

February 2023



Kuwait Quarterly Economic Brief



**Economic activity solid
but easing in final quarter
of 2022**

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Highlights

- Key economic metrics were solid in 4Q22, though growth in consumer spending and real estate sales moderated.
- The labor market recovered last year with expatriates returning post-Covid; the government plans an increase in Kuwaiti hires.
- Inflation slowed to 3.2% by year-end, moderating on fading pent-up demand, easing supply chain bottlenecks and base effects.
- The FY23/24 draft budget sees consumption-supporting increases in spending, with large allocations to wages and subsidies.
- Bank credit expanded in 2022 at the fastest annual pace (7.7%) since 2015, though growth moderated in 2H22.

Economic metrics were solid in 4Q22, with consumer spending, credit demand and real estate activity in particular holding up well amid intensifying global economic headwinds and tightening financial conditions. However, the breakneck pace of activity registered by some indicators was clearly moderating by 4Q22, due to a combination of fading post-pandemic pent-up demand and base effects. Also slowing was headline inflation, which ended the year at 3.2%, having been as high as 4.7% in April. Oil prices managed to reverse some of their earlier global recession fear-linked declines to post annual gains of more than 10% (Brent) by the end of December.

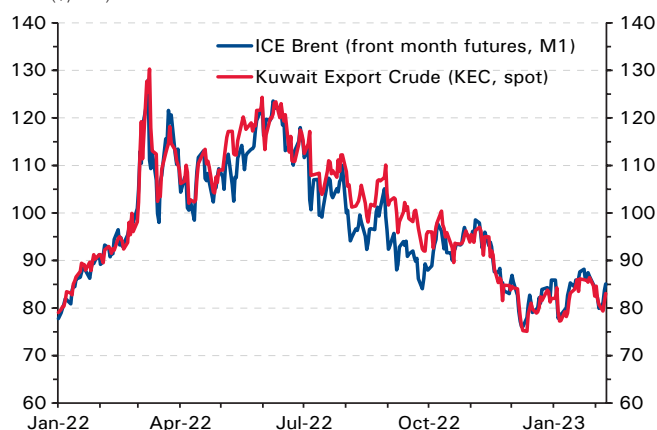
The government has unveiled an expansionary draft budget for the next fiscal year (FY23/24), pushing spending to record levels. We think the proposed fiscal stance will support consumption and economic activity in 2023, albeit doing little to address the issue of medium-term fiscal sustainability.

Oil prices stabilize by end 2022 after recession fears

The price of Kuwait Export Crude (KEC) ended 2022 at \$82/bbl, falling 14.6% q/q but up 3.5% on the year—a second consecutive annual gain following 2021's increase of 56%. (Chart 1.) Global benchmark oil prices had by December's close largely recovered from the previous month's decline (when China's Covid-19 woes and a global recession pushed prices down 10% m/m), buoyed by China's shedding of its Zero-Covid policy, the imposition of EU sanctions and the EU/G7 price cap (set at \$60/bbl) on Russia's seaborne crude shipments. KEC averaged \$101/bbl in 2022, slightly above global benchmarks Brent and WTI. Responding to the softening macroeconomic conditions, OPEC+ announced in October a group-wide production cut of 2 mb/d from November 2022 to end-2023.

▶ Chart 1: Oil prices

(\$/bbl)



Source: Refinitiv, KPC

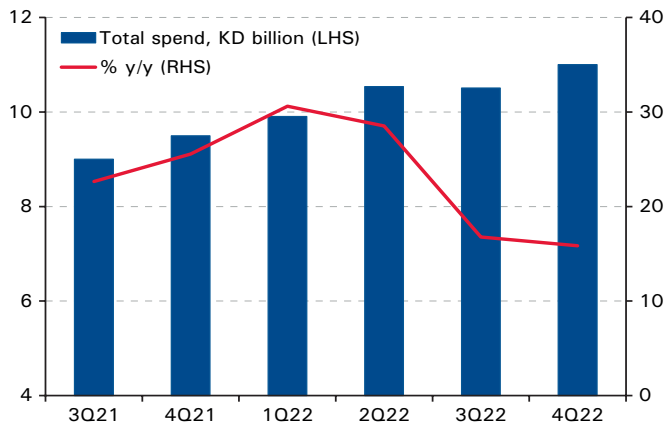
For Kuwait, this translated into a cut of 135 kb/d from August's reference level, bringing output down to 2.68 mb/d—a level that Kuwait was in full compliance with by December. Output is expected to remain at this level throughout 2023 unless market tightness pushes the group to raise production. We see oil prices rising from current levels of around \$83/bbl to an average of \$90/bbl in 2023 on tightening oil market fundamentals. Oil demand is expected to outstrip supply due to a combination of rebounding Chinese consumption, lower Russian production due to the crude and refined products embargoes—Russia just announced a 500 kb/d cut in output—and continued OPEC+ supply management.

