Economic Update

NBK Economic Research Department I 10 May 2020

Kuwait

Twin challenge of Covid-19 and plunging oil prices to hit Kuwaiti growth this year

> Economic Research
+965 2259 5500
econ@nbk.com

Highlights

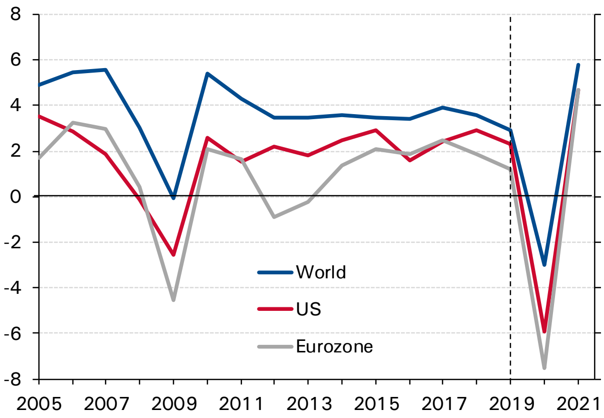
- **The outbreak of the coronavirus has had a huge impact on the global economy, with the IMF forecasting a 3% contraction in World GDP this year – much worse than during the financial crisis – including falls of 6% for the US and 8% for the Eurozone.**
- **Kuwait – along with the rest of the Gulf region – is facing the twin challenges of the virus and a collapse in oil prices. Despite various emergency policy measures aimed particularly at easing liquidity pressures on smaller firms, a sharp recession in the non-oil economy is seen this year. A large rebound is expected in 2021, so long as the virus is contained and oil prices recover.**
- **Alongside negative growth, the fiscal deficit will move abruptly higher and passing the debt law has become a priority.**

Global output to plunge this year – but rebound in 2021

The outbreak of the coronavirus has had a huge impact on the global economy, and looks set to trigger a downturn far deeper, though potentially shorter, than during the financial crisis and unparalleled in modern history. Analysts' views on the impact are still evolving, but the IMF expects global GDP to contract by 3% in 2020 including falls of nearly 6% in the US and even 8% in the Eurozone, amid widespread business closures, restrictions on movement and trade, a surge in layoffs and a severe drop in various asset prices. (Chart 1.) This compares to global growth of above 3% projected just a couple of months ago and a drop to 0% even at the height of the financial crisis in 2009.

Chart 1: Real GDP

(% y/y)



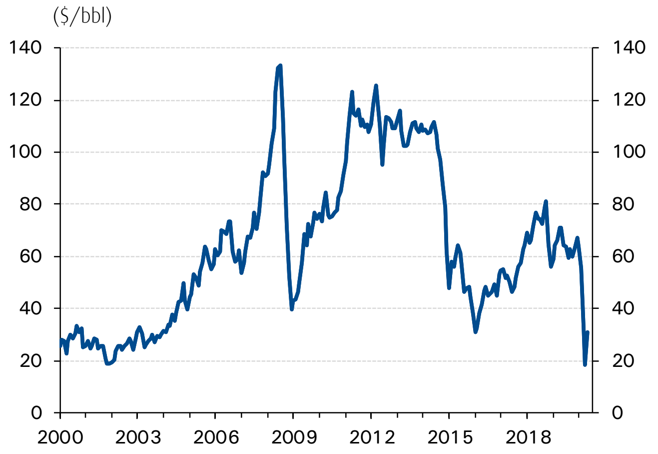
Source: IMF WEO April 2020

In this report we take a brief look at the short-term economic impact on Kuwait's economy, where despite some early containment measures the virus has spread and the shock to growth – as is the case elsewhere in the Gulf – looks severe. Before the virus struck, non-oil growth across the GCC region this year had been projected at moderate levels of around 2% or so, but a sizeable fall in non-oil output across the region is now our base case view for 2020 – though hopefully short-lived and followed by a strong recovery next year.

Of course the path of the pandemic itself is key to both the scale and longevity of the economic downturn and the strength of the subsequent recovery. Predicting this is fraught with uncertainty, but in our projections below we assume that the virus outbreak is successfully contained in Q2 and restrictions on movement and businesses are gradually eased later in the quarter, then fully lifted in H2. But if the virus is not contained effectively, persists for longer or even returns in a 'second wave' later on in the year, the economic impact would be greater.

On top of and of course partly due to the virus's impact on the global economy, the entire Gulf region including Kuwait is also reeling from a collapse in oil prices. (Chart 2.) Brent crude plunged more than 50% from above $50/bbl in early March to $23 at the end of the month, recovering slightly to around $30 by early-May. The virus has cratered global oil demand by 20-30% (20-30 mb/d). Moreover, faced with unsustainably low oil prices, a coalition of OPEC+ and G20 oil producers, led by Saudi Arabia, Russia and the US, agreed to a huge program of supply cuts stretching over two years to reduce the demand-supply mismatch, limit the build-up in stock levels and put a floor under prices.

