

Kuwait: The official budget for FY2020/21 projects a deficit of KD14.1 billion

> Issa Hijazeen
Senior Economist
+965 2259 5359
IssaHijazeen@nbk.com

> Daniel Kaye
Head of Research
+965 2259 3136
Danielkaye@nbk.com

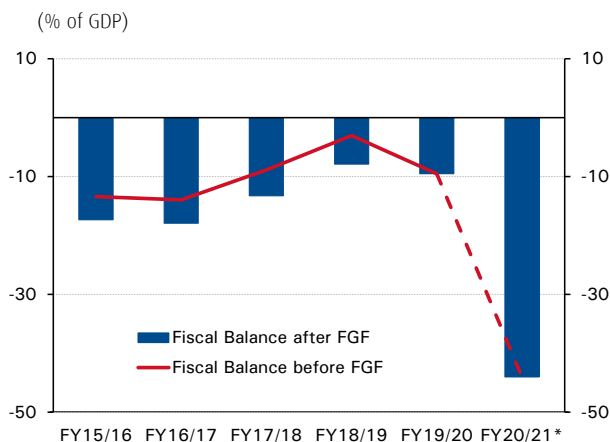
Highlights

- The FY2020/21 budget reveals a record budget deficit of KD14.1 billion, though we expect a smaller figure.
- Revenues are expected to decline due to a collapse in oil revenues to KD5.6 billion, but could end up higher.
- Spending is cut 4% from last year's budget to KD21.6 billion, though still up from last year's outturn.
- Capital spending is budgeted to drop by 29% to KD2.3 billion – one of the largest cuts on record.

The Ministry of Finance recently released details of the FY2020/21 budget, which was approved in September and projects an unprecedented deficit of KD14.1 billion due to the collapse in oil prices and revenues. (Chart 1.) Meanwhile, a cut in spending versus the previous year's budget includes sharply lower allocations for capital spending. This cut seems to imply less support for the economy at a time when demand is weak, but the underlying picture is more complicated. The delayed approval of the budget due to the Covid-19 pandemic, the fact that projected spending is still above last year's outturn, and that some of the cut comes from lower fuel subsidies (due to a lower oil price assumption) make its impact on growth more difficult to predict, though lower capex allocations could still weigh negatively on economic activity.

\$30/bbl and 2.5 mb/d. (Chart 2.) This implies a drop in expected oil revenues by 59% to KD5.6 billion. Moreover, non-oil revenues are projected to fall by 3.8%, including a 22% rise in taxes from foreign companies. These assumptions could be a bit optimistic given the significant decline in trade that could affect customs proceeds, as well as the deterioration in foreign and domestic companies' performance this year due to the pandemic. Moreover, the FY2020/21 budget assumes that electricity and water revenues will remain the same, which is doubtful due to lower consumption rates as the number of expats likely declines. Still, due to the drop in oil revenues, non-oil receipts are projected to reach a record share of 25% of total revenues (though the eventual outcome is likely to be smaller).

▶ **Chart 1: Fiscal Balance**



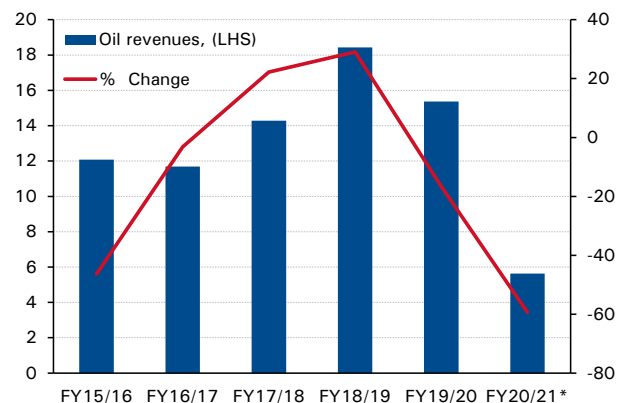
Source: Ministry of Finance, NBK estimates,
* Data after FY19/20 are budget estimates.

Oil revenues plummet on lower oil price assumption

Total revenues are expected to decline by 53% (budget-on-budget) based on oil price and production assumptions of

▶ **Chart 2: Oil revenues**

(KD billion)



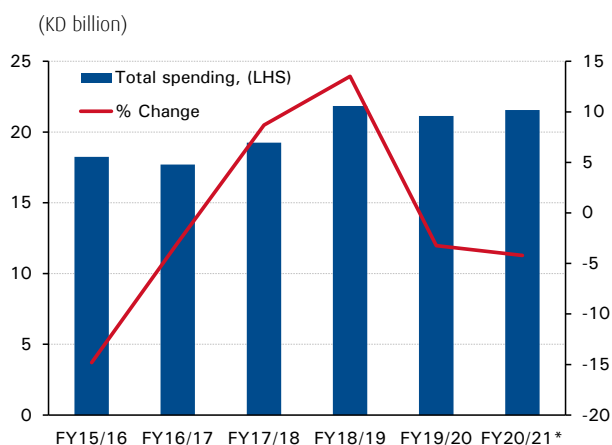
Source: Ministry of Finance, NBK estimates,
* Data after FY19/20 are budget estimate.

