Economic Update

NBK Economic Research Department I 21 December 2020

Public Finance

Kuwait: Fiscal deficit at KD1.9 billion in 1H FY20/21 mainly on weak oil revenues

> Issa Hijazeen
Senior Economist
+965 2259 5359
IssaHijazeen@nbk.com

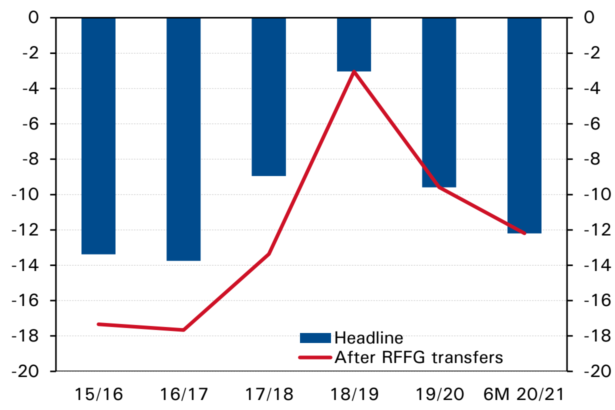
Highlights

- **The fiscal deficit in 1H FY2020/21 came in lower than expected but is set to increase to about KD10 billion in the full year, though lower than the KD14.1 budget estimate.**
- **Liquid assets in the GRF may not be sufficient to finance the deficit; approving the debt law becomes critical but should be accompanied by serious reforms.**
- **Capital spending stood at understandably weak levels, at KD0.4 billion, but could pick up by fiscal year-end.**

The government's fiscal deficit stood at a smaller-than-expected KD1.9 billion during the first half of FY2020/21 (April-September), according to the latest data released by the Ministry of Finance. This is equivalent to 12% of estimated pro-rated GDP and compares with a small surplus of KD0.1 billion during 1H FY2019/20. (Chart 1.) Total revenues plunged by 48% to KD4.6 billion, driven by the collapse in oil prices earlier this year. Spending meanwhile fell by 25% to KD6.5 billion, but this may not in our opinion be a good reflection of the true underlying picture due to issues of timing in the recording of some spending transactions. The underlying deficit will be larger, and on current oil prices, we expect a deficit of around KD10 billion for the year as a whole.

Chart 1: Fiscal Balance

(% of GDP)



Source: Ministry of Finance, NBK estimates

Oil revenues are ahead of budget estimates

Oil revenues fell by 51% y/y to KD3.9 billion essentially due to the plunge in the price of Kuwait Export Crude by 47% to an average of $34.6/bbl as well as the fall in oil production to 2.36 mb/d (12.7%) due to OPEC+ supply cuts. Still, oil revenues are running ahead of budget estimates at 69% of expected full-year revenues because the actual price is to date ahead of the conservative oil price assumption of $30 in the budget.

Meanwhile, non-oil revenues were unsurprisingly soft given the backdrop of very weak economic activity caused by the Covid-19 pandemic (they declined by 12.2% y/y to KD0.7 billion, or 36% of the full-year budget estimate due to the decline in taxes & fees and other revenues by 17.4% and 7.2%, respectively). Non-oil revenues remained small at 15% of total revenues though could benefit in H2 from improving economic activity and more normal trade patterns. We note that due to the drop in oil prices, the remaining $2.4 billion (KD0.7 billion) in UNCC compensation payments from Iraq targeted to be paid by 2021 are now expected by 2022.

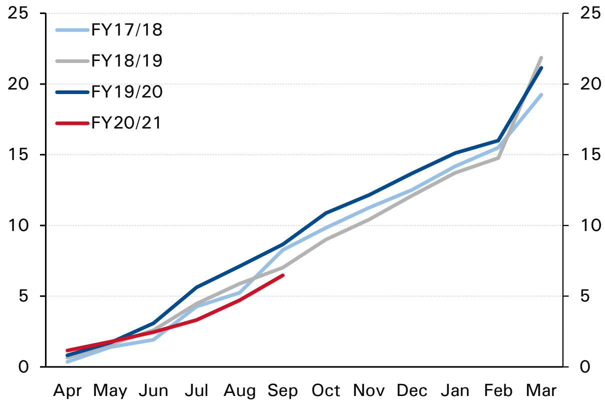
Spending down, but likely affected by recording issues

Reported spending also saw a large drop, of 25% to KD6.5 billion in the first six months, coming mainly from a 23% drop in current spending, which constituted 94% of total spending. (Chart 2.) This also left current spending well below comparable year-to-date levels in previous fiscal years and at just 32% of total budget allocations for the full year. While the government is striving to limit spending levels to contain the rise in the deficit, the size of the recorded spending cut also reflects factors other than deliberate restraint.

Compensation of employees, which constituted 25% of current spending, came at KD1.6 billion, down 43% y/y, representing only 20% of total budget allocations. We think this is mostly due to delayed reporting and it will recover toward the end of the year. Another important category, goods and services outlays, declined by 18.9% to KD1.1 billion. But this probably reflects the impact of lower oil and gas prices on the purchase of fuel for power stations by the Ministry of Electricity and Water. This is in effect a reduction in transfer payments from one part of the government to another, and has little impact on demand in the economy.

