Economic Update
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Kuwait: Fiscal deficit reaches all-time high of KD10.8 billion in FY20/21

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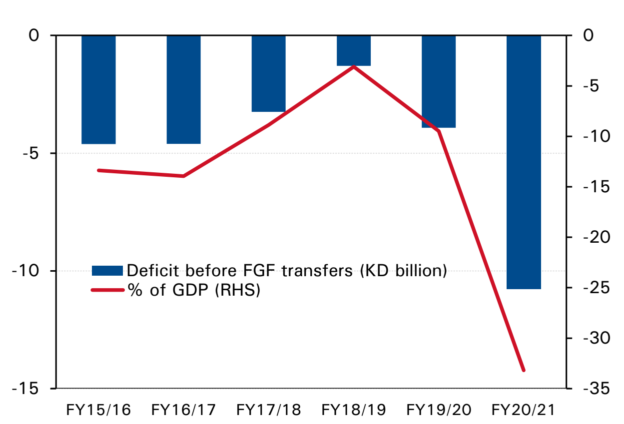
Highlights

- **Kuwait's fiscal deficit reached an all-time high of KD10.8 billion, or 33% of GDP, in FY20/21.**
- **Oil revenues fell to KD8.8 billion on a combination of low oil prices and OPEC+ crude production cuts.**
- **Total spending increased slightly by 0.7% y/y due to Covid-19 related spending.**
- **Capex registered its weakest performance in years (-27.5% y/y), with only 75% of the budget allocation spent.**
- **Financing the FY21/22 deficit will remain a challenge in the absence of the debt law given the near-depletion of the GRF.**

Similar to its GCC peers, Kuwait's fiscal position was heavily affected by the Covid-19 pandemic and the oil price shock that ensued. The deficit swelled from KD3.9 billion in the previous fiscal year to KD10.8 billion, or 33% of GDP, in FY20/21. (Chart 1.) The fall in the price of Kuwait Export Crude (KEC) was one of the main drivers of the deficit. The government tried to limit the increase in the deficit through compressing capital expenditures to compensate for the increase in the hard-to-reverse current expenditures. Total government spending rose at a mild rate of 0.7% to reach KD21.3 billion as capex was pared back while current spending rose by 4.7% due in part to Covid-19-related emergency measures. Budget financing needs remained large in the absence of parliamentary approval to issue new debt (the last issuance was in October 2017) or the ability to tap into the Future Generations Fund (FGF). The General Reserve Fund (GRF) remained the only source of financing, with its liquid assets almost exhausted.

Chart 1: Kuwait fiscal deficit

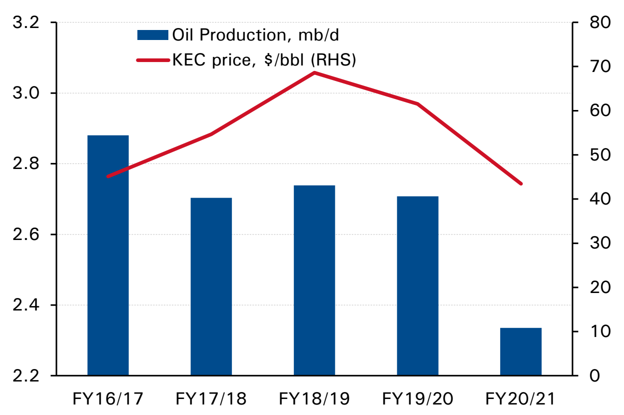


Source: Ministry of finance, CSB

Significant fall in revenues on lower oil prices and pandemic restrictions

The sharp decline in oil prices and lower non-oil revenues on account of slower economic activity led to a much higher budget deficit. Total revenues declined in FY20/21 by 38.9% to reach KD10.5 billion. Oil and gas revenues, which constituted 83.6% of total revenues, fell by 42.8%, driven mainly by the collapse in oil prices (KEC fell by 29.3% y/y to an average of $43.5/bbl) and the decline in oil production (-13.7% to 2.34 mb/d) due to the OPEC+ production cuts. (Chart 2.)

Chart 2: KEC oil price and production



Source: OPEC monthly oil market report

The pandemic took a toll on non-oil revenues, which fell by 6.5% to KD1.7 billion. Taxes and fees were hit hard (down 10.6% y/y), following the weak performance of local and foreign companies amid the pandemic and the steep decline in revenues from import duties due to much lower imports (-15.8% in 2020). Other non-oil revenues followed the same trend, declining by

2.6%, with receipts from electricity and water down 14.1% and 8.0% y/y, respectively. Moreover, paid compensations for the Iraqi invasion remained relatively stable at $1 billion in FY20/21 (approximately $2.1 billion in war reparations remains outstanding as of end-January 2021).