Strong but easing consumer activity

Measured by card transactions, consumer spending was solid in 4Q22, up 16% y/y (+4.7% q/q), providing a solid boost to non-oil activity during the quarter on the back of expansive government fiscal support amid elevated high oil prices. (Chart 2.) However, growth continued to slow from the 17% y/y

recorded in the previous quarter (and the peak of 31% posted in 1Q22), as the pronounced, post-pandemic boost in pent-up demand, employment gains, wage growth and consumer sentiment normalized. Higher loan costs, as global and local interest rates rise, may also have been a consideration for potential borrowers. Total spending in 2022 rose by 22% y/y. This year should see spending growth continue on its easing trajectory. The recently announced expansionary government budget could support spending, though.

Chart 2: Consumer spending (cards data)



Source: Central Bank of Kuwait (CBK)

Employment recovers as expats reverse declining trend

The labor market appears to be recovering after the Covid-19 shock, with both population and employment rising again. Data provided by Kuwait's Central Statistical Bureau (CSB) and Labor Market Information System (LMIS) show overall employment (excluding domestic workers) rising 3.8% y/y in 3Q22 on the back of returning expatriate workers, though sustaining this rate may require increased traction in project activity. (Table 1.) Meanwhile, Kuwaiti employment levels rose 3.4% y/y to 439K in 3Q22, driven largely by public sector hires. 2023 is likely to see further increases, with the MoF's FY23/24 draft budget penciling in spending on 21K new jobs for Kuwaitis.

Table 1: Employment ex. domestic workers

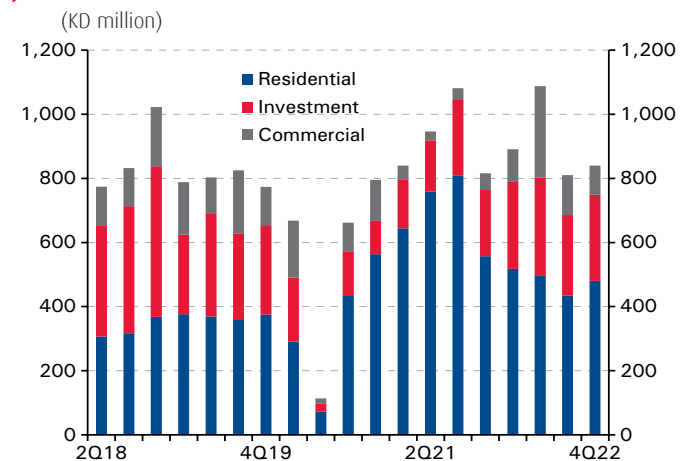
	Employment ('000)			% y/y		
	Kuwaiti	Non-Kuwaiti	Total	Kuwaiti	Non-Kuwaiti	Total
3Q21	424	1,480	1,904	5.8	-9.5	-6.5
4Q21	430	1,452	1,882	5.8	-8.5	-5.6
1Q22	435	1,450	1,885	5.7	-5.6	-3.2
2Q22	439	1,477	1,916	4.5	-2.2	-0.7
3Q22	439	1,538	1,977	3.4	4.0	3.8

Source: LMIS/ CSB

Real estate sales inched up in 4Q22

Real estate transaction levels were slightly improved in 4Q22, rising to KD840mn (+3.7% q/q; +2.9% y/y), supported by a quarterly uptick in residential (+10.6% q/q) and investment sales (+6.8% q/q). (Chart 3.)

