Quarterly Economic Brief

NBK Economic Research Department I 21 May 2020

Kuwait

Growth outlook hit, fiscal deficit to widen as virus-related lockdowns cause huge disruption

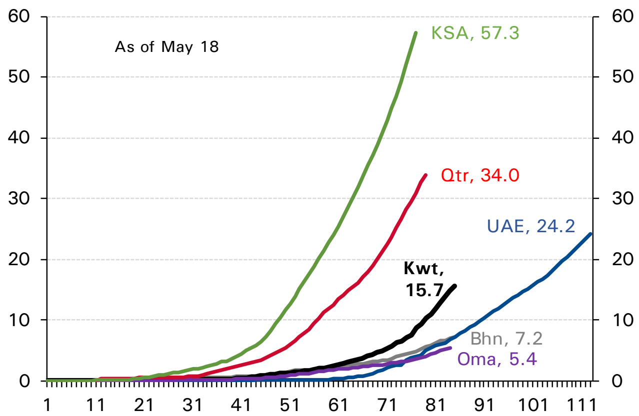
Highlights

- **Kuwait's economy like others in the Gulf is being hit hard by the fallout from and response to the Covid-19 pandemic.**
- **The plunge in oil prices has led to OPEC oil output cuts, with Kuwait's production set to average below 2.5 mb/d this year.**
- **In the most recent official data, GDP growth was negative at -1.1% in 4Q19, with non-oil growth at a modest 0.6% y/y.**
- **A fiscal deficit of KD0.2 billion was recorded in 11MFY19/20, but will end the year higher and expand sharply in FY20/21.**
- **Inflation rose to 1.9% in March, but should soften ahead on economic conditions and possible fresh weakness in housing rents.**
- **Credit growth edged up to 4.4% y/y in March on strong business lending; the CBK cut its discount rate to 1.5%.**
- **The All-Share index had fallen 30% in mid-March from its January peak on oil and virus worries, but has since stabilized.**

The economic events of the first few months of 2020 proved epic in proportion as the Covid-19 pandemic ripped through the global economy resulting in business closures, mass layoffs and supply chain disruptions as governments resorted to drastic lockdown measures to contain the virus's spread. Gulf countries including Kuwait were not spared. Kuwait saw its first confirmed Covid-19 case on February 24, and the number had escalated to nearly 16,000 by mid-May, despite the declaration of a 'public holiday' from March 12 that saw businesses shuttered and economic activity much reduced, a partial curfew imposed from March 22 and a fuller 24-hour curfew (with limited exceptions) from May 10. (Chart 1.) On top of this, the economy has had to contend with a collapse in oil prices partly triggered by the pandemic, with serious repercussions not just for economic growth but the government finances as well.

Chart 1: Confirmed Covid-19 cases

(Number, days since the first confirmed case)



Source: WHO and national sources

While it is too early to predict the economic impact with confidence – not least due to the uncertain path of the virus – Kuwait's economy along with others in the Gulf will certainly undergo a large recession this year. Oil production will likely fall 8% on average due to OPEC-mandated supply cuts which will weigh on GDP growth overall. But non-oil GDP could contract at least 4% even incorporating a steady but gradual pick-up in activity in the second half of 2020, assuming that the virus is effectively contained and oil prices start to recover.

The policy response so far has focused mostly on ensuring the supply of credit to affected firms and alleviating some of the pressure on households by postponing debt repayments. Interest rates have been cut by 125 bps, some central bank regulations have been eased to provide banks with more lending capacity to support the economy, and banks in conjunction with the government will provide subsidized loans to affected firms with especially attractive terms on offer to SMEs. Banks will also delay loan repayments for six months for all affected customers. While there have been some cuts in government fees and a proposal to hike the private sector wage subsidy, Kuwait has so far stayed away from large, direct fiscal measures.

