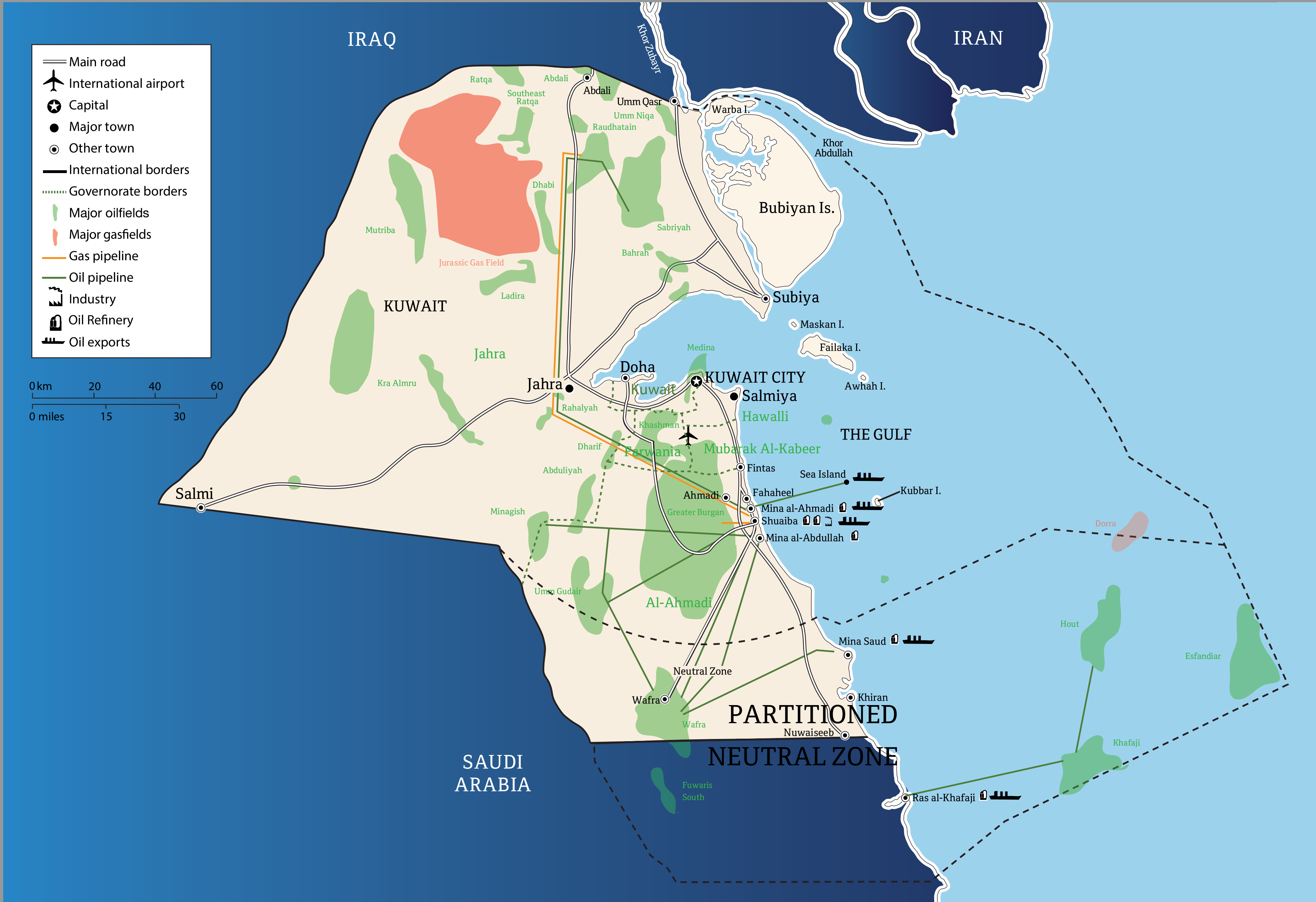
Kuwait Economic Insight 2013



IRAQ
IRAN
Main road
International airport
Capital
Major town
Other town
International borders
Governorate borders
Major oilfields
Major gasfields
Gas pipeline
Oil pipeline
Industry
Oil Refinery
Oil exports
0 km
20
40
60
0 miles
15
30
Khor Zubayr
Ratqa
Southeast Ratqa
Abdali
Abdali
Umm Qasr
Umm Niqa
Raudhatain
Warba I.
Khor Abdullah
Bubiyan Is.
Dhabi
Sabriyah
Mutriba
Jurassic Gas Field
Bahrah
Subiya
Ladira
KUWAIT
Maskan I.
Failaka I.
Medina
Jahra
Doha
KUWAIT CITY
Awhah I.
Kra Almru
Jahra
Kuwait
Salmiya
Rahalyah
Hawalli
Khashman
THE GULF
Dharif
Farwania
Mubarak Al-Kabeer
Abduliyah
Fintas
Sea Island
Kubbar I.
Salmi
Ahmadi
Fahaheel
Mina al-Ahmadi
Minagish
Greater Burgan
Shuaiba
Mina al-Abdullah
Dorra
Umm Gudair
Al-Ahmadi
Hout
Mina Saud
Esfandiar
Neutral Zone
Wafra
Khiran
Wafra
PARTITIONED
Nuwaiseeb
Khafaji
SAUDI ARABIA
NEUTRAL ZONE
Fuwaris South
Ras al-Khafaji

Contents

Economics Team

economics@qnb.com.qa

Mohamad Moabi
Assistant General Manager
+974 4453 4638
mohamad.moabi@qnb.com.qa

Joannes Mongardini
Head of Economics
+974 4453 4412
joannes.mongardini@qnb.com.qa

Justin Alexander
Senior Economist
+974 4453 4642
justin.alexander@qnb.com.qa

Roy Thomas
Senior Economist
+974 4453 4648
roy.thomas@qnb.com.qa

Rory Fyfe
Economist
+974 4453 4643
rory.fyfe@qnb.com.qa

Hamda Al-Thani
Economist
+974 4453 4646
hamda.althani@qnb.com.qa

Editorial closing, 15th May 2013

Summary

- Kuwait's huge endowment of oil reserves makes it the *second wealthiest economy in the GCC* with per capita GDP of around US$47,600 in 2012, when total GDP reached US$182bn. It is expected to rise to US$184bn in 2013.

- Implementation of an *ambitious national development plan* had been stalled by political hold-ups for three years, but has begun moving ahead in 2013 given a more pro-government parliament.

- Kuwait aspires to *reduce its dependence on expatriates* (68% of the 3.8m population in 2012). However, the labour needed to implement the development plan is expected to drive population growth of 2.8% in 2013-14.

- Kuwait has had two years of strong GDP growth, due to a surge in oil production. However, *real growth is forecast to slow to 3.4% in 2013-14*, with non-oil taking the lead.

- Plans to boost oil production, from 3.2m barrels/day in 2012, will depend on advanced techniques to *access heavy oil in the north and tap condensate-rich gas fields*.

- In services, *public administration is growing rapidly, as the payroll expands, but financial services has been contracting* as investment companies deleverage, although we expect the sector to return to growth in 2013-14.

- High oil prices together with income surpluses (which are rare in the GCC) have led to *record current-account surpluses* and an average surplus of US$115bn is forecast in 2013-14.

- Uniquely in the GCC, the dinar is pegged to a currency basket, dominated by the dollar but also likely featuring the euro and yen, which *we forecast will result in a slight weakening in 2013-14*.

- *Inflation is expected to remain moderate*, at 2.7% in 2013 and 3.2% in 2014.

- The *fiscal surplus is estimated to have reached a record US$54bn in 2012/13* and is forecast to remain high at US$42bn in 2013/14-2014/15, as oil revenue slips a little.

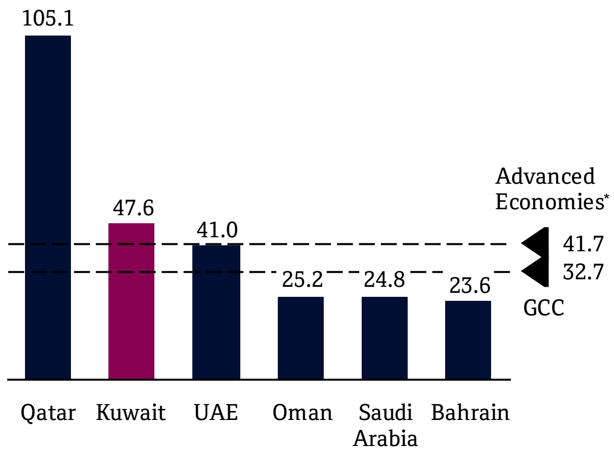
- *There is room for growth in banking assets, which are equivalent to 93% of GDP*, as a cycle of deleveraging comes to an end. Hence profits could also pick up.

- The banking sector's *capital adequacy ratio was a healthy 18.5%* at end-2011, although the non-performing loan rate of 7.3% was high by regional standards.

1. Overview

Kuwait is the second wealthiest country in the GCC on account of its substantial oil resources. The production of oil and the circulation of oil revenue through the rest of the economy have given Kuwait a per capita GDP of around US$47,600, ahead of the averages for the GCC and for advanced economies (Fig 1.1). It is also more than ten times the US$4,600 average for the non-GCC MENA countries. As with other GCC countries, this high level of wealth has created a substantial demand for labour, drawing in large numbers of expatriate workers.

