

Economic impact of Covid-19 on Kuwait



Economic Research Department
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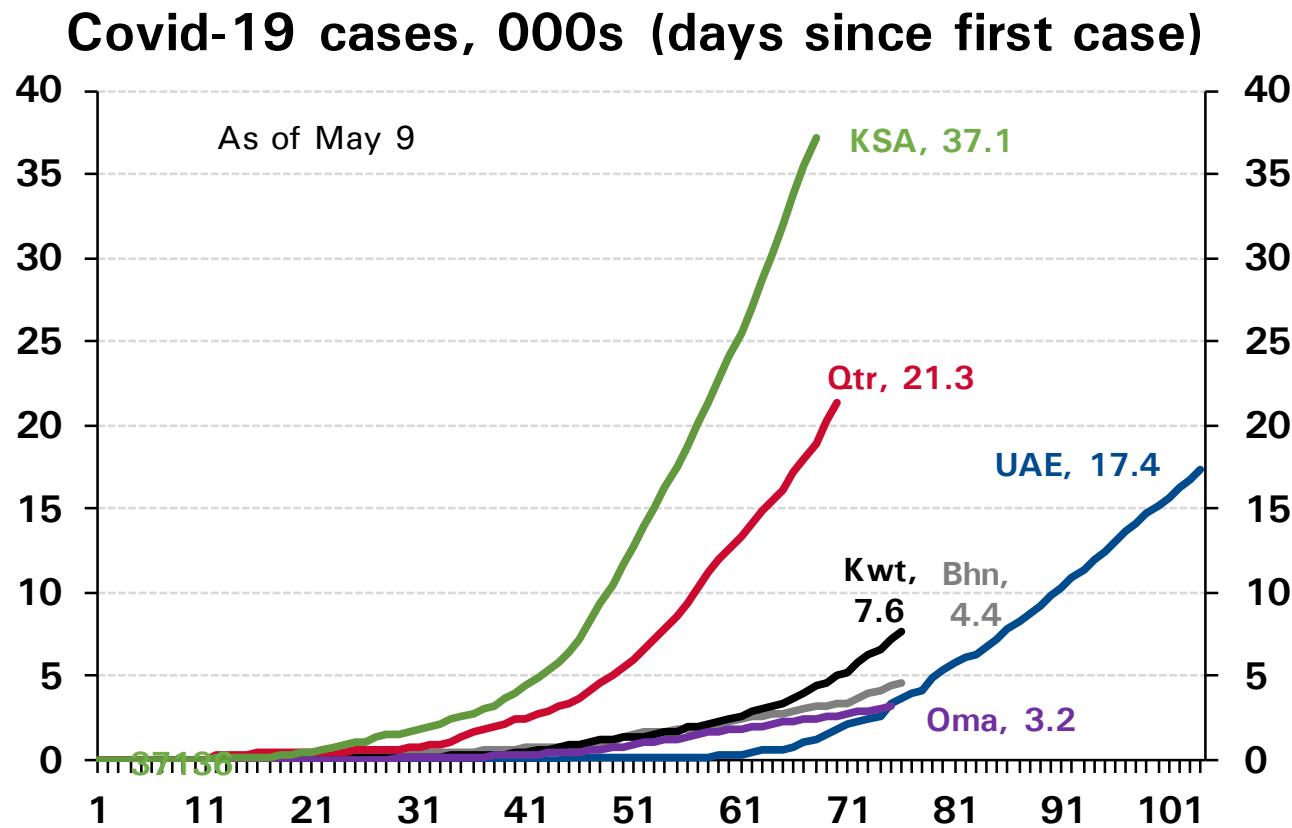
May 2020

Summary: Large economic hit but bounce seen in H2

- Like all countries in the Gulf region and elsewhere, Kuwait's economy has taken a major near-term hit from the spread of and required response to the Covid-19 pandemic.
- The main impact has come from a combination of forced business closures, travel restrictions and supply chain disruptions that have hit the retail, hospitality, travel and transportation sectors hard.
- On top of this, the collapse in global oil prices partly triggered by the virus has hit confidence and the government's finances.
- We see an economic rebound in H220 assuming the virus is contained in Q2 and oil prices start to recover. But a return to 'normal' will take longer and some sectors could change forever.

Virus spread: Rapid rise in cases since February

- Kuwait's first confirmed case of COVID-19 was announced on 24 February; it now has around 7,600 cases, the 4th highest in the Gulf.