Chart 2: Total spending

(KD billion)



Source: Ministry of Finance

Meanwhile, subsides dipped by 43% y/y, to around a third of its allocations in the FY2020/21 budget. The decline in the subsidy to gas stations may also reflect the fall on oil prices. Moreover, social subsidies, which include health services abroad, were only around 32% of its budget provisions. While health subsidy is likely to remain contained through the fiscal year, others items are reasonably small, often volatile and so it is still too early to draw meaningful conclusions.

Elsewhere, the miscellaneous and other transfers category (which includes scholarships and wages of the Judicial system) was down 15.7%. However, this item could yet end up higher than FY2019/20 by the end of the fiscal year due to the allocation of KD0.5 billion under this category in urgent funds to confront the spread of Covid-19. On the other hand, grants, which include transfers to independent entities (such as the Public Authority for Manpower and the Public Institution for Social Security) remained at a similar level to the same period in FY2019/20. These transfers could be crucial for these entities to carry on with their operations, given their low revenue base.

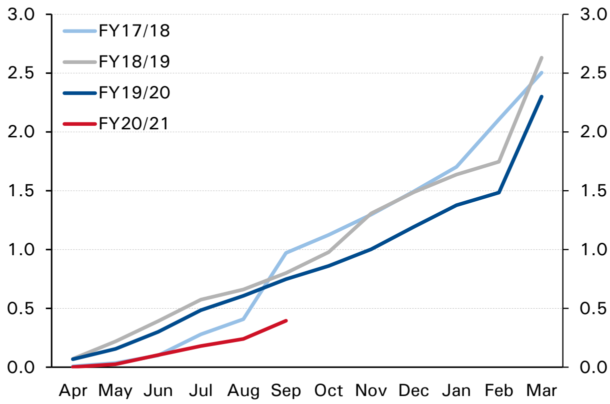
Capital spending was weak as expected

Meanwhile, capital spending has been weak and is proceeding at a slower pace than usual for this stage of the year. (Chart 3.) It stood at KD0.4 billion, or 17.1% of the annual budget allocation, and down 47% y/y. The fall in capex spending was very likely related to the impact of the pandemic on economic activity. It was also due to cancelation, postponement, or cost cutting measures in view of the widening budget deficit.

We do not expect this year to be a stellar one for capex – its official full-year budget allocation had been cut by around KD1 billion to KD2.3 billion – but it is still likely to pick up by the end of the fiscal year. While historically the implementation ratio of budgeted capital expenditures has averaged around 80%, the expected rate of 70% in FY2020/21 would give way to more capex spending by March 2021. However, it is doubtful that the ratio will reach 80%, which would translate into spending of KD1.8 billion given the still the precarious pandemic situation and the need to cut spending in light of budget financing constraints.

Chart 3: Capital spending

(KD billion)



Source: Ministry of Finance

The new government and parliament will confront hard choices

While the fiscal deficit in 1H FY20/21 has come in somewhat smaller than we would have expected on a pro-rata basis, Kuwait's new government nevertheless will be confronted by hard reform choices given the scale of the likely full-year deficit, low oil prices and continued pressures on spending (especially given the pandemic). Recent press reports suggest that as little as KD1 billion remains in liquid assets in the General Reserve Fund used to finance the deficit, which in principle might cover another 1-2 months of the governments' financing needs.

However, reforms depend also on the relationship between the government and the National Assembly. While we suspect that more liquid funds could be made available if the situation required, there does not seem to be a serious alternative to ratifying the debt law in the near future, requiring parliamentary approval. Still, increasing debt must not come at the expense of serious fiscal reforms, especially given the subdued outlook for oil prices. As well as tapping new sources of revenues including though the introduction of VAT and excise taxes, the government will need to focus on rationalizing current spending especially subsidies and directing the proceeds of new borrowing toward financing new development and infrastructure projects that could boost growth and create jobs.

Table 1: Public finances, KD million unless otherwise stated

	6M FY2018/19	6M FY2019/20	6M FY2020/21	% y/y
Revenues	10,331.5	8,754.5	4,551.8	-48.0
Non-oil	601.9	757.7	665.6	-12.2
Oil	9,729.7	7,996.8	3,886.2	-51.4
Total Expenditures	7,013.8	8,666.3	6,472.6	-25.3
Current Expenditures	6,212.9	7,916.5	6,077.1	-23.2
Compensation of Employees	1,773.4	2,638.9	1,505.0	-43.0
Goods & Services	1,016.6	1,393.7	1,130.1	-18.9
Subsidies	257.2	341.6	193.8	-43.3
Grants	2,337.3	2,547.4	2,569.0	0.8
Social Subsidies	226.2	522.2	280.9	-46.2
Miscellaneous & Transfers	602.3	472.7	398.3	-15.7
Capital Expenditures	800.9	749.8	395.5	-47.3
Budget Balance	3,317.7	88.2	-1,920.8	...

Source: Ministry of Finance

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
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 France SA
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
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
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