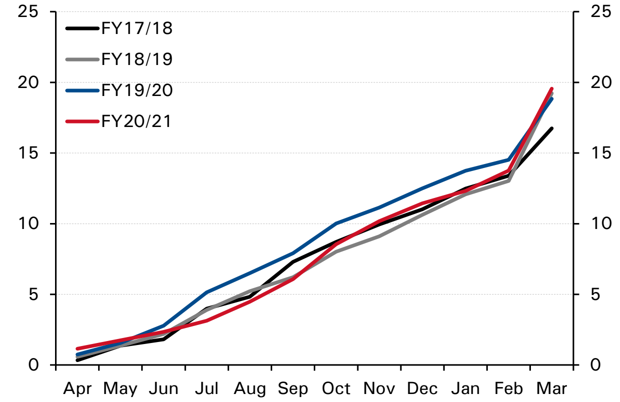
Total expenditures rise, albeit moderately, driven by still-strong current spending

Current spending increased at a solid pace while capex spending fell sharply as it bore the brunt of the government's cutbacks amid short-term liquidity constraints. Yet, the increase in current spending (by 3.8% to KD 19.4 billion), which represents the bulk of total spending (about 91%), pushed the latter up 0.7% y/y (to KD21.3 billion) though came in below its budgetary provision.

The rise in current spending during FY20/21 was due to Covid-19-related spending as the government allocated KD0.5 billion in emergency funds to support pandemic containment measures and a budgetary supplement of KD0.6 billion to pay bonuses for frontline workers. (Chart 3.) By excluding these two items, current spending actually declined last year by around 4.8% to KD20 billion.

Chart 3: Current Spending

(KD billion)



Source: Ministry of finance

The government made an effort to reduce the non-wage current spending. Purchases of goods & services plummeted by 10% to KD2.9 billion, while the cost of electricity generation and water distillation declined by 11.3% to KD1.4 billion, reflecting partly the decline in oil and gas prices as well as electricity generation by 0.4% in 2020. Excluding this item, government purchases of goods and services declined by 8.8% y/y.

Compensation of employees (38.1% of current spending) declined by 1.8% to KD7.4 billion, lower than the three-year average of around 4.1%. The decline is likely a reflection of a lower wages for employees under contracts, which fell by -18.7% y/y to KD0.6 billion, perhaps due to the departure of expatriates. In addition, bonuses and allowances (constitute 57.6% of compensation of employees' category) fell by 0.4% to KD4.3 billion.

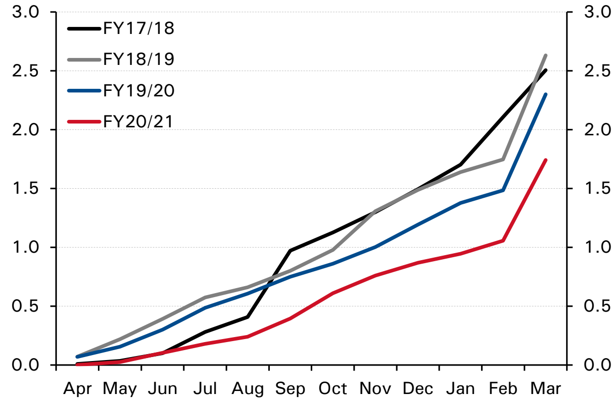
Moreover, fuel subsidies fell largely on the back of both lower oil prices and domestic consumption, the latter on pandemic-related restriction measures including the closure of the airport. In addition, social benefits declined 11.7%, with overseas healthcare services falling 18.9% to reach KD0.4 billion.

In contrast, grants (including transfers to public authorities and independent entities), which represents 25.5% of total spending increased by 3.8%, while other current spending shot up in FY20/21 due to Covid-19 related spending (KD0.5 billion of emergency funds and the supplementary budget for front line workers' bonuses of KD0.6 billion).

Capital spending was hard hit by the government's rationalization of spending amid tighter liquidity and mobility restrictions, which resulted in the delay, reappraisal or cancellation of some projects. Capital spending declined 24.3% to KD1.7 billion, about 75% short of the full-year budget provisions. (Chart 4.)

Chart 4: Capital Spending

(KD billion)



Source: Ministry of finance

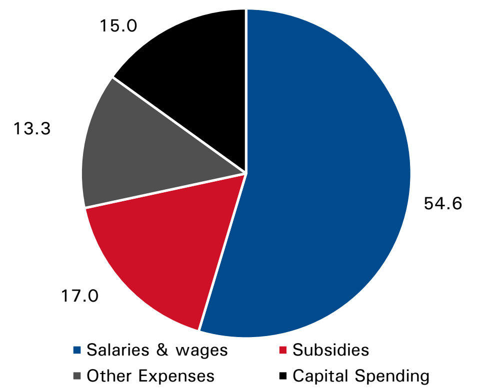
The accumulated deficit for the last 7 years has resulted in the near depletion of the General Reserve Fund (GRF), with total withdrawals reaching KD41 billion from FY15/16. The audit bureau recently reported that the GRF's net assets fell to KD9.6 billion at the end of 2020, and by the end of March 2021 that figure had fallen further to around KD1.6 billion in available in liquidity. However, the government has taken several measures during FY20/21 to reduce the rate of depletion and ensure the availability of cash. These include halting transfers to the FGF and assets swaps with the GRF (of around KD7.5 billion). The rise in oil prices since the beginning of 2021 has, however, helped in alleviating some of the pressures on the GRF.

