Kuwait: Current account surplus narrowed to near three-year low in 1Q20

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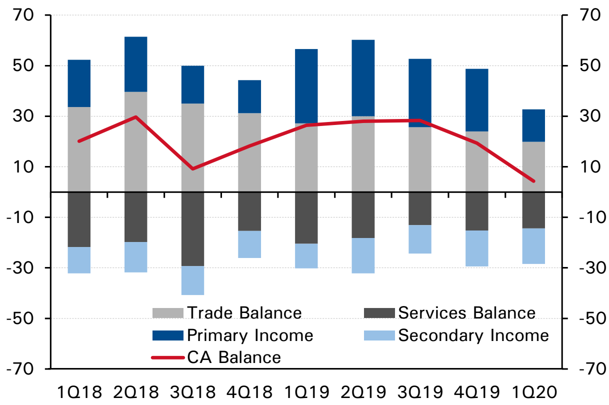
Highlights

- **The current account surplus narrowed to KD 0.4 billion in 1Q20 (4.3% of GDP) on low oil prices.**
- **The trade balance surplus fell by 26.7% y/y, while the service account improved mainly on account of less travel due to pandemic-related restrictions.**
- **Kuwaiti Investment returns witnessed a sharp decline due to weak international financial markets' performance in 1Q20.**
- **The CBK's gross international reserves increased to KD 12.2 billion, covering around 8.5 months of imports.**

Kuwait's current account registered a multi-year low surplus of KD 0.4 billion (4.3% of 1Q20 GDP) since 2Q17, according to the Central Bank of Kuwait (CBK). The decline in Kuwait Export Crude (KEC) price and investment income from abroad were the main factors that contributed to the narrowing surplus (Chart 1). On the other side, the financial account showed a decline in net outflows to KD 0.1 billion as government deposits abroad decreased during the same period.

Chart 1: The Current account main components

(% of GDP)



Source: Central Bank of Kuwait, CSB

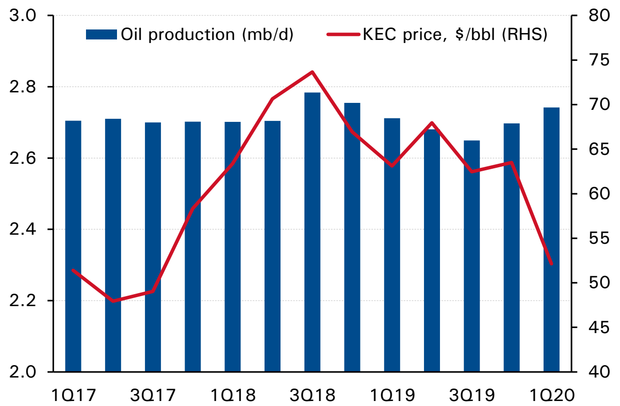
Low KEC price narrowed trade balance surplus

The trade balance surplus fell by 26.7% y/y during 1Q20 as KEC oil price declined by 17.4% to an average of 52.1 $/bbl (Chart 2), while oil production remained relatively stable at 2.7 mb/d, generating a decline in oil exports (89.7% of total exports) by 20.1% y/y. On the other hand, imports dipped by 9.6% y/y, which helped in partially offsetting this decline. Moreover, the persistent deficit in the services account declined by KD 0.6 billion as travel payments fell due to the pandemic related-restrictions and flight cancelations, which reduced the number of Kuwaiti outbound tourists.

Moreover, the primary income surplus, which records the net income of capital and labor, witnessed a steep decline of KD 1.7 billion as investment returns from Kuwait's investment abroad fell by the same amount. Income on direct investment was hit by the impact of the pandemic on economic activity, which affected demand and supply chains, while portfolio investments' income (dividends and interest on traded financial instruments) was adversely affected by the weak performance of the regional and international financial markets, which saw significant declines in their equity Indices compared to March 2019. On the other hand, foreign direct investments in Kuwait generated a return of around KD 58.1 million, declining by 69% y/y compared to 1Q19.

Chart 2: KEC price and production

($/bbl., mb/d)



Source: OPEC

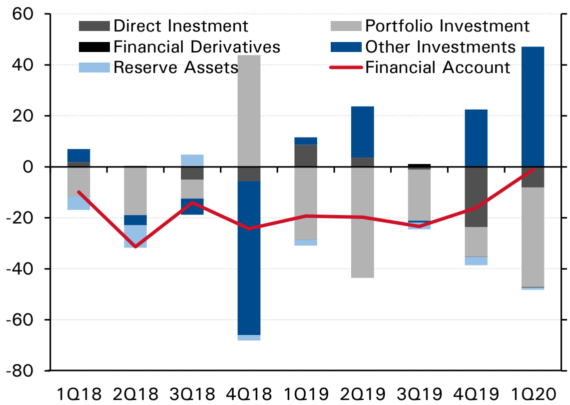
The secondary income deficit, which measures transfers (mainly foreign aid and workers' remittances), widened to KD 1.4 billion in 1Q20. This rise in outflows can be attributed to the significant increase in workers' remittances by 42.8% y/y in 1Q20.

Declining financial outflows

The financial account of the balance of payments, which measures changes in residents and non-residents' net overseas assets holdings, saw a decline in net outflows to KD 0.1 billion, down from KD 1.9 billion in 1Q19 (Chart 3). These developments were mainly influenced by the decline in government deposits abroad, despite the rise in portfolio equity investments abroad.