Source: WHO / National sources

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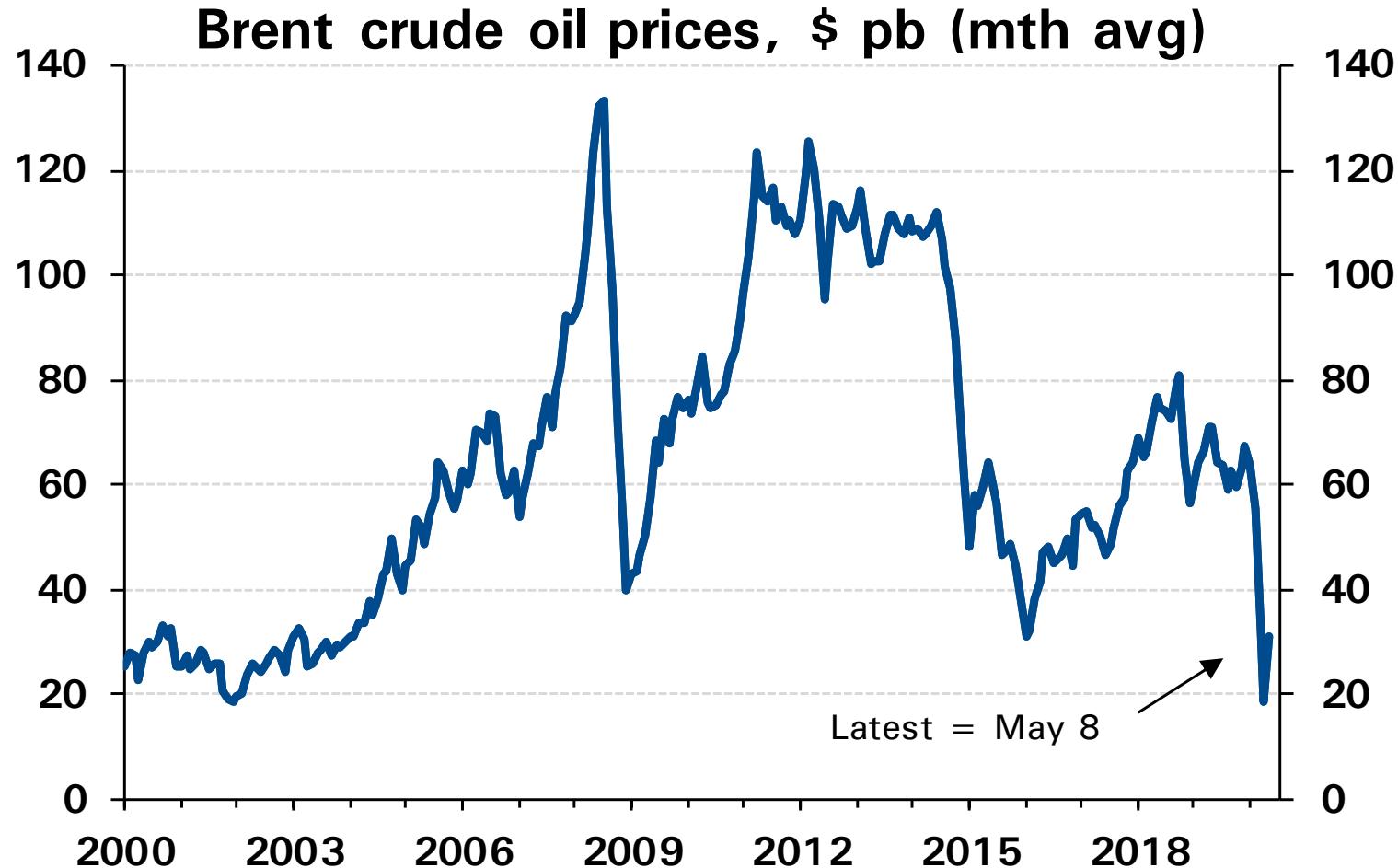
Lockdown steps: Limited business for 11 weeks

- Kuwait was the first country in the Gulf to announce a public holiday that forced some business to close or reduce activity on March 12. A partial curfew has been in effect since March 22.
- The public holiday is currently due to last until at least May 28, or 11 weeks (around 20% of the full year). A more severe 24-hour curfew was put into effect from May 10.
- As yet there are few economic indicators to help guide us on the scale of the drop in economic activity.
- Some estimates from other countries point to a drop in activity of around one-third during lockdowns. But some of this could be made up once economies are reopened.

