Kuwait

Economic growth is slowly returning following last year's pandemic-linked contraction, with private and government consumption as well a higher oil prices driving the rebound. Fiscal sustainability is in the spotlight amid a sixth consecutive and record fiscal deficit in FY20/21 and liquidity constraints made more acute by the absence of a debt law. Higher oil prices could provide fiscal space with which to enact macroeconomic and structural reforms, though this will require closer executive-legislative cooperation.

Economic activity recovering from pandemic-hit 2020

Kuwait's economy is slowly emerging from the economic dislocation caused by the coronavirus pandemic in 2020. GDP fell by an estimated 8% last year—the steepest decline in output since the 2009 financial crisis—as businesses were shuttered, staffing levels cut, projects halted and incomes pressured amid a precipitous drop in oil prices. (Chart 1.) Pandemic-related policy support, especially for SMEs, was also limited and centered mainly on debt repayment.

Growth prospects have improved with the lifting (until recently) of most restrictions. Consumer sentiment is more upbeat, and pent-up demand has boosted consumer spending growth, which stood at 20% y/y in February (KNet data). Bank credit to households is increasing at the fastest pace since mid-2018. (Chart 2.) After a lackluster 2020, the projects market should gain a little more traction over the forecast period, helped by greater private-sector buy-in. Though the re-imposition of a partial curfew in March and the uncertain pace of vaccinations will be worth watching, non-oil growth should recover to about 4% this year before normalizing at 2.5% in 2022.

Oil GDP (in its broadest definition) should rise by 1% this year and by 7% in 2022 as crude oil production increases in line with the easing of OPEC+ cuts and the full commissioning of the Clean Fuels and New Refinery Projects, which should double Kuwait's refining capacity. Gains in both Jurassic light and Lower Fars heavy crude output will help offset some of the decline in production capacity due to the ageing Burgan field. (Chart 3.)

Fiscal sustainability in the spotlight amid tighter liquidity

Last year's twin Covid-19 and oil price shocks led to a record and sixth consecutive fiscal deficit of KD8.9bn (28% of GDP). Financing the deficit and achieving fiscal sustainability has taken on greater urgency following the near depletion of the General Reserve Fund (GRF), the inaccessibility of the Reserve Fund for Future Generations (RFFG), Kuwait's sovereign wealth fund (SWF), and the absence of parliamentary approval for a new debt law. While the authorities have been able to buy themselves some time through cuts in capex, asset swaps between the GRF and the RFFG and moves to reschedule more than $20bn in accrued dividends with state oil company KPC, systemic fiscal reforms are imperative.

The government unveiled an expansionary budget for FY2021-22 that sees spending rising by 7% y/y (budget-on-budget), revenues by 45% and the deficit widening to KD12.1bn. We see the deficit narrowing, however, to KD6-7bn (17% of GDP) this year and further to 10% of GDP by 2023 due to a combination of spending restraint and greater oil revenues thanks to higher oil prices. (Chart 4.) Tapping new non-oil revenue sources, however, appears limited to possible excise duties and the VAT.

We do believe that the debt law will pass this year, which should alleviate some of the liquidity pressures. There is also an economic case for deficit financing via debt issuance rather than reserve drawdowns in the current low interest rate environment. Moreover, public debt, at KD3.8bn (12% of GDP) at end-2020, is the lowest in the region so there is ample scope.

The current account looks to have performed better than expected in 2020, benefitting from higher investment income and a rebound in oil export revenues to register a surplus of 4% of GDP. Foreign reserve assets at CBK were stable at $47.5bn (42% of GDP) at end-2020, providing more than 12 months of import cover. Financial buffers are substantial with more than $550bn of assets held by the aforementioned SWF.

Inflation rising on rebounding consumer demand

Inflation almost doubled in 2020 to 2.1% due to pandemic-linked supply-chain issues, higher international food prices and pent-up consumer demand after lockdown measures were eased last summer. Expatriate departures and income impairments during the pandemic have not materially affected residential rents in the CPI index. Inflation will remain low, but could reach 3% in 2022 as the economy recovers and assuming a possible rollout of a 5% VAT in 2022-23. (Chart 5.) Monetary policy is likely to remain accommodative over the forecast period (the discount rate was cut by 1.25%, to 1.5% last year in March) in line with a dovish US Fed policy stance.

Oil dependence and policy stasis the main risk factors

Acute sensitivity to oil prices (almost 90% of export and fiscal revenues are oil-derived) and the absence of systemic economic reforms due to legislative impasse are the primary risks weighing on the outlook. A medium-term fiscal framework in the context of a comprehensive economic plan is needed to attain fiscal sustainability and maintain Kuwait's good standing with credit rating agencies and investors. While relations between the new parliament and the government are currently strained, stronger collaboration can expedite Kuwait's diversification agenda.