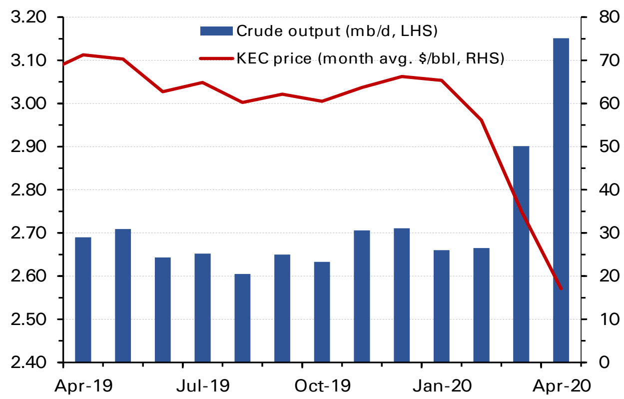
While the near-term economic outlook is grim and even the pace of recovery is uncertain, the longer-term prospects are not so. There is every reason to expect economic growth to bounce back to good levels before too long – exhibiting the same type of resilience that Kuwait has displayed during difficult moments in the past. Moreover, we think the chances of a worst-case scenario where long-term structural damage is done to the economy as a result of the virus response and lockdowns are minimal (although the fiscal deficit will need to be addressed). Indeed, although near-term pain is impossible to avoid, such crises often prove a catalyst for reforms that benefit long-term economic performance; in Kuwait's case this would include diversifying the economy and fiscal revenues, improving the business climate, boosting investment levels and making public spending more efficient.

Ending of OPEC+ deal sees oil prices plunge

The oil price war for market share that kicked off when Russia refused to agree to deeper OPEC+ production cuts amid depressed oil demand resulting from Covid-19 has dominated headlines since early March. Oil prices tanked, with the international benchmark, Brent, falling 66% in 1Q20, and to a 22-year low of $19.3/bbl in mid-April, before recovering slightly in recent weeks to above $30/bbl. Kuwait's main crude blend, KEC, closed out the quarter at $25.7/bbl (-62% q/q), before continuing down to a low of $11.7/bbl in April. It too has rebounded, to around $27/bbl. April's OPEC+/G20 agreement, in which Kuwait agreed to a two-year schedule of tapering production cuts starting 1 May, was instrumental in stabilizing prices. The hope is that these cuts will slow down the rate of global crude stock builds, which are thought to be at historically high levels, and, over time, allow supply and demand to rebalance at a higher price point. We expect oil prices to average $35/bbl in 2020, down 45% from 2019's average of $64/bbl.

The ending of the OPEC+ agreement and the subsequent 'pump to the max' policy gave Kuwait license to bring on additional crude supplies from the 500 kb/d shared Neutral Zone as well as additional light crude from its Jurassic fields. Production from the offshore Khafji field, which along with the onshore Wafra field is shared equally with Saudi Arabia, commenced in February. Free of OPEC quotas, Kuwait was therefore able to ramp up production from 2.66 mb/d in February to 3.15 mb/d in April, though output will be cut sharply from May. (Chart 2.)

Chart 2: Crude oil output and prices



Source: JODI / KPC

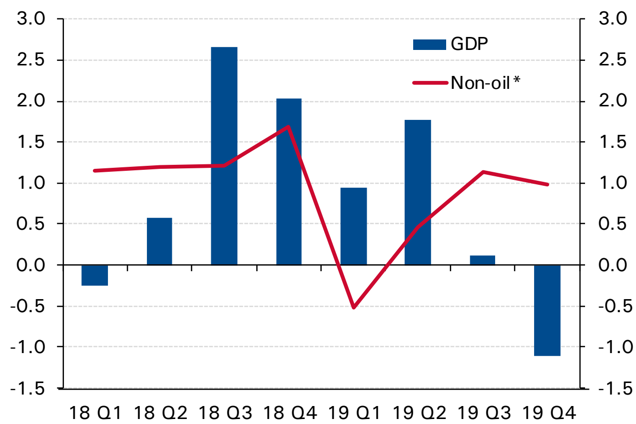
Economic growth turns negative in 4Q19 due to oil cuts

Official data showed that GDP in the last quarter of 2019 retreated by 1.1% y/y. (Chart 3.) The contraction was oil-related, with oil GDP declining 2.6% due to lower oil and gas production linked to Kuwait's participation in the OPEC+ production cuts.