Oil impact: Output, prices unlikely to rebound quickly

- Adding to the challenge, oil prices have been hammered by a combination of a shuttering of global activity and the breakdown of an OPEC+ supply deal. Brent has plunged 66% to \$20 since mid-Feb.
- OPEC has now announced unprecedented production cuts effective from May and to last 2 years. So far this has had little positive impact on prices but could become more effective over time.
- Recovery in oil prices will be gradual given uncertainty over global economy and the huge overhang of oil inventories that must be reduced. We assume Brent averages \$35 this year and \$50 next.
- OPEC-driven cuts will see Kuwait's oil output fall 8% this year on average to 2.46mb/d, and to 2.42 in 2021.

Oil impact: Prices have crashed to historic lows



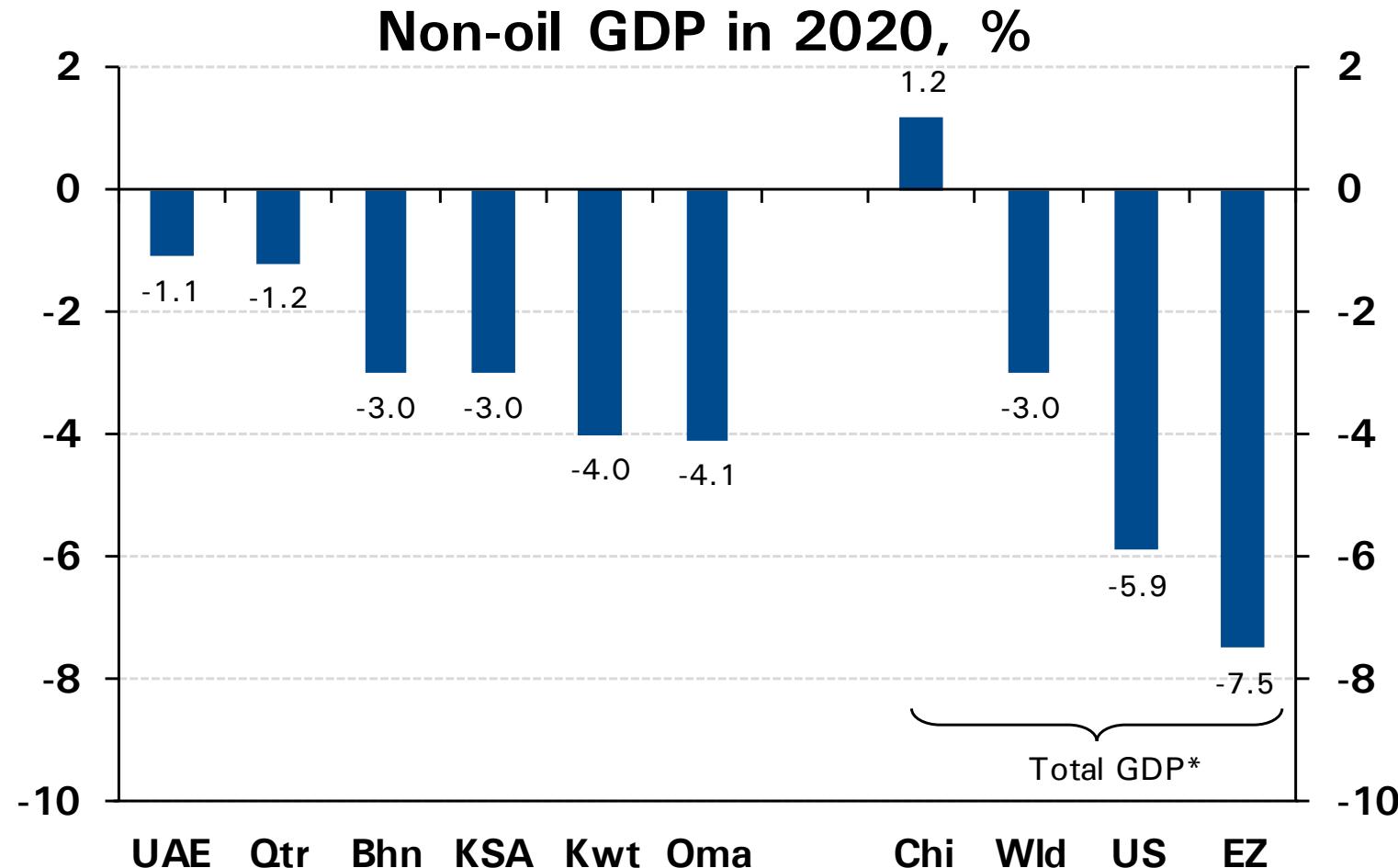
Source: Refinitiv

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Economic impact: Negative growth seen this year

- Estimates of the impact on non-oil growth this year are highly uncertain and still being adjusted. The IMF projects Kuwait's non-oil GDP to decline 2.5% this year; we forecast a drop of 4%.
- This would be the weakest performance since financial crisis, comparable to falls recorded across Gulf economies but far smaller than in the US and Europe.
- One factor limiting the drop could be the large role of the government sector in the economy, where the impact should be more modest. Also Kuwait could be less exposed to a drop off in global trade and capital flows than some countries.
- We expect non-oil growth to rebound 3% in 2021.

