

Macroeconomic outlook

Kuwait: growth accelerating, driven by pick up in project execution

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Overview and outlook

- Non-oil growth is accelerating as capital spending on projects improves; non-oil growth is expected at 5-6% in 2015 and 2016.
- Government development projects are critical for Kuwait's improved outlook and are seen gaining momentum, and delays reduced.
- Kuwait's fiscal position remains healthy; surplus is seen narrowing on rapid government spending growth and lower oil prices.
- Inflation expected to remain under control, supported by the recent strengthening of the dinar and limited global inflation.

While Kuwait's economic growth had not kept pace with its GCC neighbors in recent years, we believe this has changed. Non-oil growth finally reached the regional average in 2013 and we think that it will maintain that pace through 2014 and 2015. After a long delay, the government's development plan, including ambitious capital spending targets, has begun to boost activity significantly, though not to the level envisioned. Nonetheless, non-oil economic growth has benefited from the boost to investment and is expected to continue to do so in the medium term.

The consumer sector remains a strong driver of economic growth, though it has moderated since 2013. While large pay hikes for Kuwaitis are not expected in the near term, household income growth will remain healthy supported by robust employment growth. The sector will also benefit from expectations of stronger private sector hiring and pay in the coming period, benefiting both Kuwaitis and skilled expatriates.

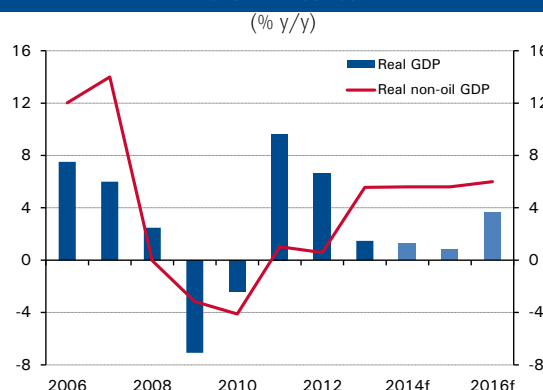
Risks for Kuwait remain subdued in the near term, with Kuwait's fiscal position allowing it to navigate the recent decline in oil prices relatively well. The sovereign wealth fund and others are estimated to hold over \$500 billion, or 310% of GDP. In the medium to long term, the challenges are more serious, as government spending growth threatens to reduce the state's fiscal space. However, the government is already looking at measures to boost non-oil revenues and limit spending growth in the coming years.

Table 1: Key economic indicators

		2013	2014e	2015f	2016f
Nominal GDP	KD bn	49.9	49.8	47.6	49.5
Nominal GDP	USD bn	176	174	164	171
Real GDP growth	% y/y	1.5	1.3	0.8	3.6
Oil	% y/y	-0.8	-1.3	-2.3	2.0
Non-oil	% y/y	5.6	5.6	5.8	6.0
Inflation	% y/y	2.7	3.0	3.5	3.5
Budget balance	% of GDP	25.9	17.0	11.0	8.0

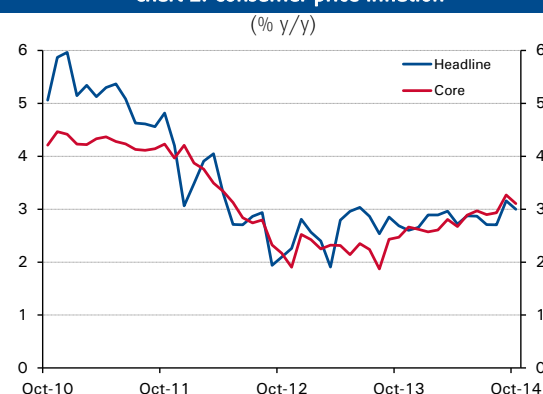
Source: Central Bank of Kuwait, Ministry of Finance, Central Statistical Bureau, NBK estimates

Chart 1: Real GDP



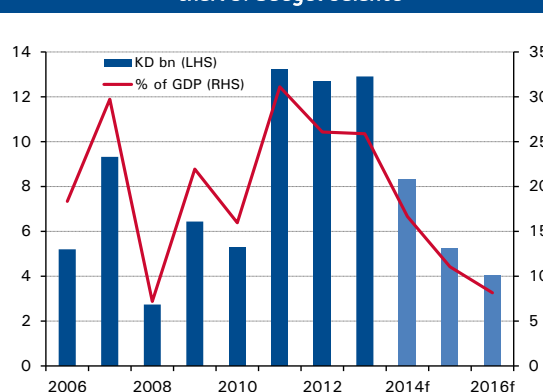
Source: Central Statistical Bureau, NBK estimates

Chart 2: Consumer price inflation



Source: Central Statistical Bureau

Chart 3: Budget balance



Source: Ministry of Finance, NBK estimates

Kuwait's non-oil growth finally closes gap with GCC

Real non-oil growth accelerated notably in 2013 and is expected to maintain a more robust pace in the coming period. The improved growth is driven by capital spending and the government's ambitious development plan. The latest official figures show non-oil real growth accelerating to 5.6% in 2013, compared to a meek 0.6% growth the year before. Growth is seen remaining around 5-6% in 2014 and in the coming two years, as implementation of the government's development projects maintains its robust pace.