Fig 1.1: GDP Per Capita (2012)
(US$k)

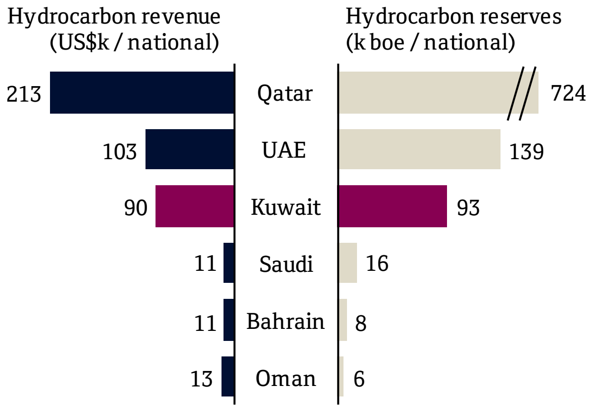


Source: National sources, International Monetary Fund (IMF) and QNB Group estimates; *35 of the most developed economies globally

Kuwait has a huge hydrocarbon endowment relative to its population of nationals

Kuwait was one of the first countries in the region to experience an oil-led boom. 67 years since production began, it still has one of the highest levels of reserves in the world, in absolute terms and relative to its population of nationals (Fig 1.2). Moreover, the state receives about US$90,300 per national in revenue each year from hydrocarbons.

Fig 1.2: Oil and Gas Wealth (2012)



Source: BP, IMF and QNB Group estimates

The delayed development plan is beginning to move forward, facilitated by a new parliament

Like other GCC countries, Kuwait has ambitions to leverage its hydrocarbon revenues to diversify its economy and create world-class infrastructure. Its Vision 2035, issued by the Supreme Council for Planning Development in 2010, provided an overarching framework for these ambitions.

In order to implement the vision, the first in a series of medium-term development plans was also published in 2010. It was intended to run for four years until the current 2013/14 fiscal year, and envisaged US$110bn of investment from the public and private sectors. Major projects in the plan include a metro, airport expansion, power stations and an oil refinery. Initial steps were also expected on megaprojects, such as a massive deepwater port on Boubyan Island and a 25km causeway across Kuwait Bay leading to a new city at Subiya.

However, implementation of the plan has been hampered by disagreements between the government and parliament and by bureaucratic checks and balances. The issues in contention include ensuring value for money in public contracts and the appropriateness of private sector financing for major projects. These issues have delayed the award of contracts and have sometimes led to the cancelation of previously approved projects. As a result, public capital spending in the first two years of the plan averaged just US$8bn, well below the level envisaged in the development plan, and is likely to have been even lower in 2012/13. Private sector investment has also been limited given Kuwait's bureaucratic hurdles, and it received less than 1% of the foreign direct investment that flowed into the GCC over the last decade.

The development plan included performance targets for key indicators, such as real GDP growth, the share of nationals in the private sector workforce and the share of fiscal revenue from non-oil source. Delays in the plan's implementation mean that few of the targets are likely to be met, and indeed some of the indicators have even deteriorated since 2010.

However, in December 2012, a parliament that is broadly supportive of the government was elected. This should facilitate progress on development plan investments. A contract to build the Kuwait Bay causeway was awarded in November 2012 and in January 2013 the first public-private partnership contract was awarded. There are already signs of progress in the tendering of other major project contracts and a new medium-term development plan is being developed which is expected to have more success than its predecessor. A new companies law passed in November 2012 should also facilitate the private sector.

2. Demographics

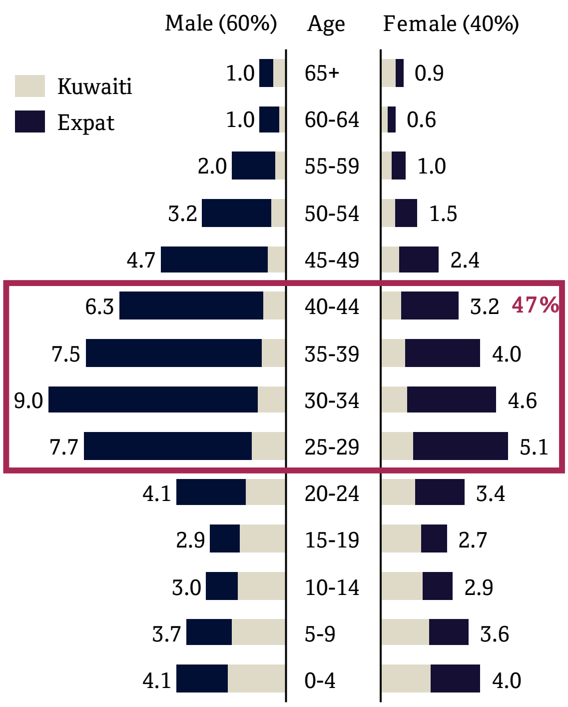
A. Population

Expatriates are 68% of the population but plans to reduce their share are unlikely to succeed

Kuwait is the third most populous country in the GCC with 3.82m people at the end of 2012, of whom 32% are Kuwaiti nationals. The national population is young, with 48% are below 20 years old. However, the demographics of expatriate workers—mainly male and without dependants—skews the overall population, resulting in 47% of residents being aged 25-44 (Fig 2.1). 55% of expats are Asian and 41% are Arabs.

Fig 2.1: Population Pyramid by Nationality (2012)

(% of total)



Source: Public Authority for Civil Information (PACI) and QNB Group analysis

The growth rate of nationals has averaged 3.0% over the last decade, driven by one of the world's highest birth rates and by naturalisation of some stateless residents (called the "Bidoun"). Expat population growth fluctuates with demand for workers. After a period of rapid 9.7% growth in 2004-07, it was nearly flat in 2008-09 during the slowdown but picked up to 4.9% in 2012.

The state aims to reduce the share of expatriates in the population (from 68% currently) with plans to reduce expat numbers by 100,000 a year. It is unlikely to achieve this given dependence on expat labour in the private sector. However, there is considerable overstaffing in some services sectors and tighter visa controls could slow growth. QNB Group forecasts overall population growth of 2.8% in 2013-14.

Almost all of the population lives in a nearly continuous metropolitan region, a triangle of about 500 km^2 south of Kuwait Bay with its points at Jahra, Kuwait City and Fahaheel. This region has a density similar to Singapore. The other inhabited areas are two farming regions (Abdali in the north and Wafra in the south), the resorts and second homes that line the southeast coast.

B. Labour Force

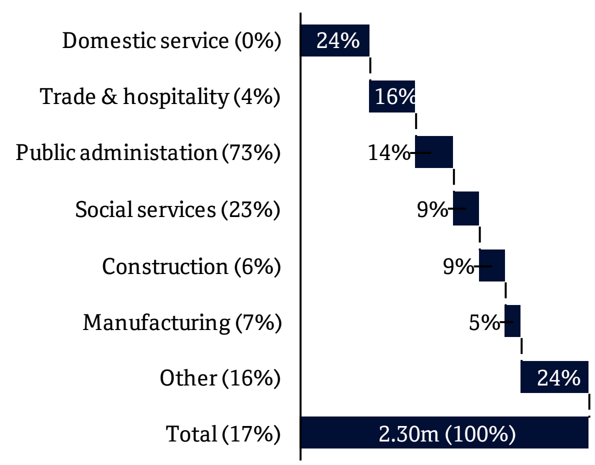
Most workers are in the services sectors and far fewer are in construction than the GCC average

The labour force totalled 2.30m at end-2012, of whom 83% are expatriates. The data shows that 76% of nationals work in the public sector, where they fill 71% of the jobs, but they only make up 5% of the private sector, where 93% of expatriate work. Moreover, parliament is considering a proposal to further boost nationals to 80% of the public sector through compulsory placement and higher salaries, which would accentuate the public-private divide.

The labour force is largely concentrated in services sectors (Fig 2.2). This is because the construction and manufacturing sectors are relatively small compared with other GCC countries. Kuwait's oil-boom came earlier than its neighbours and much of the basic infrastructure and real estate has, therefore, already been built. At the same time, political obstacles have hampered progress on new projects. These factors explain why the share of construction workers is a third that seen in other GCC countries. Progress in implementing the development plan would require more construction workers, undermining efforts to reduce expatriate numbers.

Fig 2.2: Labour Force by Sector (2012)

(% share by sector, the proportion of Kuwaitis in each sector is also shown in parenthesis after the sector names)



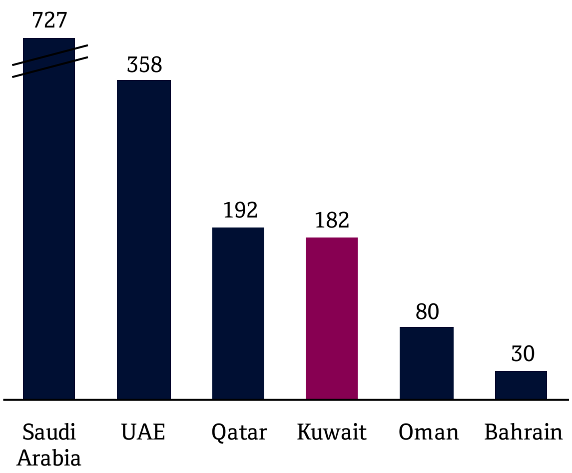
Source: PACI and QNB Group analysis

3. GDP

A. Nominal GDP

Kuwait is the fourth largest economy in the GCC, with nominal GDP of US$182bn in 2012 (Fig 3.1). This is equivalent to about 12% of the regional economy.