Economic impact: Growth negative across GCC

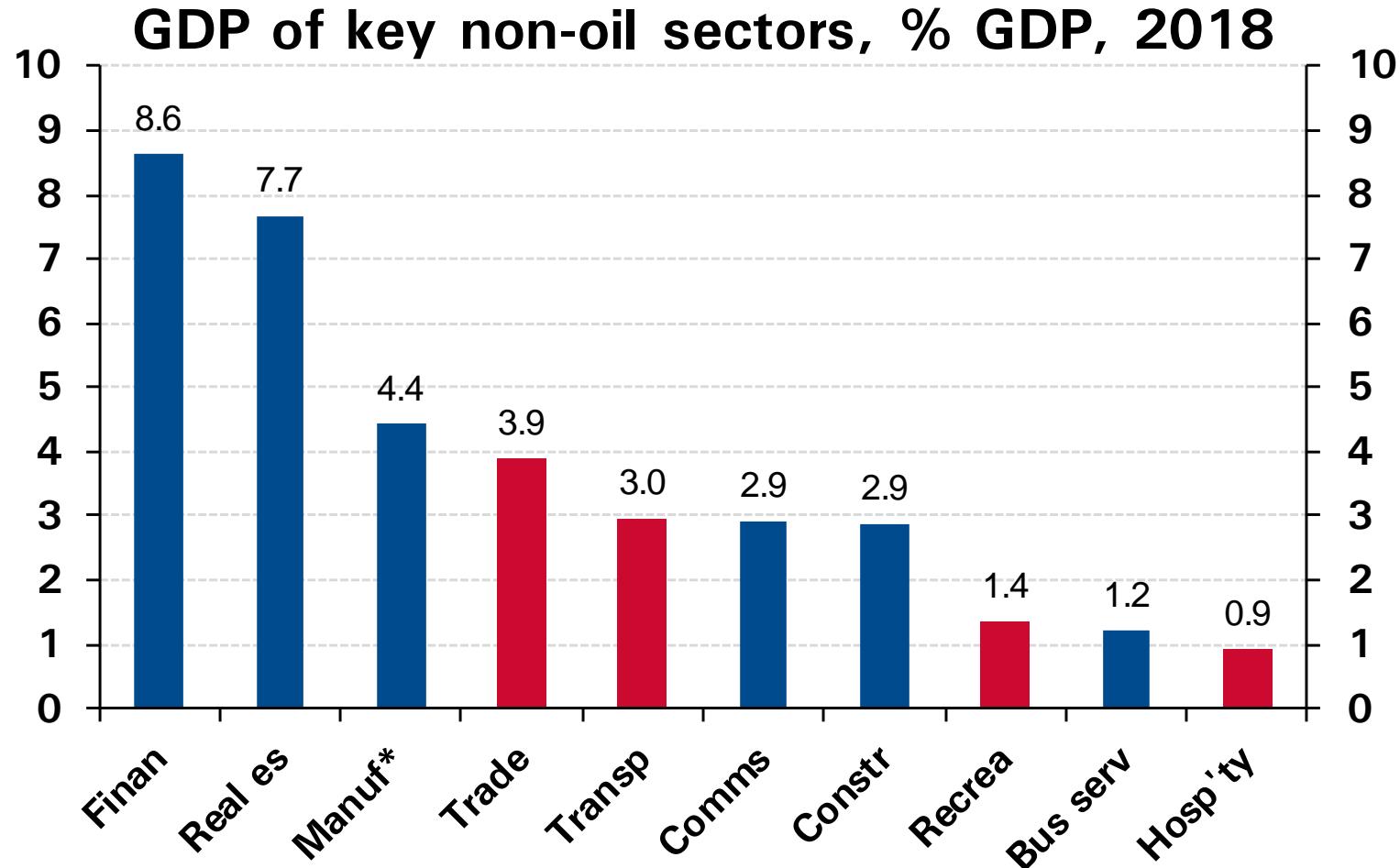


Source: NBK / IMF WEO April 2020 * From IMF

Economic impact: Some sectors take very direct hit

- All sectors will be affected, but for some the impact is especially large and direct.
- **Retail** will suffer from mall and shop closures and social distancing
- **Hospitality** (esp. restaurants) similar, and consumer hygiene fears
- **Transport** affected by reduced travel and movement restrictions
- **Recreation and leisure** hit by reduced spending on non-essentials and worries over crowd gatherings
- Though in Kuwait, the combined shares of these sectors is fairly small at below 10% of total GDP, less than in many other countries.