Other indicators have also reflected the pick-up in economic activity and the accelerating pace of growth. Private credit growth has been picking up gradually, reaching 7.7% y/y in September 2014. If the recent write-off of Family Fund loans by banks is taken into account, adjusted credit growth is estimated to have reached 9% y/y.

Total real GDP growth was more modest, at 1.5% in 2013, as a result of a small decline in oil sector output. Oil production declined by 0.8% following two years of strong double-digit growth in output triggered by the loss of oil supplies from some OPEC producers, including Libya and Iran. We expect oil production levels to decline further in 2014 and 2015. Output will return to modest growth in 2016.

Domestic demand growth maintains healthy pace

Growth in domestic demand slowed somewhat in 2013 following strong growth the year before. Domestic demand rose by 5.7% in real terms in 2013, following 9% growth in 2012. Most of the moderation came from slower growth in private consumption. Government current spending growth also slowed but maintained a rapid pace of 10%.

Investment spending picks up as project implementation improves

Meanwhile, momentum in investment is rising, both from government and private sources. Total investment spending in Kuwait grew by 6.2% in real terms in 2013 (nominal growth topped 10%).

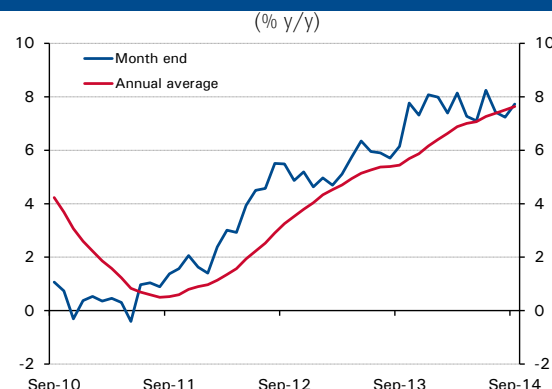
Implementation of the government's development plan has been picking up, and momentum is expected to improve further in 2015 and 2016. The government recently presented its second five-year plan to cover the period from FY15/16 through FY19/20. National Assembly approval is expected early in 2015.

The plan targets investment of KD 11.8 billion a year over the five year period. Even a more realistic execution at around 80-85% of the target will have a positive impact on growth. The plan projects non-oil growth of around 10% y/y, though growth is more likely to average around 6-8% instead.

Some of the important projects that have recently been awarded include KNPC's clean fuels project and the first phase of the Al-Zour North IWPP. The clean fuels project, to cost KD 4.6 billion, was awarded in 1Q14 and should boost Kuwait's oil refining capacity by 2018. The Al-Zour North IWPP, the first private investment in the country's power and water sector in recent history, was also awarded early in 2014 and promises to kick start the "public-private partnership" (PPP) model that the government plans to use extensively in upcoming projects.

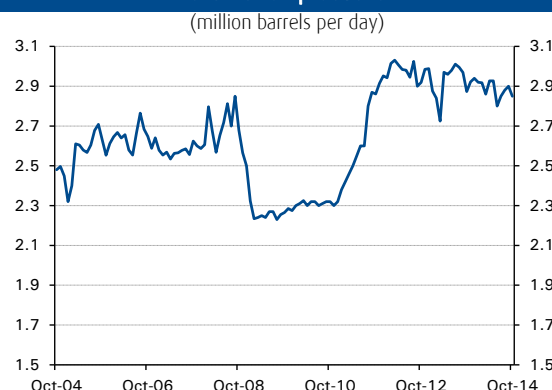
Investment levels in Kuwait have been at historic lows in recent years when compared to GDP. Total investment averaged 13.5% of GDP between 2011 and 2013. As a result of the development plan's improving implementation, this ratio is expected to rise to 18% in the next five years. While this will bring it closer to the GCC average, Kuwait

Chart 4: Private credit



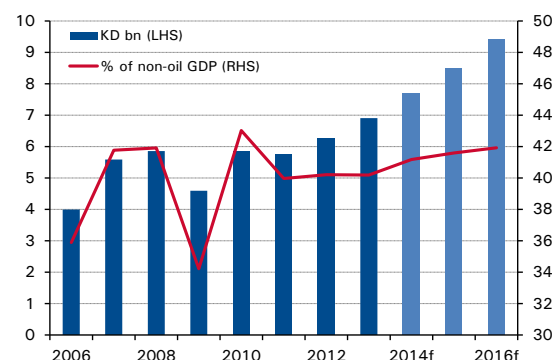
Source: Central Bank of Kuwait

Chart 5: Oil production



Source: JODI

Chart 6: Investment



Source: Central Statistical Bureau, NBK estimates

will still trail other countries in the region.