Fig 3.1: Nominal GDP in the GCC (2012)
(US$bn)

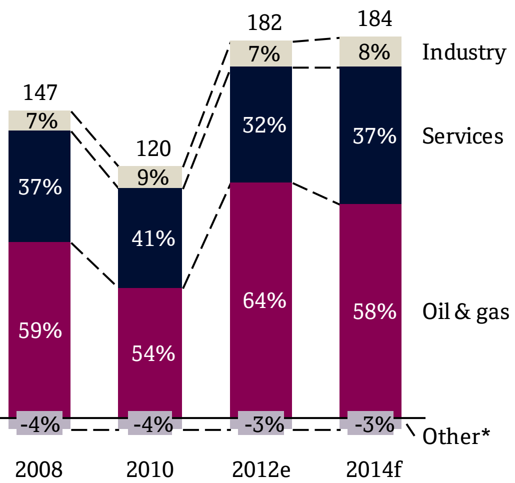


Source: National sources (Bahrain, Qatar, Saudi) and QNB Group estimates

Kuwait is the most oil dependent GCC economy

The economy is dominated by oil and gas production, which comprised an estimated 64% of nominal GDP in 2012 (Fig 3.2), the sector's highest share in decades, on account of higher production and record prices. Kuwait is even more oil dependent than its neighbours, as the oil sector's share in aggregate GCC GDP in 2012 was 48%, well below its share in Kuwait.

Fig 3.2: Nominal GDP by Sector (2008-14)
(US$bn and % share of total)



Source: Central Bank of Kuwait (CBK) and QNB Group forecasts; *Imputed bank charges (a negative), import duties and agriculture. Note: Oil refining is included in industry, comprising about 3% of GDP

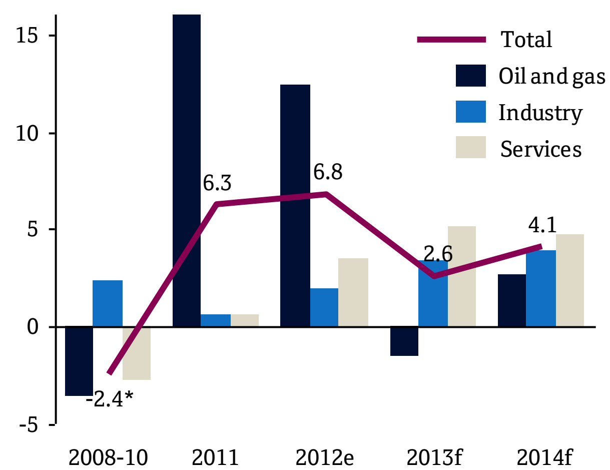
Declining oil prices in 2013-14 are forecast to be a drag on GDP and a weakening Kuwait dinar will also reduce GDP in US dollar terms. However, these factors will be offset by a surge in non-oil sectors as government investment picks up, boosting GDP to US$184bn in 2014. And reducing the share of oil to 58%.

B. Real GDP

The oil sector has driven growth in recent years but services have underperformed

Growth was strong in the last two years, averaging 6.5% in 2011-12, as the oil sector expanded at double digit levels due to capacity increases and the unwinding of OPEC-mandated production-cuts introduced in 2010 (Fig 3.3). However, the rest of the economy has been performing poorly. According to recently revised data[1], services contracted at a rate of 2.8% in 2008-10 and only grew by 0.6% in 2011, though we estimate that it picked up to 3.6% in 2012, driven mainly by expansion in the public sector. Services output is still lower in real terms than it was in 2007. Industry has been expanding slowly over the last three years, but has not yet fully made up the ground lost during a 5.2% contraction in 2009.

Fig 3.3: Real GDP Growth by Major Sectors (2008-14)
(% change)



Source: CBK and QNB Group forecasts; *CAGR for the three year period

Non-oil growth is forecast to pick up in 2013-14

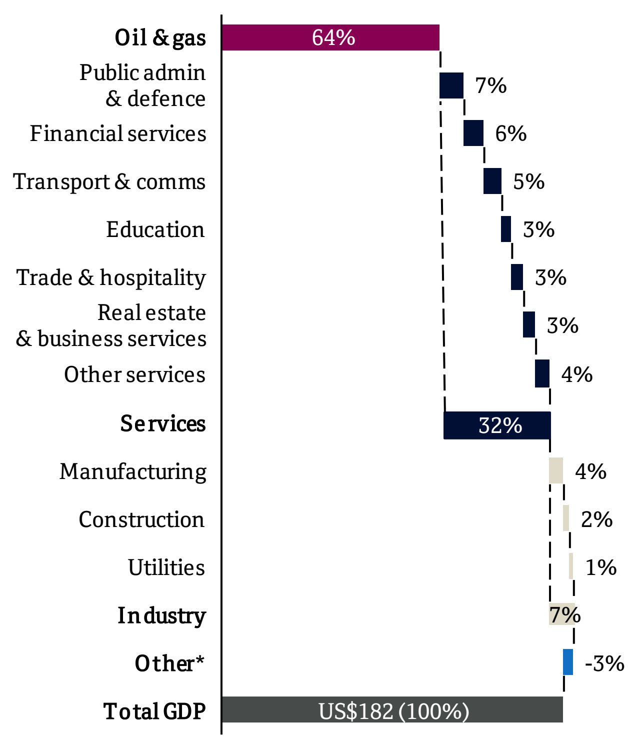
High levels of government oil revenue are expected to finally filter through to the rest of the economy in 2013-14, particularly as barriers to implementing some major projects are overcome, driving non-oil growth to an average of 4.7%. However a small cut in oil production is expected in 2013, dragging overall growth down to 2.6%, before it picks up to 4.2% in 2014.

[1] Real GDP data for 2006-10 was revised in March 2013. In particular, non-oil was revised down sharply from 16% growth in 2010 to a 4% contraction.

4. Economic Sectors

This chapter provides a more detailed analysis of the three main components of GDP: oil and gas (Section A), services (Section B) and industry (Section C). These are broken down into various sub-sectors (Fig 4.1).

Fig 4.1: GDP by Economic Sectors (2012)
(% share and US$bn)



Source: QNB Group estimates; *Imputed bank charges (a negative), import duties and agriculture

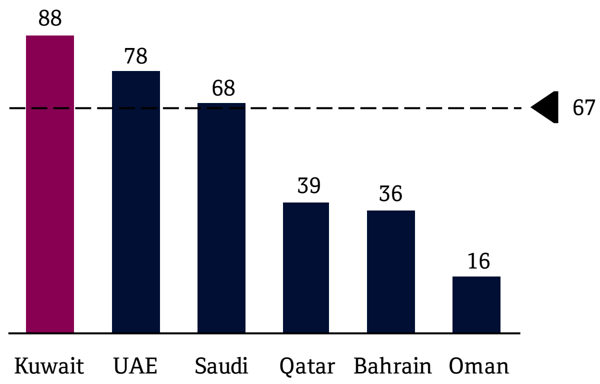
A. Oil and Gas

Kuwait has the world's sixth largest oil reserves, which would last 88 years at current production

Kuwait's official oil reserves of 104bn barrels are the second largest in the GCC and the sixth largest in the world (about 6% of the global total). This includes its 2.5bn barrels share of reserves in the Saudi-Kuwait Neutral Zone. Kuwait's stated reserves have not changed since 2004 and there has been talk in recent years that a reassessment is imminent. Some senior officials suggested in 2010 that reserves would be revised up significantly in 2011, although that did not occur. Conversely, there has been debate within and outside Kuwait about whether existing reserves might already be overstated[2]. The issue is sensitive because the permitted oil production quotas of members of the Organisation of Petroleum Exporting Countries (OPEC) are partly related to reserve levels.

At 2012 production levels of 3.2m barrels per day (b/d), Kuwait's official reserves would last for 88 years, the longest in the region (Fig 4.2).

Fig 4.2: GCC Oil Reserves-to-Production (2012)
(Years of production at current output levels)



Source: BP and QNB Group estimates

Oil production is dominated by the Burgan field, but growth will come from northern fields

The bulk of Kuwait's reserves are in Burgan, south of Kuwait City, the second largest field in the world and the mainstay of Kuwaiti production since 1946[3]. Burgan contains high quality light crude that is inexpensive to exploit and still accounts for nearly half of Kuwait's production. Production at Burgan has plateaued at around 1.5m b/d, a level which the Kuwait Oil Company (KOC) hopes to maintain for several decades. KOC has begun to use enhanced oil recovery techniques, such as water injection, to sustain production levels.

Most of Kuwait's other reserves are in the north, where much of the crude is heavy oil which, together with the local geology, make extraction expensive and technically difficult. For this reason, Project Kuwait was envisaged in 1997 to harness capital and technical expertise from foreign oil companies to exploit these fields. However, this clashed with Kuwait's strong tradition of national control in the oil sector and, after over a decade of debate, Project Kuwait failed to overcome parliamentary opposition. A more modest plan, to engage ExxonMobil on a technical services contract to extract heavy sour oil from the Ratga field, has been in discussion since 2007 but has also faced opposition.

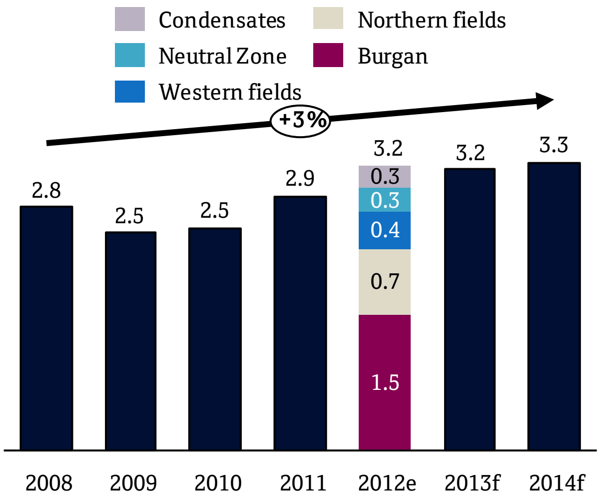
[2] Criteria for estimating proven reserves differ between countries, and Kuwait, like other GCC countries does not publish its methodology or a breakdown. Concerns about overstatement have focused mainly on the maturing Burgan field. Conversely, a reason for understatement is that Kuwait excludes fields without a development plan from its reserves.

