April 2021

Kuwait Quarterly Economic Brief

Economy improving slowly with ongoing pandemic but should be buttressed by reforms

National Bank of Kuwait
Economic Research Department

Economy improving slowly with ongoing pandemic but should be buttressed by reforms

Highlights

- **The economy looks in better shape so far in 2021, though normalization is delayed due to the persistence of the pandemic.**
- **Recently released GDP data shows the extent of the economic contraction in 2020 – by as much as 13.4% y/y in 2Q20.**
- **Consumer spending increased by 59% y/y in March supported by recent strength in household lending.**
- **Employment growth for nationals slowed slightly to 2.1% in 2020, while expatriate employment fell 7.0%.**
- **Long-standing reforms are needed to take growth to a higher level and create more jobs in the private sector.**
- **The widening gap in public finances should provide a further impetus to deficit-reducing fiscal measures, although the recent increase in oil prices would relieve some of the pressures on budget financing.**

Kuwait's economy so far in 2021 looks to be recovering gradually from the economic dislocation caused by the coronavirus pandemic. The contraction in GDP in the second and third quarters last year was the sharpest on record (data back to 2011), while the public finances registered one of the largest deficits amid a big drop in oil prices. Inflation has continued to rise on the back of higher food prices and supply-side constraints.

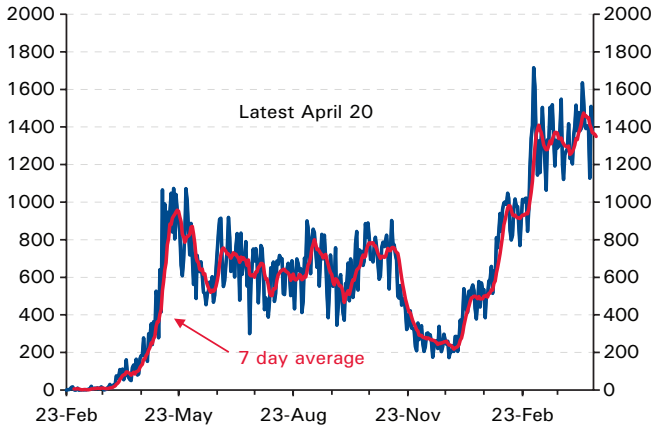
High frequency economic data in the first quarter of 2021 shows that improvement was driven by consumer spending and household borrowing. The stock market has also performed relatively well during 1Q21, lifted by vaccine optimism and expectations of improved business activity down the line. Hopes are high that, with an increase in awards in 1Q21, activity in Kuwait's projects market will finally gain traction this year following the pandemic-affected 2020. This is taking place against a backdrop of markedly higher oil prices, which, in turn, is a reflection of OPEC+ supply side management and improved global oil demand growth.

Having said that, uncertainty is still high: the reintroduction of partial curfews amid rising coronavirus infections both in Kuwait and abroad will have slowed down the normalization process. (Chart 1.) In Kuwait, lending to businesses has been soft, though the approval of the "loan guarantee" law should provide some support. The impact of the deferral of Kuwaiti loan repayments for six months is uncertain on economic activity although it would add to the fiscal burden, and so would the recent KD0.6 billion to front line workers.

The still tense relation between the newly elected parliament and the government does not augur well for the legislative and long-awaited reform agenda, especially on the fiscal front, including the much debated debt law.