Consumers remain a robust driver of growth

The consumer has been and remains a key driver of growth in Kuwait, even as growth in the sector has moderated somewhat. Household income growth has remained robust, supported by steady hiring. Income growth has averaged around 5-6%. Household borrowing has also maintained a healthy double-digit rate of growth as has consumers' card spending.

As a result of robust consumer demand, several sectors that depend on consumer spending have done very well. The trade sector grew by 11% in 2013 while the hotels and restaurants sector has expanded by 6% in real terms. Communication was another sector that has maintained a healthy pace thanks to strong demand from consumers, with growth in the sector at 8.5%.

Strong real estate sector

Real estate sales maintained healthy growth in 2014, driven particularly by a strong investment sector. Total real estate sales for the 12 months ending in October 2014 were up by 19% y/y to a monthly average of KD 351 million. The investment sector has seen growth in excess of 50% while residential sales have been mostly flat. The commercial sector, which tends to be quite volatile, has seen growth ease in 2014 following a very strong year in 2013, but has maintained robust sales activity.

Kuwait continues to enjoy a strong fiscal position

Kuwait has maintained a budget surplus throughout the last 15 fiscal years, with an average surplus of 21% of GDP. The latest fiscal year (FY13/14) ending in March 2014 achieved a surplus of 26% of GDP. This has happened despite healthy spending growth that topped 11% over the last 14 years.

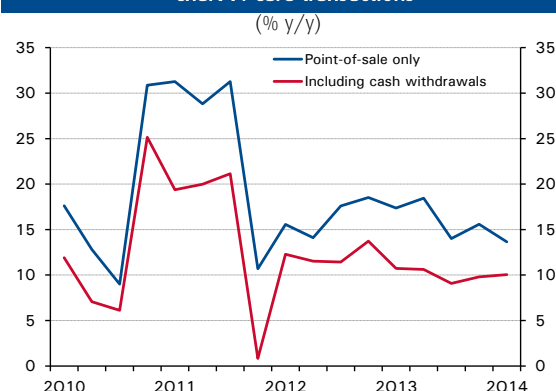
Oil prices at historic highs and rising oil production since 2011 have helped produce the large surpluses in recent years. That is likely to change as oil prices retreat. The average price of oil has already fallen by 18% from the average for FY13/14. Oil production is also expected to decline slightly. As a result, the fiscal surplus is likely to shrink to 17% in FY14/15 and further to 11% in FY15/16. However, the fiscal outlook will depend on whether or not OPEC agrees to reduce oil output to support oil prices in the coming months.

While the retreat in oil prices has not pushed the government budget into deficit, the cabinet is already looking at ways to limit spending growth in FY15/16. The initial spending proposal for FY15/16 is 5.6% lower than the prior year's budget at KD 21.9 billion. The government has also proposed a number of subsidy cuts that could save the budget around KD 1 billion if they are fully implemented.

The cabinet is proposing to cut spending by as much as 15% at various ministries, with a focus on cuts in subsidies, reductions in expat hiring and a freeze on general pay raises. Importantly, the cabinet has reiterated its commitment to leave capital spending plans untouched, which should ensure that the medium term growth outlook is unaffected.

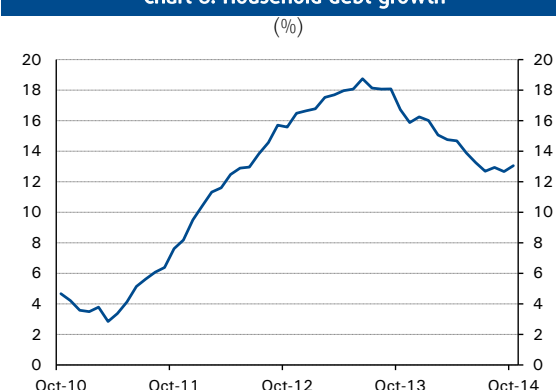
Kuwait's fiscal position is bolstered by substantial public sector wealth. It maintains a sovereign wealth fund estimated at KD 154 billion, or 310% of GDP. This, in addition to the country's relatively comfortable fiscal outlook, have helped Kuwait maintain a sovereign rating just two notches below AAA, with Moody's giving it a Aa2, and S&P and Fitch rating it AA.

