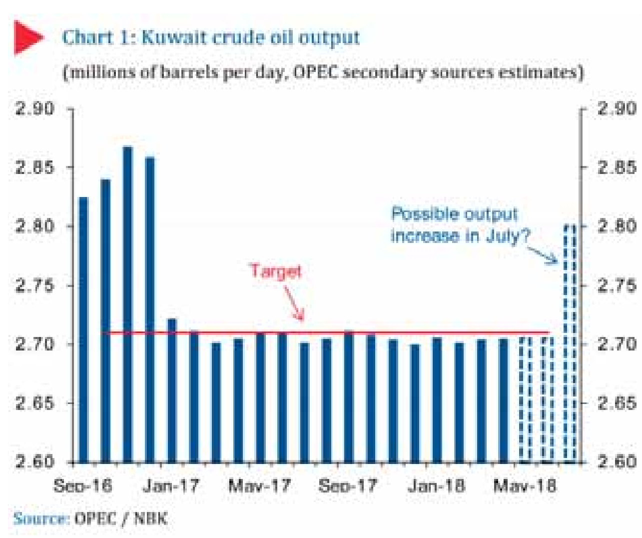
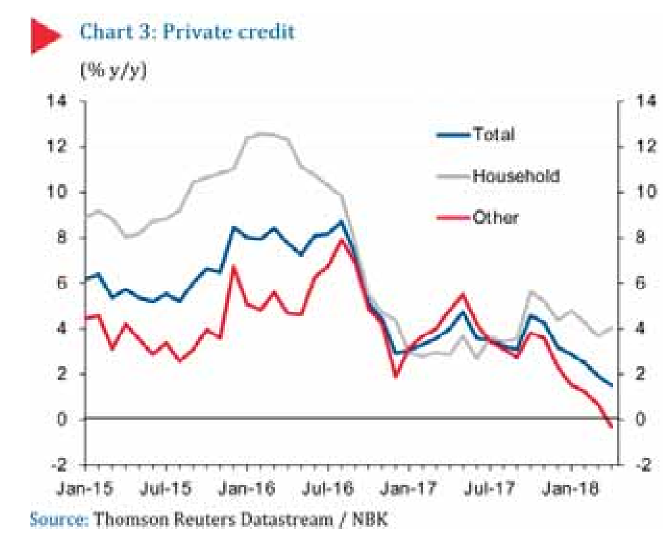
NBK Economic Update

Kuwait Brief: Oil output rising on OPEC policy shift; CBK rates held

Domestic real estate sales eased back in April following a bumper March

KUWAIT: Although oil prices have eased back a touch over the past few weeks, we have revised up our forecast for economic growth this year on fresh assumptions about oil production in light of an expected change in output targets by the OPEC+ group in June. Weak credit data for May, however, suggest that non-oil growth is struggling to gain momentum, although some of this may be related to seasonal factors and we still look for a mild pick up in 2H18 once the new expansionary budget begins to take effect. It appears that parliament is softening its opposition to the new debt law and is linking it to budget reforms. The law would allow the government to borrow up to KD25 billion from KD10 billion previously and extend debt maturities to 30 years. However opposition to the law remains substantial.





Kuwait to benefit if OPEC+ target is lifted

Having seen a big rally in previous months, crude oil prices fell back in late May and early June. The price of Kuwait Export Crude declined from a peak of nearly $76/bbl in mid-May to $72 towards the end of the month, following similar trends in the global benchmark, Brent. The initial fall reflected the view that crude may have risen too far, too fast, but more fundamentally on news that the OPEC+ group - whose supply restraint has been central to price strength - would raise production by up to 1 million b/d when it meets on 22nd June.

Prices have since edged up again, with KEC at $74 in mid-June. Although the meeting could well be a fractious one with strong opposition from other OPEC members to any increase in output (Iran, Iraq), we think that some easing of supply restraint in H218 is likely to be adopted by the group driven mainly by Saudi Arabia (which already increased its output last month),to offset some of the 0.5 million b/d plunge in output in Venezuela over the past year and possibly future sanctions-driven losses in Iran.

