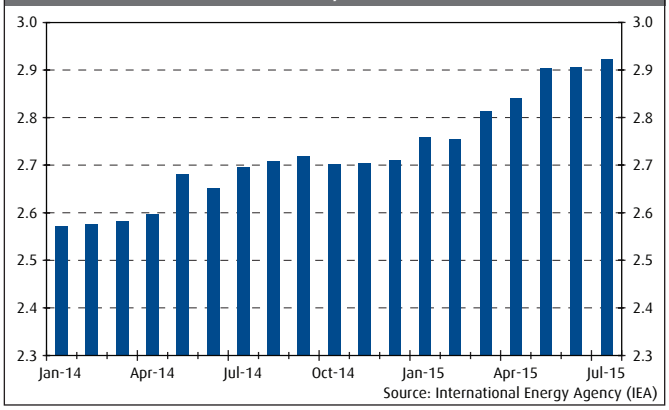
Meanwhile, in the futures markets, the price for long-dated crude oil continues to trade higher than spot crude (i.e. crude for immediate delivery). The differential between the two prices in the so-called contango curve has narrowed, however, indicating that the appetite for storage for speculative purposes may be waning. As of September 30, according to the futures market, the price of Brent crude is expected to increase to $55.2/bbl by December 2016 and to $58.6/bbl by December 2017.

Crude supply glut should ease in 2016 as oil demand rebounds and oil supply begins to be negatively affected by low oil prices

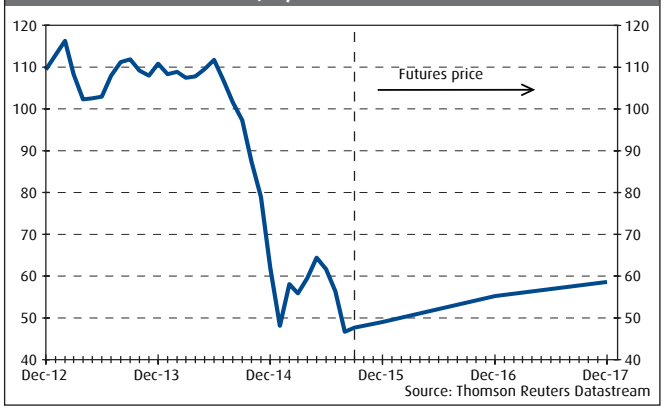
The expectation that oil prices will rebound going into 2016 and beyond is based on a predicted unwinding of the demand/supply mismatch. The oil supply glut, which the International Energy Agency (IEA) estimated to be around 1.6 million barrels a day (mb/d) during the third quarter of this year (3Q15), should begin to ease as demand rebounds from the lows of 2014 and supply growth slows due to cuts in investment and ultimately production due to low oil prices.

Looking ahead, the current oil surplus could steadily decline and turn into a deficit of almost -0.5 mb/d by 4Q16 as oil demand growth outpaces oil supply growth. On the demand side, 2015 should see demand rising to a five-year high of 1.7 mb/d before moderating in 2016 to 1.4 mb/d. Preliminary estimates for 3Q15 show that

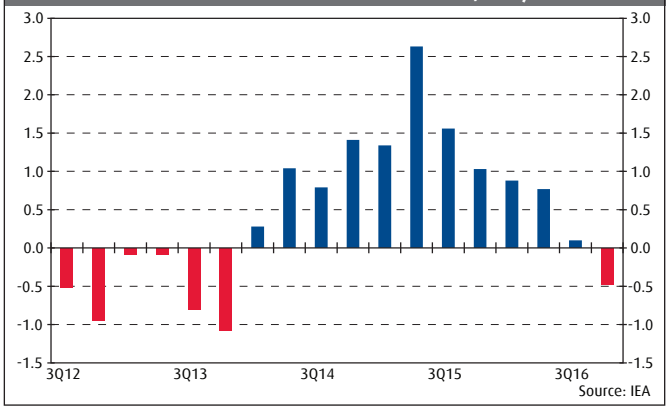
OECD COMMERCIAL OIL STOCKS, BILLION BARRELS



BRENT FUTURES PRICES, $/BBL



BALANCE OF WORLD OIL DEMAND & SUPPLY, MB/D



demand growth topped 1.7 mb/d for the third quarter in a row, boosted by better-than-expected numbers from the US, China, Europe and Russia. Improving macroeconomic fundamentals, baseline revisions in the US and still strong demand from China's petrochemical and transport sectors helped keep demand firm. Underpinning this trend is the stimulative effect on crude oil demand of lower oil prices.

Conversely, low oil prices are having a negative effect on global supplies, especially on non-OPEC crude oil production. According to the IEA, non-OPEC supply growth, having peaked in 4Q15 at 2.6 mb/d, is expected to slow considerably, to -0.3 mb/d by the end of the year before bottoming out at -0.9 mb/d at the end of 2Q16. For 2015 as a whole, the IEA expects non-OPEC supply growth to slow to 1.1 mb/d, from 2.3 mb/d last year. In 2016, non-OPEC supply growth is projected to contract by 0.5 mb/d. The IEA anticipates that a significant portion of this will be due to declines in US light tight oil production (LTO) i.e. shale. With oil prices below the estimated breakeven cost for major US shale plays, the decline in drilling and completion rates that has been observed since the start of the year is expected to extend well into 2016.

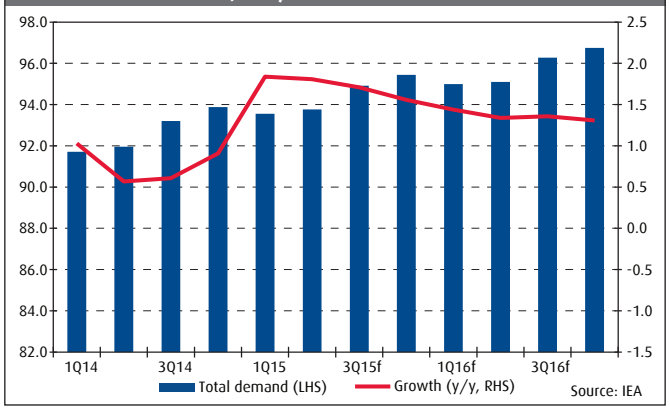
OPEC output, meanwhile, at 31.9 mb/d in August*, remains elevated near the 22-month high recorded in July and well above the group's official production ceiling of 30 mb/d. Production has surged by more than 1.5 mb/d year-on-year (y/y) even while prices have fallen by more than 50% over the same period. Compared to July, however, OPEC production did decline by 20,000 b/d on slightly lower output from Saudi Arabia, the UAE and Angola among others. Nevertheless, Saudi Arabia, along with the UAE and Iraq, continues to pump at or near record levels. Saudi Arabia's output of 10.2 mb/d in August was the sixth in a row to top 10.0 mb/d, suggesting that the kingdom remained steadfast in its pursuit of market share. Elevated output was also in response to heightened domestic power demand during the hot summer months.

Iraqi production, which includes output from the Kurdistan Regional Government's (KRG) oil fields, hit another all-time high, of 3.76 mb/d, in August. Output has surged despite the conflict with Islamic State (IS) and plunging oil prices.

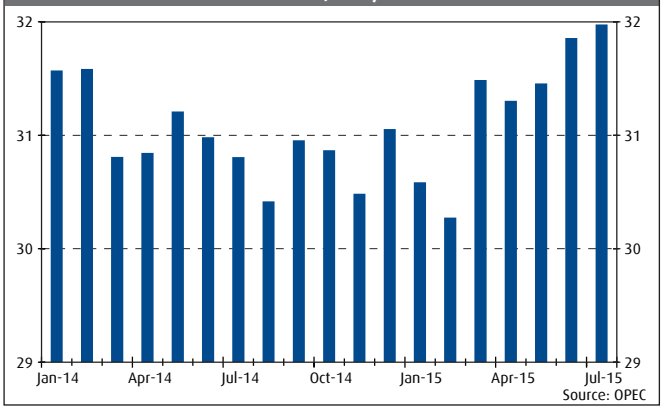
Kuwait, meanwhile, boosted oil production by 70,000 b/d to 2.89 mb/d, according to official sources. This was the highest figure in a year, and resulted from the successful application of enhanced oil recovery (EOR) techniques to the country's maturing fields. Otherwise, output could conceivably be down by at least 250,000 b/d in view of the cessation of production from both the Khafji and Wafra oil fields that Kuwait shares with Saudi Arabia in the Neutral Zone. The two countries have yet to resolve the operational dispute that shuttered production.