Chart 3: Real estate sales



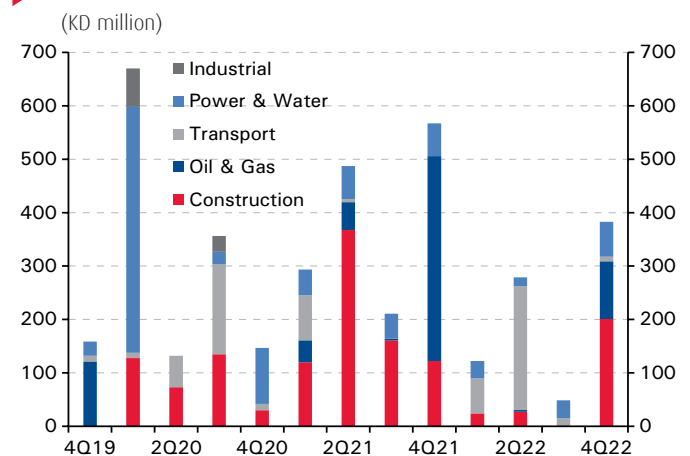
Source: Ministry of Justice (MOJ)

In contrast, commercial property sales fell in 4Q22, though gained substantially over 4Q21 (+74%) amid an improvement in the business environment. For 2022 as a whole, real estate sales fell by a modest 1.5% to KD3.6bn. This was largely a reflection of the marked decline in residential sales (-30% to KD1.9bn) after an exceptional 2021. The outlook for 2023 should be good, though with borrowing getting costlier and property values high, especially residential, there is an element of downside risk to activity. On the plus side, we do see business conditions and the expatriate rental market—a key driver of the commercial and investment segments—continuing to normalize.

Project awards tick up in the last quarter

Project activity picked up in 4Q22 after a weak Q3, with the value of awarded contracts rising more than 6-fold to KD383mn thanks to oil sector projects. (Chart 4.) Nevertheless, the year-total came in at KD832 (-47% y/y), the lowest figure since 2005.

Chart 4: Project awards



Source: MEED Projects

This is likely a reflection of legislative delays, higher procurement costs for raw materials and continued labor shortages post-Covid. The outlook for project awards in 2023, according to MEED Projects, is on paper better at KD4.2bn, with tenders expected for the Kuwait Authority for Partnership

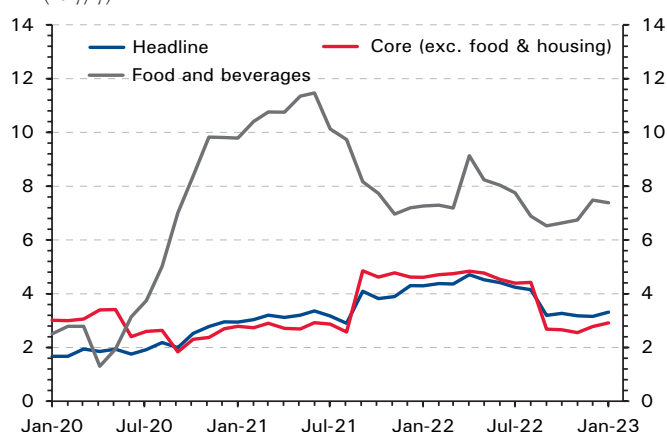
Projects' (KAPP) Al-Zour IWPP project (KD1.2bn) and KOC's North and South revegetation project (KD1.0bn). However, the government's resignation is likely to delay project approvals.

Inflation broadly steady in Q4

Consumer price inflation was largely steady in 4Q22, with December's figure of 3.2% y/y unchanged from the rate at the end of September. (Chart 5.) Price pressures in the food and beverages category appear to be intensifying once more. Prices here rose 7.5% y/y in December from 6.5% in September, driven by increases in fish & seafood prices (+25% y/y). Meanwhile however, housing inflation (mainly rents) eased to 1.4% in December from 2.2% at end-3Q22. Core inflation (which excludes food and housing) ticked up to 2.8% in December (2.7% in September) on price increases in the restaurants & hotels and miscellaneous subcomponents (including personal care services and jewelry). For 2022 as a whole, inflation averaged 4%, up from 3.4% in 2021 on pent-up demand, high international food prices and global supply-chain bottlenecks. Local price pressures were also in play, notably in the education category (+12% y/y). Inflation is forecast to slow to 2.8% in 2023, though judging by just-released CPI figures for January, which showed the headline rate increasing fractionally to 3.3% y/y, inflation could prove stickier than earlier anticipated. Nevertheless, the trajectory is likely to be downward amid easing supply bottlenecks, a softer macroeconomic backdrop and further, albeit at a slower pace, monetary tightening.