Chart 1: Confirmed Covid-19 cases in Kuwait

(Number per day)

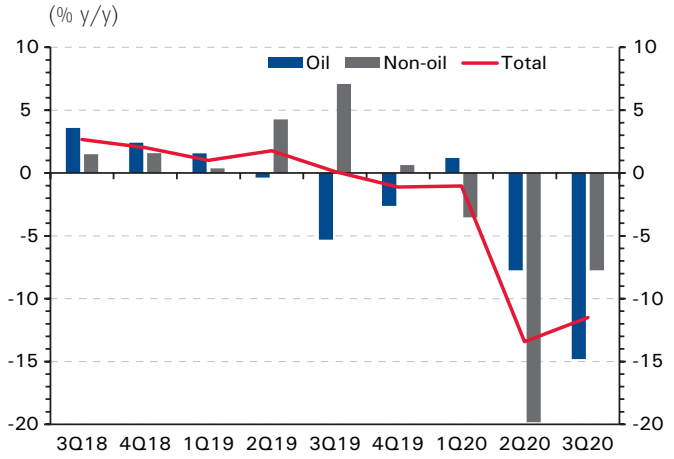


Source: Ministry of Health

GDP contracts sharply in Q2 and Q3 2020, to rise in 2021

Third quarter 2020 GDP data released last month revealed a fourth consecutive year-on-year contraction for the Kuwaiti economy. Real GDP declined by 11.5% y/y in 3Q20, weighed down especially by weakness in the oil sector (-14.8%) due to OPEC+ cuts while non-oil economic activity was adversely affected by pandemic-related restrictions, as businesses were only being opened gradually in a phased sector-specific approach. (Chart 2.) That said, consumer spending skyrocketed in 3Q20 (+26% y/y) once full curfew had been lifted – and growth has been in double digits ever since.

Chart 2: Real GDP

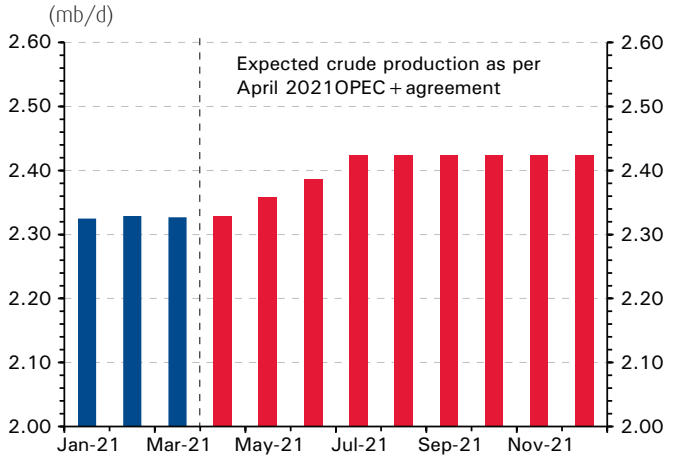


Source: Central Statistical Bureau

In light of these quarterly figures, we now see GDP growth in 2020 as a whole at -8.0% y/y. This year should see a return to growth, of 1.2%, driven by non-oil sector gains (4%) stemming from private consumption due to pent-up demand and higher government spending due to higher oil prices.

Oil GDP is projected to improve in the remainder of the year following the recent OPEC+ decision to release gradually more oil into the market starting in May. (Saudi Arabia will restore its 1 mb/d of the voluntary cut production as well.) Kuwait's compliance with the OPEC+ supply cut agreement was in excess of 100% (average) during the quarter with production averaging 2.33 mb/d but is expected to rise to 2.43 mb/d in line with its new quota. Production is then seen at this level until the expiration of the OPEC+ agreement in April 2022. (Chart 3.)