For the third month in succession, Iranian production edged up in August, to 3.18 mb/d. Iran is preparing the ground for

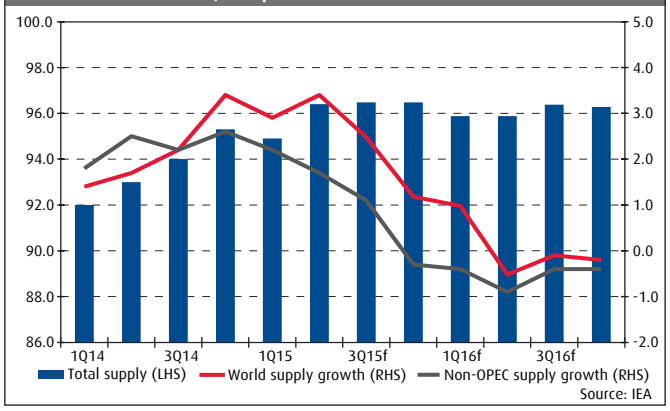
WORLD OIL DEMAND, MB/D



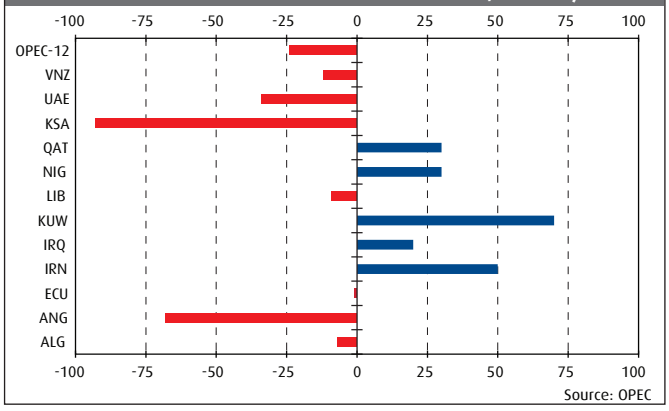
OPEC CRUDE OIL PRODUCTION, MB/D



WORLD OIL SUPPLY, MB/D



OPEC CRUDE OIL PRODUCTION CHANGE IN AUG, 000' B/D



a full return to the oil markets in early 2016 when sanctions are expected to be lifted. Iran expects output to rise by 500,000 b/d as soon as sanctions are removed and by 1.0 mb/d within months. Many observers view this figure as optimistic, however.

Iran's return to the oil markets in 2016 amid the persistent supply glut that has forced down prices is likely to dominate proceedings at OPEC's next meeting in December. It remains to be seen whether the group will accommodate Iran by lowering individual quotas or continue with its Saudi-led strategy of resisting production cuts in the interests of preserving market share.

* OPEC data obtained via direct communication with national authorities with the exception of Libyan crude output data which was taken from secondary sources.

Consumer Sector

Consumer sector remains robust despite some moderation
The consumer sector continued to grow more rapidly than the rest of Kuwait's economy despite some slowdown in growth. Household debt growth remained in the double-digits, though it has moderated over the last twelve months. Consumer spending growth also maintained a robust pace, driven by good sentiment and healthy growth in household income. Indeed, employment growth has been improving over the last 12 months, supporting the consumer sector. While overall expatriate employment has been strong, there was some weakening in skilled expat hiring over the last 12 months.

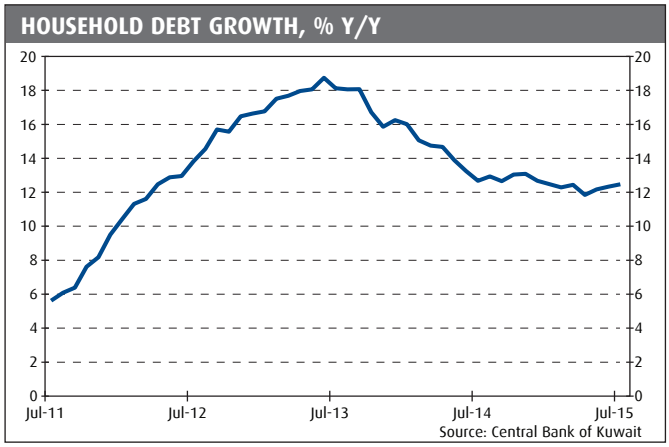
Household's debt growth stood at 12.5% year-on-year (y/y) in July, mostly unchanged from the pace a year ago. Personal facilities excluding credit for the purchase of securities rose to KD 10.2 billion. Most of the growth has been in installment loans, which largely finance home acquisition. Installment loans grew by 15% y/y in July, with the pace picking up slightly from a year ago. This most likely reflects the role strong demand for housing plays in driving household debt growth.

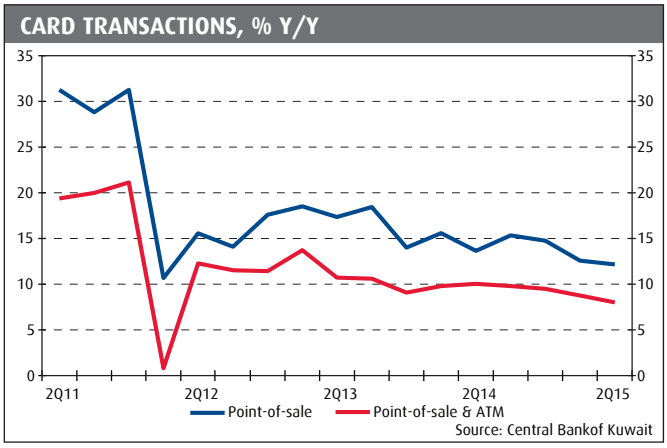
Consumer spending remained relatively robust, though it has begun to moderate in 2015. While growth in the value of point-of-sale transactions (POS) in 2Q15 stood at a healthy 12% y/y, it was still the slowest in over three years. If consumers' ATM cash withdrawals are also included, spending softened to 8%. National account data also pointed to some moderation in consumer spending, as nominal private consumption growth eased to 5.9% in 2014 (preliminary figures), it slowest pace in four years. In real inflation adjusted terms, growth also slowed.

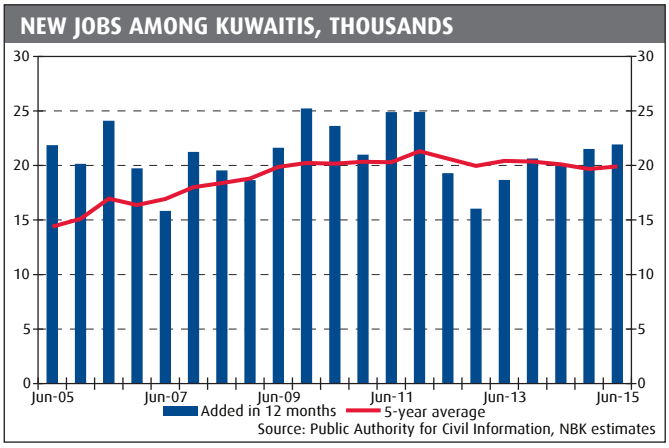
Employment among Kuwaiti nationals has been picking up slightly over the last 12 months, providing some additional support to the sector. New hires among Kuwaitis over the 12 months ending in June 2015 are estimated at 21,900 compared to 20,100 a year before. Net employment growth has been mostly steady at around 3% y/y.

Hiring among skilled expatriates appears to have slowed somewhat over the last 12 months, especially among the more highly skilled. Employed non-Kuwaitis with at least a secondary education rose by 8,600 during the 12 months ending in June 2015, down from 15,000 a year before. The weakness was more notable among those with a university education. By contrast, total expatriate employment in the private sector continued to see strong growth, rising by 7.5% y/y, implying robust growth in the unskilled segments.

The consumer sector is expected to maintain healthy growth, supported by robust hiring and healthy consumer sentiment. Employment growth among Kuwaitis, combined with strong housing demand, is likely to continue to drive strong household debt growth. The weaker hiring trend among skilled expats could hurt growth slightly, though the impact is expected to be relatively small.







Monetary Developments

Credit growth accelerated to 5.5% in July despite weak month

Credit was down in July, though growth rose to 5.5% y/y on basis effects. Total credit declined by a net KD 133 million during the month. The main source of weakness in July was a drop in lending for securities purchases, which reversed a large gain the month before. Nonbank credit also saw a larger decline than usual. These were partly offset by relative strength in household borrowing, and lending to the real estate and trade sectors. Private deposits saw large withdrawals on the month, with money supply growth picking up despite the decline. Meanwhile, interbank and deposit rates held steady.