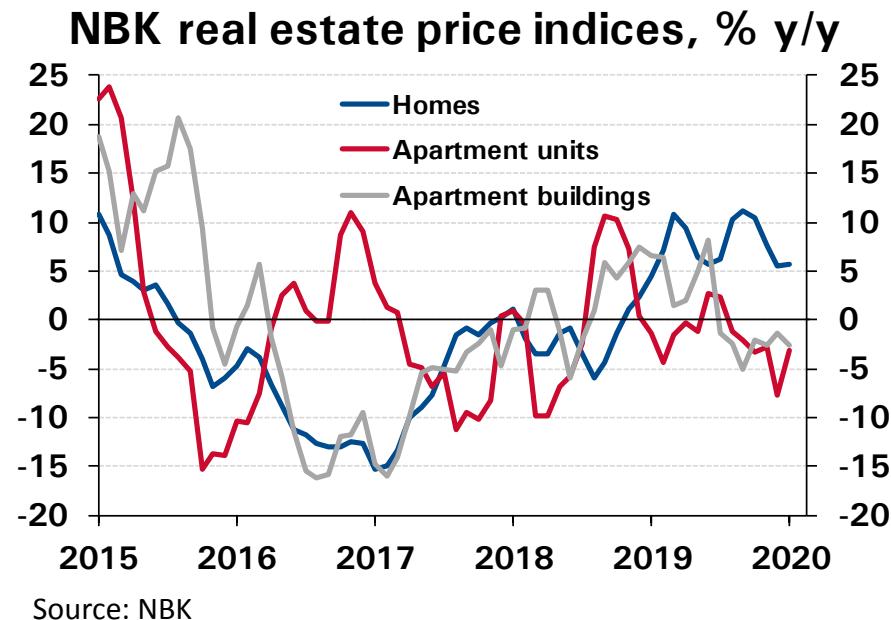
Economic impact: Some sectors take direct hit (cont.)



Source: CSB / NBK * excludes oil refining

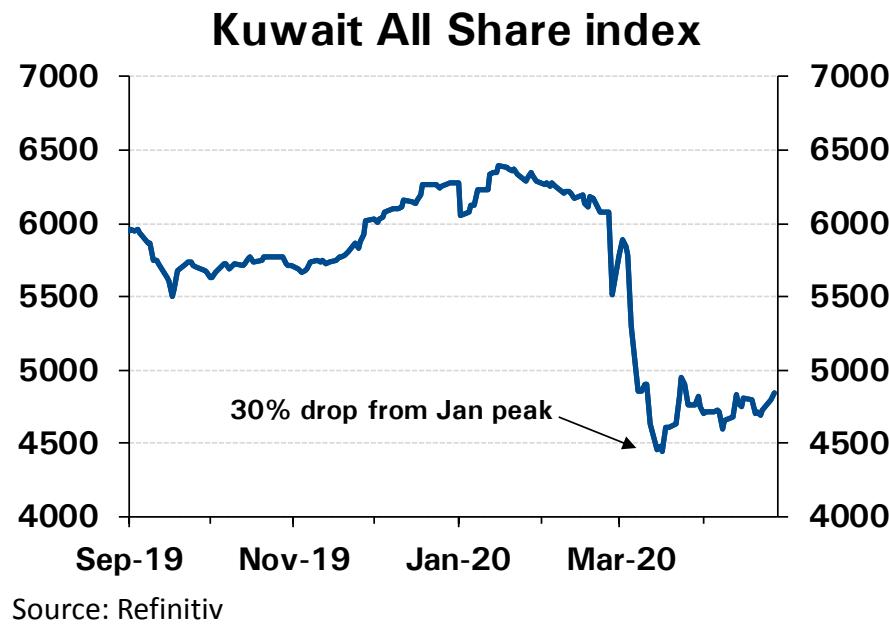
Economic impact: Real estate also under pressure

- Residential property may hold up given solid fundamentals, but the apartment sector was already soft and could see fresh weakness given economic pressures including on expats.
- Malls and commercial properties lowering and postponing rents for their struggling tenants. This will be reflected in softer commercial property prices and sales.



