Kuwait

Kuwait's economy is gradually emerging from the pandemic, with consumption leading the rebound amid markedly higher oil prices. Oil production is increasing steadily as per the OPEC+ schedule, providing a welcome boost to oil GDP. Corporate activity and employment growth is a notable soft spot, though. Following a succession of fiscal deficits, the near-depletion of liquid assets in the GRF has heightened liquidity risks, but also focused policymakers' minds on fiscal sustainability and macroeconomic reforms.

Private consumption has led the economic rebound…

Kuwait's economy is slowly recovering from last year's pandemic, a year that was characterized by severe curtailments in private consumption and government investment spending, business closures, expatriate layoffs and a sharp fall in oil prices. GDP contracted by 8.9%, the steepest decline since 2009, with the oil and non-oil sectors both shrinking by about 8.9% amid deep OPEC+ oil output cuts, curfews and limited fiscal policy support. (Chart 1.) Growth prospects have improved, however, underpinned by higher oil prices and a successful vaccine rollout. Domestic demand has led the recovery, with the most recent data releases showing robust growth in consumer spending (Knet; +23% y/y) and household credit (+11% y/y). (Chart 2.) Project activity is also slated to accelerate as the government prioritizes major road, hospital and airport infrastructure projects.

…while private sector business activity has lagged

Corporate activity has lagged, though, weighed down by the uncertain business, regulatory and political environment. Reflecting the challenging landscape, credit growth to businesses in 2021 has been lackluster (+0.3% y/y in August). The labor market has also been in flux, following the departure of thousands of mainly low-skilled expatriates during the pandemic, while the employment of nationals in the private sector has retreated from 2019 levels (-2.7% to 62,296 in 1H21). The authorities will be keen to reverse this trend; they also envisage greater business participation in the development plan.

OPEC+ cuts unwinding, refining gains to boost growth

The OPEC+ decision to ease output cuts to satisfy rising global oil demand will allow Kuwait to lift crude production and boost oil sector GDP, probably by about 4.4% y/y on average in 2022-24. Oil producers will be mindful of oversupplying the market, so output gains will be moderate. (Chart 3.) The full commissioning of the Clean Fuels and Al-Zour refinery projects, which will have effectively doubled Kuwait's refining capacity, will lead to incrementally higher output of more valuable refined products over the forecast period—boosting non-oil GDP (under which they are recorded in the national accounts) by about 0.9% pts to 3.2% on average. Headline GDP growth should average 3.9%.

Inflation up on supply chain woes and rising food prices

Inflation nearly doubled to 2.1% in 2020 on the back of supply-chain pressures, higher international food prices and pent-up consumer demand. (Chart 4.) Inflation could average 2.6% this year before slowing in 2022. A VAT of 5% could be introduced in 2023, which will lead to a spike in prices that year. Monetary policy will remain accommodative but tighten slightly over the forecast period as the US Fed slowly lifts interest rates.

A record fiscal deficit in 2020, spending restraint likely

The twin shocks of Covid-19 and low oil prices caused Kuwait's fiscal deficit, its 6th in a row, to swell to a record KD10.8bn (33% of GDP) in FY20/21. (Chart 5.) Revenues declined sharply (-39% to KD10.5bn), while expenditures grew marginally (+0.7% to KD21.2bn). Cutbacks in capital spending helped offset some other outlay increases—mainly Covid-related. Looking ahead, while the FY21/22 budget is expansionary, we see spending restraint as more probable. The government appears serious in looking for cost-efficiencies, with a flurry of reports on deliberations over ministry budget cuts, fee increases, and even subsidy cuts. A large restructuring of the public sector was also recently proposed. Our base case view sees the most politically sensitive reforms taking time to materialize, but some non-oil revenue augmentation, limited initially to excise duties and VAT (worth up to 1.5% of GDP), is projected by 2023. We expect the fiscal deficit to halve this year to around KD4.2bn (10.3% of GDP), before narrowing further to 9.5% of GDP by 2024.

Higher liquidity risk forces focus on fiscal sustainability

In an era of fiscal deficits, financing has become the critical issue for policymakers, especially given the near depletion of the General Reserve Fund (GRF) and the absence of debt issuance (due to legislative impasse). Near-term liquidity risks have risen and so has the imperative of a comprehensive deficit-financing strategy, as cited by S&P in its July downgrade of Kuwait's credit rating to A+ (still solid investment grade). Asset swaps with the massive Future Generations Fund and accrued dividends restructuring with KPC have, along with higher oil prices, helped inject liquidity to the GRF. These are only stop-gaps, though. Kuwait also has a $3.5bn Eurobond maturing in early 2022. Ultimately, we do expect a new debt law to be approved over the coming months.

With around $700bn in SWF assets (KIA) and very low public debt (12% of GDP), Kuwait easily has the financial resources needed to meet its obligations, but also, it is hoped, the space to gradually phase-in the structural reforms needed to reconfigure the economy, boost the role of the private sector and navigate the global energy transition away from fossil fuels.