Despite the weaker July credit figures, we still appear to be seeing an accelerating growth trend since the start of 2015; annualized growth in total credit during the three months through July stood at 6.9% compared to a low of 2.2% in December 2014.

Household borrowing growth remained healthy, though the monthly gain of KD 79 million was slightly weaker than recent trends. Still, growth accelerated to 12.5% y/y. The monthly gain came from installment loans, while consumer loans saw a small decline. Household borrowing remained the largest contributor to credit growth in 2015, accounting for more than half of the gains.

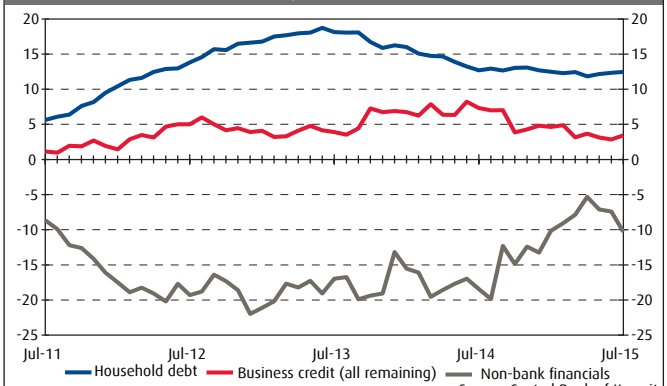
Credit to non-bank financial companies saw a relatively large decline, losing KD 69 million, the largest in 18 months. The sector's credit was down 10.3% y/y.

All remaining credit declined by KD 143 million, though growth rose to 3.4% y/y. The bulk of the decline was in lending for the purchase of securities, which was down by KD 222 million. Gains in the trade, real estate, and construction sectors helped offset some of the decline. Taken alone, business credit excluding securities saw a healthy gain, with credit growth rising to 4.5% y/y.

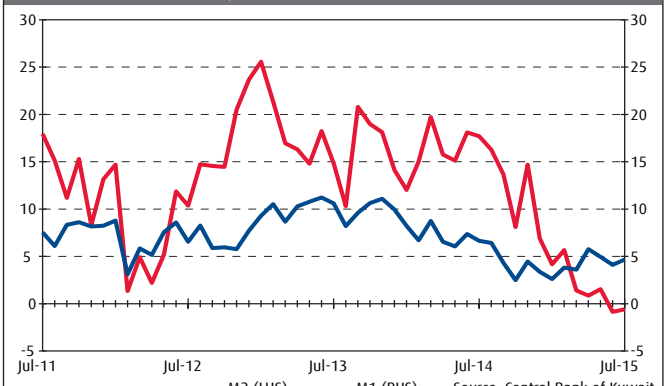
Private deposits saw a large KD 453 million decline in July. This was likely due to the summer travel season, though the decline was smaller than last year's. Money supply (M2) growth still rose to 4.7% y/y. The decline in deposits was in both dinar (-KD 315 million) and foreign currency deposits (-KD 138 million). There was also a move away from KD sight and savings deposits towards KD time deposits. Narrower money supply (M1) was still down 0.6% y/y due to a basis effect as a result of last year's introduction of the new paper currency, which temporarily increased the amount of currency in circulation.

Average customer deposit rates on dinar time deposits, and interbank rates were steady in July. Average rates on the 1-month, 3-month, and 6-month time deposits were steady at 0.61%, 0.77%, and 0.97%, while 12-month rates added one basis point to settle at 1.21%. KD interbank rates held steady at 1.00%, up 21 basis points year-to-date.

CREDIT COMPONENTS, % Y/Y GROWTH



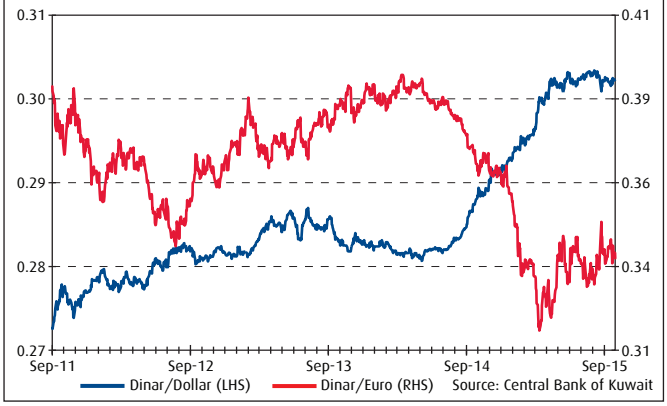
MONEY SUPPLY, % Y/Y GROWTH



MONETARY HIGHLIGHTS

	July 2015	Change m/m	Change 3-mnth	Change y/y
	KD mn	%	%	%
Local Bank Assets	**56,876**	**-1.2**	**0.0**	**4.8**
of which:				
Claims on Government	1,577	0.2	0.4	0.9
Credit to Residents	31,616	-0.4	1.6	5.5
Foreign Assets	12,189	-3.3	-6.2	7.6
Money Supply (M2)	**35,226**	**-1.4**	**-0.4**	**4.7**
Private Deposits	33,713	-1.3	-0.5	6.5
KD Sight Deposits	8,004	-4.1	1.2	5.8
KD Savings Deposits	4,866	-1.2	0.4	-2.1
KD Time Deposits & CDs	16,710	0.5	0.1	2.4
FC Deposits	4,134	-3.2	-6.9	47.9

EXCHANGE RATES



Consumer Price Inflation

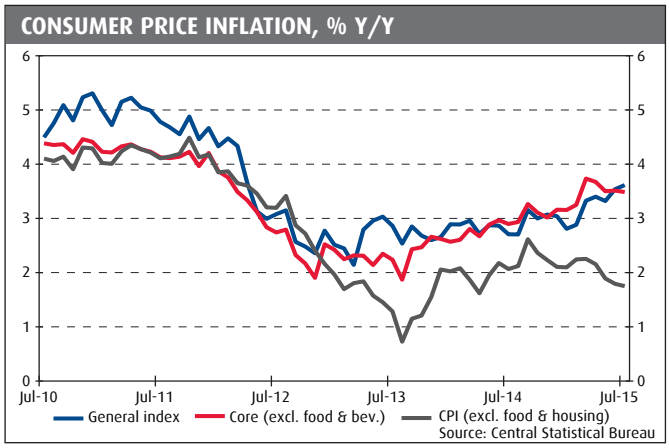
July inflation, overall and core, stabilizing near 3.5%
Inflation in consumer prices saw a small increase in July, rising from 3.5% year-on-year (y/y) in June to 3.6% y/y. Inflation across all components, with the exception of food, either slowed or remained unchanged in July. Food inflation rose ahead of the Eid holiday, when the demand for food typically sees a stronger pick up. Food inflation is expected to subside in the near-term, amid an ongoing decline in international food prices. Core inflation, which excludes food, remained steady at 3.5% for the third consecutive month in July as pressures from all components, excluding housing, have been retreating. Easing inflation across most components and a stronger dinar will ensure limited upward inflationary pressures going forward. We expect annual consumer price inflation to average close to 3.5% in 2015.

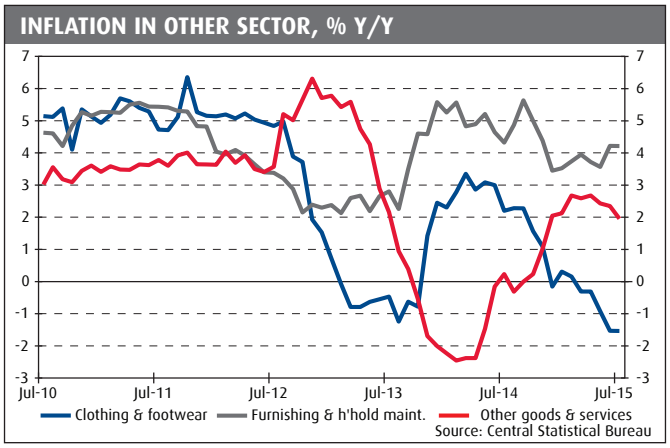
Inflation in the wholesale price index eased recently after upward pressures from its major components subsided (manufacturing and mining & quarrying, in particular). Against a backdrop of softer global oil prices, we expect inflation in the wholesale price index to remain in-check in the near to medium-term and to help in easing inflationary pressures on consumer prices.