Chart 3: Kuwait crude oil production

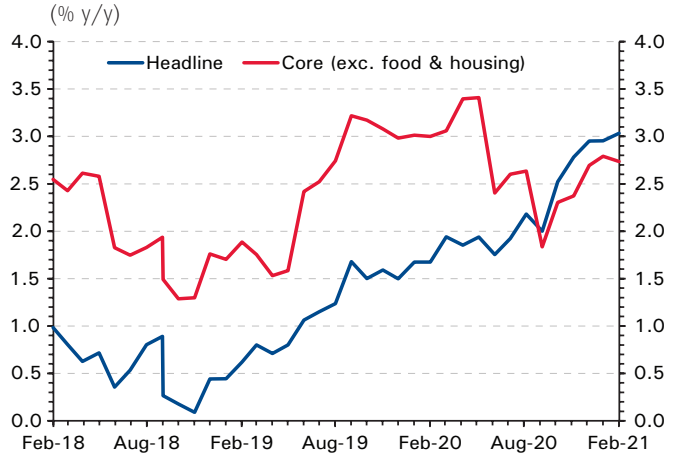


Source: Refinitiv / NBK

Inflation in February unchanged from January

Consumer price inflation stood at 3.0% y/y in February, largely driven by a continued, significant climb in international food prices (10.4%) due to supply-side disruptions brought on by the pandemic and higher food prices. (Chart 4.) The housing services index, meanwhile, has not budged since June 2019, despite reports of variations in rents pre and post-pandemic, especially considering the exodus of thousands of expatriates and anecdotal reports of decreases in rents given to some tenants during the pandemic. Core inflation, which excludes food and housing costs, fell slightly to 2.7% y/y. Looking ahead, we expect inflation to average 2.5% this year, edging up a bit further if VAT were to be implemented next year.

Chart 4: Consumer price inflation

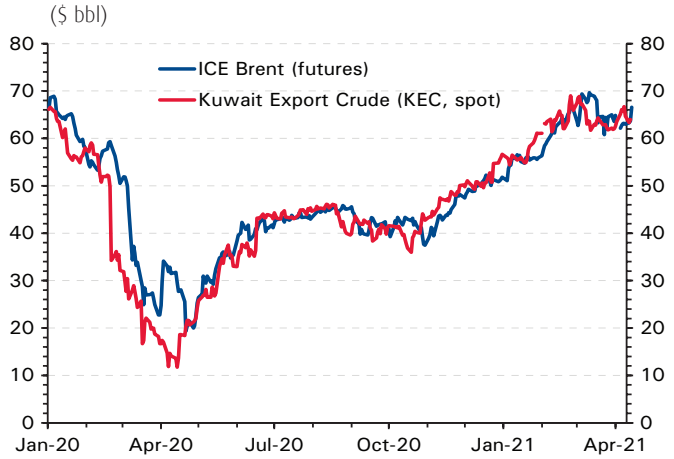


Source: Refinitiv / NBK

Oil prices rally to 22-month highs

Optimism about the prospects for a global economic recovery amid increasing vaccinations and the OPEC+ mediated supply tightness are the primary reasons for the increase in oil prices. Brent price closed out the first quarter of the year up 22% q/q at $63.5/bbl, having almost breached a 22-month high of $70 in mid-March. (Chart 5.)

Chart 5:Oil prices



Source: Refinitiv / KPC

Prices have been largely range-bound heading into April on renewed demand-side concerns sparked by the re-imposition of coronavirus lockdowns in several economies. Recently, though, better-than-expected economic data out of the US and China (although India, a large consumer of oil, has been hammered by massive infections which could affect oil demand) and the International Energy Agency's upward revision to global oil

demand in 2021 appear to have improved sentiment. Kuwait Export Crude (KEC) has outperformed Brent, gaining 26% in 1Q21 to $63.9/bbl at end-March.

