KUWAIT MACROECONOMIC REPORT

Dec 2023 – Kuwait Chamber of Commerce and Industry – Economic Research Department

- After revised data showed better-than-expected resilience during the COVID-19 pandemic, Kuwait's overall economy is set to slow down in 2023 and 2024 due to oil production cuts and mixed performance in non-oil activities before picking up in 2025.
- Kuwait is expected to return to a deficit from 2023 onwards due to one-off spending, declining oil prices, and increased expenditures. The current account balance will remain in surplus in 2023 but will gradually decline with the expected weakness in oil prices and robust demand for imports and travel services. Meanwhile, inflation gradually declined in 2023 and is expected to continue as local factors impeding the passthrough of lower global prices dissipate.
- The medium-term economic outlook of Kuwait is susceptible to downside risks, particularly given the expected weakness in oil prices. International credit and rating institutions have highlighted political stability as a crucial challenge for economic growth in Kuwait.

REAL ECONOMY

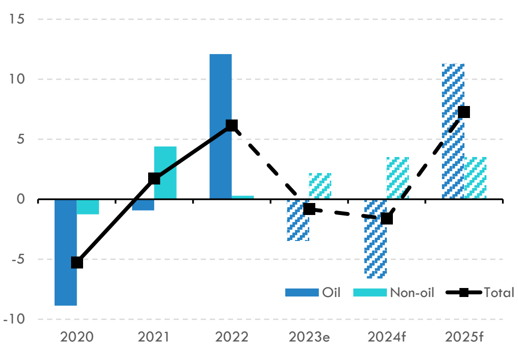

CHART 1: REAL GDP (%Y/Y)
Sources: CSB, KCCI estimates

After showing better-than-expected resilience during the Covid-19 pandemic, Kuwait's overall economy is set to slow down in 2023 and 2024, due to oil production cuts and mixed performance in non-oil activities, before picking up in 2025. The country is expected to contract by 0.8% in 2023 and 1.6% in 2024. An expected return to regular oil production levels and homogenous non-oil growth could see the country expand by 7.3% in 2025.

New official and revised data, which covers up to the second quarter of 2023, shows a more resilient non-oil sector throughout the pandemic years (2020 and 2021) but also weakening growth in the following years. The non-oil sector contracted less than expected in 2020 (-1.2% actual vs. -8% expected), thus softening 2021's rebound (+4.4% actual vs. +7.2% expected).

On the other hand, 2022's non-oil GDP was underwhelming, showing little to no growth, implying that Kuwait's rebound was mixed and short-lived for some sectors. Weakness in manufacturing and utilities had offset growth in most other sectors. Non-oil growth in 2022 was 0.3%, coming in much lower than earlier expectations of 4%. Strong growth in sectors such as construction (+17.4% y/y) and transport (+20.6% y/y) was offset by noticeable weakness in major sectors such as manufacturing (-11.3% y/y) and utilities (-19.0% y/y). (Transport includes output from logistics, shipping services, and air travel.)

The non-oil sector is expected to slightly improve by 2.0% in 2023 as construction, transport, and financial services output strength benefited from reduced contractions in core non-oil sectors. As of the first half of 2023, non-oil GDP rose 2.4% y/y compared to the same half in 2022, signaling an upturn. The construction and transport sectors (+1.7% and +3.5%, respectively) continue to lead growth and are supported by a healthy pick-up in financial services (+2.9%). Meanwhile, core non-oil sectors such as manufacturing, utilities, and public admin and defense displayed smaller declines (-2.9%, -2.5%, and -1.5%, respectively). The non-oil sector, expected to expand by 3.5% per year in 2024 and 2025, will likely continue to be supported by construction, transport, and financial activities, while core sectors such as manufacturing and public admin stabilize at lower levels**.**

Hydrocarbon output is still expected to contract by 3.4% in 2023 and will further contract by 6.6% in 2024, following additional cuts by OPEC (Chart 1). The November announcement will see Kuwait cut its reduced output by another 135,000 barrels per day until the end of 2024. Production is expected to return to normal levels in 2025.