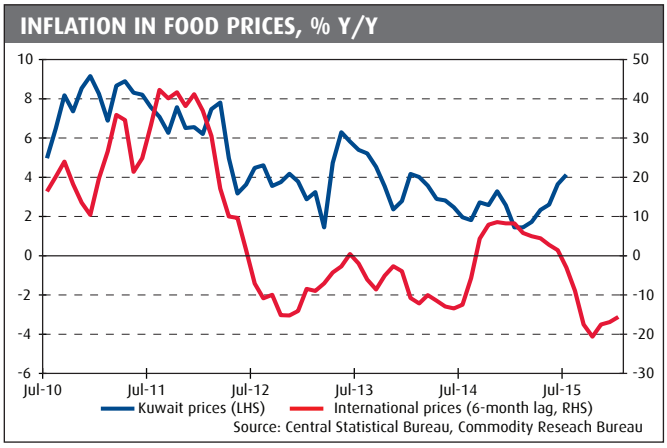
Inflation in food prices continued to inch higher in July, coming in at 4.1% y/y versus June's 3.6% y/y. The rise in food prices was mainly due to a stronger rise in food demand ahead of the Eid holiday, which is typical of that period. A hike in the cost of fish and seafood over the summer may have also pushed overall food inflation higher: fish and seafood prices rose by 12.2% y/y and 14.5% y/y, respectively, in June and July. However, prices in this subcomponent are expected to come in lower. In August, a local boycott against exuberant price hikes forced prices down. Also, international food prices are declining; according to the Commodity Research Bureau global commodity index, prices were down by around 16% y/y in July; as a result, we expect upward pressures on local food inflation to remain limited over the coming months.

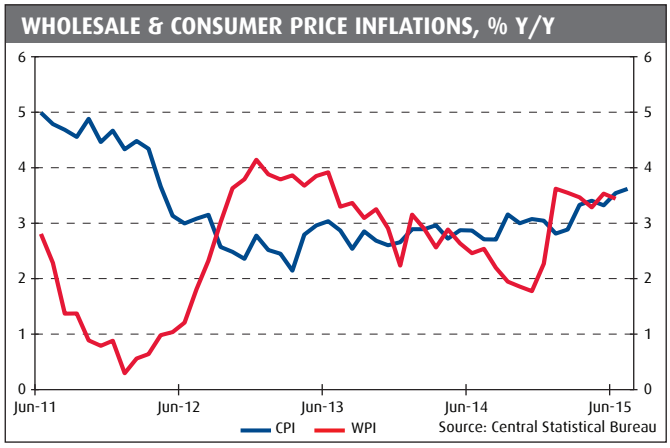
Housing rent inflation accelerated to a six-year high of 6.5% y/y, though it appears pressures are easing following strong gains in 2014. Rents rose by an annualized 3.2% during 2Q15, their slowest pace in almost a year. Further easing is expected in this segment especially with real estate activity cooling off substantially thus far in 2015.

Inflation in clothing & footwear, and furnishings & household maintenance remained subdued in July. Clothing & footwear inflation remained unchanged from June's reading, declining by 1.5% y/y on the back of seasonal promotions and lower foot traffic due to the shorter opening hours during Ramadan. Inflation in this segment has been trending downwards for nearly a year due to a high base and a stronger dinar (most goods in this segment are imported).









Inflation in furnishings & household maintenance appears to have steadied for now, after coming in unchanged from June's figure of 4.2% y/y.

Inflation in the 'other goods & services' component continued to slow in July. Inflation in this component, which includes prices of personal care products and jewelry and certain business charges, has been trending lower since it peaked in April of this year. The slowdown can be explained by the stronger dinar, given that the bulk of the goods in this component are imported.

Tobacco & cigarette price inflation witnessed a large slowdown in July, sliding from 6.0% y/y in June to 1.5% y/y. This was mainly due to a high base around the same time last year when Kuwait's Ministry of Health was mulling over a potential tax hike on tobacco products. This led to strong gains in demand for tobacco products (in anticipation of a potential tax hike) and ultimately tobacco prices. We expect inflation in this segment to gradually rise to its pre-2014 summer rates of around 6% y/y in the near-to-medium term.

Wholesale price inflation has remained rather steady since the start of 2015, on the back of stable manufacturing costs and a slowdown in mining & quarrying inflation. Inflation in the wholesale price index, which is typically more volatile than consumer price inflation, eased slightly in July, to 3.4% y/y. Moderating inflation in the manufacturing, and mining & quarrying components helped offset the rise in agriculture, livestock & fishing inflation over the summer. The latter's rise was mainly due to hikes in fish & seafood prices. However, upward pressures from this component are expected to have subsided in August after the local boycott of the fish market forced prices to come down. Inflation in the wholesale price index is expected to remain steady in the coming months amid softer global oil prices and a stronger local currency. This, in turn, should help keep consumer price inflation in check and near our expectations of 3.5%.

CONSUMER PRICE INFLATION

CPI basket (%)	Weight	Month Change		Year-on-year		Annual Avg.	
	%	Jun-15	July-15	Jun-15	July-15	2013	2014
Food & beverages	18.4	0.7	0.5	3.6	4.1	4.0	2.9
Tobacco & cigarettes	0.3	0.1	0.3	6.0	1.5	7.1	7.8
Clothing & footwear	9.3	-0.4	-0.4	-1.5	-1.5	-0.1	2.2
Housing services *	28.9	0.8	0.0	6.5	6.5	3.8	4.4
Furnishing & h'hold maint.	11.3	0.7	0.1	4.2	4.2	3.2	4.8
Healthcare	1.6	0.1	0.1	2.1	2.2	1.2	-0.6
Transportation	7.9	0.2	0.0	0.6	0.4	1.3	1.5
Communication	4.0	0.0	0.1	0.3	0.5	0.0	-0.8
Recreation & culture	4.3	-0.2	-0.1	-0.5	-0.8	1.9	0.9
Education	3.0	0.0	0.0	4.4	4.4	0.8	4.7
Restaurants & hotels	3.3	2.0	0.0	6.9	6.9	0.5	3.1
Other goods & serv.	7.8	0.2	-0.3	2.3	2.0	2.3	-0.7
Core**	**81.6**	**0.4**	**0.0**	**3.5**	**3.5**	**2.3**	**2.9**
General Index	**100.0**	**0.4**	**0.1**	**3.5**	**3.6**	**2.7**	**2.9**

Source: Central Statistical Bureau
*Updated once every quarter
**Excludes food & beverages

Projects

PPP projects expected to provide healthy boost to economy

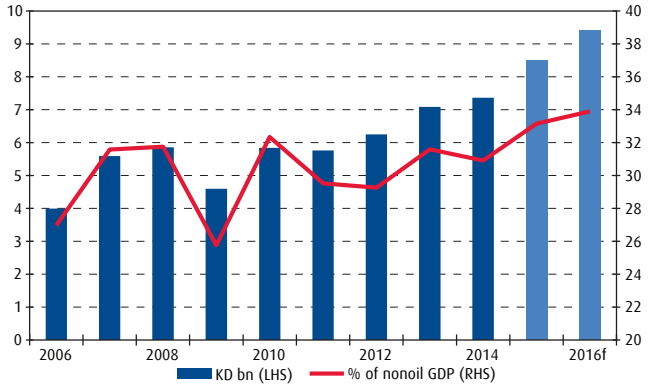
Since 2010, Kuwait has been implementing a strategic Development Plan whose aim is to improve infrastructure across a number of sectors and deepen the country's economic base, especially outside of the oil sector. Unlike previous investment initiatives, the current development agenda envisions a central role for the private sector. The extensive use of the public-private partnership (PPP) framework in the current plan is intended to increase the contribution of the private sector to the country's economic growth and to spur private sector job creation, among many other benefits. The recent decline in oil prices has refocused attention on the importance of expanding the nonoil economy and the private sector, and increased the need to diversify the financing sources for projects.

The Development Plan (DP) seeks to boost aggregate investment, pledging to spend upwards of KD 32 billion between 2015 and 2019. Earlier this year, the authorities approved the second five-year development plan. Projects are planned in a number of sectors, including oil, transport, infrastructure, power and water. Implementation of the DP is well underway, though there has been some delay. The pace of implementation of the plan's projects is critical to Kuwait's current medium term economic outlook, which expects nonoil economic growth to average around 4% in 2015 and 2016 and to accelerate beyond that towards 5-6%.