Non-oil GDP, in contrast, edged up 0.6% y/y (1.0% excluding the Financial Services Indirectly Measured/tax & subsidy adjustment), helped by growth in the 'other services' category (+5.7%), which includes real estate and business services, manufacturing (+3.6%), public administration and education sectors. However, the increase in the manufacturing component (15% of non-oil GDP), which includes refining, plastics and chemicals, was puzzling, given that just under half of output in this sector is dependent on crude and gas feedstocks, which we know declined in 4Q19. Refined products output, for example, fell by 4.5% y/y in 4Q19. Non-oil declines were recorded across the trade (-2.6%), transportation & storage (-3.0%), construction (-8.1%) and telecommunications (-8.2%) sectors.

Chart 3: Kuwait real GDP

(% y/y)



Source: CSB / NBK * excluding FISM/tax & subsidy adjustment.

On a full year basis, Kuwait's GDP growth in 2019 appears to have slowed to 0.4% from 1.2% in 2018. Non-oil growth, however, accelerated to 3.0% from 1.3% the previous year. However we expect this number to be revised down when the more comprehensive full-year accounts are published later on.

As mentioned above, the positive if modest growth of 2019 has been swept aside by the tumultuous events of 2020 which point to very weak performance this year. Non-oil growth momentum is almost certainly going to reverse in 1Q20 due to the corona pandemic, with businesses shuttered and consumption cratering. While official national accounts data is still pending, anecdotal evidence and firms' survey data point to deep contractions in output, sizeable falls in orders and lower payroll numbers.

Fiscal position in small deficit in first 11 months

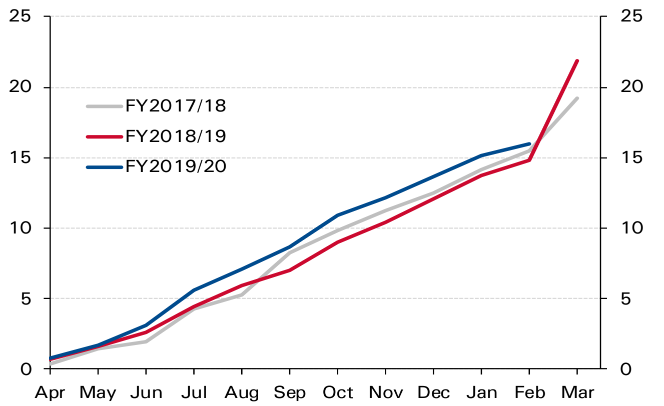
The government registered a deficit of KD0.2 billion before transfers to the Future Generations Fund (KD1.8 billion after transfers) during the first eleven months of FY19/20 (to February). This compares to a surplus of KD3.6 billion at the same stage a year earlier. The rise in the deficit was due to lower oil prices, which drove a decline in total revenues by 15% to KD15.8 billion. On the other hand, public spending increased by 8.2% to

KD 16.0 billion, driven by higher current expenditures. (Chart 4.) Given the usual jump in spending in the final month of the year, we expect the full-year budget deficit to reach KD3.6 billion or around 9% of GDP (before transfers) compared to around 3.0% of GDP in the previous fiscal year.

In light of the scale of the recent collapse in oil prices, the government and parliament are reportedly re-examining the budget figures and assumptions for FY20/21. The Supreme Council of Planning and Development has recommended that the government take extra measures to curb public spending, including decreasing spending of public institutions, other than wages, by at least 20% and deferring all planned projects, which could cut public expenditure by KD4.5 billion this year. In the draft budget spending had been set at KD22.5 billion, unchanged from last year and for now we continue to assume that spending comes in only just below this figure at KD21.9, to include cuts in non-essential capital spending but a rise in current spending including on emergency and health-related items. Based upon this and an oil price of $35/bbl this year on average, we project the fiscal deficit could reach more than KD12 billion over the full year, or around 40% of GDP, before transfers to the FGF.

