Economic Update

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Public finances

Kuwait: Higher oil prices to leave budget close to balance this year

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

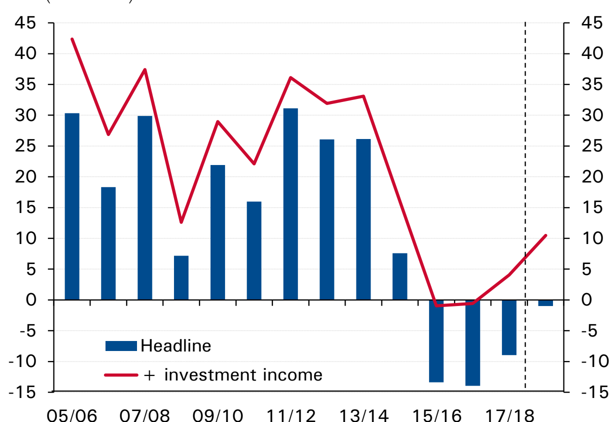
Highlights

- **Higher oil prices could see the fiscal deficit narrow to just 1% of GDP this year, its best position in four years.**
- **Last year the deficit stood at 9% of GDP amid a strong increase in expenditures, and despite higher oil revenues.**
- **We expect further solid growth in spending this year, while non-oil receipts will rise on the resumption of UNCC payments.**
- **The smaller deficit will limit further drawdowns of the General Reserve Fund, which has been a government concern.**
- **Despite the stronger near-term fiscal picture, continued reforms are needed to improve the longer-term outlook.**

The surge in oil prices in recent months to above $80/bbl is set to narrow the government's fiscal deficit further this year, and there is even a possibility of a balanced budget for the first time in four years. This would be a dramatic turnaround in the public finances, with the deficit having reached as large as 14% of GDP in FY2016/17. (Chart 1.) This year should also see another notable rise in government spending, providing support for economic growth and allowing for continued focus on infrastructure projects important for the government's development program. The smaller deficit will also limit drawdowns from the government's General Reserve Fund.

Chart 1: Fiscal balance*

(% of GDP)



Source: CSB / Thomson Reuters Datastream / NBK *Before RFFG transfers

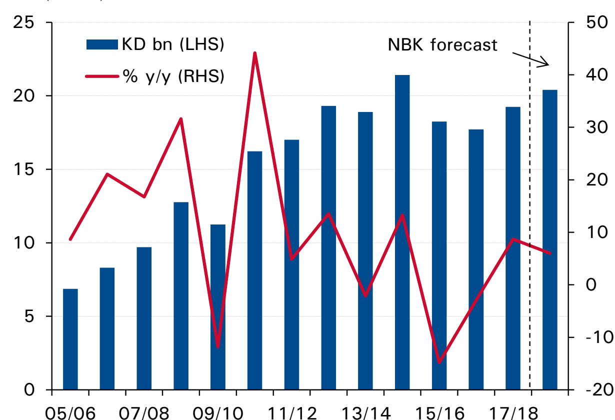
FY2017/18 deficit shrank on higher oil prices

The fiscal year (running April-March) started with the public finances still in pretty weak shape. Final data for FY2017/18 revealed a deficit of 9.0% of GDP (before mandatory transfers to the Reserve Fund for Future Generations) an improvement on the 13-14% of GDP recorded in the previous two years. Revenues in FY17/18 jumped due to a 22% rise in oil prices and despite lower crude oil production due to OPEC policy (and possibly partially offset by increasing gas production). Non-oil revenues rose by a robust 22% to KD1.7 billion, or 11% of total revenues, thanks to a large rise in miscellaneous revenues.

Meanwhile spending recorded its first rise in three years, up 8.7% and following a cumulative cut of 17% in FY15/16-FY16/17 in response to the collapse in oil prices in mid-2014. (Chart 2.) The increase in spending was driven by three key factors. First, there was a 23% rise in outlays on goods & services linked to increased fuel costs due to the higher price of oil – largely a transfer between government departments.