At the core of Kuwait's Development Plan is an effort to involve private investors. This is being done through a PPP program that currently includes projects valued at KD 10 billion, mainly in power, water, wastewater treatment, housing and transportation. Once in full swing, these projects could conservatively add KD 1 billion per year to capital spending, hence boosting, by themselves, real GDP growth by almost 2%.

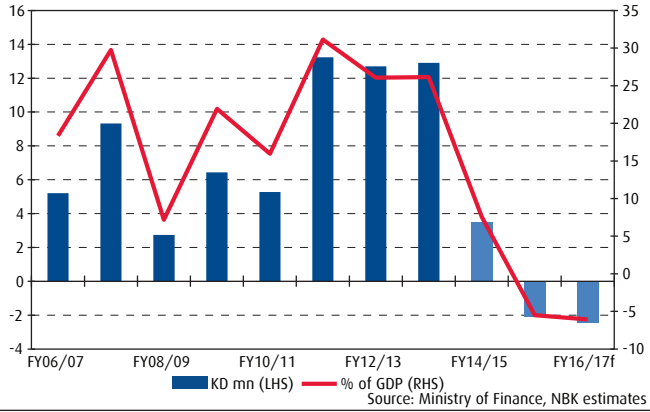
While projects have taken some time to take-off, an amendment to the legal and institutional framework in 2014 has reinvigorated the initiative. Amendments ironed out some issues that had prevented projects from taking off sooner and should lead to better regulation of the PPP initiatives. Among other things, the changes replaced the Partnerships Technical Bureau (PTB) with the Kuwait Authority for Partnership Projects (KAPP). The new body has greater independence and executive powers and should manage PPP initiatives more effectively.

INVESTMENT



Source: Central Statistical Bureau, NBK estimates

BUDGET BALANCE



Source: Ministry of Finance, NBK estimates

KEY PUBLIC-PRIVATE PARTNERSHIP (PPP) PROJECTS

	Sector	Cost KD mn	Status
Al-Zour North IWPP	Power & water	2,500	Awarded
Kuwait Health Assurance Company	Healthcare	250	Awarded
Khairan IWPP	Power & water	510	Tendering
Al-Abdaliyah ISCC	Power	220	Tendering
Umm Al-Hayman WWTP	Wastewater	465	Tendering
Kabd municipal solid waste	Waste	265	Tendering
Egaila service & entertainment center	Mixed	90	Tendering
School development program	Education	20	Tendering
National rail	Transport	2,400	Pre-tendering
Metro	Transport	2,100	Pre-tendering
South Jahra labor city	Housing	70	Pre-tendering
Failaka Island development	Mixed	900	Pre-tendering

Source: Kuwait Authority for Partnership Projects, MEED

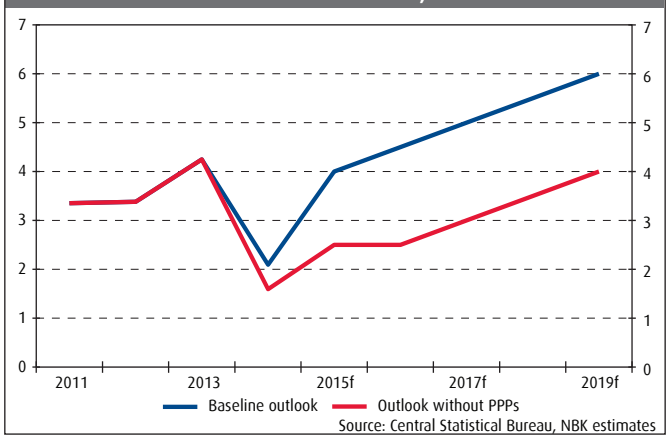
The use of PPPs has been on the rise globally over the last two decades. PPPs have been used extensively in Europe, especially in the United Kingdom, in Canada, as well as many emerging economies. In 2013, the UK had over 600 PPP schemes worth over $100 billion, including hospitals, schools, and roads. PPPs have been popular around the world, particularly in power, water, healthcare, and transportation. In Kuwait, PPPs have typically taken the form of a build-own-operate (BOT) contract.

There are a number of advantages to using PPPs in Kuwait's development initiative. Among them is that PPPs can help reduce the financial burden on the state and limit growth in government spending and the public sector. They can also introduce economic efficiencies and facilitate the adoption of new technologies and know-how, especially when projects attract foreign investors. In Kuwait, PPPs will also help develop the private sector, generate private sector jobs, and deepen financial markets.

One of the main advantages of the PPP framework is that it attracts private funding for projects that would otherwise have been financed with government resources, thus reducing the fiscal burden on the state. In Kuwait's case, the Development Plan requires around a third of the capital spending to come from the private sector. However, for Kuwait, ample fiscal resources including sovereign financial reserves of over three times GDP, means private funding was never the main goal. Still, now that oil prices have declined, Kuwait's government has less fiscal space than it did just a year ago so reducing the burden on public funds will certainly help.

For Kuwait, one of the core advantages of the PPP scheme is that it helps diversify the economy and generate private sector jobs. Indeed, most PPP projects are in areas where private initiative has been limited due to government restrictions. Now, for the first time, the private sector is being encouraged to invest in power & water, new cities and a metro. Also, with PPPs requiring the private sector to take on more risk and a larger role in the operation of the new facilities, these schemes increase the capacity and technological know-how of the sector.
There are a number of other advantages to the PPP structure, including shifting risk to the private sector and reducing overall project cost. A project usually carries a number of risks, including the risk of faulty design, poor implementation, cost overruns, and completion delays. In a PPP scheme, the private sector takes on these risks and is better able to control them and to allocate those risks efficiently.

IMPACT ON NONOIL GROWTH OUTLOOK, %



Source: Central Statistical Bureau, NBK estimates

PPP schemes can also help reduce project implementation and life-cycle costs. Studies have shown that public-private partnership projects can introduce cost savings through the use of innovation in design and construction. But cost savings can extend past implementation, with the private investor having an incentive to control the overall cost of the project over its life-cycle including the cost of maintenance and operation.

Kuwait's PPP program can also benefit domestic financial markets and increase ordinary Kuwaitis' stake in the country's development. The program includes measures such as requiring 50% of PPP ventures to be offered to Kuwaiti nationals in a public offering. This will help deepen the financial system, including both bond and equity markets, and increase Kuwaiti citizens' stake in the success of the development plan.

While there has been some delay in implementing the PPP projects in Kuwait, notable progress has already been made. The first phase of the Al-Zour North IWPP was awarded in 2013 and is already 77% complete. The second phase of the project is expected to be awarded in the coming months. Once complete, the Al-Zour North IWPP is expected to bring the total investment to KD 2.5 billion and increase Kuwait's electric power generation and water desalination capacities by 30% and 80%, respectively. Another PPP initiative that has moved ahead is a company to provide health insurance and healthcare to over a million expatriates. Kuwait Health Assurance Company (KHAC) is still in early operational stages and is committed to building and operating 3 hospitals and 15 clinics.

The Development Plan's focus on public-private partnerships is expected to serve Kuwait well in the coming years, with the initiative helping to boost private sector growth and job creation as well as limit the burden on the public sector. The latter has become more crucial now that oil prices have tumbled and that fiscal deficits are a reality. The projects are likely to improve economic efficiency and to introduce new technologies, especially with the involvement of international companies as strategic partners.

Public Finance

Capital spending picks up despite drop in oil revenues

The interim public finance figures for the first five months of fiscal year 2015/16 (FY15/16) point to a relative slowdown in total government spending five months into the fiscal year. The slowdown was driven by a slight dip in current spending, while capital spending saw a rise. Revenues were down due to the sustained drop in oil prices from a year ago. The government recorded a preliminary surplus of KD 3.1 billion during the period.

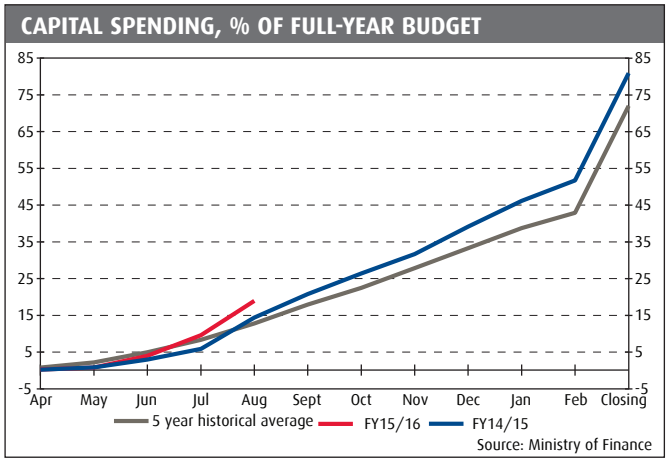
As of August, total government spending stood at KD 4.2 billion fiscal-year-to-date (fytd); this is 6% lower than during the same period last year. However, at 22% of the FY15/16 budget, the spending rate stands slightly above the historic average of 14%, indicating that spending cuts have not yet been fully reflected in the interim figures.