Chart 3: Financial account main components

(% of GDP)



Source: Central Bank of Kuwait, CSB

Moreover, direct investment, which reversed its trend in 3Q19, continued to register net outflows due to the rise of Kuwaiti investments in equity securities. At the same pace, portfolio equity investments registered a net outflow of KD 3.9 billion compared with a relatively smaller outflow of KD 2.4 billion in 1Q19. On the other hand, other Investments registered a net inflow of KD 4.7 billion despite the rise in non-resident deposits at local banks by KD 0.9 billion as government deposits abroad witnessed a decline of KD 3.6 billion in 1Q20.

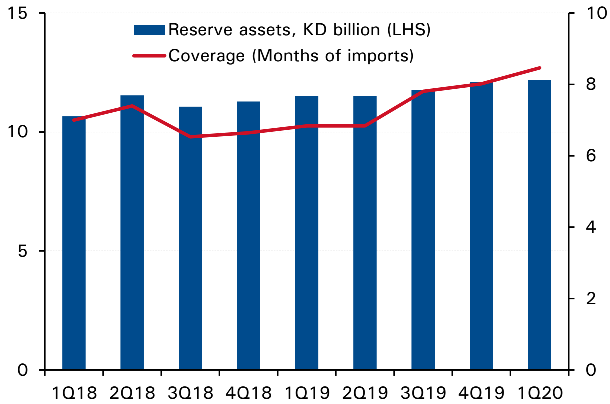
Reserve assets saw a moderate increase

The CBK's gross international reserves increased by around KD 91 million to KD 12.2 billion (30.5% of 1Q20 GDP, around 8.5 months of imports, and 32.1% of broad money (M2)) at the end of March 2020 (Chart 4). These reserves do not include the large buffers held by the Kuwaiti investment authority, which are estimated at around 400% of GDP, reflecting the successive surpluses recorded by the country's balance of payment and providing Kuwait with exchange rate and financial stability.

Moreover, the nominal effective exchange rate for the Kuwaiti dinar versus key trading partners appreciated in 1Q20 by 2.0% compared with a larger appreciation of 4.0% in the corresponding period of the previous year. The US dollar appreciated against major currencies in 1Q20 (appreciating against the Euro, Yuan, and the Turkish Lira by 2.9%, 3.5%, and 13.6% y/y, respectively) given the reportedly high share of the US dollar in the basket that the Kuwaiti Dinar is pegged to. Meanwhile, Inflationary pressures in Kuwait remained relatively low at 1.7% y/y in 1Q20 versus 2.5% for its trading counterparts, supported by the strength of dinar and its impact on imported goods and services and administrative measures that limit the pass-through from foreign to domestic prices. Accordingly, the real effective exchange rate witnessed a mild appreciation of 1.3% y/y in 1Q20 compared with an appreciation of 3.0% y/y in 1Q19.

Chart 4: Central Bank foreign reserves

(KD billion)



Source: Central Bank of Kuwait, NBK estimation

Looking forward

The results of 1Q20 have shown a moderate impact of the pandemic on the balance of payments. However, the impact of the pandemic and health-related restrictions measures are expected to be more severe in the following quarters as it will have a significant impact on the trade balance (goods and services) as well as the returns on Kuwaiti investments abroad. Nevertheless, the expected decline in workers' remittances and imports due to weak economic activity may partially negate some of these developments. Therefore, the current account balance is expected to register a deficit of 2% of GDP in the current year. On the other side, significant changes in the portfolio and "other investments" are expected during the current year as portfolio investments are likely to witness rebalancing, which could be reflected in a stronger preference for liquidity, despite low interest rates.

Table 1: Summary of Kuwait's Balance of Payments

	KD billion		% Change	% GDP	
	1Q19	1Q20	1Q20	1Q19	1Q20
Current account	2.7	0.4	-83.7	26.3	4.7
Goods (net)	2.7	2.0	-26.7	27.1	21.8
Exports	5.0	4.0	-19.0	49.3	43.8
Oil Exports	4.5	3.6	-20.1	44.8	39.3
Imports (FOB)	2.2	2.0	-9.6	22.2	22.0
Services (Net)	-2.1	-1.4	-29.7	-20.4	-15.7
Primary Income (Net)	3.0	1.3	-56.5	29.3	14.0
Investment Income (Net)	3.0	1.3	-56.4	29.4	14.0
Secondary Income (Net)	-1.0	-1.4	43.9	-9.7	-15.3
Workers remittances	0.9	1.4	42.8	9.4	14.7
Capital Account	0.0	-0.1	...	0.0	-0.6
Financial Account	-1.9	-0.1	-94.4	-19.2	-1.2
Direct Investment (Net)	0.9	-0.8	...	8.6	-8.8
Portfolio Investment (Net)	-2.9	-3.9	37.1	-28.5	-42.8
Financial Derivatives (Net)	0.0	0.0	...	0.0	-0.1
Other Investments (Net)	0.3	4.7	...	3.0	51.5
Reserve Assets	-0.2	-0.1	-61.1	-2.3	-1.0
Errors & Omissions	-0.7	-0.3	...	-7.1	-2.9

Source: Central Bank of Kuwait

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