Chart 4: Government spending

(KD billion, year-to-date)



Source: Ministry of Finance / NBK

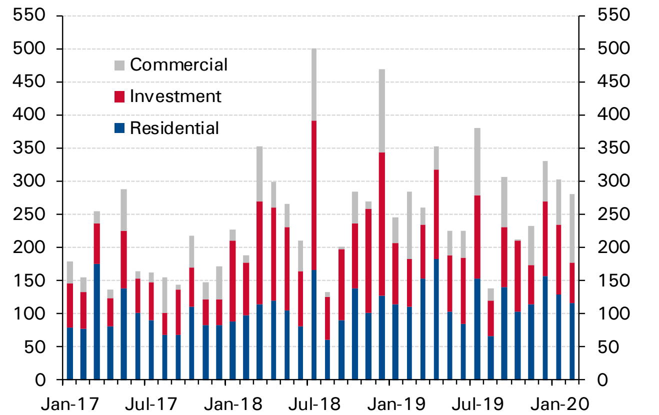
Financing a deficit of this size would likely deplete most of the assets held by the General Reserve Fund (GRF). This, in combination with the prohibition on issuing new debt until the debt law is passed by parliament, has triggered discussions to provide temporary relief to the GRF through selling its illiquid assets to the FGF, or providing KD2 billion from the central bank, though the suggested measures are not enough to prevent the accelerated depletion of the fund. While the government still has huge financial assets held by the FGF which underpin Kuwait's overall economic resilience, fiscal and structural reforms are key to offset the risks of lower oil prices in the medium term.

Real estate sales solid ahead of likely virus impact

The real estate market started the year with decent sales and activity, at KD302 million and KD280 million in January and February respectively, and almost 1,000 combined transactions, and with prices mostly stable as of January. (Chart 5.) Although our previous view was for the real estate market to be steady in 2020 on a relatively soft but stable overall economic climate, the risks now look skewed towards the downside. This is in light of a highly uncertain coronavirus situation and the slump in oil prices. It is too early to say how large the property market fallout from the economic downturn will be, especially in the absence of recent data due to the lockdown. But based on past episodes of economic turmoil, it is likely that the prices of property – like other key asset classes – will be affected, possibly in some areas more than others.

Chart 5: Real estate sales

(KD million)



Source: Ministry of Justice

We expect newer investment areas with higher supply for sale to bear a greater impact relative more established, typically more resilient prime areas. As for sales, expect sales in March and April to be nearly non-existent due to the lockdown. As such, the true state of the market will become apparent in the first few months after the lockdown is lifted. The spread of the virus, travel bans, and the lockdown, if prolonged, will weigh on immigration, which will in turn affect demand for property rentals and negatively affect property prices. Additionally, lower oil prices and economic instability may cause investors and homebuyers to be more wary of market conditions, resulting in the postponement of would-be property purchases. The commercial sector will be hard hit by the impact of the huge downturn in economic activity with struggling businesses already reportedly seeking delays in rental payments.

Consumer spending likely to have been hit hard

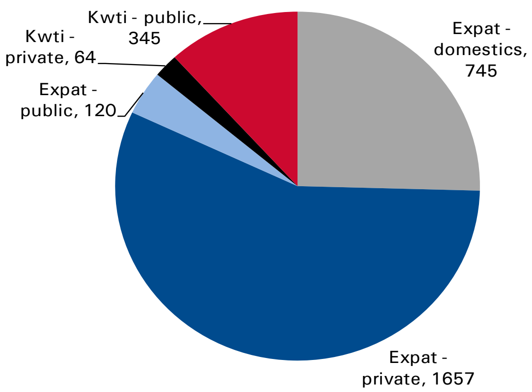
Consumer spending is likely to have taken a major hit towards the end of Q1 after strict virus-containment measures were imposed. While data is likely to point to a steep rise in consumer staples driven by a front-loading of purchases amid travel restrictions and fear of food shortages, this is likely to be offset by a sharp drop in consumer discretionary sales. This is against a backdrop of increased income insecurities and the full and/or partial closure of department stores, malls, restaurants, coffee shops, cinemas, hairdressers and car repair shops.