Chart 7: Card transactions



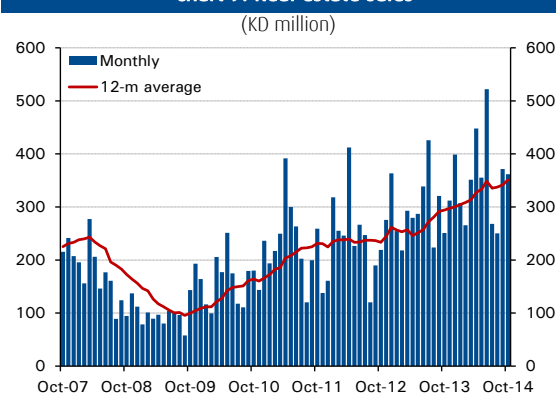
Source: Central Bank of Kuwait

Chart 8: Household debt growth



Source: Central Bank of Kuwait

Chart 9: Real estate sales



Source: Ministry of Justice

Inflation to remain under control

Inflation in consumer prices has remained subdued at around 3.0% y/y in October 2014. Core inflation was slightly higher at 3.1% y/y. Inflation has generally remained under control thanks to low inflation internationally and easing domestic pressures, especially in residential rents. Inflation is expected to remain around current levels in the coming period.

A stronger dinar to have positive impact

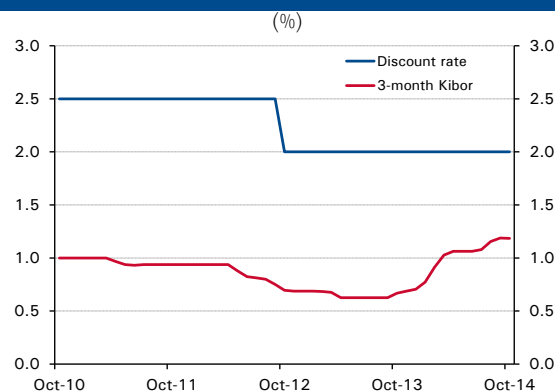
The Kuwaiti dinar (KD) has strengthened somewhat over the last few months, in large part due to the stronger dollar. The dinar, which is pegged to a basket of major currencies, has declined against the USD since June 2014 but has moved up against all other major currencies. As of October 2014, JP Morgan's KD index had increased by around 3.1% since May.

A stronger dinar will help keep inflation low. A 1% increase in the KD's value, if sustained over time, could result in a 0.25-0.5 percentage point decline in the inflation rate. The impact of a stronger dinar on the trade surplus and government revenues is also expected to be positive. A 1% decline in the USD/KWD rate is expected to add around KD 250 million to state revenues, or 0.5% of GDP.

Stock market underperforms

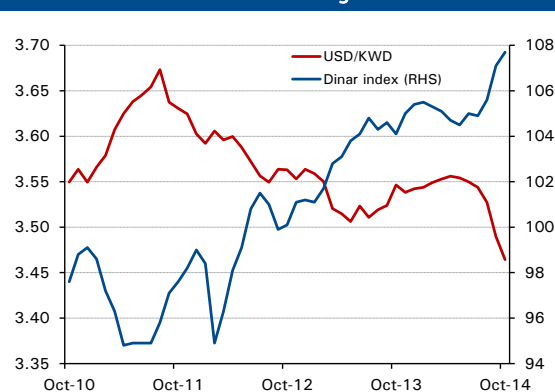
Kuwait's equities have generally underperformed the regional indices. By the end of November, the Kuwait Stock Exchange's value-weighted index (IXW) had only risen by 0.4% since the start of 2014, compared to a 6.7% increase in the S&P GCC index and to a 12% gain in the S&P 500. The market had done better during the first nine months of the year, with IXW gaining around 10% through the beginning of October 2014. Since then, the market has seen a consistent slide.

Chart 10: Interest rates



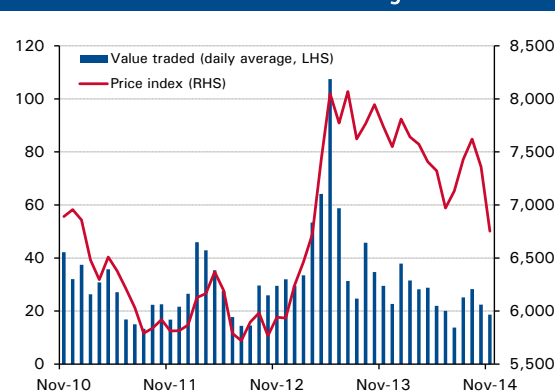
Source: Central Bank of Kuwait

Chart 11: Exchange rate



Source: Thomson Reuters Datastream

Chart 12: Stock exchange



Source: Kuwait Stock Exchange, Thomson Reuters Datastream

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