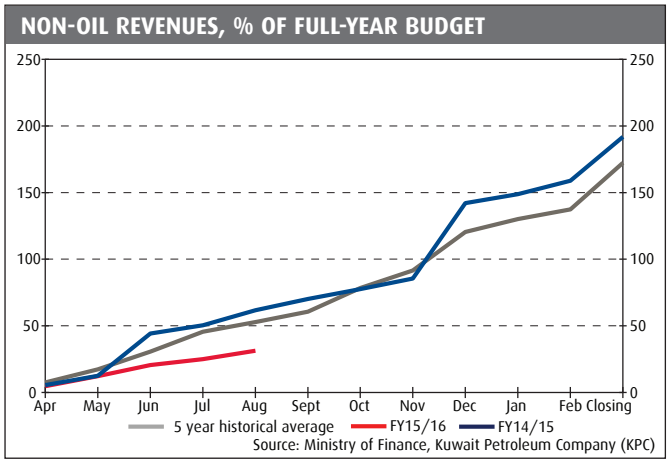
Current spending continues to constitute the bulk of total spending, which came in at KD 3.8 billion fytd. Current spending is driven mainly by the 'miscellaneous expenditures & transfers' segment, which includes military salaries and transfers to the social security fund. Miscellaneous & transfers came at KD 2.2 billion fytd, down 13% year-on-year (y/y); goods & services were at KD 0.2 billion fytd, down by 43% y/y. Wages & salaries stood at KD 1.3 billion fytd, up 8% y/y mostly due to basis effects.

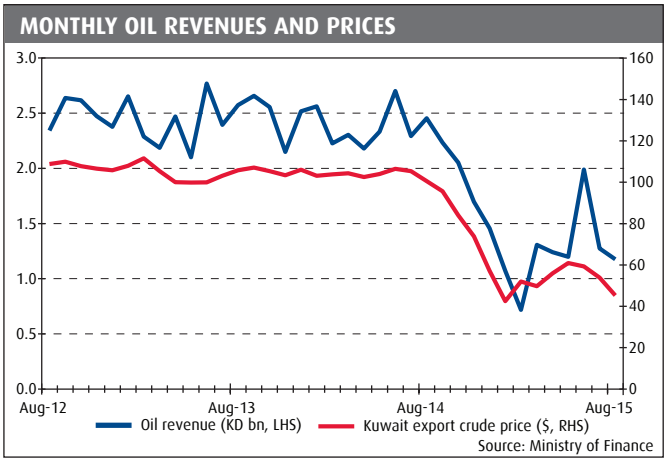
Capital spending was at KD 0.4 billion fytd in August, up an impressive 35% y/y. It currently stands at 19% of the full-year budget, six percentage points above the five-year average. This reflects the government's commitment to its strategic developmental projects. Spending on transportation & equipment reached KD 56 million compared to only KD 8 million for the same period last year. Similarly, spending on projects, maintenance & land purchases, was up a strong 21% y/y.

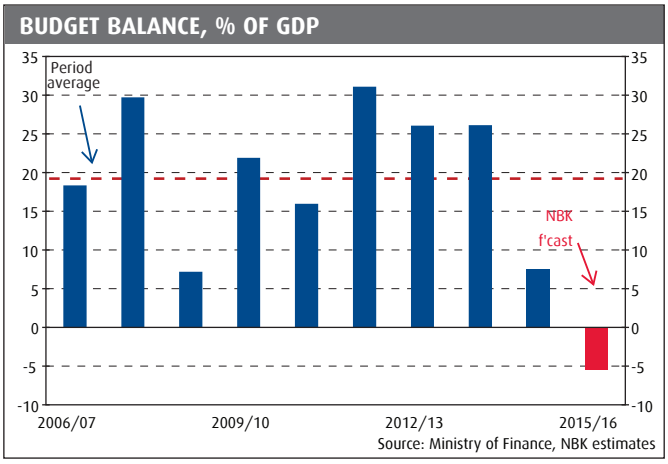
Total government revenues were KD 7.3 billion in the five months to August, down 42% y/y. At 60% of the full-year budget, this is markedly lower than the historic average of 80% for the five month period. Both oil and non-oil revenues witnessed significant declines; recording drops of 42% y/y each, respectively.

Oil revenues were almost cut by half on the backdrop of lower crude oil prices and slightly lower oil production. The Kuwait export crude (KEC) price averaged $45.3 per in August of this year. While oil prices are expected to average slightly higher at $55 per barrel in 2015 and 2016, Kuwait's oil production is at a two-and-a half year low due to a halt in production from two oil fields in the Neutral Zone over an operational dispute with Saudi Arabia.









Similarly, non-oil revenues were down on lower miscellaneous revenues & fees, which make up a bulk of non-oil revenues. Non-oil revenues fytd stand at 31% of the full-year budget, compared to a five-year average of 53%.

The government plans to introduce several reforms that should boost non-oil revenues and reduce reliance on oil resources, though impact on the current fiscal year will be limited. Petrol subsidies reform could be introduced in the coming months, though it will be phased in over several years. Legislation for a 10% corporate income tax could be passed by mid-2016, with implementation not expected before another year. This tax will replace the current tax on foreign companies, as well as the zakat, labor support and KFAS taxes, and it could generate up to KD 1 billion in revenues. Kuwait also plans to introduce a value added tax (VAT) though this awaits a GCC-wide decision.

The interim budget surplus, at KD 3.1 billion, was the smallest in a decade as revenues came in lower than expected and the spending rate remained high compared to the same period last year. The surplus is expected to turn into a deficit of KD 2.1 billion by the end of FY15/16, or 5.5% of GDP. Total government spending is projected to decline by 15% in FY15/16 while revenues are seen declining by 35%.

GOVERNMENT REVENUES AND EXPENDITURES

	Actual (5 months)			5 months: actual to full-year budget	
	FY15/16	FY14/15		FY15/16	Average[1]
	KD bn	KD bn	% y/y	%	%
Revenues	**7.3**	**12.7**	**-42.4**	**60.1**	**80.8**
Oil	6.9	12.0	-42.5	64.0	83.6
Non-oil	0.5	0.8	-41.7	31.3	52.8
Expenditures	**4.2**	**4.5**	**-6.3**	**21.9**	**17.8**
Wages	1.3	1.2	7.6	24.9	20.1
Goods & services	0.2	0.4	-43.0	9.2	14.2
Vehicles & equipment	0.06	0.01	615.4	19.7	4.9
Projects, maint. & land	0.4	0.3	21.2	18.9	14.1
Miscellaneous & transfers	2.2	2.5	-12.7	24.6	19.3
Balance	**3.1**	**8.3**	-	-	-
After RFFG	2.4	5.1	-	-	-
Note:					
Current expenditures[2]	3.8	4.2	-9.7	22.3	17.8
Capital expenditures	0.4	0.3	35.3	19.0	12.8
Oil production (mbpd)	2.89	2.88	0.3	-	-
Oil prices ($/bbl, KEC)	45.3	100.5	-55.0	-	-

Source: Ministry of Finance, NBK estimates

[1] 5-year average for comparable period.

[2] Includes the wages & salaries, goods & services, and miscellaneous & transfers categories.

Real Estate

Sales remain slow though prices are holding up

While sales continue to be slow in the real estate sector, prices seem to be holding up relatively well so far, notwithstanding pockets of softness. For the first eight months of the year, total real estate sales reached KD 2.1 billion, down 23% from the same period last year. Following a strong run in 2010-2014, the low oil price environment and the geopolitical tensions in the region finally dampened real estate market activity. For the month of August, activity slowed across the residential and investment sector year-on-year (y/y) but was relatively stronger in the commercial sector.