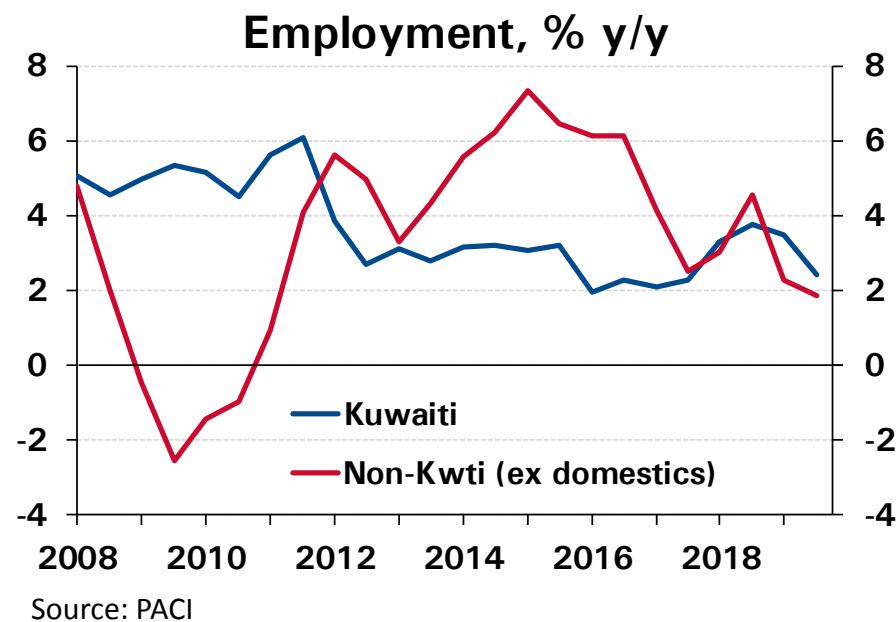
Economic impact: Equity markets reacted sharply

- Kuwait's stock market followed global trends, and by mid-March was -30% from its Jan peak though has crept back up since.
- The MSCI EM index inclusion (due May) was postponed to November but could generate \$2-3 billion in passive inflows.
- Investor sentiment will remain weak until the virus and oil prices pressures subsides; full recovery may take some time.



Economic impact: Labor market likely to contract

- Jobs market set to contract amid growth slump and uncertainty over outlook.
- Many private sector jobs held by expats are likely to be the most vulnerable.
- Kuwaiti jobs unlikely to be badly affected and more nationals could fill many expats vacancies.
- But a number of foreign workers may need to be rehired when the economy rebounds, possibly raising the cost of doing business.