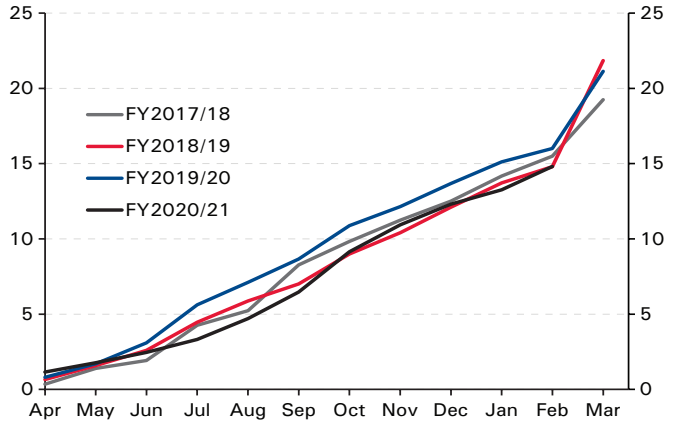
Large fiscal deficit in FY20/21

Lower oil production and prices are likely to push the budget deficit in the fiscal year that ended in March to a high level if lower than projected in the official budget. Low oil revenues drove the increase in the deficit with the KEC oil price down 35% y/y during the period to $41.5/bbl, while oil production declined by 12.6% on OPEC+ production cuts. Moreover, non-oil revenues, although relatively small, shrank by 16.1% amid repercussions of the Covid pandemic. Meanwhile, while government spending fell by 7.4% due mainly to the sizeable decline in capex (-29%) on delays and postponements to project work. The government registered a deficit of KD6.0 billion during the first 11M of FY20/21 (April-February). However, based on seasonal spending patterns, the deficit could end up at about KD9 billion (28% of GDP) for the whole fiscal year.

The recent rise in oil prices if sustained will help reduce the government's financing needs for the current fiscal year. Aside from halting transfers into the Future Generations Fund (FGF), the government has taken additional steps to boost liquidity at the General Reserve Fund (GRF) in all likelihood for a few months through some swap operations (with the FGF) and collections of retained earnings from state-owned enterprises including the Kuwait Petroleum Corporation. The budget deficit for this fiscal year could end up at about KD7-8 billion, much lower than projected in the draft government budget (KD14.1 billion) but large enough not tobe financed with existing resources without passing the debt law or withdrawing from the FGF.

Chart 6: Government spending

(KD billion, year-to-date)



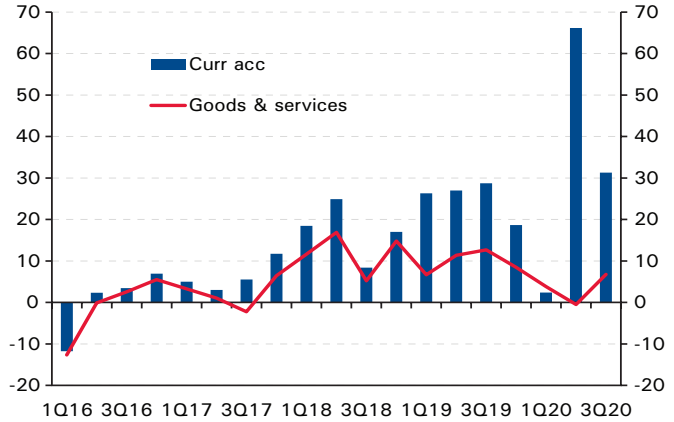
Source: Ministry of Finance

The external sector should improve further in 1Q

The latest available data for 3Q20 showed an improvement in the external position due to the rebound in oil prices from their pandemic-lows and also high returns on investments abroad (FGF and PIFSS) due to a rebound in international markets. (Chart 7.) With oil prices rising, the current account should have improved further in 1Q21. With a possible easing of restrictions and travel in the remainder of the year, we could witness a widening of the service account but the external position should remain robust.

Chart 7: Current account balance

(% GDP)