Chart 5: Consumer price inflation

(% y/y)



Source: CSB / Haver

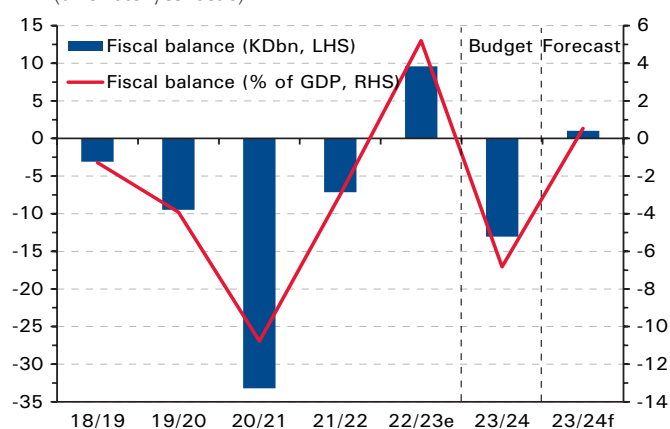
FY23/24 budget draft sees record spending

The government released its preliminary draft budget for FY23/24. A second consecutive fiscal deficit, at KD6.8bn (13% of GDP), is projected on expenditures of KD26.3bn (+11.7% budget-on-budget, b/b) and revenues of KD19.5bn (-16.9% b/b). (Chart 6.) The revenue estimate is based on an assumed oil price of \$70/bbl and crude oil production of 2.68 mb/d, down from \$80/bbl and 2.73 mb/d, respectively, in the previous budget. On the expenditure side, it should be noted that a large

portion of the increase relates to the one-off settlement of previous years' arrears for electricity and domestic fuel subsidies (KD1.5 bn). The remaining outlays include higher provisions for wages and social security (KD1.0bn on leave compensation and student allowances), while the government sees capex declining to KD2.5bn (-15.2% b/b). In its budget presentation, the government included for the first time a below the line revenue item entitled "earnings generated by government-owned independent entities" totaling KD1.8bn. This inclusion brings the deficit down to KD5.1bn. Stripping out the new items on both the revenue and expenditure sides would see the deficit widen to KD5.3bn, a still large increase on the KD123mn deficit projected for the current fiscal year (FY22/23).

Chart 6: Fiscal balance

(on a fiscal year basis)



Source: Ministry of Finance, NBK estimates

We do think, however, that the government could end up posting a small surplus, possibly around KD600mn (1.2% of GDP), given our view that realized oil prices and thus oil revenues will be higher than budgeted (\$90/bbl versus \$70/bbl) and given the government's history of not spending its entire budget allocation (90-95% of budget).

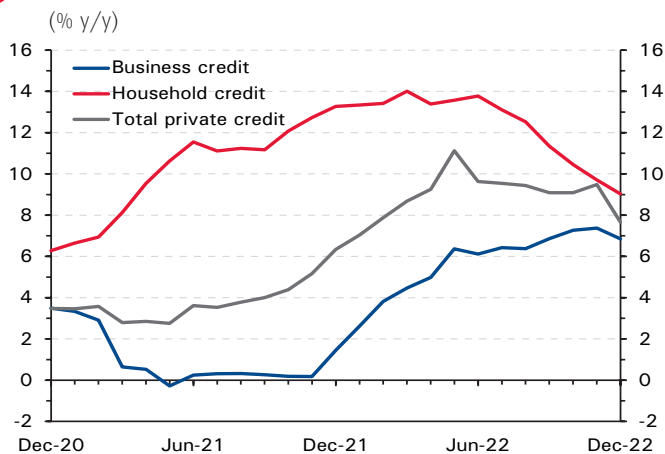
While the projected rise in government spending will support demand in the economy in the near term, it also adds to longer-term fiscal sustainability pressures, especially in the context of continued over-reliance on volatile oil revenues (88% of total revenues), limited non-oil revenue streams, a lower capex target and slow reform progress due to legislative gridlock. Given the current political impasse, it may also be some months before the budget is approved by parliament, potentially pushing the boost to the economy from higher spending until later in the year.

Credit growth in 2022 posts fastest increase since 2015

Despite slowing towards the end of the year, domestic credit growth clocked in at 7.7% y/y in 2022, the fastest yearly increase since 2015. Business credit growth softened to 6.8% from 7.3% at the start of the quarter, but this is still the highest annual increase since 2013. Three sectors: real estate, construction, and 'other services' accounted for nearly 90% of

the increase in business credit in 2022. Meanwhile, household credit growth slowed for the second straight quarter in 4Q22, finishing the year at a still-strong 9.1% (+1.5% q/q), but down from its record high of 13.1% in 2021. Going into 2023, we expect credit growth to continue moderating but remain robust at 5-6%. While tighter monetary policy may become a consideration for borrowers, we think that credit demand will remain relatively resilient.