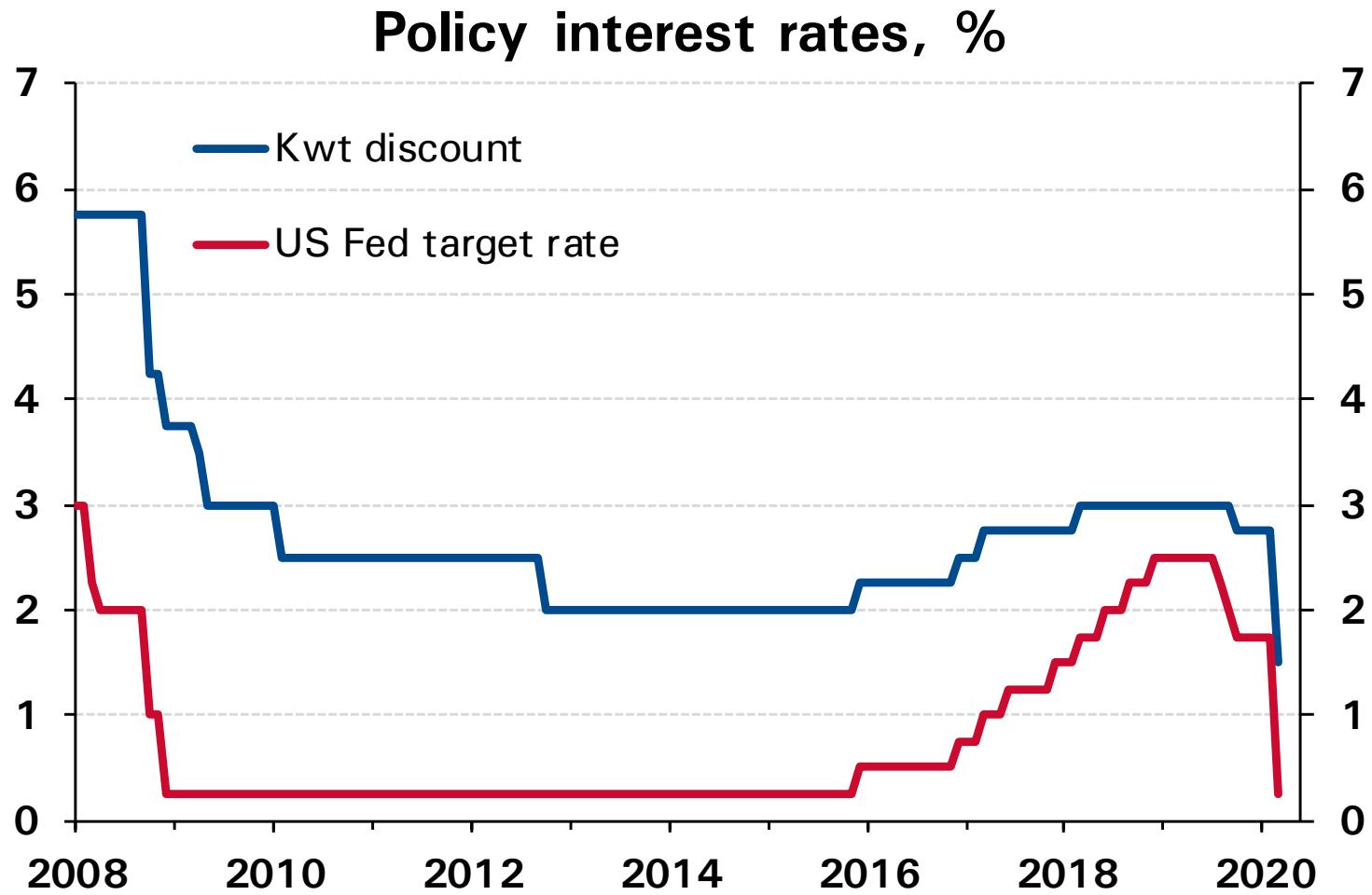


Source: PACI

Policy measures: Bank lending supported

- Policy measures by the authorities so far have focused on ensuring the supply of bank credit to affected firms and easing pressure consumers by freezing loan repayments.
- **Interest rates** were cut by a cumulative 125 bps to 1.5% (discount rate) following multiple cuts by the US Federal Reserve.
- **Bank regulations** on loan-to-value limits, risk weightings and liquidity requirements have been relaxed to ease stress on banks and give them more space to lend and support the economy.
- **Loan repayments** have been frozen for 6 months for all affected customers at no extra cost.

Policy measures: Bank lending supported (cont.)