[3] Two associated structures, Ahmadi and Magwa, were discovered later, just to the north, but are usually considered as being extensions of Burgan.

Nonetheless, over the last decade KOC has succeeded in raising production from the northern fields close to the original Project Kuwait target. These fields, mainly Raudhatain and Sabriya, now generate about a quarter of Kuwait's total crude production (Fig 4.3).

Fig 4.3: Oil production by field (2008-14)

(m b/d, crude oil and condensates, CAGR shown)



Source: BP, OPEC and QNB Group estimates and forecasts

The remaining oil comes from a group of producing fields in the west, particularly Minagish and Umm Gudair. Oil is also produced in the Partitioned Neutral Zone, an artefact of a territorial dispute with Saudi Arabia which was resolved in 1969 with the division of the territory. However, oil produced in the previously disputed area—by Chevron, mainly from the Wafra and Khafaji fields—is shared equally between the two countries.

Production increases will come from northern heavy oil, the Neutral Zone and condensates

Kuwait cut production in 2009-10 in response to low oil prices but has subsequently restored supplies. 2012 production was the highest since 1972, but government officials have indicated that production may be eased back slightly in 2013 to leave some spare capacity. We expect production to rising again in 2014 to 3.3m b/d.

The long term aim is to raise production to 4m b/d. Originally, the goal was to reach this level by 2020, but comments in March 2013 by the KOC's chairman suggest the target date has been pushed back to 2030. The increase in oil is planned to come from three places: northern heavy oil fields, the Neutral Zone and gas fields. Firstly, water and steam injection techniques are being used to increase heavy crude production from northern fields. Secondly, Neutral Zone production is planned to increase, particularly from Wafra where steam injection will also be used to unlock heavy crude. Thirdly, production of gas from non-associated gas fields, particularly the Jurassic fields in the north, will also result in sizable amounts of liquid condensates as a valuable by product. However, there have been substantial delays in all three of these areas, leading KOC to move back its target date.

Efforts to boost gas production are facing delays

Kuwait's official gas reserves are 63trn cu ft, just 4% of the GCC total. Production in 2012 is estimated at about 1.5bn cu ft per day (equivalent to around 270k b/d of oil). Most of this is associated gas from oil fields, less than 200m cu ft/day is from non-associated gas fields.

However, there is potential for a considerable uplift to gas production. KOC has stated that it aims to produce 4bn cu ft/day by 2020. However, this target is unlikely to be met as most of the increase was expected to come from the northern Jurassic gas structures where progress has been slow. The Jurassic structures are difficult to access and the contract terms on offer have not attracted international companies with the requisite expertise. An US$800m advisory contract signed with Shell in 2010, to assist KOC with gas development, has been hampered by a parliamentary investigation. These delays in bringing gas on stream mean that Kuwait now has to import liquefied natural gas during the summer months to meet peak electricity demand.

B. Services

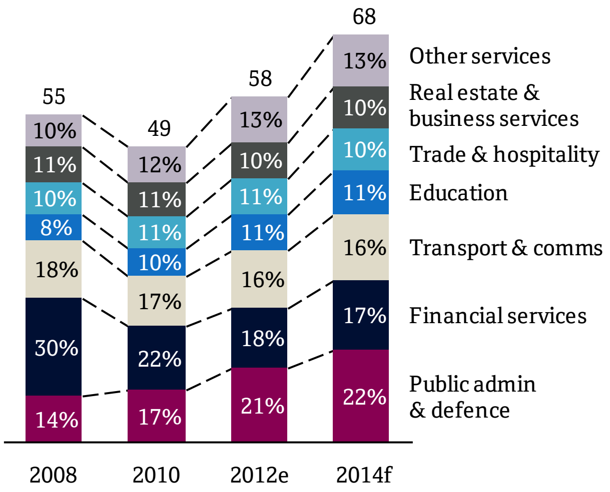
Financial services has contracted significantly while public administration has expanded

There has been an important structural change in the services sector in recent years. Financial services (including banking, see Chapter 8) was the dominant sub-sector in 2004-10, peaking in relative terms at 33% of services in 2007. However, it has contracted every year since then, mainly as a result of deleveraging by investment companies. Many of these companies struggled after the downturn in asset prices in late 2008 and have had to conform to new CBK regulation limiting leverage to 200% of equity.

At the same time, public administration has expanded, driven by rapid growth in government current expenditure, and we estimate that it overtook financial services to became the largest services subsector in 2012 (Fig 4.4). Government spending has also boosted the education sector and health (a core component of the "other services" residual category in the chart).

Government spending growth, the main way that oil revenue is cycled into the non-oil economy, is expected to boost most of the services sub-sectors in 2013-14.

Fig 4.4: Services Sector Nominal GDP (2008-14)
(US$bn and % share)



Source: CBK and QNB Group forecasts

Logistics and real estate have become stagnant

Kuwait has a particularly strong transport and communications sector, which has the largest share of non-oil GDP of any GCC country. The two main telecoms operators, Zain and Wataniya (majority owned by Oreedoo of Qatar), have large regional operations. Logistics companies, such as Agility, are also highly active, although they have underperformed recently, partly because the withdrawal of US forces from Iraq has removed an important source of business.

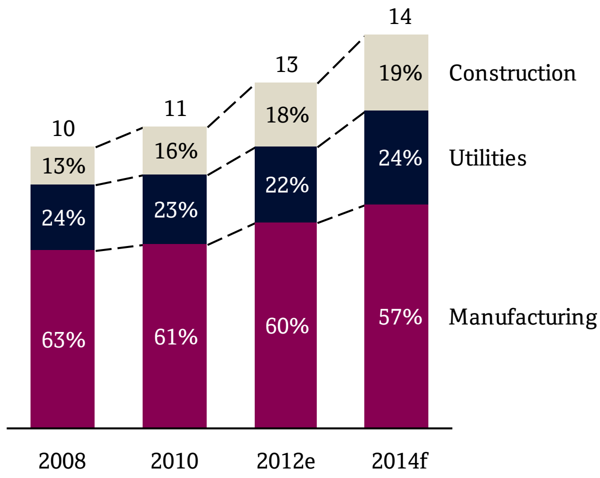
The size of the real estate sector has been essentially flat in nominal terms (at about US$4.2bn) since 2005. The number of property transactions has declined from its peak, partly due to laws barring companies from trading in residential property and to restrictions on bank lending. However, the sector should receive a boost from government plans to expand housing.

C. Industry

Kuwait has significant downstream refining and petrochemicals capacity and plans to expand

Kuwait refines nearly a third of the oil it produces through three refineries with a theoretical capacity of 936k b/d. Refining comprises the bulk of the manufacturing sector, which accounted for 60% of industry in 2012 (Fig 4.5). Two major refining projects are planned. The Clean Fuels Project aims to modernise two of the aging refineries, boost their capacity slightly and enable them to produce low-sulphur fuels. A 615k b/d refinery is also planned at Al Zour to process the heavy crude expected from the Ratga and Wafra fields. Both have been delayed for years due to parliamentary opposition, but are now expected to be tendered in 2013.

Fig 4.5: Industry Sector Nominal GDP (2008-14)
(US$bn and % share)



Source: CBK and QNB Group forecasts

Kuwait also owns three small refineries in Europe and, uniquely amongst Gulf states, an international retail network. It sells about 400k b/d through its network of about 5,000 Q8-branded petrol stations in Europe. It is also developing large refining and petrochemical joint ventures in Vietnam and China.

The state-owned Petrochemical Industries Company produces 3.15m tonnes/year (t/y) of urea for fertilizers, 1.2m t/y of aromatics and 1.65m t/y of ethylene, some of which is processed into higher value petrochemicals. The petrochemicals plants are mainly operated by Equate, a joint-venture with Dow Chemicals. A new plant, Olefins III, is under consideration, and would expand ethylene production by 1.4m t/y, if sufficient gas feedstock can be secured.

In the utilities sector, Kuwait has among the highest per capita consumption of electricity in the world, due to subsidies and the hot climate. It is struggling to meet this demand as political obstacles have held up tenders for new power stations. However, progress was made in January 2013 when a contract was awarded for Al-Zour North, the first privately funded power and water project. This should drive growth in utilities sector GDP. At least two additional plants are planned.

The construction sector is small for the GCC

Kuwait's construction sector is small by regional standards, representing only about 2% of nominal GDP, compared with 6% in the GCC as a whole. This is because the real estate sector is already fairly well supplied with commercial and residential properties and because of the political obstacles that have hampered major industrial and infrastructure projects. However, we forecast strong growth in 2013-14 as a series of long-delayed projects get underway.