Fiscal Balance

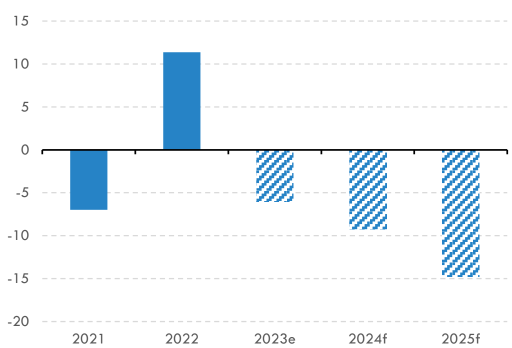

CHART 2: FISCAL BALANCE (% OF GDP)
Sources: Ministry of Finance, KCCI estimates

According to July 2023's closing accounts, Kuwait registered a fiscal surplus of 11.5 % of GDP in fiscal year (FY) 22/23, its first since 13/14. (Chart 2.) Higher oil prices were behind the net increase while current expenditures expanded.

Due to large one-off spending, sticky current spending, declining oil prices, and reduced oil production, the government is expected to return to a deficit from 23/24 onwards. (Chart 2.) According to the 23/24 budget, expenditures are expected to increase by 11.7% that year due to "extraordinary" non-recurring payments in salaries and subsidies. Going forward, subdued oil income and structurally high expenditures will keep the balance in deficit in 24/25 and 25/26. Kuwait export crude (KEC) oil prices are expected to retreat to $75 per barrel in fiscal year 24/25 and $61.5 in fiscal year 25/26.

Current Account Balance

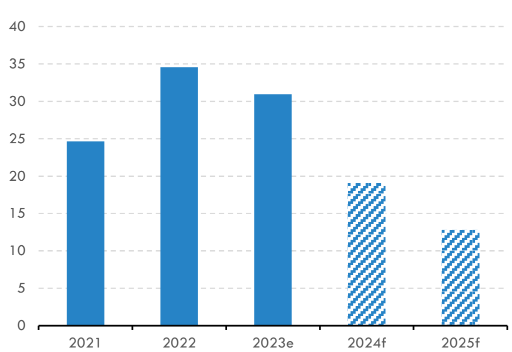

CHART 3: CURRENT ACCOUNT BALANCE (% OF GDP)
Sources: Central Bank of Kuwait, KCCI estimates

Lower oil exports, higher imports, and increased travel services outflows are expected to lead to a decline in 2023's current account balance, dropping it to 15.2 billion (30.9% of GDP) after registering its largest surplus in 2022. The price of KEC averaged $84.3 per barrel in 2023, down 16.9% from 2022. That and higher imports from improved economic activity may shrink the trade balance to KD 16.6 billion (33.8% of GDP). On the other hand, service outflows are expected to pick up as travel and transportation activity remains strong.

The current account balance is expected to remain in surplus in 2024 and 2025, 19% and 12.8 % of GDP, respectively. Although lower, oil prices will still offset expected import growth following healthy local consumption, supporting the trade balance. Greater expected service outflows from travel and transportation and higher remittance flows as expatriate workers grow are also expected to increase.

Credit and Monetary Policy[1]

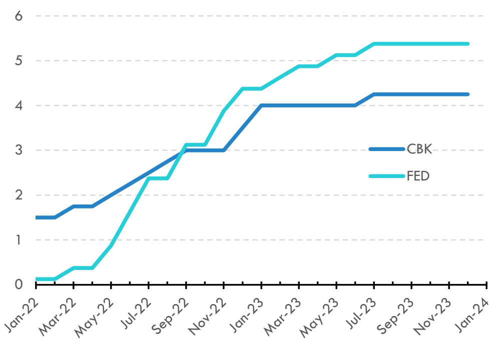

CHART 4: POLICY RATES (%)
Sources: Central Bank of Kuwait, US Federal Reserve

Business lending trends echoed domestic developments, while higher interest rates weighed on credit extended to households in 2023. As of December 2023, credit growth eased to 2.1% y/y from 8.6% at the end of 2022. Declines were observed in both business and household lending. Business credit slowed to 0.9% y/y, as contractions in lending to the manufacturing and oil sectors counteracted strong pick-ups in borrowing by the trade and construction sectors. On the other hand, growth in household borrowing eased to 1.6%. Higher interest rates cooled appetite for homes and subdued demand for consumer loans, keeping the latter unchanged from 2022.

Kuwait hiked its interest rate as expected following the Fed's latest move in July 2023. However, the CBK continues to use the flexibility provided by its currency basket to maintain a spread to the Fed rate. As of Dec 2023, Kuwait's policy rate stood at 4.25% while the Fed Funds rate steadied at 5.375%. Since July, the Fed has held rates as US inflation eased, providing some reprieve for Kuwait's currency and rates. The Fed is expected to hold rates steady in 2024, although markets expect possible cuts by the second quarter of 2024.