Consumer confidence in Kuwait was trending lower even before the virus hit and oil prices collapsed. According to Ara's consumer confidence index, consumer confidence slipped to an over three-year low of 99 in February from 100 in January, on the back of drops in the 'future economic situation' (96 from 103) and durable goods (92 from 107) subcomponents, mainly reflecting weaker sentiments among expats to some extent amid ongoing Kuwaitization efforts. Growth in borrowing for personal consumption purposes (i.e. not housing) was still very strong at 28% y/y in March due to an earlier easing in lending restrictions by the central bank, but is off its previous highs. Data from Knet showed that consumer spending rose by a very solid 13% y/y in 4Q19.

Estimates of job losses are uncertain at this stage. But according to a survey by local PR firm Bensirri, 45% of respondents have suspended or shutdown their business and others would follow if the lockdown persists for an extended period. We would expect job losses to be focused on the expatriate community, which accounts for around 97% of the private sector workforce. (Chart 6.) Some steps have been taken to ease pressure on household incomes. In addition to interest rates being cut, loan repayments have been frozen for six months, and there is a proposal to double the private sector wage subsidy for citizens for six months, though this would come in the form of a payment to employers who do not cut salaries or make layoffs. The latter measure is said to be worth KD200-220 million, or around 1-2% of estimated household spending last year. Our very broad initial estimates suggest that the loan freeze measure could temporarily free up KD1 billion in income, equivalent to more than 5% of spending last year.

Chart 6: Employment by nationality and sector

(000s, end-2019)



Source: PACI

Inflation edges up to 1.9% in March

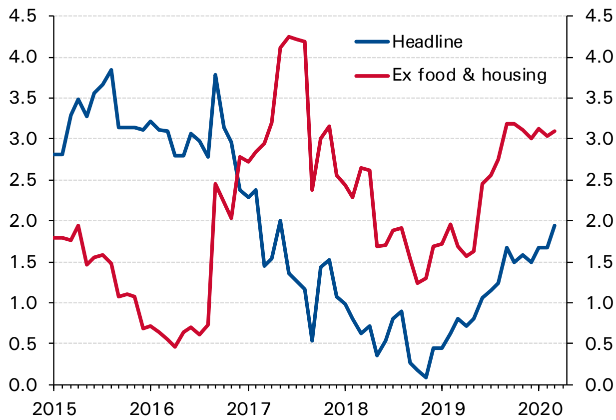
Inflation rose to 1.9% y/y in March from 1.7% in February and 1.5% at the end of Q4. (Chart 7.) The pick-up from February was supported by an ease in deflation in housing rents from -0.9% to -0.2%. Food price inflation, in contrast, was unchanged at 2.8%. It is worth noting that given the lockdown and business closures in place since mid-March, it is likely that statistical sampling was difficult at the end of the quarter, potentially affecting the quality of the data.

Core inflation (i.e. excluding food and housing) was up 3.1% in March versus 3.0% in February, as higher inflation in clothing & footwear (2.8% from 2.7%), other goods & services (4.0% from 3.2% and communication (4.1% from 3.9%) more than offset lower inflation in transportation, recreation and education.

Looking ahead, while weaker housing demand is likely to lead to a fresh wave of declines in rents in the months to come and thus weigh on inflation overall, food price inflation may rise – albeit steadied by government initiatives to prevent price gouging during the pandemic. We expect headline inflation to ease to around an annual average of 1.0% in 2020 from 1.1% in 2019. Core inflation is also likely to face downward pressures due to the weak economic climate, edging closer to 2.0% in 2020 from 2.4% in 2019.