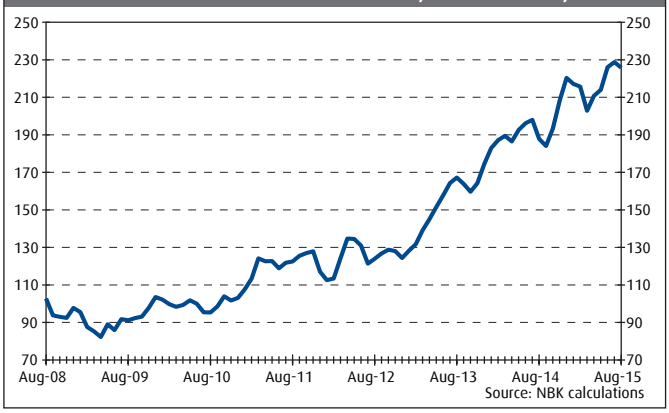
To date, total residential sales in 2015 reached KD 983 million, and were KD 81 million in August. KD volumes and number of units sold year-to-date (ytd) were both down 22% compared to the same period last year. Prices were up slightly for land following a correction in recent months, and about unchanged y/y for homes (see below). Between 2008 and 2014, vacant plots were the properties of choice for buyers. However, we might see a change in trend in 2015, as more residential homes are getting sold than land plots. In terms of square footage, there is a preference for homes ranging between 300-400 square meters (sqm) and plots of 400-500 sqm.

The sustained low oil price environment has taken its toll on the investment sector so far (primarily apartment buildings). There, total sales reached KD 893 million ytd, a 27% decline from the same period last year. There is a visible shift from investment buildings and vacant plots toward investment apartments that are relatively small-ticket purchases but still with a somewhat higher return than the stock market or bank deposits.

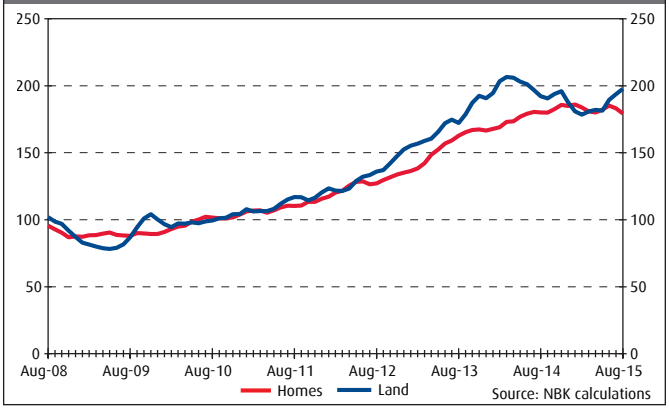
On the other hand, commercial sector sales activity also slowed though less severely. KD sales volumes were down 14% to KD 251 million ytd. In August, the sector recorded eight transactions with the highest being for one complex in Farwaniya and another showroom in Dajij worth KD 5 million each.

Real estate prices have actually weathered the low oil price environment relatively well thus far in 2015. This is also reflected in our newly developed NBK real estate

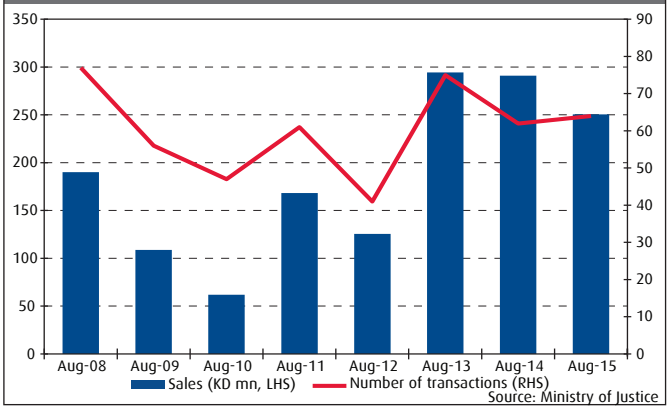
RE INVESTMENT-BUILDING PRICE INDEX, INDEX POINT, 3MMA



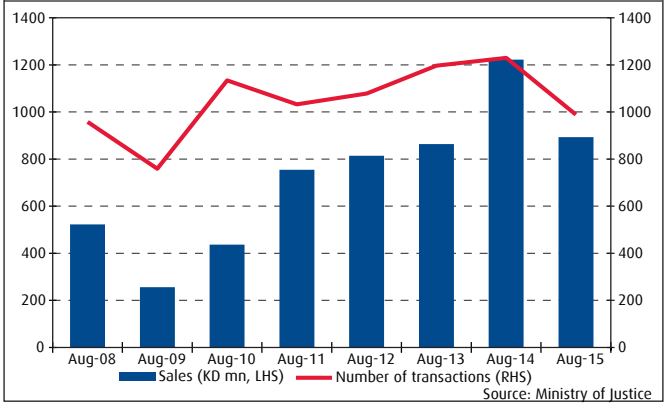
RE RESIDENTIAL PRICE INDICES INDEX POINT, 3MMA



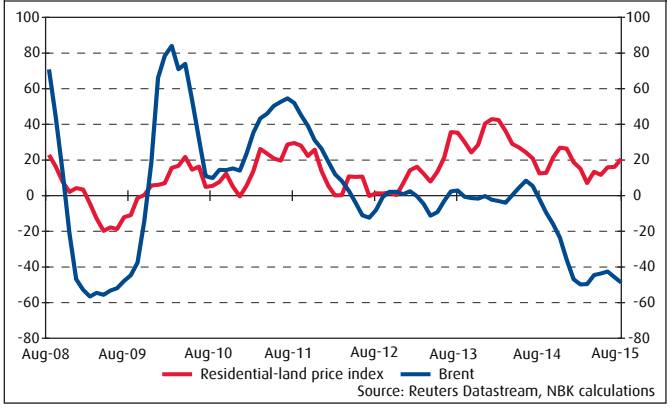
COMMERCIAL REAL ESTATE YTD,



INVESTMENT REAL ESTATE



BRENT VS NBK REAL ESTATE PRICE INDEX, %



price indices. Based on Ministry of Justice data, NBK has constructed three price indices:

- The real estate residential-home index
- The real estate residential-land index
- The real estate investment-building index.

All three indices have exhibited a positive upward trend since 2005, with a downturn along the timing of the 2008 financial crisis. The real estate indices all rallied strongly between 2009 and 2014, with prices almost doubling during the period. Price growth was strongest for residential land and "investment" buildings. The rally was supported by a recovering economy and a sustained period of high oil prices, above $100/bbl. Record low interest rates and a lackluster equity market further directed liquidity to the real estate market. In fact, as soon as oil prices hit the $100/bbl back in 2011, the Kuwaiti real estate sector witnessed double digit growth for two consecutive years.

More recently, real estate price indices appear to have cooled off in Kuwait following the 5-year rally that started in 2009. The frothy market (like in other GCC markets) began showing signs of cooling off towards the second half of 2014, not coincidentally after international oil prices tumbled by over 50%. Prices of residential land were the first to correct around December 2014, somewhat at odds with the conventional wisdom that residential land properties are less volatile than investment properties. Focus was really on properties generating income it would seem.

Residential home prices have cooled off from last year's highs, showing a mild correction thus far in 2015. In August, the NBK residential-home index stood at 176 points, 1.5% lower y/y. The index's annual growth is still oscillating between positive and negative territory, signaling some resistance from prices. On the other hand, the NBK residential-land index went into a correction during the first five months of the year and appears now to be stabilizing.

LAND PRICE/SQM OF SELECTED HIGHLY ACTIVE RESIDENTIAL AREAS

	Price/sqm			% Change	
	Aug-15	Jul-15	Aug-14	1 month	Y/Y
Al Salam	1,030	1,030	1,025	0.0	17.0
Al Shuhada	1,300	1,300	933	0.0	39.4
Al Sadeeq	952	1,091	1,085	-12.8	-12.3
Hatin	957	957	810	0.0	26.5
Abou Fatira	674	677	666	-0.4	2.0
Al Fneitis	836	732	716	14.2	15.6
Al Massila	694	725	627	-4.3	10.8
Al Aquila	856	844	786	1.3	8.4
Subah Al Ahmad	344	343	405	0.4	69.4