Chart 2: Government spending

(Actual)



Source: Ministry of Finance / NBK

Second, there was 6% rise in wages and salaries, which

accounted for around one quarter of the rise in total spending. Finally, there was a 13% rise in construction-related capital expenditure, as the government pushed ahead with implementation of infrastructure projects. The ratio of actual-to-budgeted capex rose to 87% from 80% a year earlier and higher than the historical average of 74%.

After mandatory transfers of 10% of total revenues to the RFFG, the deficit stood at 13.4% of GDP or KD4.8 billion. Around KD0.7 billion was financed through the issuance of dinar bonds, with the rest financed from the government's General Reserve Fund which according to the finance minister had assets of KD26.4 billion at end-year.

Spending to see further solid rise this year

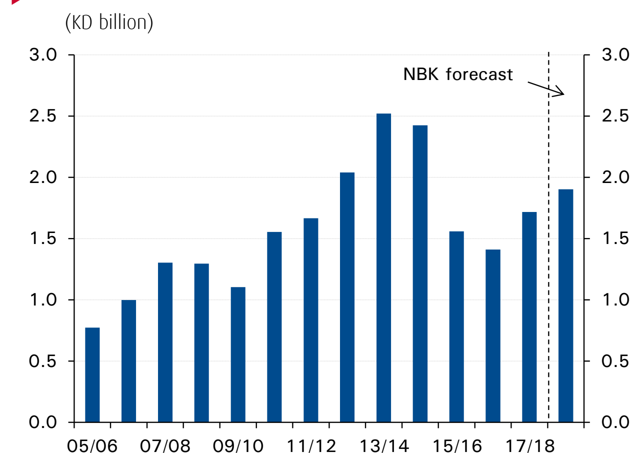
Higher oil prices will improve the fiscal position much further this year. Brent crude prices are forecast to average $74/bbl in FY18/19 ($70 for Kuwait Export Crude), up 29% on their average for last year helped by a combination of solid global demand, the impact of sanctions on Iran, falling Venezuelan output and a relatively limited supply capacity from other OPEC producers. A further rise in oil revenues provides space for the government to lift spending again, whilst at the same time generating a sharp narrowing of the deficit and perhaps even a balanced budget.

For FY18/19, budget revenues are projected to rise 25% to KD20 billion based upon higher crude oil prices but also a near 4% rise in Kuwait's crude oil production to 2.8 million b/d following the relaxation of OPEC production targets since June. Meanwhile, non-oil revenues are projected up 11% to a four-year high of KD1.9 billion helped by the resumption of UNCC payments by the Iraqi government from April. These payments – dependent upon the oil price – were suspended in 2014 but should boost non-oil revenues for the next few years, with around $5 billion in payments remaining at the start of this year. (Chart 3.)

In terms of outlays, the government's budget emphasized the need to reduce wasteful spending, increase efficiency and continue infrastructure investment. We forecast expenditures rising 6% to KD20.5 billion. This is around KD1 billion less than in the approved budget, but nevertheless reflects a 95% rate of actual-to-budget spending that is higher than the average of the past decade. Within this overall total, we project another strong increase in capital spending of 10% (comparable to that projected in the budget), while current spending rises by under 6%, below the 8% recorded last year as the government looks to limit growth in less productive areas. There will however be further upward pressure on goods and services spending from rising oil prices.

Chart 3: Non-oil fiscal revenues

(KD billion)



Source: Ministry of Finance / NBK

Continued needs for reforms, despite stronger position

The net result of these forecasts is that the deficit will shrink to just KD0.5 billion or 1% of GDP this year, assuming a lower oil price in the final few months of the year. If oil prices do not soften, the deficit could be eliminated entirely: at current levels of oil production, each $1 increase in oil prices generates around 0.8% of GDP per year in additional oil revenues, so only a small overshoot in oil prices would be needed. It should also be noted that this figure understates the true strength of the government's broader financial position, since it excludes the investment income earned – via the Kuwait Investment Authority – on its assets held overseas. We estimate that these are now worth 11-12% of GDP, so if added would in principle push the fiscal balance back to large surplus.