Chart 7: Consumer price inflation

(% y/y)



Source: Refinitiv / NBK

Credit growth stable in March; CBK cuts policy rates

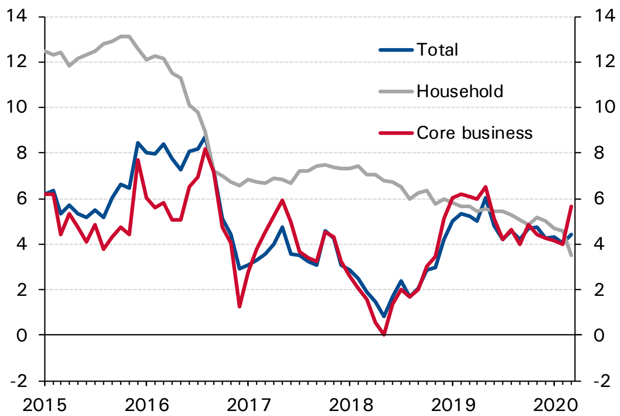
Credit increased by 1.7% q/q in 1Q20, resulting in a broadly stable y/y expansion of 4.4% by the end of March compared with 4.3% in 2019. (Chart 8.) Growth was fully driven by business lending (+3.4% q/q), which pushed the y/y growth to 5.7% (4.3% in 2019). The "trade" sector was a main driver of business lending as it expanded by nearly 8% q/q.

Household credit was broadly flat, bringing down y/y growth to a multi-year low of 3.5% (5% in 2019). For the first time in many years, housing loans decreased through the quarter, softening the y/y increase to just 1.1%. Expectedly, the growth in personal consumption loans moderated to 28% y/y at the end of 1Q20 after peaking at 37% in November 2019.

In response to the extraordinary economic developments linked to the coronavirus outbreak, the central bank, tracking the Federal Reserve, cut the discount rate by 100 basis points to 1.5% in mid-March, and in a major development, eased some liquidity and capitalization requirements in early April. This included increasing the maximum allowed loans-to-deposits ratio from 90% to 100% and reducing capital adequacy requirements by 2.5%, among other measures. These regulatory changes have increased by a wide margin banks' lending capacity (to an estimated KD 4.5 to 5 billion).

Chart 8: Bank credit

(% y/y)



Source: Refinitiv / CBK / NBK

In addition, the government approved in April a subsidized loan scheme for the benefit of SMEs and other companies/customers that have been impacted by the coronavirus. That scheme calls for banks to extend loans at a maximum rate of 2.5% per annum for two to three years, subject to certain terms and conditions. The banks will provide the funding and assume the credit risk, while the government will pay a major portion of the interest cost. It has been estimated that this scheme might total around KD 2 billion (5% of loans as of end-March).

Looking ahead, we expect credit demand to be muted by the very weak operating environment due to the coronavirus and low oil prices. However, there are some helpful factors. Loan growth will be supported by the aforementioned subsidized loan scheme, especially with the relaxation of liquidity/capitalization requirements by the CBK. Another factor that will artificially support net loan growth is the deferral of loan repayments which will keep loans longer on balance sheets. Finally, especially in the short term, credit growth may also be supported by companies tapping their credit lines with the banks, to shore up their funding, in the face of plunging revenues; this possibly was already at play in March, when credit growth stood at 1.2% m/m, the highest in nearly two years.

Finally, deposit growth was weak in 1Q2020, standing at -0.4% q/q to reflect a 0.7% y/y increase. In continuation of the trend seen in 2019, private sector deposits decreased q/q while government deposits increased. By the end of 1Q2020, private sector deposits were down by 3.4% y/y while government deposits were up by a whopping 25% (KD 1.5 billion).

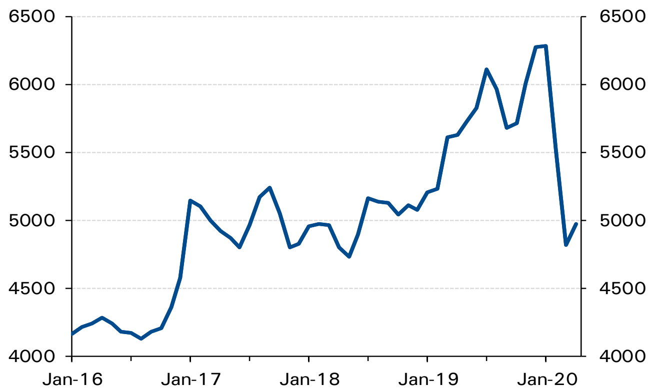
Virus and oil market concerns weigh on equities