Source: Ministry of Justice, NBK Calculations

REAL ESTATE SALES & KCB HOUSING LOANS

	Year average		2015			m/m	y/y
Real estate sales	2013	2014	June	July	Aug	%	%
Sales values (KD mn)	**300.2**	**355.8**	**270.4**	**247.4**	**189.8**	**-23.3**	**-24.2**
Residential	150.5	158.3	120.3	95.3	81.6	-14.4	-26.8
Investment	116.6	151.0	124.0	120.8	82.3	-31.9	-34.1
Commercial	33.1	46.4	26.1	31.2	25.9	-17.0	86.1
Number of transactions	**669.1**	**635.1**	**492**	**388**	**403**	**3.9**	**-34.0**
Residential	515.8	483.6	352	251	245	-2.4	-52.1
Investment	144.9	143.2	134	128	150	17.2	56.3
Commercial	8.4	8.3	6	9	8	-11.1	100.0
Average transaction value (000 KD)	**449.1**	**557.1**	**549.6**	**637.6**	**471.0**	**-26.1**	**15.0**
Residential	293.1	334.0	341.7	379.8	333.2	-12.3	52.7
Investment	804.7	1,084.7	925.4	944.0	548.4	-41.9	-58.4
Commercial	4,379.0	4,936.8	4,352.5	3,468.0	3,239	-6.6	-6.6
KCB housing loans							
Value of approved loans (KD mn)	**32.8**	**25.4**	**18.8**	**13.7**	**21.8**	**59.7**	**-8.5**
New construction	27.6	20.8	14.2	9.9	16.8	68.7	-15.9
Purchase of existing homes	3.6	3.3	3.9	3.6	4.1	12.9	57.9
Additions & renovations	1.6	1.3	0.8	0.1	0.9	825.0	-26.1
Number of approved loans	**562.1**	**423.3**	**342**	**252**	**368**	**46.0**	**-3.7**
New construction	400.5	303.3	208	149	245	64.4	-16.4
Purchase of existing homes	57.8	52.2	51	49	61	24.5	41.9
Additions & renovations	103.8	67.8	83	54	62	14.8	34.8
Value of disbursed loans (KD mn)	**12.2**	**16.9**	**21.0**	**14.5**	**18.0**	**23.4**	**27.2**
New construction	7.8	13.1	16.5	10.9	12.8	17.7	13.3
Purchase of existing homes	2.7	2.5	2.6	2.1	3.8	81.5	53.6
Additions & renovations	1.7	1.2	1.9	1.6	1.3	-14.6	314.7

Source: Ministry of Justice / Kuwait Credit Bank

Note: Our real estate indexes database comprises 62,000 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 indexes are based in 2010, i.e. 2010 price index equals 100. The indexes are not adjusted for seasonality nor for number of business days. They also do not cover the commercial sector.

At one point earlier in the year, the residential-land index was down over 10% on y/y basis; it now seems to be stabilizing as the index logged a 4% y/y increase in August.

Prices in the investment building sector held up better, with growth slowing but remaining in positive territory. NBK's investment-building index stood at 222 points, locking a double digit growth of 22.6% y/y. The elevated prices of investment buildings might be the reason behind investors' change of appetite away from investment buildings and towards investment apartments. Also, though volumes have slowed in the investment sector, prices appear to be holding up well.

Kuwait Stock Exchange

Kuwait up as regional and international markets decline in September

Kuwait's bourse saw a small increase in September, while regional and international markets continued to correct. Internationally, markets continued to be driven by the strong Chinese correction and uncertainty around the Fed's policy. Regionally, declining oil prices and geopolitical developments continued to influence GCC markets. Activity in the local market remained weak. Market liquidity remained lower than historic averages and equities continued to trade well below book value. As a sign of the malaise, several companies made requests to delist from the Kuwait Stock Exchange, though the companies in question were all relatively small and had little impact on market capitalization. Market capitalization was KD 26.6 billion at the end of September, having added almost KD 200 million during the month.

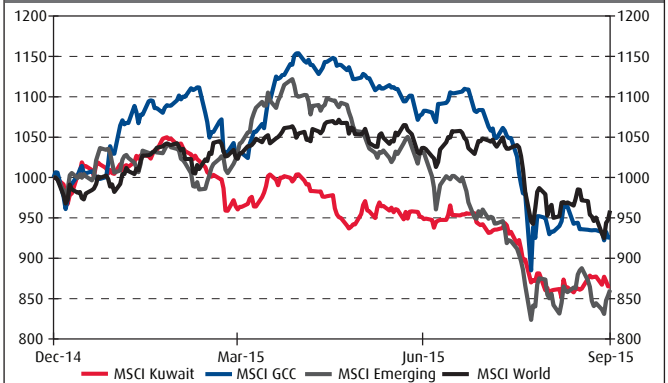
The value-weighted index was up 0.8% in September. Meanwhile, the price index retreated 1.6% and stood at 5726 at the close of the month, indicating a worse performance by small caps. Performance was also mixed across the sectors. Basic materials and consumers goods sectors fared the best with their indices up 6.7% and 5.2%, respectively. On the other hand, oil and gas companies continued to take losses with the sector index retreating 6.2%. Understandably, this sector is more affected by oil prices and hence continues to underperform.

Volumes edged a bit lower in September following a pickup in activity in the previous month. Daily traded value averaged KD 13 million in August, down 4% compared to August. Activity might have weakened in September due to the Eid holiday.

The share of foreign buying increased notably from 10% in August 2015 to 18%. The fact that Kuwait outperformed other GCC and international markets might have attracted some short-term foreign investors to the market. Something similar happened in June 2015.

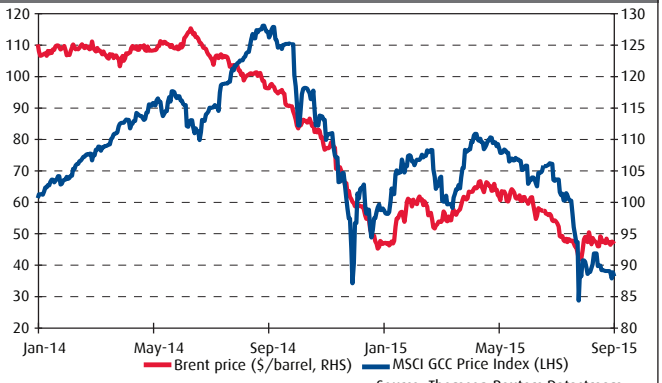
In the absence of any domestic catalyst, the direction of the local market will probably remain dependent on international factors: China, the Fed, regional geopolitics and of course oil prices. Domestically, focus will now be on 3Q15 earnings announcements. On the legislative front, the CMA is in the process of finalizing the amendments to its bylaws, a step generally seen as positive in terms of financial market regulation.

REGIONAL MARKETS (REBASED INDEXES)



Source: Thomson Reuters Datastream

GCC MARKETS & OIL



Source: Thomson Reuters Datastream

KSE PERFORMANCE BY SECTOR, SEPTEMBER 2015

	Price Index	Weighted Index	% Change: Price Index		% Change: Weighted Index		Market Cap. (KD mn)	% of Market	Trading Activity (daily average)		Price to Earnings*
	30-Sept-15	30-Sept-15	m/m	ytd	m/m	ytd	30-Sept-15		mn shares	KD mn	30-Sept-15
KSE	**5726**	**388**	**-1.6**	**-12.4**	**0.8**	**-11.5**	**26,609**	**100.0**	**144.5**	**13.0**	**15.2**
Banks	927	473	2.4	-7.7	1.4	-8.2	13,407	50.4	12.0	3.7	15.5
Basic Materials	1010	538	7.7	-10.7	6.7	-11.5	579	2.2	0.3	0.1	20.5
Consumer Goods	1065	858	-7.8	-13.1	5.2	-13.4	1,309	4.9	1.2	0.5	20.4
Consumer Services	1026	481	-6.3	-5.1	-0.4	-3.2	752	2.8	4.8	2.7	...
Financial Services	649	445	-1.3	-22.0	-1.5	-19.5	2,499	9.4	48.5	0.0	12.7
Healthcare	940	481	-8.6	0.0	-2.7	1.5	181	0.7	0.1	1.3	17.5
Industrials	1066	513	-2.0	-0.4	-3.0	-10.5	2,416	9.1	12.1	0.0	14.0
Insurance	1114	593	1.2	-5.4	0.6	-3.1	347	1.3	0.1	0.2	13.6
Oil & Gas	804	325	-2.2	-24.4	-6.2	-30.8	261	1.0	5.2	2.2	...
Real Estate	925	538	0.0	-18.1	-1.3	-9.5	2,139	8.0	51.2	0.0	12.1
Technology	886	395	2.5	-3.3	1.6	-6.3	53	0.2	0.3	1.7	15.4
Telecommunications	558	306	1.3	-2.1	3.4	-20.4	2,667	10.0	8.6	...	12.7
Parallel	1307	440	-0.4	7.0	-1.0	-11.1	...	...	...	...	...

Source: Kuwait Stock Exchange, Thomson Reuters Datastream

* PE is calculated using market cap as of month close and 12 months trailing earnings.

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