Chart 2: Brent crude oil prices



Source: Refinitiv

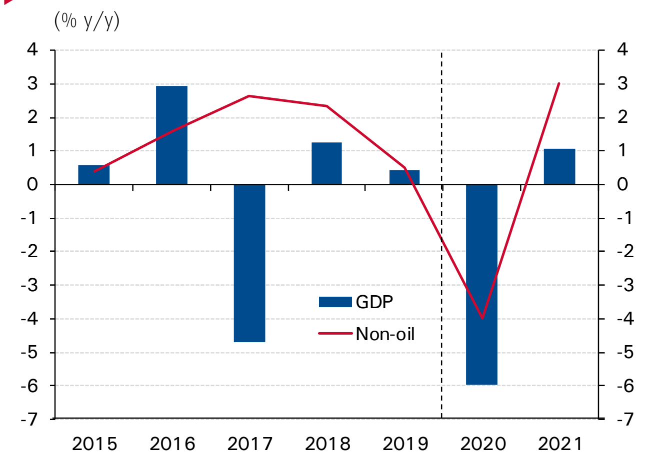
For the Gulf oil producers, this means initial scheduled oil output cuts of 23% versus earlier benchmark levels, moderating to 18% in 2H2020 then 14% through 2021 – cuts which will reduce economic growth. In our baseline, we estimate that oil prices will rise modestly as global oil demand recovers and the supply cuts take effect, but will still average only $35/bbl for the year versus $64/bbl in 2019 with the glut of crude taking time to work off. And just as with the forecasts for economic growth, prices could turn out even lower if efforts to contain the virus prove unsuccessful.

Kuwait's non-oil GDP to see large drop this year

Like other Gulf countries, Kuwait's non-oil economy will take a major hit from the shuttering of key parts of the economy for weeks due to virus-containment measures (including a full 24-hour curfew through most of May) and the precipitous drop in oil prices. It will also be affected adversely by drops in confidence, asset prices, investment, consumer spending, and potentially lower public spending as the government looks to address the fiscal deficit. Policy measures so far to alleviate the economic impact have included a cumulative 125bps cut in interest rates, the deferral of debt repayments for six months at no cost for all affected customers, three-year subsidized loans to help cover payroll and essentials, reductions in various government fees and changes in bank regulations to encourage lending. While helpful, these are unlikely to be enough to prevent a substantial near-term economic weakening.

Given the path of the virus described above, our base case is for non-oil activity to drop by 4% in 2020, incorporating a strong recovery in Q3 once businesses reopen and restrictions on movement have eased. (Chart 3.) The government's early drastic measures aimed at containing the virus's spread (it was the first Gulf country to implement widespread business closures in mid-March), in addition to the policy measures mentioned above, should help Kuwait get back to business as quickly as possible. However, these early measures could also imply a more intense initial impact on activity. We would also expect a strong economic recovery in 2021.

Chart 3: Kuwait GDP

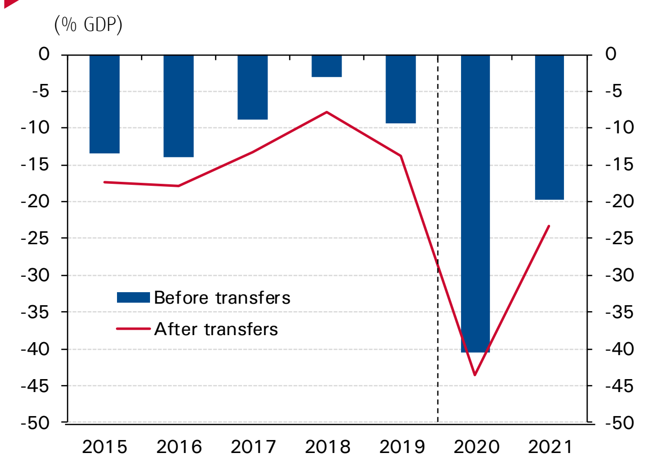


Source: CSB / NBK forecasts

Meanwhile, oil GDP will undergo a still-larger decline due to the OPEC-mandated 23% (versus the October 2019 baseline) production cuts effective from May, moderating slightly in H2. This should leave Kuwait's oil production down 8% on average in 2020 at just below 2.5 mb/d. A similar-sized fall in oil GDP would leave total GDP down nearly 6%. Overall growth could turn positive again in 2021 helped by the easing in oil production cuts (although on average, oil production could still be lower than this year) and rebounding non-oil growth.

On the public finances, we now expect a deficit of more than KD12bn in FY20/21 (40% of GDP) and above KD13bn (43% of GDP) after transfers to the Future Generations Fund. (Chart 4.) This compares to a pre-transfers deficit of KD4bn (9% of GDP) last year.

Chart 4: Kuwait fiscal balance



Source: Ministry of Finance / NBK forecasts

Funding of the deficit could be a challenge, and would exhaust most of the estimated KD16bn remaining in the General Reserve Fund, especially in the absence so far of a new debt law. Passing this law has become a government priority and would provide for extra flexibility, especially since public debt currently stands at just 12% of GDP, which is very low by international standards.

Meanwhile, although Kuwait has huge overseas assets estimated at $570bn (last year) held by KIA including the Reserve Fund for Future Generations, these cannot under current laws be accessed. Tapping into these assets would also substantially ease any future funding pressure, though would be contentious and best be accompanied by major fiscal reforms to reduce the deficit by controlling expenditures and boosting non-oil revenues to minimize the drawdowns and provide for long-term sustainability.

Table 1. Kuwait key macroeconomic forecasts

	Unit	2018	2019e	2020f	2021f
NGDP	KD bn	42.5	40.9	30.8	35.0
RGDP	%	1.2	0.4	-6.0	1.0
- Oil	%	0.2	-1.6	-8.0	-1.0
- Non-oil	%	2.3	0.5	-4.0	3.0
Fiscal bal*	% GDP	-3.0	-9.4	-40.5	-19.7
Pub debt**	% GDP	14.5	12.6	27.6	30.1
Inflation	%	0.6	1.1	1.0	1.5
Curr acc	% GDP	14.5	7.5	-20.7	-10.0
Oil prod	Mn b/d	2.74	2.68	2.46	2.42
Brent	$/bbl	71.6	64.2	35.0	50.0

Source: National sources, NBK
* Before transfers to the SWF ** Assumes debt law is approved

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353