Boursa Kuwait's performance year-to-date has been severely affected by the historic drop in oil prices coupled with virus concerns. High valuations at the start of the year, as well as the ending of support from benchmark index classification upgrades may have weighed too; the latter had been largely responsible for the surge in net foreign inflows and lifted the market in 2018-2019. The All-Share index was down a steep 24% YTD as of mid-May, led by losses in the premier market. (Chart 9.) However it has stabilized more recently, rising by a modest 1% in the second quarter-to-date on a more stable oil market, despite ongoing virus uncertainty and the extended lockdown.

The drop in equity prices has led to a steep decline in market capitalization, which stood at just under KD20 billion at end-April, compared to over KD35 billion at the end of 2019, equating to a 44% loss in market value. Turnover by volume however remained strong, averaging 4 billion shares per month in the year to the end of April, a 25% increase over the same period last year. Kuwaiti and GCC investors have been net buyers so far this year, while foreign investors are net sellers: net foreign outflows totaled about KD67 million in 2020 as of April, versus net inflows of KD281 million over the same period last year.

Chart 9: Boursa Kuwait All-Share index

(Index, end month)



Source: Refinitiv

The outlook for GCC equities will largely be influenced by virus developments, oil prices, and the swiftness of economic recovery post the pandemic and associated lockdowns. With oil prices forecast to modestly recover in 2H20 on oil output cuts and lower global stockpiles, and as oil demand and business activity improves with the anticipated reopening of major economies, we expect this to have a positive effect on equities. Price support may also come from lower, more attractive prices relative to the start of year. On the other hand, relatively weak 1H20 corporate earnings, a bleak overall economic outlook with a large expected fiscal deficit, a possible resurgence of US-China trade tensions and the general lack of a fresh catalyst may weigh down on stocks in 2H20.

Table 1: Key economic data

	2013	2014	2015	2016	2017	2018	Estimates/forecasts 2019	2020
				(KD billion)				
Nominal GDP	49.4	46.3	34.5	33.1	36.6	42.5	40.9	30.8
Oil (including refining)	32.7	29.2	15.7	13.6	16.2	21.0	19.3	8.7
Non-oil	22.4	23.2	23.9	23.9	25.2	26.1	27.1	26.3
				(percent change)				
Real GDP	1.1	0.5	0.6	2.9	-4.7	1.2	0.4	-6.0
Oil (including refining)	-1.8	-2.1	-1.7	3.9	-9.0	0.2	-1.6	-8.0
Non-oil	4.2	4.8	0.4	1.6	2.6	2.3	0.5	-4.0
Private credit (end-year)	8.1	6.1	8.5	2.9	3.1	4.2	...	...
Money supply (M2, end-year)	10	3.4	1.7	3.6	3.8	3.9	...	...
Inflation (% y/y, average)	2.7	3.2	3.7	3.5	1.5	0.6	1.1	1.0
Inflation (% y/y, end-year)	2.6	3.0	3.1	2.4	1.1	0.4	1.5	0.7
				(percent of GDP)				
Fiscal balance (before FGF transfers)	26.1	7.6	-13.4	-13.9	-8.9	-3.0	-9.4	-40.5
Revenues	64.4	53.9	39.5	39.6	43.7	48.4	44.0	30.4
Oil	59.3	48.6	35.0	35.4	39.0	43.4	38.8	23.5
Non-oil	5.1	5.2	4.5	4.3	4.7	5.0	5.2	6.9
Expenditures	38.3	46.3	52.9	53.6	52.6	51.4	53.4	70.9
Transfers to Future Generations Fund	16.1	13.5	4.0	4.0	4.4	4.8	4.4	3.0
Fiscal balance (after transfers to FGF)	10.0	-5.9	-17.3	-17.9	-13.2	-7.9	-13.8	-43.5
Investment income*	7.0	8.5	12.4	13.4	12.9	11.3	11.9	15.8
Public debt	3.1	3.4	4.6	19.6	19.8	14.5	12.6	27.6
Current account balance	40.3	33.4	3.5	-4.6	8.0	14.5	7.5	-20.7
Goods balance	51.8	47.7	24.4	17.8	21.3	29.1	24.0	2.5
Exports	66.5	64.2	47.5	42.5	45.7	51.4	47.7	32.4
Imports	14.7	16.6	23.2	24.7	24.4	22.3	23.7	29.9
Services (net)	-8.5	-11.1	-17.4	-18.3	-16.7	-17.3	-19.7	-22.7
Investment income (net)	8.0	9.6	11.1	11.7	15.6	13.2	14.6	13.0
Worker remittances	-11.0	-12.7	-14.5	-15.8	-12.2	-10.6	-11.3	-13.5
Exchange rate (KD per US$1, average)	0.284	0.285	0.301	0.302	0.303	0.302	0.304	...
CBK discount rate (percent, end-year)	2.00	2.00	2.25	2.50	2.75	3.00	2.75	...
Kuwait export crude price ($/bbl, avg)	105	95	48	39	51	69	64	34
Oil production (million b/d, average)**	2.92	2.87	2.86	2.95	2.70	2.74	2.68	2.46