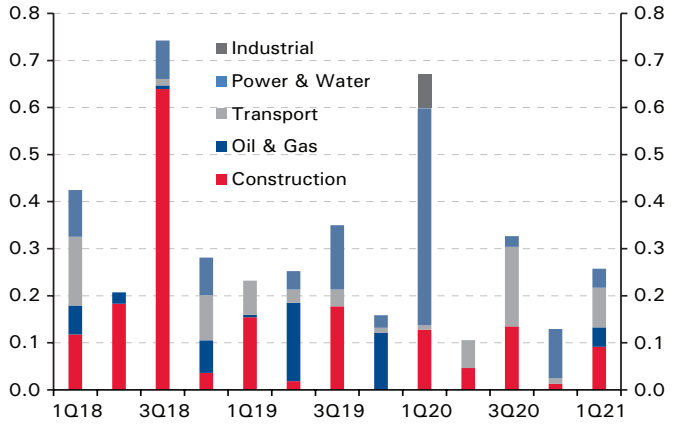
Source: Central Bank of Kuwait

Project awards gather pace, but fall short of expectations

The value of project awards in 1Q21, at KD257 million, was higher compared to a year earlier but lower than previously expected for the quarter (KD1.4 billion). The bulk of awards stemmed from the construction (KD92 million) and transport (KD84 million) sectors. The ongoing mobility restrictions to curb the spread of the coronavirus and the uncertain economic conditions have likely affected progress in project tendering and execution. (Chart 8.) MEED projects estimates around KD4 billion in the project pipeline for the remainder of 2021, including many that have been postponed from 1Q21 to 2Q21. That said, given the ongoing pattern of delays and setbacks and the extension of the current partial curfew until mid-May, it is very likely that a much smaller figure will materialize.

Chart 8: Project awards

(KD billion)

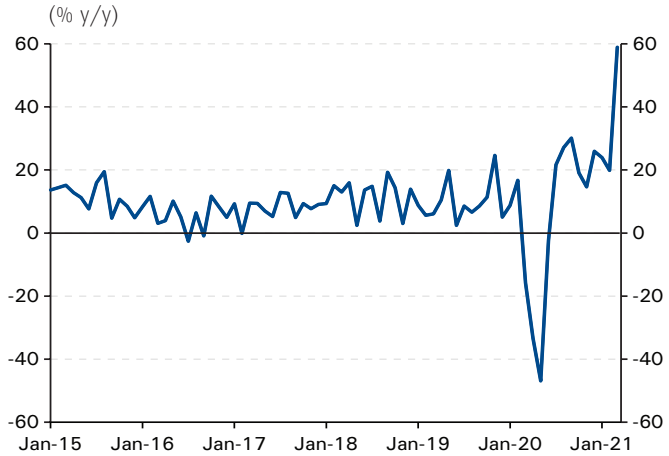


Source: MEED Projects (accessed 4 April 2021); data is provisional.

Consumer spending growth supports growth

Consumer spending growth accelerated sharply to 59% y/y in March, when pandemic restrictions were first implemented. (Chart 9.) In month-on-month terms spending rose 12.7%, which although strong at face value, is actually below the March readings in earlier years. Still, overall the numbers suggest that consumer spending continues to be one of the strongest areas of the economy, with little significant impact from the reintroduced curfew in March that especially affected restaurants and malls. The pandemic-related restrictions expedited the move toward online spending, growing by 123%, in March, pushing the amount of online transactions to KD0.79 billion, or 36% of total spending, up from 12% just two years ago.

Chart 9: Consumer spending



Source: Knet

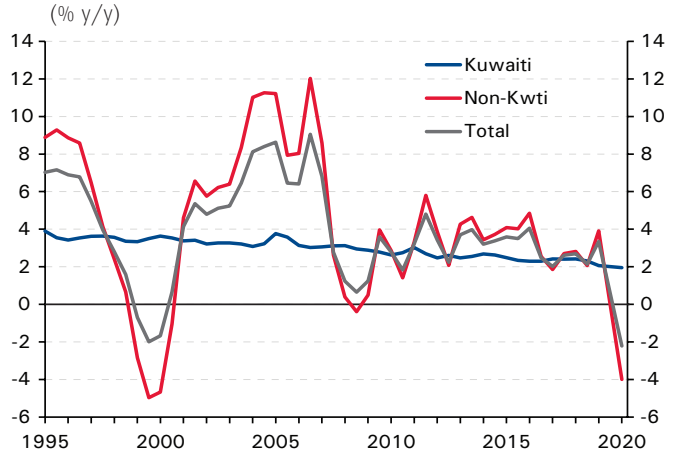
While spending remains solid and the economic outlook has improved, uncertainty surrounding the pandemic, the impact of renewed restrictions and ongoing political wrangling amid reports on the difficult budgetary situation have dented consumer confidence. Ara's consumer confidence index continued its slide from 102 in October to 96 in February, the lowest level since May 2020.