Inflation

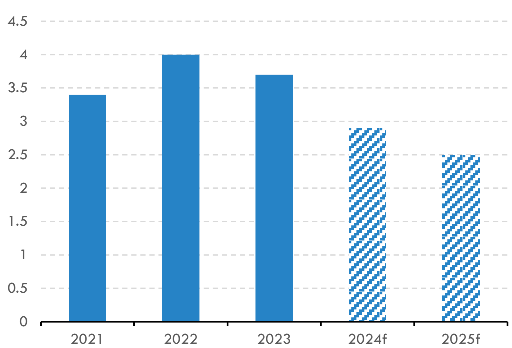

CHART 5: INFLATION (% Y/Y AVERAGE)
Sources: CSB, KCCI estimates

The rise in consumer prices eased in 2023, increasing by 3.6% in 2023 compared to 4.0% in 2022, signaling slowly subsiding inflationary pressures. The slight decline in inflation stemmed mostly from receding inflation in food prices (16.7% of the basket), while the price of housing services (33.2% of the basket) and core goods and services (50.1% of the basket) maintained pressure on consumer prices.

Despite lower global prices, domestic factors may be interrupting their passthrough in the short term. The return of expatriates and still healthy consumer demand are particularly pressuring housing rents and demand for goods. Additionally, the COVID-19 pandemic's lingering impact on small and medium enterprises and escalating operational costs, particularly expatriate wages, are seeing some of those higher prices passed on to consumers.

Price inflation is expected to return to trend, dropping to 2.6% in 2024 and 2.5% in 2025. The decline will stem from a higher passthrough of slowing global inflation in food prices and goods as the impact of local factors dissipates. Current interest rates are already acting as a break on consumer and housing purchases.

[1] CBK revised its credit data again in November 2023. Therefore, historical year-on-year comparisons are currently limited to 2023.

OUTLOOK

The medium-term economic outlook of Kuwait is susceptible to downside risks, particularly given the expected weakness in oil prices. Despite enacting certain pro-business laws in the second half of 2023, the key to unlocking the economy's growth potential depends on Kuwait's ability to apply impactful and credible reforms, starting with a conducive political environment.

International credit and rating institutions have highlighted political stability as a crucial challenge for economic growth in Kuwait. In its October 2023 Article 4 Consultation, the IMF notes that frequent changes in government and the political deadlock between parliament and government have impeded necessary structural and fiscal reforms, particularly its development plan. Similarly, in its October 2023 sovereign credit assessment, Fitch Ratings mentions Kuwait's political backdrop as a drag on growth despite its exceptionally strong fiscal and external balance sheets. Fitch is not confident about the country's ability to reconcile its political differences.

Kuwait Outlook (December 2023)

Indicator	**Year** **Fiscal year** **Unit**	**2020** **20/21**	**2021** **21/22**	**2022** **22/23**	**2023** **23/24** Estimate	**2024** **24/25** Forecast	**2024** **24/25** Forecast
Real GDP *	% y/y	-5.3	1.7	6.1	-0.8	-1.6	7.3
Oil *	% y/y	-8.9	-0.9	12.1	-3.4	-6.6	11.3
Non-oil *	% y/y	-1.2	4.4	0.3	2.2	3.5	3.5
Oil production + condensate (daily average)	mbbl/d	2.63	2.59	2.83	2.72	2.55	2.81
Nominal GDP *	KD billion	32,924	42,766	55,985	49,217	49,701	49,269
KEC oil price (Annual year average)	$bbl	40.1	70.6	101.5	84.3	75.4	61.6
KEC oil price (Fiscal year average)	$bbl	43.7	80.1	97.2	83.9	72.1	59.0
Fiscal breakeven oil price **	$bbl	79.8	77.3	74.2	90.5	85.5	79.3
Fiscal balance **	KD billion	-10.8	-3.0	6.4	-3.0	-4.6	-7.3
	%GDP	-32.7	-7.0	11.4	-6.0	-9.3	-14.8
Current account balance	%GDP	4.4	24.6	34.6	30.9	19.1	12.9
Inflation (annual average)	% y/y	2.1	3.4	4.0	3.6	2.6	2.5

Sources: Official Sources and KCCI estimates

* Estimates for year 2023 and forecast onward

** For the fiscal year