Kuwait's oil sector is likely to benefit from any relaxation in production targets. It has stuck faithfully to its share of output cuts initially announced in 2016, reducing production by nearly 5% to just over 2.7 million b/d at present. If the group's output rises by 1 million b/d and Kuwait's share of this is similar to its share of the original cut, it would imply Kuwaiti production rising by 80,000 b/d or 3% to nearly 2.8 million b/d. We have altered our oil production and GDP forecasts to reflect this change in assumptions. Previously we had expected the deal to unwind at the end of the year. If it is brought forward to July, then some of the production increase we expected for 2019 will fall this year instead. Oil sector GDP is therefore now seen rising 1.5% this year and the same in 2019, versus 0% and 1.5%, respectively, before. This will lift overall GDP growth to 2.5% this year from 1.8% previously.

Real estate sales dip, but still strong in April

Real estate sales declined by 15.1% m/m in April to reach KD 300 million compared to KD353 million in March. However, sales levels are still high relative to the 2017 and 2018 monthly averages of KD181 million and KD277 million, respectively. The monthly decline was partly due to the base effect of stronger sales in March, which were the highest since December 2014. The number of transactions, on the other hand, increased by 19% m/m to 679 from 575 in March. Investment sector sales remained particularly strong in April, whereas commercial sales fell back after a bumper March.

Year-to-date, average monthly sales and transactions in 2018 have been higher than the monthly averages for 2017, suggesting that 2018 may be a more active year for real estate if current trends continue. Prices appeared to stabilize in April, posting slightly positive m/m changes across the various sectors, with the exception of the investment apartment subsector, where prices continued to decline. The stabilization in prices might be explained by a rise in demand due to the large price falls seen in 2017 and 1Q2018 as a result of the market-wide oversupply.

Trade surplus rises on higher oil prices, softer imports

Recent strength in oil prices has led to an improvement in the external trade position. The merchandise trade surplus widened in 1Q18 to KD2.3 billion - an estimated 23% of GDP - from KD1.9 billion in 4Q17. The pick up mostly reflects a 5% rise in oil revenues to KD4.4 billion led by higher prices for Kuwait Export Crude which rose 8% q/q to an average of $63/bbl. Oil revenues account for nearly 90% of all merchandise exports.

But imports also contributed, falling 3% q/q to KD2.6 billion. Import growth was strong last year, reaching a five-year high of 10% for 2017 in a sign that demand in the economy was strengthening. Annual import growth remained positive in 1Q18 at 3% y/y, but down from 12% in 4Q17. One of the reasons for last year's strength was unusual growth in capital goods imports, which reached 20% but slipped to just 1% y/y in 1Q18. Consumer-oriented imports were also soft at 4% y/y, affected by weakness in car imports; autos account for 9% of all goods imports.

Stock market sees mild rally in early June

Boursa Kuwait's All Share index ended May in the red, though subsequently regained most of its losses on improved global sentiment and oil prices, as well as regional dynamics. However, the stock market is still underperforming, with its current retreat over 2Q18 (-4.2% quarter-to-date) more than offsetting the rally it experienced the previous quarter. The index is down 0.9% year-to-date.

Average daily trading activity in the first five months of the year dropped by half compared to its average in 2017, dropping to KD 11.5 million per day. Kuwaiti investors were net sellers during that period, taking advantage of foreign investor buying ahead of the FTSE upgrade. This pushed the 3-month average share of foreign activity in the bourse to a record 22%.

June also saw the private placement of crane operator Integrated Holding Company, which raised more than KD 130 million and was more than twice oversubscribed, reflecting the pent-up demand for investing opportunities in Kuwait. With more than 1000 shareholders, the firm is eligible to list on the premier market, which may further support domestic activity. The lull of the summer months will see trading remain somewhat subdued, but it is expected to pick up around September when the inclusion of Boursa Kuwait into FTSE Russel's Emerging Market index starts to be phased in. The bourse recently adopted FTSE Russell's industry classification benchmark, hoping to bring the market closer in line with international standards, all while facilitating foreign buying.