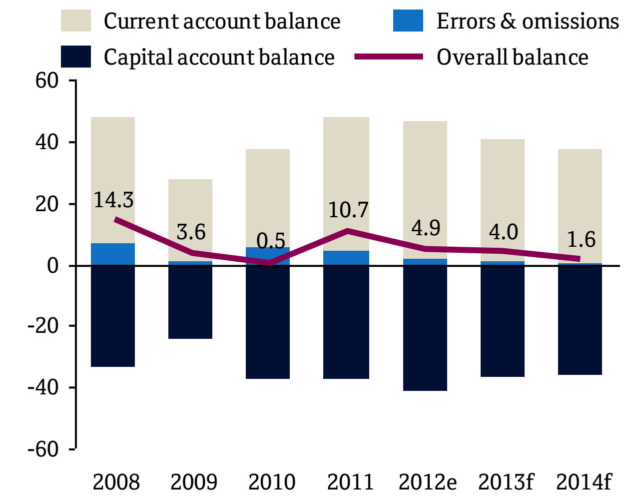
5. External Sector

A. Balance of Payments

Huge current surpluses have enabled a build up in both international reserves and foreign assets

Kuwait's balance of payments is dominated by large and persistent current account surpluses and slightly smaller capital outflows, resulting in an overall surplus in every year since 2004 (Fig 5.1).

Fig 5.1: Balance of Payments (2008-14)
(% of GDP)



Source: CBK and QNB Group forecasts

The bulk of the capital outflows are portfolio investments[4] by the Kuwait Investment Authority (KIA), along with some direct investments by Kuwait companies. The overall payments balance swells the central bank's official international reserves, which reached US$33bn at end-2012, equivalent to 17 months of import cover, high by regional standards. They are forecast to grow moderately in 2013-14 (Fig 5.2).

Fig 5.2: International Reserves (2000-14)

Source: CBK and QNB Group forecasts

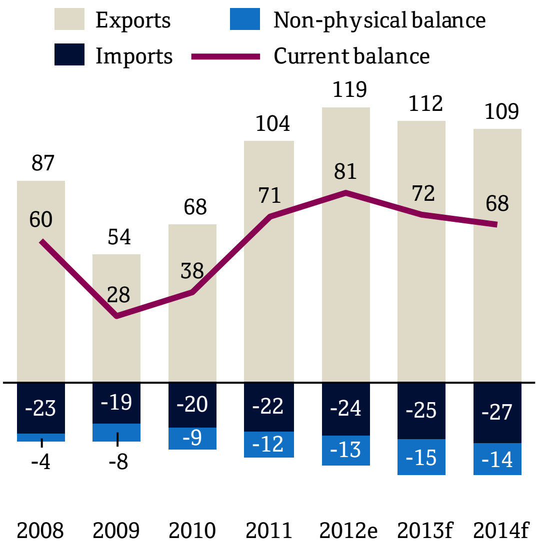
[4] Details of state assets are not generally published. However, a recent State Audit Board report implied that the Future Generations Fund (part of the KIA that is allocated 25% of annual fiscal revenue, recently raised from 10%) had US$261bn in assets as of 31 March 2012. All of these assets, together with part of the General Reserve Fund (the other main KIA fund), are invested abroad.

Current Account

Trade and income surpluses are slightly offset by services and transfers deficits

Kuwait has achieved a current-account surplus, usually sizable, every year since 1992. The current-account balance is estimated to have peaked in 2012 at US$81bn, as high oil prices and production resulted in Kuwait's largest ever trade surplus (Fig 5.3). We forecast that the surplus will ease back slightly in 2013-14 owing to lower oil prices and growth in imports, driven by the implementation of industrial and infrastructure projects.

Fig 5.3: Current Account (2008-14)
(US$ bn)



Source: CBK and QNB Group forecasts

As regards the non-physical components of the current account, Kuwait is the only GCC state to post a sizable income surplus, estimated at 6% of GDP in 2012. In most other GCC countries, foreign oil companies play an important role in production, and repatriate much of the income they earn. By contrast, foreign companies play only a minor role in the Kuwaiti oil sector. Therefore, the large income receipts from the foreign operations and investments of Kuwaiti companies (such as telecoms firm Zain) more than offset the income payments remitted by foreign companies in Kuwait.

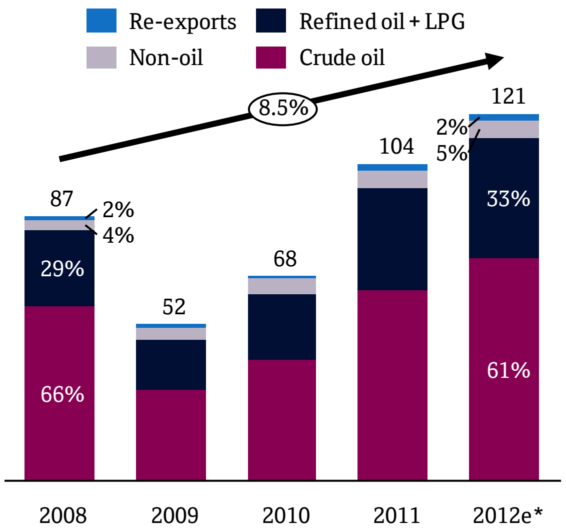
However, as with fellow GCC states, Kuwait is a net importer of services and also has a sizable transfers deficit, due to remittances by the expatriate community. These two factors more than offset the income surplus to produce a moderate non-physical deficit.

Exports

Non-oil exports are the lowest in the GCC

Kuwait's exports are overwhelmingly dominated by crude and refined oil (Fig 5.4). Non-oil exports, most of which are petrochemicals, were only an estimated 5% of exports in 2012, well below the GCC average of 17%.

Fig 5.4: Exports (2008-12)
(US$ bn, % share and CAGR shown)

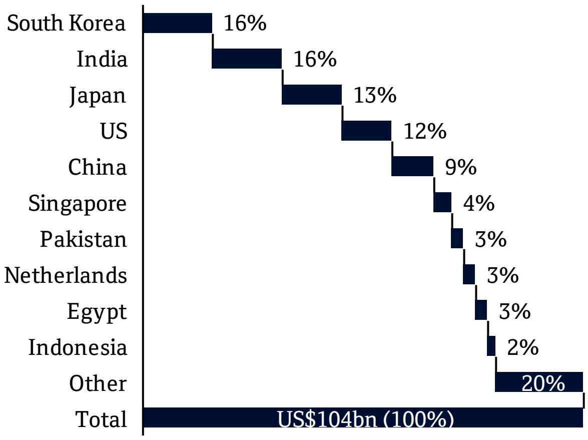


Source: CBK, IMF and QNB Group analysis; *Total exports and total oil exports are IMF actuals, while the breakdowns are QNB Group estimates

Two thirds of exports go to just five countries

Kuwait's exports are highly concentrated, with two thirds of exports going to just five countries (Fig 5.5). Japan, Korea and the US have long been major markets, while India and China have rapidly risen in importance, together buying 25% of Kuwait exports in 2012, compared with just 4% in 2005.

Fig 5.5: Export Destinations (2012)
(US$ bn, % share)



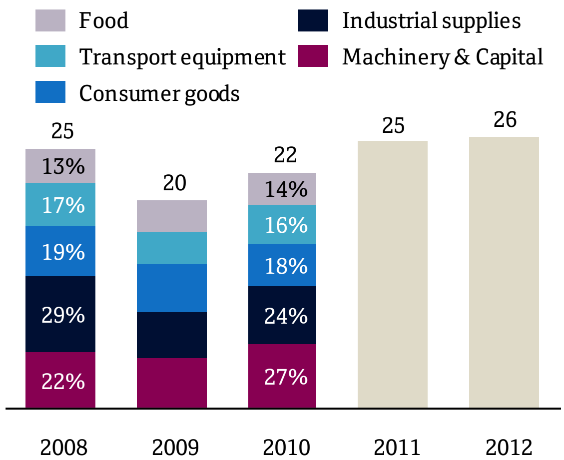
Source: IMF Direction of Trade Statistics and QNB Group analysis; Note: The sum of exports by country tends to be less than overall figure used in Fig 5.4

Imports

Imports have been flat due to weak demand

Imports have been relatively flat in recent years (Fig 5.6). There has been a particular decline in building materials (part of "industrial supplies") due to the weak construction market. As a number of major projects get underway, we forecast that import growth will pick up.

Fig 5.6: Imports (2008-12)
(US$ bn, % share)

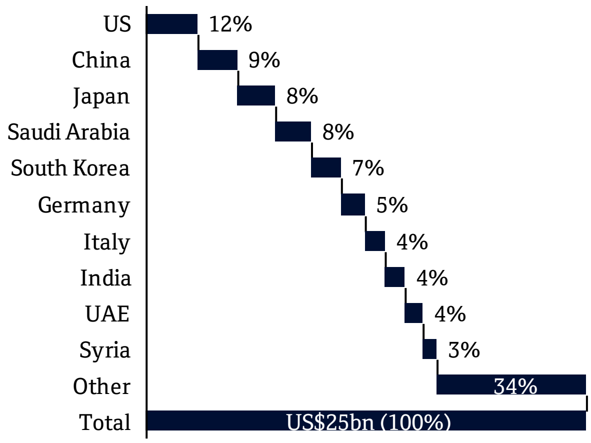


Source: Central Statistical Organisation (CSO) and QNB Group analysis; Note: totals are CIF (including customs, insurance and freight) and thus higher than in Fig 5.3; no breakdown by category is available yet for 2011-12

China is an increasingly important import source

Imports are sourced from a diversified group of countries. The US has so far maintained its longstanding position as the top supplier, according to IMF data, but China's importance has been growing steadily (and in fact it eclipsed the US in the CSO's 2011 data). Collectively, the EU countries provide 21% of imports.

