Public finance

Kuwait: New budget keeps spending unchanged; deficit likely at 13% of GDP

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The National Assembly recently approved the budget for the fiscal year 2016/17 (FY16/17) with an official deficit projection of KD 8.7 billion, or 26% of GDP. The deficit, before the mandatory transfer to the Future Generations Fund (FGF), is likely to be significantly smaller as the price of oil for the fiscal year is expected to average above the $35 per barrel assumed in the budget. We estimate a deficit of 13% of GDP, comparable to last year's (Chart 1). The persistent budget deficit, a result of sustained low oil prices, will be partly financed by sovereign bond issuance; it has also triggered much needed fiscal and structural reform.

The government budget projects a third consecutive year of revenue decline due to lower oil prices. Total revenues are seen 16% lower in FY16/17, at KD 10.2 billion. While the budget assumes slightly higher oil production of 2.8 million barrels per day, oil revenues are seen declining on a lower oil price assumption of $35 per barrel, compared to last year's $45. With oil prices currently hovering around $40 per barrel (Chart 3), we expect oil revenues to be around 35-40% higher than official projections, and to be mostly unchanged from the year before. Meanwhile, non-oil revenues are budgeted at KD 1.6 billion, up 11% from the previous year, though they remain a small share of total revenues.

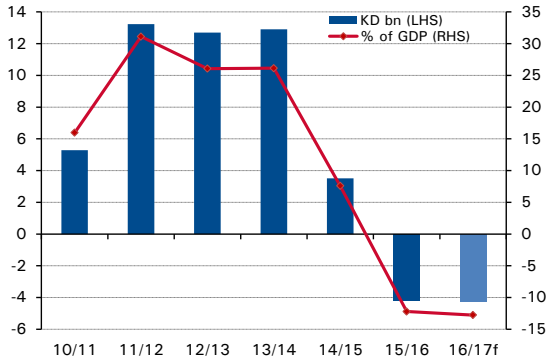
Government spending is projected to decline only slightly, on the heels of a year which saw overall spending cut by over 17%. Allocated expenditures in the budget were reduced by 1.5% to KD 18.9 billion, though the two largest chapters, wages and salaries (chapter 1) and miscellaneous & transfers (chapter 5), are to grow by 2.7% and 1.5%, respectively. Expenditures on goods and services (chapter 2) and projects, maintenance and land purchases (chapter 4) are set to decline by 14% and 13%, respectively.

Overall government capital spending is expected to maintain healthy levels despite the lower oil price environment. While the budget allocates KD 2.2 billion in projects, maintenance & land purchases (chapter 4) and transportation & equipment (chapter 3), 8.4% lower than the previous year and the lowest level in six years, the figure does not include around KD 1 billion in additional on-budget development plan projects allocated for the year and included in miscellaneous expenditures & transfers (chapter 5). As a result, total on-budget capital spending is expected to rise by 2.7% to KD 3.3 billion, according to earlier announcements of the draft budget.

The bulk of government development plan projects are off-budget and their spending pace is picking up. Those include projects in the oil sector and public-private partnerships (PPP). According to MEED Projects, the pace of awards of government projects has remained healthy, with KD 2.25 billion worth of projects awarded during the first half of 2016. Another KD 8.4 billion could be awarded before the end of the year.

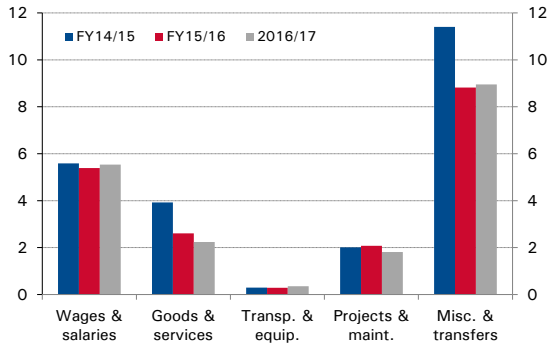
The National Assembly approved financing part of the budget deficit by raising KD 5 billion in local and international bonds and sukuk during FY16/17. Finance Minister Anas Al-Saleh said that the ministry

Chart 1: Budget balance
(% GDP, before FGF)



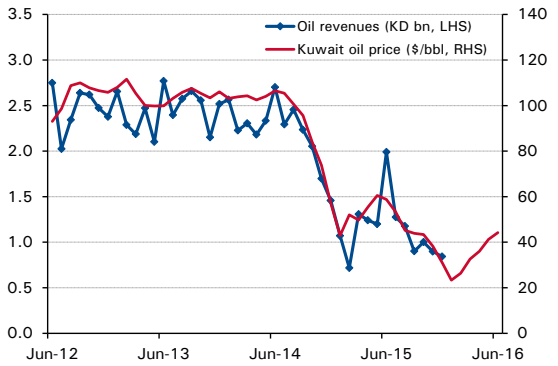
Source: Ministry of Finance, Central Statistical Bureau, NBK estimates

Chart 2: Spending breakdown
(KD billion)



Source: Ministry of Finance, NBK estimates

Chart 3: Oil revenues and the price of oil



Source: Ministry of Finance, Kuwait Petroleum Corporation

will borrow KD 2 billion through dinar issuances in the local market. The ministry already raised KD 900 million in government bonds and sukuk during the first four months of FY16/17. The ministry plans to borrow a further KD 3 billion from international markets, in instruments denominated in foreign currency. The rest of the deficit will be financed by withdrawals from the General Reserve Fund (GRF).

In March 2016, the government approved a reform plan in an effort to reduce the fiscal deficit and address other imbalances in the economy in the medium term. The plan includes significant cuts in subsidies, and the introduction of a corporate income tax and a value added tax (VAT). In a first step, the National Assembly (NA) approved increases in electricity tariffs to take effect in September 2017; electricity and water subsidies currently eat up over half the subsidy bill. While the step was a historic move, the NA approved a watered down version of the cuts which should still save the budget around 1% of GDP.

The government is also looking to introduce new taxes to boost nonoil revenues, though not before 2019. The government has proposed a 10% corporate income tax on local and foreign companies. The new tax is expected to replace existing taxes on corporate earnings in a measure that will broaden the tax base. Authorities are also preparing to introduce a 5% VAT in conjunction with other GCC countries. Both measures will require legislation and already appear to be behind schedule.

Table 1: Budget revenues and expenditures (official projections)

	FY15/16	FY16/17	
	KD bn	KD bn	% y/y
Revenues	12.2	10.2	-16.1
Oil	10.8	8.6	-19.8
Non-oil	1.5	1.6	11.2
Expenditures	19.2	18.9	-1.5
Wages & salaries	5.4	5.5	2.7
Goods & services	2.6	2.2	-13.9
Transportation & equipment	0.3	0.4	23.5
Projects, maintenance & land purchases	2.1	1.8	-12.8
Miscellaneous & transfers	8.8	9.0	1.5
Surplus (deficit) before FGF	-7.0	-8.7	24.0
Future Generations Fund (FGF)	1.2	1.0	-16.1
Surplus (deficit) after FGF	-8.2	-9.7	18.0

Source: Ministry of Finance

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