Source: Refinitiv

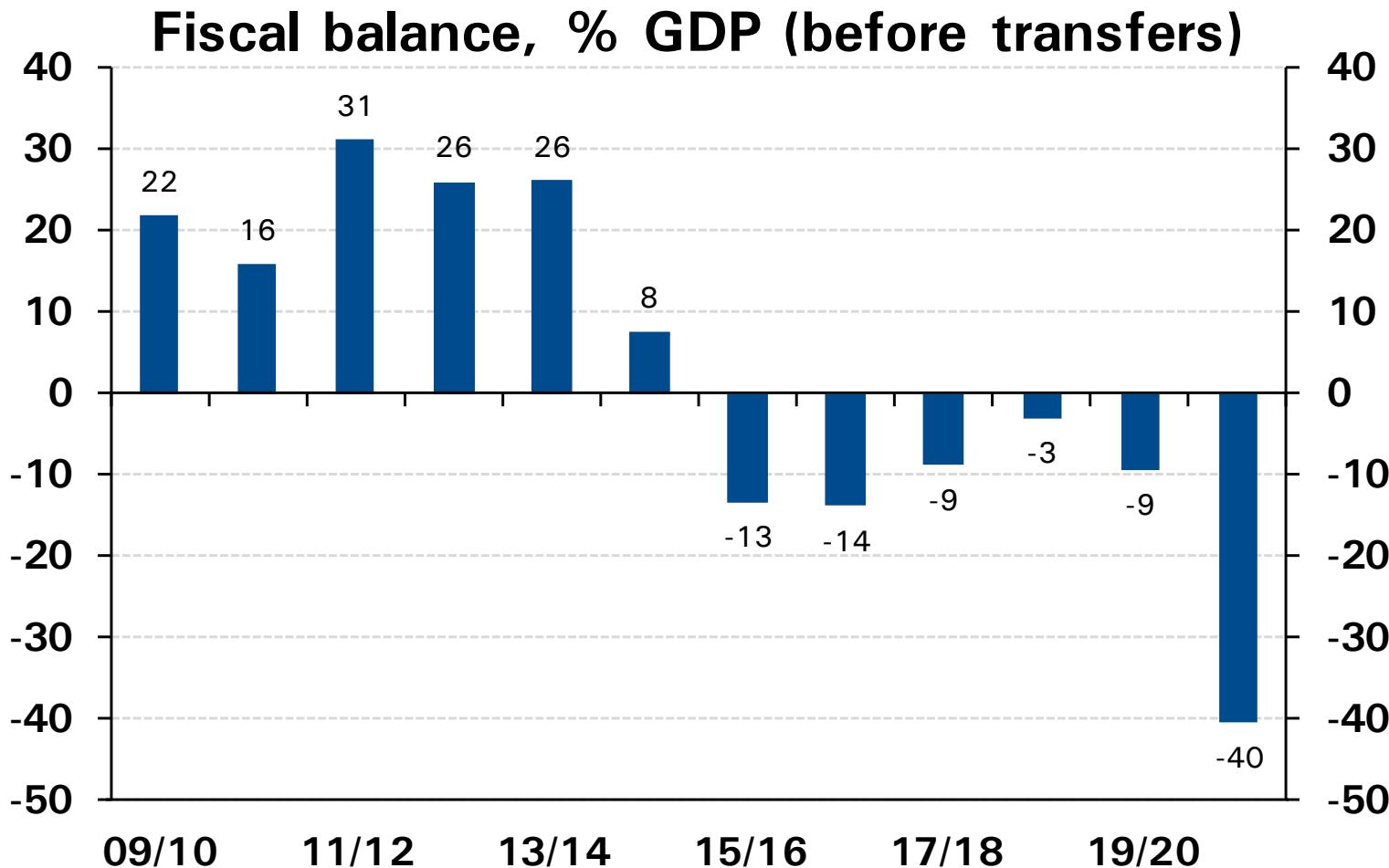
Policy measures: Bank lending supported (cont.)

- In partnership with the government, banks will also provide subsidised up to 3-year loans for business:
 - **Interest rate** of 2.5%, government will pay full interest in year 1, half in year 2 and none in year 3.
 - **For SMEs**, government will pay full interest in years 1 and 2 and half in year 3. 80% of these loans will be provided by a government SME fund at zero interest.
 - **Will cover** expected cash-flow shortfall to end-2020, cannot be used to repay debt and is for firms that were healthy pre-crisis.
- Some cuts in government fees, spending measures. However Kuwait has so far stayed away from large direct fiscal measures.

Economic impact: Fiscal deficit set to widen

- The drop in oil prices will have an immense impact on the public finances, which could in turn shape the way the government responds to the crisis and have long-term implications.
- The fiscal deficit could reach KD13bn or around 40% of GDP this year (9% last year) – the weakest since the Iraqi invasion.
- We assume that overall spending will be maintained at last year's level, with cuts in capital spending offset by higher current spending including on health and other emergency measures.
- This will support the economy in the near term. However we would expect spending to be cut next year as the government takes steps to bring the deficit under control.

Economic impact: Fiscal deficit set to widen (cont.)



Source: MoF / NBK

Economic impact: Measures to fund the deficit

- Financing the deficit could be a challenge. This year's deficit could deplete most of the est. KD16bn held in the General Reserve Fund.
- The government has huge financial resources in the longer-term Future Generations Fund, but these cannot be easily accessed under current laws.
- One option would be for parliament to pass the debt law, which would enable the government to issue new debt and take advantage of Kuwait's good credit rating and low interest rates.
- However this step is controversial among some MPs, and would also best be followed by reforms to improve long-term financial stability, such as spending controls or revenue raising measures.

Reforms: Priorities once virus impact contained

- In our view, the debt law should be passed quickly to ensure there is sufficient fiscal space to avoid drastic spending cuts (esp. capex) that would risk hurting demand and long-run growth potential.
- The government could also extend its current measures to include direct support such as (temporary) private sector wage guarantees or moves to make the loan subsidy program even more attractive.
- Once the virus is contained, urgent measures are needed to raise non-oil budgetary revenues (i.e. excise taxes, VAT) and rationalize subsidies. Broader economic challenges should also be addressed such as improving the business environment and promoting private activity to create more jobs for Kuwaitis entering the labor force.
- These reforms would help unlock Kuwait's full potential.

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Thank you.

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