Fig 5.7: Import Sources (2012)
(US$ bn, % share)



Source: IMF Direction of Trade Statistics and QNB Group analysis ; Note: The sum of imports by country tends to be less than overall figure used in Fig 5.6

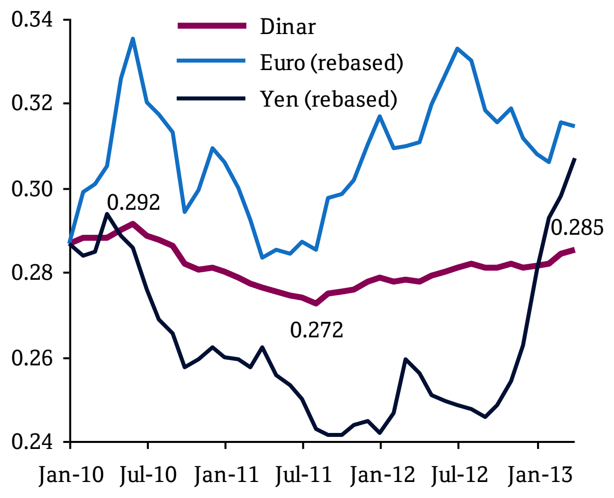
6. Money and Prices

The dinar is pegged to a basket of currencies dominated by dollars but including euro and yen

Uniquely amongst the GCC currencies, the Kuwaiti dinar is not pegged to the US dollar but instead to a basket of currencies. This system was reintroduced in 2007 owing to concerns at that time about the inflationary impact of a weak dollar on import prices. Although the CBK does not reveal the precise composition of the basket, which may change over time, it is understood to be heavily weighted to the dollar. As a result, the exchange rate against the dollar is relatively stable and has not deviated from the mean by more than 5% since 2008, despite high volatility in other currencies related to the global economic crisis. The exchange rate has averaged 0.280 dinars to the dollar over the last five years. The IMF says this is in line with fundamentals.

The other most important components of the basket are likely to be the euro and yen, given that these are currencies used by important trade partners of Kuwait and the dinar tends to mirror movements their movements relative to the dinar (Fig 6.1). Its strongest recent level was in mid-2011 when the euro and yet were also near their recent peaks. Assuming that the yen and euro continue to weaken against the dollar, we expect the dinar will also weaken slightly in 2013-14.

Fig 6.1: Dinar Exchange Rate (Jan 2010-April 2013)
(Dinars per US dollar; yen and euro rebased to dinar's value in Jan 2010)

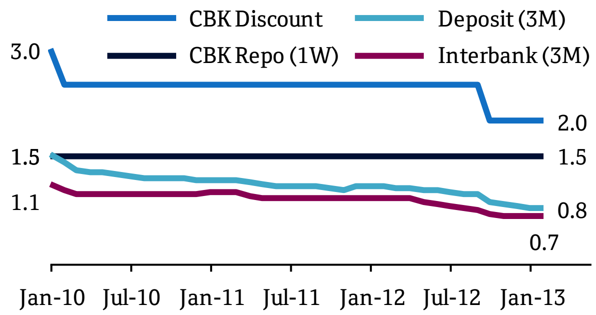


Source: CBK and QNB Group analysis

Interest rates have been cut to discourage capital inflows and stimulate the private sector

The importance of the dollar in the currency basket means that the CBK broadly tracks movements in US interest rates, to discourage hot money capital flows, albeit with slightly more flexibility than currencies that have fixed pegs. When the US Federal Reserve began its cycle of monetary loosening in late 2007, the CBK's repo rate broadly followed the trend of US interest rate cuts, reaching a low of 1.5% in February 2010, where it remains, influencing interbank rates. The CBK has also lowered its discount rate, albeit with a slight lag, down from a high of 6.25% in January 2008 to 2.5% in February 2010, and then to 2.0% in October 2012 (Fig 6.2). The intention of these cuts is to stimulate lending to the private sector and hence growth in the non-oil economy. The US has indicated that it will not raise rates until at least mid-2015 and so Kuwait's rates are also expected to remain low until then.

Fig 6.2: Interest Rates (Jan 10 - Feb 13)

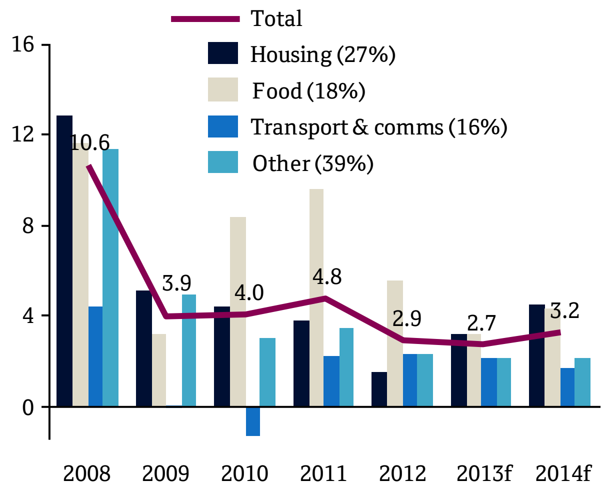


Source: CBK and QNB Group analysis

Inflation is expected to remain moderate

In the aftermath of the regional spike in inflation in 2008, Kuwait's consumer price index (CPI) has been increasing at a moderate rate, averaging 3.9% in 2009-12 (Fig 6.3). Unlike some other GCC countries, Kuwait did not experience housing deflation during this period because the rise in housing costs during the boom period before 2009 was much less intense than elsewhere in the Gulf. Inflation in most CPI categories has been low recently, and indeed 2012 saw the least inflation since 2004. Looking ahead, we forecast even lower inflation, of 2.7% in 2013, as food price inflation moderates, picking up slightly in 2014 to 3.2%.

Fig 6.3: Consumer Price Inflation (2008-2012)
(% change, weights shown in legend)



Source: CSO and QNB Group forecasts

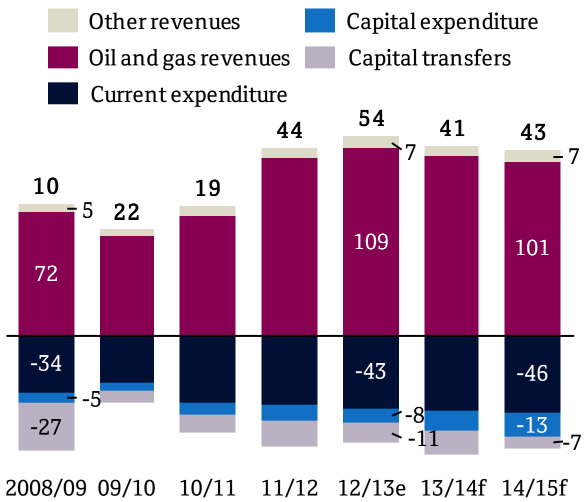
7. Public Finance

Kuwait has posted record fiscal surpluses, reaching 31% of GDP in 2012/13

Kuwait has achieved record fiscal surpluses in recent years, including an estimated US$54bn in 2012/13 (Fig 7.1). The surplus was also a record in relative terms, at 31% of GDP, compared with an average of 18% over the previous decade. We forecast that slightly lower oil revenues, combined with moderate increases in expenditure, will result in surpluses in 2013/14 and 2014/15 that average US$42bn. The surpluses have cumulatively totalled around US$238bn over the last decade.

Fig 7.1: Fiscal Balance (2008/09-2014/15)

(US$ bn, overall balance in bold, fiscal year starts on April 1st)



Source: CBK and QNB Group forecasts

Total revenue is about 15% higher than the fiscal account indicates

Fiscal revenue is mainly oil-related and has been driven by record oil prices and rising production. Kuwait has a higher level of control of the upstream and much of the downstream value-chain compared with other GCC countries where foreign involvement is greater. This means that it extracts more fiscal revenue per barrel of oil produced. The small amount of non-oil revenue, about 6% of the total, comes largely from state-owned utilities and import duties. Total revenue in 2012/13 is estimated at US$109bn (64% of GDP), and is expected to ease slightly in 2013/14-2014/15, owing to lower oil revenue.

Kuwait's actual consolidated revenue is even greater than the fiscal data suggests, because two major items are excluded from the fiscal accounts which could have boosted revenue in 2012/13 by about 15%. Firstly, the investment revenue from Kuwait's sovereign wealth fund assets is not included as it is reinvested by the KIA. Secondly, the reparations payments that Kuwait receives from Iraq for damages incurred during the Gulf War are not included on budget. Iraq is required to allocate 5% of its oil revenue to reparations and in 2012 Kuwait received US$4.4bn in payments, equivalent to 2.4% of its GDP. US$11.2bn in reparations awards remain to be paid and at current rates this will be completed within about three years.

Capital expenditure is low but is forecast to rise as the development plan is implemented

Kuwait's current expenditure, the bulk of budgeted spending, is comprised mainly of salaries, electricity subsidies and purchases of goods and services. The salaries bill has risen rapidly in recent years, at a rate of 13.0% in the five years until 2011/12, driven by sizable raises for nationals and an expansion in payroll numbers. The electricity subsidies have also been rising rapidly, given demand growth and high fuel prices.

Capital expenditure, meanwhile, is low by GCC standards, averaging under 5% of GDP during the last five years, due to capacity constraints. The 2012/13 budgeted capital spending was down on the previous year. Partial outturn data suggests that the actual spending was also lower, probably in part because approval of the budget law was delayed until October. However, we forecast that capital expenditure will now pick up to 7% of GDP in 2014/15 as there is positive movement on implementing major projects.

The third component of expenditure is capital transfers to public agencies, which usually exceeds capital expenditure. In recent years, these transfers have mainly gone to the Public Institution for Social Security, which provides public-sector pensions. This is because it was determined in 2007 that the institution had an actuarial deficit of nearly US$40bn (nearly half of this shortfall was made up through a single transfer in 2008).