The FY21/22 budget is relatively expansionary yet without reform measures

The FY21/22 budget, which was approved by the national assembly last June, will result in a financing gap that will be hard to fill without incurring debt or tapping into the Future Generations Fund. Total spending is expected to reach KD23.0 billion, or 6.9% higher than last year's budget, with a 20% increase in capex provision to KD3.5 billion and an increase in current spending by 4.9%. (Chart 5.) Revenues on the other side are expected to increase slightly based on an oil price assumption of $45/bbl (avg.) and an oil production assumption of 2.4 mb/d (avg.). As such, oil revenues would increase to KD9.1 billion while non-oil revenue should remain insignificant (KD1.8 billion). The official budget deficit is estimated at KD12.0 billion, but with the recent cabinet decision to cut spending by at least 10%, the deficit should come out lower at KD9.7 billion. However, we believe that the oil price prices could end up higher than the one assumed in the budget leading to an even lower deficit of KD5.2 billion (13.1% of GDP).

Chart 5: FY21/22 Spending allocations

(% of total spending)



Source: Ministry of finance

Although this fiscal year deficit will likely be markedly lower than last year's, still financing this deficit remains a challenge in the absence of parliamentary approval for a new debt law or lack of access to alternative sources of financing. In addition, the government has to repay some KD1.1 billion in maturing bonds next March. With GRF assets nearly depleted, passing the debt law is necessary if FGF resources are not to be tapped. In our view, using the FGF resources should be the last resort and will need to be temporary and linked to a clear and sustainable financing strategy. This will surely requires, in a longer-term perspective, substantial fiscal reforms involving both the revenues and expenditures fronts.

Whether the General Assembly will approve the debt law or critical fiscal reforms, including those that would make the budget less vulnerable to oil prices, remains an open question. However, the recent S&P downgrade of Kuwait's sovereign credit rating for the second time in less than 2 years may provide the needed incentive for undertaking such reforms. Further delays in passing the debt law or coming up with alternative financing measures could lead to further downgrade in the future. A closer coordination between the government and the national assembly is essential to hasten the reform process and put the public finances on a more sustainable path.

Table 1: Kuwait's fiscal balance (KD billion, unless otherwise indicated)

	FY2018/19	FY2019/20	FY2020/21	% y/y FY2019/20	% y/y FY2020/21
Revenues	20.6	17.2	10.5	-16.2	-38.9
Non-oil	2.1	1.9	1.7	-13.1	-6.5
Oil	18.4	15.4	8.8	-16.6	-42.8
Total Expenditures	21.8	21.1	21.3	-3.2	0.7
Current Expenditures	19.2	18.8	19.6	-2.1	3.8
Compensation of Employees	7.2	7.6	7.4	5.6	-1.8
Goods & Services	3.0	3.2	2.9	6.4	-10.0
Subsidies	1.4	0.6	0.6	-56.6	-10.1
Grants	5.2	5.3	5.4	0.2	3.4
Social Subsidies	1.0	1.0	0.8	-2.2	-11.7
Miscellaneous & Transfers	1.4	1.2	2.4	-12.0	94.7
Capital Expenditures	2.6	2.3	1.7	-12.0	-24.3
Budget Balance (Surplus/ Deficit)	-1.3	-3.9	-10.8	-----	-----

Table 2: Kuwait's Budget (KD billion, unless otherwise indicated)

	FY2019/20	FY2020/21	FY2021/22	% y/y FY2020/21	% y/y FY2021/22
Revenues	15.8	7.5	10.9	-52.6	45.7
Non-oil	1.9	1.9	1.8	-3.8	-3.8
Oil	13.9	5.6	9.1	-59.4	62.2
Total Expenditures	22.5	21.6	23.0	-4.2	6.9
Current Expenditures	18.8	18.7	19.6	-0.5	4.9
Salaries	12.0	12.1	12.6	0.7	4.2
Subsidies	3.7	3.6	3.9	-4.0	9.4
Other expenses	3.0	3.0	3.1	-1.2	2.3
Capital Expenditures	3.7	2.9	3.5	-22.7	20.0
Budget Balance (Surplus/ Deficit)	-6.7	-14.1	-12.1	110.1	-13.8

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