Kuwait

A soft oil sector will weigh on GDP growth over the forecast period, with non-oil growth rising slightly to 2.8% by 2021. The fiscal position will likely be in deficit over 2019-21, to be financed by the General Reserve Fund (GRF) in the absence of a debt law. Credit growth has picked up supported by an accommodative monetary policy, though the boost from any Fed rate cut may be limited. Downside risks include lower oil prices, regional geopolitical tensions, slow reform progress and widening fiscal deficits that could deplete GRF resources in the medium term.

Oil sector weighs on growth performance

Economic growth is stuck in a modest 1-3% range over the forecast period, slightly below the regional average. This reflects the large size of the oil sector, where growth is capped by the OPEC+ agreement, which is almost certain, will be extended. Oil GDP will be lifted as Kuwait looks to almost double gas output by FY2023/24. The start-up of the Clean Fuels Project (2020) and Al-Zour refinery (2021) will nearly double refining capacity.

Non-oil growth will remain subdued due to fiscal pressures and slow pro-growth reforms. Non-oil growth is seen at 2.5-2.8% per year, with steady oil prices underpinning confidence and public spending rising albeit at a limited pace. Near-term prospects for consumer spending are decent with consumer loan growth at a five-year high of 11% y/y in April, supported in part by easing lending restrictions and employment growth. Project implementation could improve given an ample project pipeline, and a backlog from delays, and the government's commitment to capex under Vision 2035 goals. However, we do not expect much stronger non-oil growth absent progress on the reform agenda and larger fiscal stimulus.

Inflation is forecasted to remain low at 1-2%. Downside pressures are coming from housing rents, which showed renewed weakness in 1Q19, and food prices, which are impacted both by international prices and local subsidies. Core inflation is expected to hover at around 2% reflecting moderate economic growth, a strong dinar with respect to trade partner currencies, and the absence of taxes (VAT, Excise) or large subsidy cuts.

Kuwait would be included in MSCI emerging market index as of May 2020 conditional on meeting two conditions by November. This inclusion is expected to bring in about $2.8 billion in passive inflows and an estimated $7 billion in active inflows.

Budget to swing back into deficit, financed by reserves

The fiscal balance could register its first surplus in four years in FY2018/19 mainly due to higher oil prices and weak spending. Assuming some rebound in spending this year, a swing back into deficit is likely. Although the government's financial reserves provide a large near-term cushion and debt levels are low, underlying fiscal pressures are rising due mainly to the absence of reforms to broaden the tax base, and continued pressures on spending including from further hiring in the public sector. We estimate assets in the General Reserve Fund – used to fund the budget shortfall – of KD24 billion (60% of GDP) in March 2019 which can finance the cumulative (after transfers) budget deficit of KD11 billion through FY2021/22 and pressure on reserves would be eased further if the new debt law is approved.

The external position by contrast is robust, with a large albeit declining current account surplus seen throughout the forecast period. As well as oil receipts, the surplus is supported by returns of around KD5 billion (12% of GDP) per year on the government's assets held abroad. The financial account will see continued large net outflows, especially in the absence of sovereign debt issuance or stronger inward FDI. The latter stood at $0.3 billion in 2018, reflecting Kuwait's low rank in measures of competitiveness and 'ease of doing business.

Credit growth has picked up, seen steady this year

Credit growth has recovered, climbing back above 5% y/y so far this year after averaging 2.3% in 2018. We expect the trend to be broadly flat for the rest of this year, with stronger consumer lending more or less offset by a further cooling in housing loans. The central bank has used the flexibility of the dinar's peg to a currency basket to increase interest rates on just four out of (the US Fed's) nine. This in turn means that policy may be loosened less quickly when the cycle turns – thereby lowering the credit impact.

Outlook stable but challenges remain

Kuwait's large financial buffers provide a cushion against any possible adverse external shock. However, with budget deficits widening against an unstable oil price outlook, and in the absence of meaningful fiscal reforms that reduce current spending (the wage and subsidy bill) and lift revenues, savings in the GRF will dwindle and could be depleted in the medium term. Foreign investors and credit rating agencies would view this unfavorably. Improving the business environment and boosting private sector growth to create jobs for the increasing number of young Kuwaitis entering the labor force would offset some of the risks and put Kuwait on a sustainable path.