Kuwait has little debt but could borrow at low rates to help finance its development plan

Kuwait has very little gross public sector debt, which we estimate was just 7% of GDP at end-2012. Most of his debt is in the form of treasury bonds, which totalled US$6.3bn at end-2012.

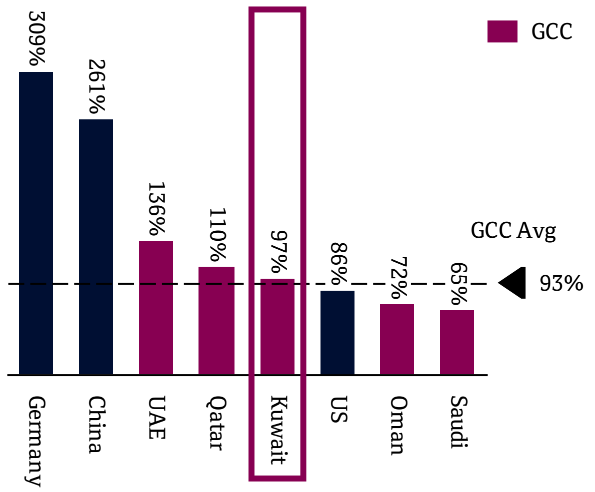
The IMF has recently urged Kuwait to consider borrowing more to help finance its development plan, as other GCC states have done. Given Kuwait's AA-credit rating, the equal highest in the region, it can borrow a low rate. Government bond issues could help establish a yield curve for private issuers and also be used as a tool to manage liquidity.

8. Banking

The level of banking assets to GDP suggests that there may be room for growth

The level of banking assets to GDP is broadly in line with the GCC, but well below a number of major economies (Fig 8.1), suggesting there may be room for growth. The sector had a capital adequacy ratio of 18.5% at end-2011, far the regulatory required minimum of 10%.

Fig 8.1: Comparative Banking Assets (2012)
(% of GDP)

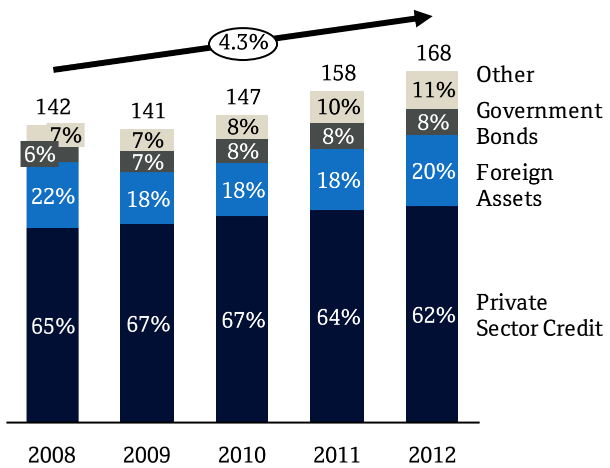


Source: Central banks, IMF and QNB Group analysis

Limited domestic opportunities have led banks to look abroad

Since 2008, asset growth has been moderate at 4.3%, with assets reaching US$168bn (93% of GDP) at end-2012 (Fig 8.3).

Fig 8.2: Banking Sector Assets (2008-12)
(US$bn, % share and CAGR shown)



Source: CBK and QNB Group analysis

Asset growth has been held back by sluggish private sector lending (which accounted for 62% of assets in 2012), which only increased at a rate of 2.9% from 2008-12. Activity in the sector has been limited due to the low rate of non-oil economic growth.

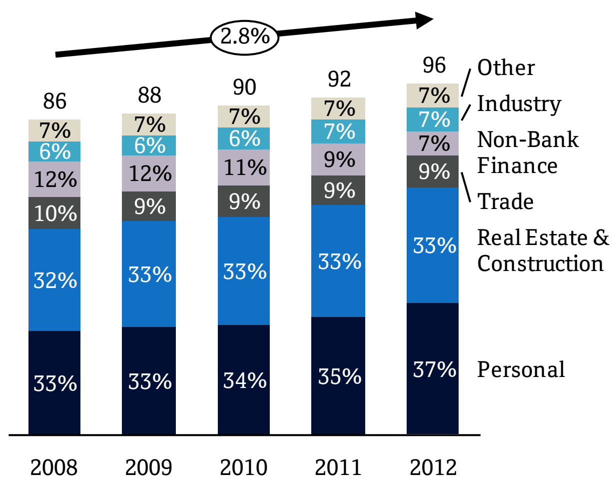
The share of foreign assets to total assets (20% in 2012) is high for the region. These are mainly deposits with foreign banks and overseas investments. Low domestic interest rates and limited local lending and investment prospects have encouraged banks to seek opportunities abroad. Foreign assets grew by 15% in 2012.

Loan growth is weak, barring consumer finance

Personal lending is the largest category of domestic private sector credit with residents (Fig 8.3) and it has grown strongly, mainly driven by loans for consumer spending (which comprise 60% of personal loans). In 2012, 27% of personal lending was for the purchase of securities. Although these loans are over-collateralised and mainly to high net worth individuals, they still pose a risk should the stockmarket face another sharp downturn.

Loans to non-bank financial institutions have declined sharply since 2009 because a number of investment companies have been deleveraging.

Fig 8.3: Credit Facilities with Residents (2008-12)
(US$bn, % share and CAGR shown)



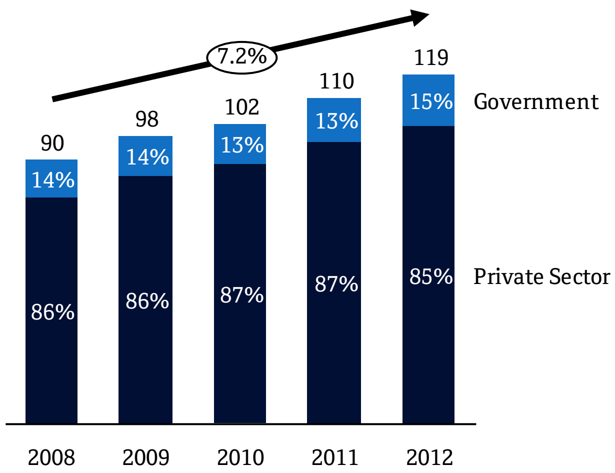
Source: CBK and QNB Group analysis

Deposits have been outpacing loan growth

Banking deposits increased by 7.2% from 2008-12 (Fig 8.4), outpacing growth in lending. Deposit growth in both the private and public sector was strong at 7.0% and 8.3% respectively. This has led to a drop in the loans to deposits ratio from 95% in 2008 to 81% in 2012.

Fig 8.4: Banks Deposits (2008-12)

(US$bn , % share and CAGR shown)



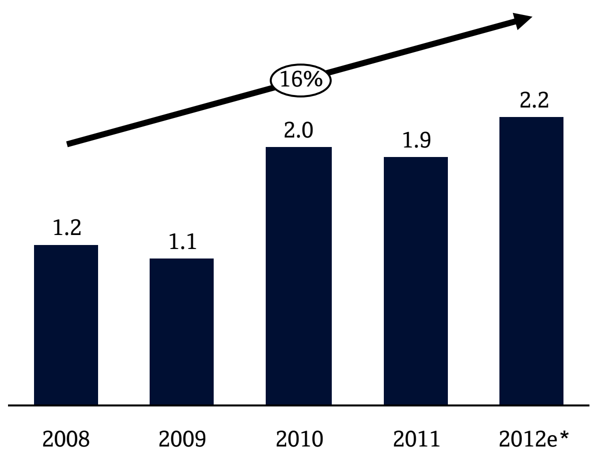
Source: CBK and QNB Group analysis

Profits have picked up in the last few years but remain low compared with the region

Since 2009, when a sizable loss at one bank dragged down the overall sector's profitability, lower provisioning needs have led to an improvement in profits (Fig 8.5). However, this growth has been mainly due to a recovery from a low base and profitability remains weak. The estimated profits of US$2.2bn in 2012 equate to a return on assets of around 1.1% and a return on equity of 8.5%. Kuwait suffered more than neighbouring countries from the financial crisis as many investment companies lost access to international credit markets, real estate activity dropped and the stockmarket fell 58% (from June 2008 to February 2009). This led to a rise in non-performing loans (NPLs), forcing banks to take increased levels of loan loss provisions, negatively impacting bottom-line profits.

Fig 8.5: Local Bank Profits (2008-12)

(US$bn , CAGR shown)



Source: Bankscope and QNB Group analysis; *based results from 9/ 11 banks

Although the situation has improved, banks still have an over-concentration of loans (40% in 2012) to construction, real estate and non-banks (mainly investment companies). Also, NPLs are high for the region at 7.3% of loans at end-2011.

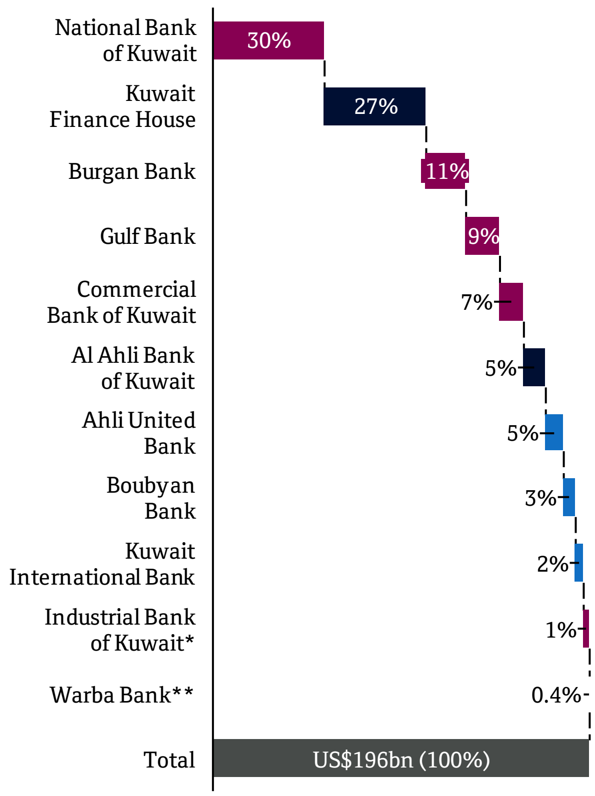
A decision by parliament in April 2013 to provide debt relief on US$2.6bn of loans extended to nationals before 2008, and potentially require banks to repay interest payments seen as excessive, could dent retail profits.