Spending sees modest cut, driven by lower capex

On the expenditure side, total spending is set to decline by 4.2% to KD21.6 billion. (Chart 3.) The decline comes mainly from capital spending whose budget allocations decrease by 29% to

KD2.3 billion. Meanwhile, current spending is broadly unchanged at KD19.2 billion. (Chart 4.) However, within the overall total, there are declines in allocations for the compensation of employees, use of goods and services, subsidies, and social benefits, offset by a rise in grant outlays and especially miscellaneous expenses (see below).

Chart 3: Total expenditures

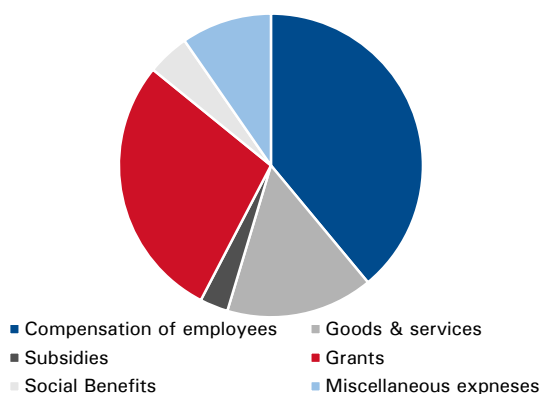


Source: Ministry of Finance, NBK estimates,
* Data after FY19/20 are budget estimates.

The government effort to curb spending is reflected in its allocations for compensation of employees, which declines by 2.5% to KD7.5 billion due to lower allocations in cash wages (91% of compensation of employees) by 1.3%. The projected decline in subsidies and social benefits comes from lower provisions for the subsidization of oil derivatives and LNG for public corporations by 9.8% and healthcare abroad by 19.4%.

Chart 4: Current spending main components in FY20/21

(% total current spending)



Source: Ministry of Finance, NBK estimates

Furthermore, purchases of goods & services are cut by around 11% to KD3.0 billion helped by the projected decline in oil prices. On the other side, the rise in grants and miscellaneous expenses is due to higher transfers to the independent entities (such as The Public Authority for Manpower and Public Establishment for Housing) by 9.4%, which include a KD2.3 billion transfer to PIFFS, as well as the inclusion of KD0.5 billion of urgent funds to confront the spread of Covid-19. These result in an increase in

miscellaneous expenses by 47%.

Meanwhile, the fall in capital spending is driven by a decline in allocations to the Ministry of Public Works by 30% to KD0.7 billion. Capital spending typically comes in well below budget, averaging a 77% spending rate over the past decade. Given the natural project delays and cancellations that have occurred in the first half of this year due to Covid-19, execution rates could again be low, even after accounting for the smaller budget. Based upon historical spending rates, capex could decline further to around KD1.8 billion.

Deficit likely to come in below official projection

Overall, the government's projection of a KD14.1 billion deficit is the widest on record, but reflects as usual some quite conservative assumptions including on the oil price, which is the lowest since FY2005/06. Our base case view is for an oil price some \$10 higher at \$40 and total revenues of KD9.5 billion, which together with a 5% y/y cut in spending to KD20 billion, generates a smaller deficit of KD10.5 billion, roughly 33% of GDP. However, the deficit outcome will be contingent on oil production and prices, which could come in above our expectations in the remainder of FY2020/21, thus resulting in a final deficit below our forecast.

Still, this is very large and although the deficit will fall in subsequent years if oil prices recover, it outlines the huge challenge the government faces to put its finances on a more sustainable footing, even if – as we assume – near-term financing difficulties due to the near-depletion of the General Reserve Fund and absence of a debt law are overcome. Aside from measures to boost and diversify revenues such as VAT and excise taxes, reforms could include changes in the structure as well as the level of government spending. For example, this year's projected drop in budgeted spending is almost entirely driven by a cut in capital expenditures. However, these should be prioritized over time in order to support infrastructure programs and enhance the economy's growth potential.

► Table 1: Public finances, KD million unless otherwise stated

	Official Budget			% y/y	
	FY2018/19	FY2019/20	FY2020/21	FY2019/20	FY2020/21
Revenues	15,089.0	15,811.7	7,502.6	4.8	-52.6
Non-oil	1,771.5	1,948.4	1,874.3	10.0	-3.8
Oil	13,317.5	13,863.4	5,628.2	4.1	-59.4
Total Expenditures	21,500.0	22,500.0	21,555.0	4.7	-4.2
Current Expenditures	18,221.6	19,228.3	19,243.3	5.5	0.1
Compensation of Employees	7,233.6	7,692.1	7,501.9	6.3	-2.5
Goods & Services	3,061.8	3,386.3	3,011.5	10.6	-11.1
Subsidies	531.6	639.5	577.6	20.3	-9.7
Grants	5,243.0	5,252.2	5,432.5	0.2	3.4
Social Subsidies	784.9	994.7	866.4	26.7	-12.9
Miscellaneous & Transfers	1,366.7	1,263.5	1,853.5	-7.6	46.7
Capital Expenditures	3,278.4	3,271.7	2,311.7	-0.2	-29.3
Budget Balance, before RFFG transfers	-6,411.0	-6,688.3	-14,052.4
RFFG transfers*	1,508.9	1,581.2	750.3
Budget Balance, after RFFG transfers	-7,919.9	-8,269.4	-14,802.7

Source: Ministry of Finance, * RFFG transfers are suspended due to parliament decision to suspend transfers if the government achieve a deficit.

Head Office

Kuwait

National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
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 France SA
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
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
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