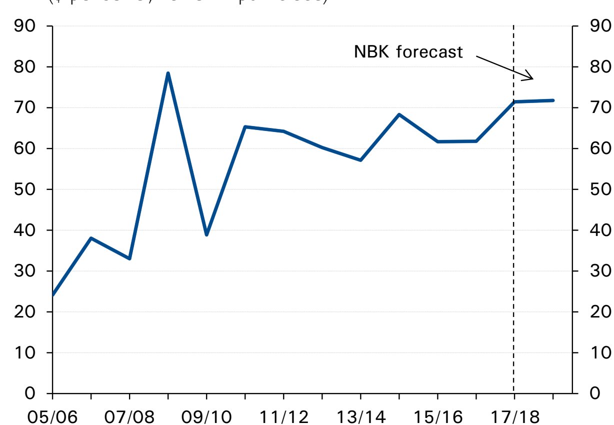
Still, despite the now much-improved situation the government is aware of the need to push for reforms to put the fiscal position on a more sustainable longer-term footing. A downturn in oil prices that widened the deficit would imply further drawdowns from the General Reserve Fund, which the Minister of Finance recently warned is being depleted, unless the new debt law is approved by parliament in its next session; that is because following the expiry of the previous law last year, the government is unable to issue any new debt. Even if the new law is passed, the cost of borrowing will be higher due to higher global interest rates.

Another problem is that while there have been several meaningful reforms over the past few years including cuts in fuel (2016) and electricity (2017) subsidies, better overall spending control, more focus on capex as well as improved transparency and reporting standards, further reforms are needed but may be difficult. The government has already had to postpone the introduction of VAT and excise duties due to political opposition which is likely to persist once the new parliamentary term starts in late October. In addition, owing to

demographic pressures and the need to lift infrastructure investment, the demands on government spending are increasing. Although, as chart 4 shows, our estimate for the budget breakeven oil price this year is close to the projected outturn at around $72/bbl and indeed only fractionally higher than last year, it is still the second highest of the modern era – exceeded only by one FY2008/09 when spending was temporarily boosted by payments into the social security fund.

Chart 4: Budget breakeven oil prices*

($ per barrel, Kuwait Export Crude)



Source: NBK estimates * Before RFFG transfers

Table 1: Public finances, KD billion unless otherwise stated

	Budget			Actual/NBK forecast			Actual % budget	
	2017/18	2018/19	% y/y	2017/18	2018/19	% y/y	2017/18	2018/19
Revenues	**13.3**	**15.1**	**13.2**	**16.0**	**20.0**	**25.3**	**120.1**	**132.9**
- Oil	11.7	13.3	13.7	14.3	18.1	27.0	122.0	136.2
- Non-oil	1.6	1.8	9.8	1.7	1.9	10.8	106.4	107.4
Expenditure	**19.9**	**21.5**	**8.0**	**19.2**	**20.5**	**6.3**	**96.7**	**95.2**
- Comp of empl'yees	6.8	7.2	6.5	6.7	-	-	99.3	-
- Goods & services	3.0	3.1	3.7	2.8	-	-	95.2	-
- **Subsides**	0.4	0.5	49.7	0.3	-	-	92.5	-
- Grants	4.7	5.2	12.0	4.7	-	-	100.0	-
- Social subsidies	1.1	0.8	-29.2	1.1	-	-	96.1	-
- Misc & transfers	1.1	1.4	21.8	1.1	-	-	98.8	-
- Capital spending	2.9	3.3	13.6	2.5	2.8	10.0	86.8	84.1
Budget balance	**-6.6**	**-6.4**	-	**-3.2**	**-0.4**	-	-	-
- % of GDP*	-18.1	-15.3	-	-9.0	-1.0	-	-	-
Bud bal after RFFG transfers	-7.9	-7.9	-	-4.8	-2.4	-	-	-
- % of GDP*	-21.8	-18.9	-	-13.4	-5.8	-	-	-

Source: Ministry of Finance / NBK * Percentage of calendar year GDP, uses NBK forecast for 2018.

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
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
(International) Plc
Paris Branch
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
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
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

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