Expat population sees large drop amid pandemic pressures

Kuwait's population experienced in 2020 the biggest annual drop recorded in almost 30 years at -2.2%, as the number of resident expatriates fell by 4.0%, while the number of Kuwaiti nationals continued to rise modestly, at 2.0%. (Chart 10.) More than 130,000 expats left the country last year (mainly low-paid and low-skilled expatriate workers) as the economic slowdown and restrictions measures forced companies to cut their workforce. Some proposed changes to the residency law and continued enforcement of Kuwaitization policies have also been a contributor.

The pandemic also caused a moderation in growth of hiring of Kuwaiti nationals from 2.4% in 2019 to a still decent 2.1% in 2020. However, employment increased in the public sector (2.7%) but fell in the private sector (-1.2%), adding pressure to the budget where a large share of spending goes to the wage bill. Excluding domestic workers, expatriate employment dropped 7.0%.

Chart 10: Kuwait's population

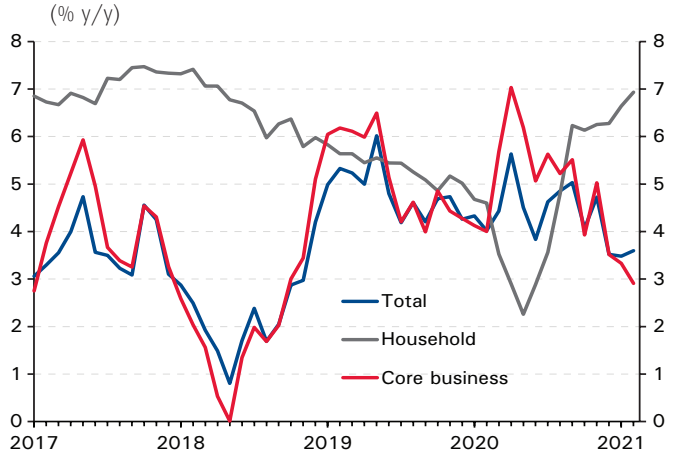


Source: PACI

Credit growth solid on household borrowing

Domestic credit started the year on a relatively decent note, with growth at 3.6% y/y by the end of February, driven more by household lending. (Chart 11.) Business credit has been generally lackluster, with y/y growth at 2.9%, on weakness in the "other" credit category (presumably credit to conglomerates and to high net-worth individuals). Lending to the oil/gas sector was robust at 7.9% y/y.

Chart 11: Bank credit



Source: Refinitiv / CBK / NBK

Household credit continued to grow strongly, reaching 6.9% y/y by end-February, driven mainly by housing loans (7.3%), while consumer loan growth softened further to 8.1%. Looking ahead, the six-month deferral of household credit instalments of Kuwaiti borrowers, all else being equal, is expected to strengthen the net growth of household credit.

As for resident deposits, they have been falling for five months in a row (3.4% y/y growth). The weakness in private-sector deposits is driven by time deposits, which could reflect the drop

in interest rates. Government deposits have been even weaker, falling by nearly 6% year-to-date (ytd) (KD466 million), possibly as the government tries to withdraw funds left in the banking sector to finance the widening budget deficit. The deferral of household credit instalments of Kuwaiti borrowers is expected to provide some support for the net growth of private-sector deposits going forward. Muted resident deposits have been partly compensated by decent non-resident deposits, which are up by 5% ytd.