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, NBK estimates.
*Based on estimated figures by CSB and NBK. ** Uses JODI/OPEC direct communication figures.

Table 2: Monthly economic data

(KD billion, unless otherwise indicated)	Dec-17	Dec-18	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20
Credit	35.4	36.9	38.2	38.4	38.6	38.6	39.1	...
Growth (% y/y)	3.1	4.2	4.7	4.3	4.3	4.0	4.4	...
Money supply (M2)	37.1	38.6	38.2	38.1	38.1	37.4	38.0	...
Growth (% y/y)	3.8	4.0	-0.3	-1.2	-1.4	-3.2	-2.4	...
Inflation (% y/y)	1.1	0.4	1.6	1.5	1.7	1.7	1.9	...
ex food and housing	2.6	1.7	3.1	3.0	3.1	3.0	3.1	...
Real estate sales (KD million)	171	470	233	331	302	280	...	...
Growth (12-month average, % y/y)	-6.9	56.1	7.5	-6.0	-4.9	-7.6	...	...
Real estate price indices:								
Residential homes	152	156	164	164	168	...	...	...
Residential plots	170	174	191	195	197	...	...	...
Investment buildings	182	195	187	193	189	...	...	...
Consumer confidence (index)	110	110	104	105	100	99	...	...
Kuwait export crude price ($/bbl, avg)	61	57	64	66	66	56	35	18
Stock market – All Share index (end-mth)	4,830	5,080	6,013	6,282	6,287	5,516	4,823	4,975
Growth (% m/m)	...	-0.6	5.2	4.5	0.1	-12.3	-12.6	3.2

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, ARA, NBK estimates

Table 3: Quarterly economic data

(KD billion, unless otherwise indicated)	4Q15	4Q16	4Q17	4Q18	1Q19	2Q19	3Q19	4Q19
GDP growth (% y/y)	1.7	4.0	-4.3	2.0	0.9	1.8	0.1	-1.1
Oil*	0.9	2.2	-5.8	2.4	1.6	-0.4	-5.3	-2.6
Non-oil*	0.3	2.7	1.6	1.6	0.2	4.3	7.1	0.6
Point-of-sale card spending	2.1	2.3	2.6	2.9	2.9	3.2	...	...
Growth (% y/y)	10.0	9.1	11.4	10.9	7.8	6.8	...	...
Current account balance	-0.1	0.6	1.2	1.8	2.7	2.8	1.3	...
Exports	3.6	4.1	4.7	5.4	5.0	5.2	4.8	...
Imports	2.1	2.1	2.4	2.3	2.2	2.2	2.2	...

Source: Central Statistical Bureau, Ministry of Finance, Central Bank of Kuwait, NBK estimates * Series break: due to classification changes, growth rates in the oil and non-oil sectors before 1Q18 are not comparable with those thereafter.

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