Dinar steady versus the US dollar

The Kuwaiti dinar was steady in the month to mid-June, almost unchanged versus the US dollar at $3.31/KD1; though up slightly against the euro and the pound. The moves reflect the recent strengthening of the dollar against other currencies on the back of political ructions in Europe, strong US economic data and the prospect of rises in policy interest rates by the Federal Reserve.

As expected, the Fed hiked interest rates by a further 25 bps in mid-June, moving the target range to 1.75-2.00%. Unlike other currencies in the region which have pegs to the US dollar, the Kuwaiti dinar is pegged to a basket of currencies dominated by the US dollar, and the central bank (CBK) chose not to raise its policy rate in June so as not to harm non-oil economic growth. The CBK indicated that it will use other monetary policy instruments to keep interest rate differentials to maintain the attractiveness of the dinar, and that banks have the capacity to raise their deposit rates while keeping the cap on their lending rates. The CBK then raised its repo rates by 25 bps and now banks raised their deposit rates by the same amount.

Asian markets up but trade war keep dealers on edge

HONG KONG: Asian equities rose yesterday on bargain-buying after the previous day's battering, but investors remain anxious as the threat of a China-US trade war hangs over markets. Shanghai and Hong Kong bore the brunt of the sell-off Tuesday after Beijing warned it would retaliate in kind to Donald Trump's threat of tariffs on hundreds of billions of dollars' worth of Chinese goods, amounting to much of its exports to the US.

The standoff follows weeks of fruitless talks between the world's two biggest economies, with the White House accusing China of a string of unfair practices including cyber-theft and forced technology transfers that are hurting American jobs and companies. Tuesday's developments surprised many traders who had characterised Trump's protectionist rhetoric as part of a strategy to get a better deal from China.

Trump senior economic aide Peter Navarro continued the forceful language Tuesday by saying China had more to lose from a trade war because it shipped more to the US. He also maintained the administration was acting "to defend the crown jewels of American technology from China's aggressive behavior". Navarro said the White House was open to talks but warned: "The fundamental reality is talk is cheap. Delay is expensive."

OPEC in focus

Still, traders stepped back in to pick up beaten-down equities yesterday. Hong Kong was up 0.8 percent after dropping 2.8 percent Tuesday, while Shanghai ended up 0.3 percent-a small dent in the previous day's 3.8 percent loss. Tokyo ended 1.2 percent higher while Sydney gained by a similar percentage, Singapore added 0.7 percent and Seoul put on one percent. There were also gains in Wellington, Taipei and Bangkok. In early European trade London rose 0.8 percent and Frankfurt gained 0.5 percent, while Paris put on 0.2 percent.

"Markets are faring much better as investors' emotions have tempered, but in general, markets remain in wait-and-see mode," said Stephen Innes, head of Asia-Pacific trading at OANDA. "Clarity is power but given the lack thereof, it's a struggle to get back in the saddle as a sense of once bitten, twice shy continues to permeate. "The spoils of trade war have attracted bargain-hunting but completely trusting the markets in the aftermath of yesterday's meltdown is bordering on too soon, too quick as sentiment remains very apprehensive."

Rakuten Securities Australia chief operating officer Nick Twidale added: "Markets are preparing for further downside whilst hoping that the latest salvos from the Trump administration prove to be another 'negotiating' tactic." The dollar clawed back early losses against the yen but analysts warn it is still likely to face further pressure as investors look to the Japanese unit as a point of safety in times of turmoil.

The euro faced more selling following dovish comments about monetary policy from European Central Bank boss Mario Draghi, while the pound was also down against the dollar. Eyes are turning to OPEC's crucial meeting as Saudi Arabia pushes, along with non-member Russia, to raise an output ceiling that has supported oil prices for 18 months. The two major producers are facing stiff opposition at the June 22-23 gathering from nations that have benefited from the increased revenues. "It does seem like an increase is coming," said Greg McKenna, chief market strategist at AxiTrader. "The question is, can such a move be achieved in order to balance the interests of OPEC's customers like the US and India while still holding the cartel together as a functioning group?" — AFP