The newly-approved "loan guarantee" law, while positive for SMEs, is not expected to have a main impact on overall credit growth given its small size (capped at KD500 million), which represents only 1.2% of total outstanding domestic credit by the end of February. Finally, in an effort to continue supporting the banks and the overall economic recovery, the CBK extended its relaxed capital adequacy and liquidity measures for an additional six months (till the end of June 2021).

Stocks see moderate rise on recovery optimism

After the sluggish performance of 4Q20, Boursa Kuwait's All-Share Index rose a solid 4.1% q/q in 1Q21, pushing market capitalization up to a 15-month high (KD34 billion), as higher oil prices and the vaccine rollout bolstered sentiment and economic recovery expectations. (Chart 12.) The index was lifted largely by the premier market (4.5%), with the technology, real estate and financial sectors in the lead. Liquidity remained ample, with an average daily turnover by value of KD39 million, reflecting continued interest in local stocks and a healthy level of activity, though net foreign inflows slowed considerably to around KD 6 million in 1Q21, largely due to the end of the market upgrade-related flows of 2020. Looking ahead, the easing of virus concerns amid the rollout of vaccines and economic recovery optimism should be supportive of market sentiment, while downside risks include the lagging pace of reforms amid the ongoing political turmoil, as well as pandemic and vaccine-related uncertainty.

Chart 12: Boursa Kuwait All-Share index

(index, end month)

Source: Refinitiv

Looking ahead, deficit financing is the main concern

Indications are that GRF resources could be fully depleted in the next few months. As such, the government intends to push the approval of the debt law through parliament along with much-needed and long-awaited reforms to redress the public finance situation.

In this context, the government recently released its action plan for 2021-25. This includes tackling budgetary pressures by rationalizing expenditures, diversifying revenue streams and addressing financing options. Among the proposed measures is the introduction of the VAT and excise taxes. However, these measures and reducing subsidies would not only take time to have an impact but also are not sufficient by themselves to rectify the financing issues. Hence, passing the debt law is not only a priority but also a must for the government to maintain its obligations. Borrowing at this stage is preferable over tapping into the FGF, and this is likely the view of both the government and parliament. Still, serious progress on the fiscal reform front is dependent upon improved cooperation between the government and parliament.

Table 1: Key economic data

	2014	2015	2016	2017	2018	2019	Forecast/estimate 2020	2021
				(KD billion)				
Nominal GDP	46.3	34.5	33.1	36.6	42.5	41.2	31.8	37.8
Oil	29.2	15.7	13.6	16.2	21.0	19.2	10.7	15.5
Non-oil	17.1	18.8	19.5	20.4	21.5	21.9	21.1	22.3
				(percent change)				
Real GDP	0.5	0.6	2.9	-4.7	1.2	-0.7	-8.0	1.2
Oil	-2.1	-1.7	3.9	-9.0	0.2	-2.0	-8.0	-1.0
Non-oil	4.9	4.2	1.5	1.7	2.7	1.0	-8.0	4.0
Private credit	6.1	8.5	2.9	3.1	4.2	4.3	3.5	...
Money supply (M2)	3.4	1.7	3.6	3.8	3.9	-1.2	3.8	...
Inflation (% y/y, average)	3.2	3.7	3.5	1.5	0.6	1.1	2.1	2.5
Inflation (% y/y, e.o.p)	3.0	3.1	2.4	1.1	0.4	1.5	3.0	1.5
				(percent of GDP)				
Fiscal balance (before FGF transfers)	7.6	-13.4	-13.9	-8.9	-3.0	-9.5	-28.0	-17.0
Revenues	53.9	39.5	39.6	43.7	48.4	41.8	33.4	37.2
Oil	48.6	35.0	35.4	39.0	43.4	37.3	28.0	32.5
Non-oil	5.2	4.5	4.3	4.7	5.0	4.5	5.3	4.7
Expenditure	46.3	52.9	53.6	52.6	51.4	51.3	61.4	54.2
Transfers to Future Generations Fund	13.5	4.0	4.0	4.4	0.0	0.0	0.0	0.0
Fiscal balance (after transfers to FGF)	-5.9	-17.3	-17.9	-13.2	-3.0	-9.5	-28.0	-17.0
Investment income*	8.5	12.4	13.4	12.9	11.3	11.8	15.2	12.4
Public debt	3.4	4.6	19.6	19.8	14.5	10.8	11.7	17.8
Current account balance	33.4	3.5	-4.6	8.0	14.1	16.3	4.0	13.0
Goods balance	47.7	24.4	17.8	21.3	29.2	26.0	13.4	21.1
Export	64.2	47.5	42.5	45.7	51.3	47.7	37.3	43.2
Imports	16.6	23.2	24.7	24.4	22.1	21.7	23.9	22.1
Services (net)	-11.1	-17.4	-18.3	-16.7	-17.5	-12.4	-12.6	-11.2
Investment income (net)	9.6	11.1	11.7	15.6	13.0	14.3	16.8	14.5
Worker remittances	-12.7	-14.5	-15.8	-12.2	-10.6	-11.6	-13.6	-11.4
Exchange rate (KD per 1 USD)	0.285	0.301	0.302	0.303	0.302	0.304	0.307	...
CBK discount rate	2.00	2.25	2.50	2.75	3.00	2.75	1.50	...
Kuwait export crude price (USD per barrel)	95	48	39	51	69	64	41	60
Oil production (million barrels per day)**	2.87	2.86	2.95	2.7	2.74	2.68	2.44	2.39