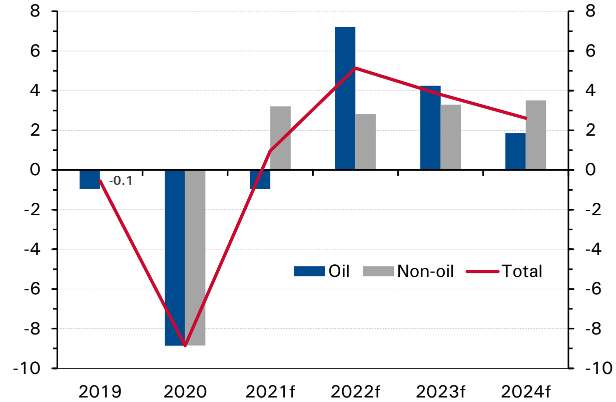
Table 1: Key economic indicators

		2020e	2021f	2022f	2023f	2024f
Nominal GDP	$ bn	106	129	134	140	145
Real GDP	% y/y	-8.9	1.0	5.1	3.8	2.6
- Oil sector	% y/y	-8.9	-1.0	7.2	4.2	1.9
- Non-oil sector*	% y/y	-8.8	3.2	2.8	3.3	3.5
Budget balance (FY)	% of GDP	-33.2	-10.3	-14.2	-11.4	-9.5
Current act. balance	% of GDP	21.1	26.3	23.4	22.5	23.1
Inflation	% y/y	2.1	2.6	2.1	3.8	1.9

Source: Official sources, NBK forecasts * Includes refining

Chart 1: Real GDP

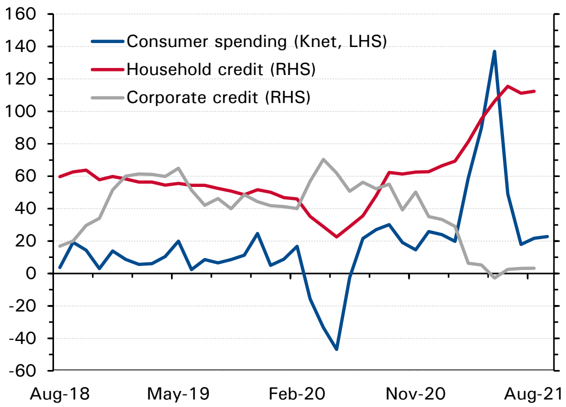
(% y/y)



Source: Central Statistical Bureau (CSB), NBK forecasts

Chart 2: Household spending and household credit

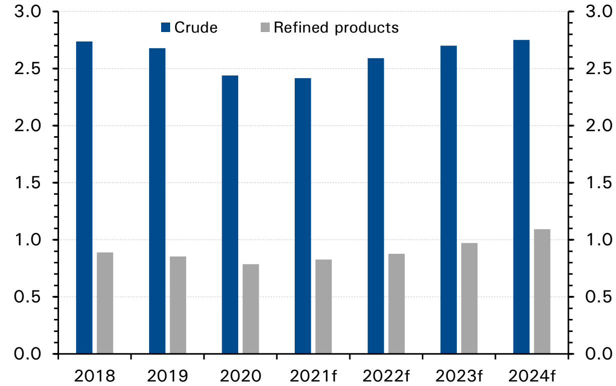
(% y/y)



Source: Knet, Central Bank of Kuwait (CBK)

Chart 3: Crude oil and refined products output

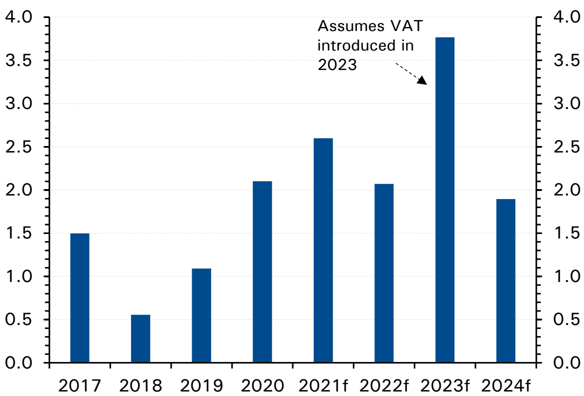
(mb/d)



Source: JODI, NBK forecasts

Chart 4: Inflation

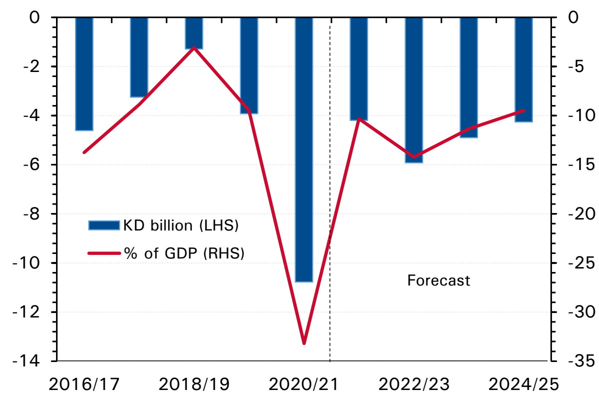
(% y/y, annual average)



Source: CSB, NBK forecasts

Chart 5: Fiscal balance

(fiscal year basis)



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