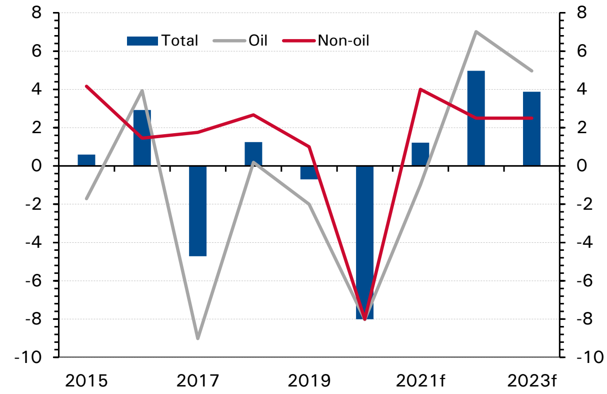
Table 1: Key economic indicators

		2019	2020e	2021f	2022f	2023f
Nominal GDP	$ bn	136	104	124	132	140
Real GDP	% y/y	-0.7	-8.0	1.2	5.0	3.9
- Oil sector*	% y/y	-2.0	-8.0	1.0	7.0	5.0
- Non-oil sector	% y/y	1.0	-8.0	4.0	2.5	2.5
Budget balance (FY)	% of GDP	-9.5	-28.0	-17.0	-12.0	-10.0
Current act. balance	% of GDP	16.3	4.0	13.0	13.0	13.0
Inflation	% y/y	1.1	2.1	2.5	3.0	3.0

Source: Official sources, NBK estimates * Includes refining

Chart 1: Real GDP

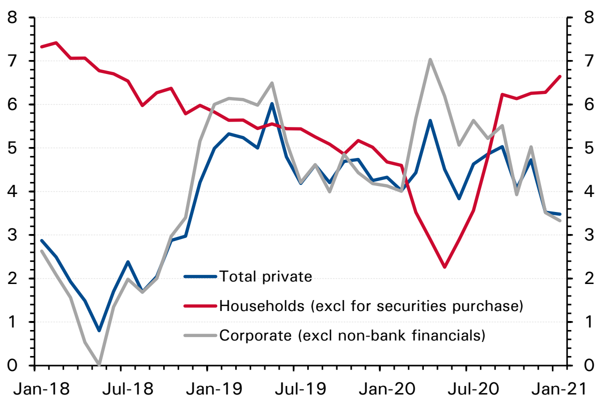
(% y/y)



Source: Central Statistical Bureau (CSB), NBK forecasts

Chart 2: Private credit to residents

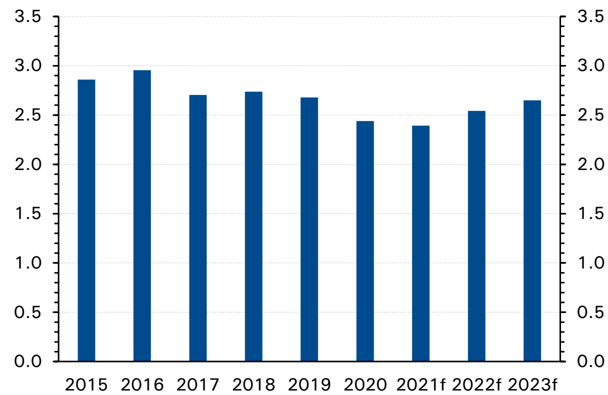
(% y/y)



Source: Central Bank of Kuwait

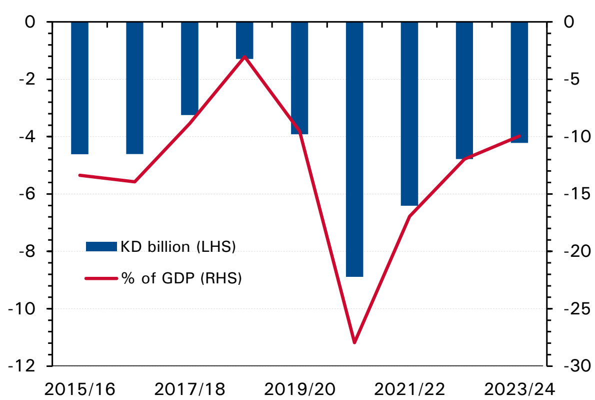
Chart 3: Crude oil production

(Million barrels per day, mb/d)



Source: Joint Organizations Data Initiative (JODI),OPEC, NBK forecasts

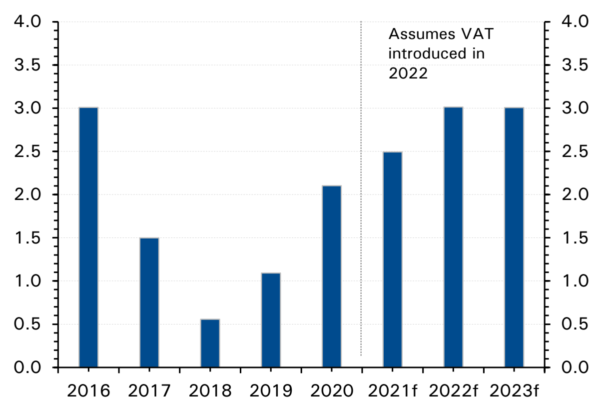
Chart 4: Fiscal balance



Source: Kuwait Ministry of Finance (MOF), NBK forecasts

Chart 5: Inflation

(% y/y, annual average)



Source: Central Statistical Bureau, NBK forecasts