The sector is highly concentrated and two local banks have a dominant market share

There are 22 banks operating in Kuwait, including 11 local and 11 foreign banks. The sector is highly concentrated with the top two banks, National Bank of Kuwait and Kuwait Finance House, accounting for 57% of assets and the top five banks accounting for 84% of assets (Fig 8.6). There are 4 Islamic banks (3 private and Kuwait Finance House, a large state-controlled bank).

Fig 8.6: Local Banks Share of Assets (2012)

(% share)



Source: Bankscope and QNB Group analysis; * Based on latest reported data (Sep-2012); ** Based on latest Dec-2011 data

Data for the assets of foreign banks are not available, but they are small relative to the local banks. Foreign banks were permitted to enter the market in 2004 but are currently only permitted to operate only one branch. Eight of the foreign banks are from the GCC (including QNB) and three come from outside the region.

Key Macroeconomic Indicators

	2008	2009	2010	2011	2012	2013	2014
Population							
Total (m)	3.44	3.48	3.58	3.67	3.82	3.94	4.04
Growth (%)	1.2	1.3	2.8	2.5	4.1	3.0	2.7
GDP							
Nominal GDP (US$ bn)	147.4	106.0	119.9	160.9	182.0	181.6	184.1
Nominal GDP (KD bn)	39.6	30.5	34.4	44.4	50.9	51.4	52.9
Growth (%)	21.6	-23.0	12.7	29.2	14.7	0.8	3.1
Oil & gas sector (% of GDP)	59.4	49.4	53.8	62.1	64.2	60.8	57.9
Real GDP growth (%)	2.5	-7.1	-2.4	6.3	6.8	2.6	4.1
Oil & gas growth (%)	3.5	-14.5	1.3	16.0	12.5	-1.5	2.6
Other sectors growth (%)	1.3	-3.1	-4.0	0.7	3.3	4.8	4.6
Fiscal indicators (% of GDP)							
Revenue	53.0	58.0	62.6	68.1	63.9	61.2	58.8
(US$ bn)	78.1	61.5	75.0	109.6	116.3	111.2	108.2
Expenditure	46.1	36.9	47.2	40.6	33.2	38.5	35.6
(US$ bn)	67.9	39.1	56.6	65.4	60.4	69.9	65.5
Balance	6.9	21.1	15.4	27.4	30.7	22.7	23.2
(US$ bn)	10.2	22.4	18.4	44.2	55.9	41.3	42.7
Current account (% of GDP)							
Balance	41.0	26.7	31.9	44.0	44.8	39.5	36.9
(as US$ bn)	60.4	28.3	38.3	70.8	81.5	71.7	67.9
Trade balance	43.4	33.9	39.7	51.2	52.0	47.9	44.4
Exports	59.0	51.4	56.4	64.8	65.1	61.9	59.2
Imports	-15.6	-17.5	-16.7	-13.6	-13.1	14.0	14.8
Services balance	-2.6	-2.1	-4.7	-4.7	-4.5	-4.5	-4.5
Income balance	7.3	7.3	7.9	6.9	6.0	5.5	6.5
Current transfers balance	-7.1	-12.3	-10.9	-9.4	-8.8	-9.4	-9.5
International reserves	13.1	21.7	20.7	18.4	18.2	19.7	20.2
Industry indicators							
Oil production ('000 bpd)	2,761	2,477	2,518	2,865	3,228	3,186	3,256
Kuwaiti crude price (US$/barrel)	91.9	60.1	76.6	105.6	108.9	104.3	98.0
Gas production (m cu ft/day)	1,342	1,131	1,164	1,340	1,474	1,518	1,609
Monetary indicators (%)							
Consumer price inflation	10.6	3.9	4.0	4.8	2.9	2.7	3.2
Food	11.6	3.2	8.4	9.6	5.6	3.2	4.3
Housing	12.8	5.1	4.4	3.8	1.5	3.2	4.5
Interbank deposit rate	2.8	1.6	0.9	0.9	0.8	-	-
Broad money growth	15.8	13.4	3.0	8.2	6.5	10.0	14.5
Exchange rate US$:KD (av)	0.269	0.288	0.287	0.276	0.280	0.283	0.288

Source: CBK, CSO, OPEC, IMF and **QNB Group estimates and forecasts;** Data as at 15th May 2013

QNB Group International Network: Branches

France
65 Avenue d'lena
75116 Paris
Tel: +33 1 53 23 0077
Fax: +33 1 53 23 0070
QNBParis@qnb.com.qa

Kuwait
Al-Arabia Tower, Bld 4
Ahmad Al-Jaber Street, Sharq Area
P.O. Box: 583, Dasman 15456 Kuwait
Tel: +965 2226 7023
Fax: +965 2226 7051
QNBKuwait@qnb.com.qa

Lebanon
Capital Plaza Building, Ahmad Shawki Street
Mina El Hosn, Solidere
Beirut – Lebanon
Tel: +961 1 762 222
Fax: +961 1 377 177
QNBLebanon@qnb.com.qa

Mauritania
Al Khaima City Center
10, Rue Mamadou Konate
Nouakchott – Mauritania
Tel: +222 4524 9651
Fax: +222 4524 9655
QNBMauritania@qnb.com.qa

Oman
QNB Building
Building No:1540, CBD Area
P.O. Box: 4050, PC 112
Ruwi – Oman
Tel: +968 24 725 555
Fax: +968 24 779 233
QNBOman@qnb.com.qa

Singapore
Three Temasek Avenue
27-01, Centennial Tower
Singapore 039190
Tel: +65 6499 0866
Fax: +65 6884 9679
QNBSingapore@qnb.com.qa

South Sudan
Plot No 64, Port Road
P.O. Box: 587 Juba
QNBSouthSudan@qnb.com.qa

Sudan
Africa Road – Amarat Street No. 9
P.O. Box: 8134
Tel: +249 183 480000
Fax: +249 183 486666
QNBSudan@qnb.com.qa

United Kingdom
51GrosvenorStreet
London W1K 3HH
Tel: +44 207 6472600
Fax: +44 207 6472647
QNBLondon@qnb.com.qa

Yemen
QNB Building
Alzubairi Street
P.O. Box: 4310 Sana'a – Yemen
Tel: +967 1 517 517
Fax: +967 1 517 666
QNBYemen@qnb.com.qa

QNB Group International Network: Subsidiaries & Associates

Egypt
Subsidiary
NSGB
Dar Champollion, 5 Champollion St
Downtown 2664
Cairo – Egypt
Tel: +202 2770 7000
Fax: +202 2770 7099
Info.nsgb@nsgb.com.eg

India
Subsidiary
QNB (India) Private
(due to commence operations Q3 2013)

Indonesia
Subsidiary
QNB Kesawan
QNB Kesawan Tower, Parc 18
Jl. Jendral Sudirman Kav. 52-53, 12190
Jakarta – Indonesia
Tel: +62 21 515 5155
Fax: +62 21 515 5388
www.qnbkesawan.co.id

Iraq
Subsidiary
Mansour Bank
P.O. Box: 3162
Al Alawiya Post Office, Al Wihda District
Baghdad – Iraq
Tel: +964 1 717 5586
Fax: +964 1 717 5514
www.mansourbank.com

Jordan
Associate Company
The Housing Bank for Trade and Finance (HBTF)
P.O. Box: 7693, PC 11118
Amman – Jordan
Tel: +962 6 500 5555
Fax: +962 6 567 8121
www.hbtf.com

Libya
Associate Company
Bank of Commerce and Development
BCD Tower, Gamol A Nasse Street
P.O. Box: 9045, Al Berka
Benghazi – Libya
Tel: +218 619 080 230
Fax: +218 619 097 115
www.bcd.ly

Switzerland
Subsidiary
QNB Banque Privée (Suisse) SA
3, Rue Des Alpes, 1201
Geneve – Switzerland
Tel: +41 22 907 7070
Fax:: +41 22 907 7071
Info@qnb.com.qa

Syria
Subsidiary
QNB Syria
Al Abbassiyeen Square
P.O. Box: 33000
Damascus - Syria
Tel: +963 11 2290 1000
Fax: +963 11 4432 221
QNBSyria@qnb.com.qa

Tunisia
Subsidiary
QNB Tunisia
Rue de la cité des sciences
B.P. 320 – 1080
Tunis Cedex – Tunisia
Tel: +216 71 750 000
Fax: +216 71 235 611
www.tqb.com.tn

UAE
Associate Company
Commercial Bank International
Al Riqqa Street, Deira
P.O. Box: 4449
Dubai – UAE
Tel: +9714 227 5265
Fax: +9714 227 9038
www.cbiuae.com

Qatar National Bank SAQ
P.O.Box 1000
Doha, Qatar

Tel: (+974) 4440 7407
Fax: (+974) 4441 3753

qnb.com.qa