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, NBK estimates.

*Based on estimated figures by CSB and NBK. ** Uses JODI/OPEC direct communication figures.

Table 2: Monthly economic data

(KD billion, unless otherwise indicated)

	Dec-18	Dec-19	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Credit	36.9	38.4	39.9	40.1	39.8	39.9	40.0	...
Growth (% y/y)	4.2	4.3	4.1	4.7	3.5	3.5	3.6	...
Money supply (M2)	38.6	38.1	40.5	40.1	39.6	39.3	39.0	...
Growth (% y/y)	4.0	-1.2	5.2	4.8	3.8	3.2	4.1	...
Inflation (% y/y)	0.4	1.5	2.5	2.8	3.0	2.9	3.0	...
ex food and housing (% y/y)	1.7	3.0	2.3	2.4	2.7	2.7	2.7	...
Consumer spending (Knet, % y/y)	13.9	5.0	19.1	14.6	25.9	23.9	19.8	58.9
Consumer confidence (Ara, index)	110	105	102	100	99	97	96	...
Kuwait export crude price (USD per barrel)	57	66	40	43	49	55	62	65
Stock market - All Share index (e.o.p)	5,080	6,282	5.345	5,459	5,546	5,780	5,649	5,776
Growth (% y/y)	-0.6	4.5	1.8-	2.1	1.6	4.2	-2.3	2.2

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, ARA, NBK estimates

Table 3: Quarterly economic data

(KD billion, unless otherwise indicated)

	4Q15	4Q16	4Q17	4Q18	4Q19	1Q20	2Q20	3Q20
GDP growth (% y/y)	1.7	4.0	-4.3	2.0	-1.1	-1.0	-13.4	-11.5
Oil*	0.9	2.2	-5.8	2.4	-2.6	1.2	-7.7	-14.8
Non-oil*	0.3	2.7	1.6	1.6	0.6	-3.5	-19.8	-7.7
Current account balance	-0.1	0.6	1.2	1.8	1.9	0.2	4.2	2.5
Goods Exports	3.6	4.1	4.7	5.4	4.7	4.0	2.0	3.1
Goods Imports	2.1	2.1	2.4	2.3	2.3	2.0	1.7	1.8

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, NBK estimates * Series break: due to classification changes, growth rates in the oil and non-oil sectors before 1Q18 are not comparable with those thereafter.

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