Table 1: Key economic indicators

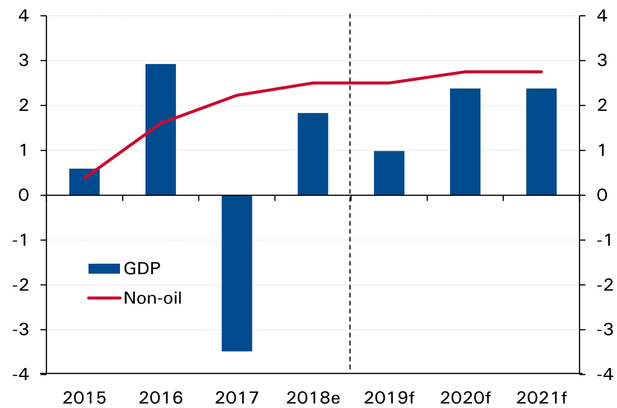
		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	120	137	134	138	143
Real GDP	% y/y	-3.5	1.8	1.0	2.4	2.4
- Oil	% y/y	-7.2	1.2	-0.5	2.0	2.0
- Non-oil	% y/y	2.2	2.5	2.5	2.8	2.8
Inflation	% y/y	1.5	0.6	1.0	1.5	2.0
Fiscal balance[1] (FY)	% of GDP	-9.0	2.0	-3.0	-4.0	-5.0
Public debt (FY)	% of GDP	20.0	14.8	12.7	14.5	16.3
Current account bal.	% of GDP	8.0	14.8	8.0	7.0	6.0

[1] Before transfers to the sovereign wealth fund

Source: Official sources, NBK estimates

Chart 1: Real GDP

(% y/y)

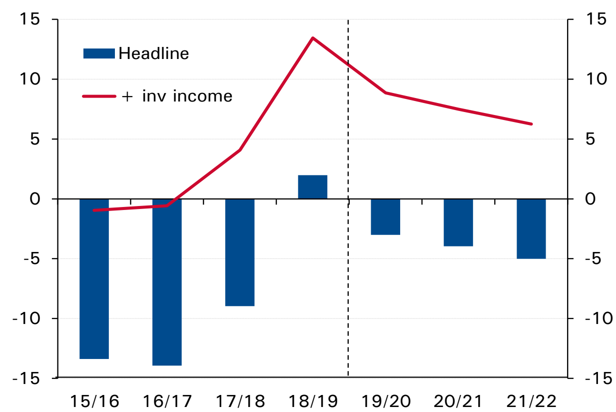


Source: Central Statistical Bureau / NBK

Chart 2: Crude oil output

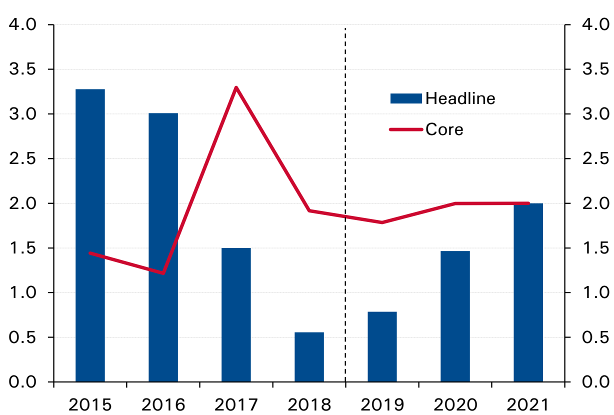
Source: OPEC

Chart 3: Fiscal balance



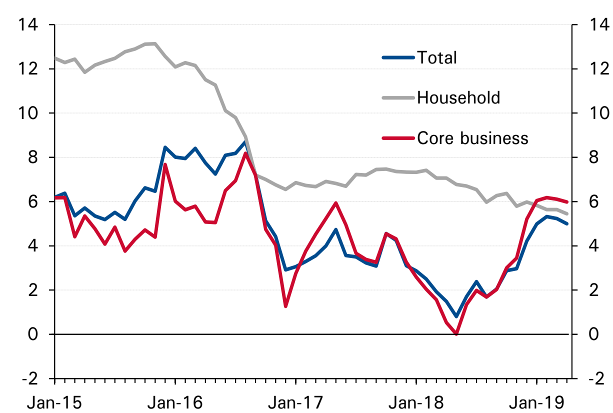
Source: Ministry of Finance / NBK

Chart 4: Inflation



Source: Refinitiv / NBK

Chart 5: Bank credit



Source: Refinitiv / NBK