Chart 7: Bank credit



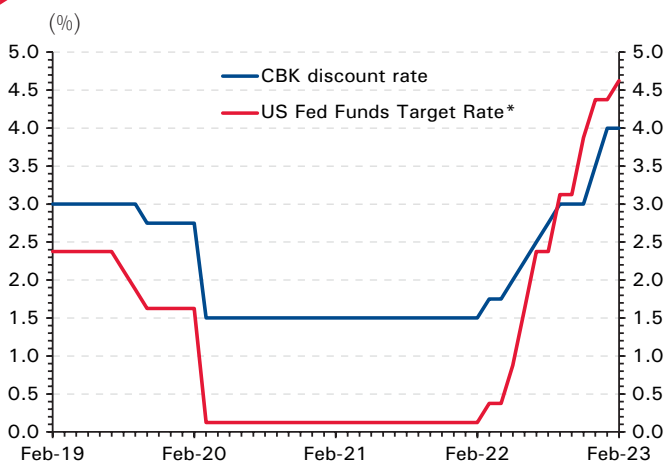
Source: Central Bank of Kuwait

Domestic deposits, meanwhile, were weak in 4Q22 for the second straight quarter, finishing the year up 5.3% y/y. Private sector and government (excluding public institutions) deposits rose 6.6% and 18.2%, respectively, in 2022. Private local currency current and savings account (CASA) deposits dropped 4.3% in 2022, while time deposits soared by 19%.

CBK trails US Fed, raises discount rate by 50 bps in 4Q22

With the quarter coming to a close, the Central Bank of Kuwait (CBK) raised its key discount rate by 50 bps to 3.5% (and by a further 50 bps to 4.0% in January 2023), capping a year of largely gradual rate rises since the US Fed embarked on its current rate tightening cycle in March 2022. (Chart 8.)

Chart 8: Benchmark interest rates



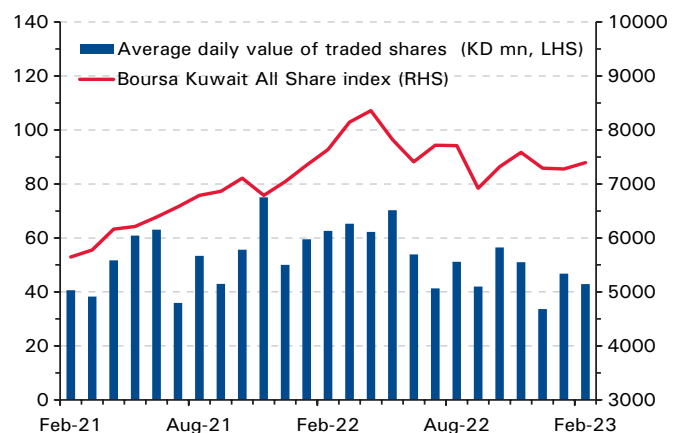
Source: CBK, Haver; *average of upper and lower limit at end of period

The cumulative increase in the discount rate in 2022 reached 200 bps (+250 bps to date), trailing the US Fed's 425 bps increase in 2022 (+450 bps to date). The last two rate rises by the CBK have been in larger 50 bps steps, resulting in a policy rate more closely aligned with the US Fed Funds target rate. Further Fed rate hikes of perhaps 75 bps in total are anticipated in 1H23, implying the prospect of further moves by the CBK as well; recent larger hikes could imply that the CBK will track Fed moves more closely than in 2022. Given mixed but overall resilient signs from the US economy and still-high US inflation, we think Fed rate cuts are more likely to be seen in 2H23.

Modest gains for KSE stocks in 2022 amid global uncertainty

Kuwait's All-Share Index rose 5.3% q/q to finish the year up 3.5%, tracking global markets higher in 4Q22 on easing inflation and rate-hike concerns and despite continued worries about global economic growth. (Chart 9.) The sectoral performance was mixed, with gains led by the technology (18%), oil and gas (9.6%) and consumer services (7.5%) sectors. Market capitalization by December's close was KD47bn, just off November's record high of KD49bn, despite lower liquidity. Turnover by value in 4Q22 was KD3.2bn, down from 1H22's quarterly average of KD4.2bn, with the thinner trading volumes likely a reflection of weaker sentiment against an uncertain economic backdrop. For the year ahead, local equities will continue to be influenced by international market developments, including oil prices, economic growth, inflation and Fed policy.

Chart 9: Kuwait All-Share Index*



Source: Refinitiv; * Final data point is as of 8 February

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