Kuwait: Fiscal deficit widened in the first 9M of FY20/21 on rising spending

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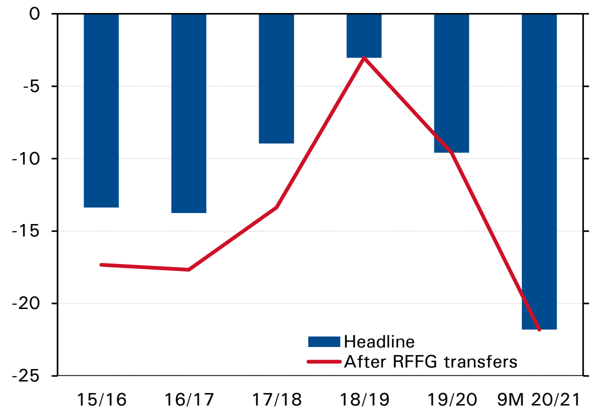
Highlights

- **The fiscal deficit in 9M FY2020/21 came in at KD5.4 billion, with oil revenues still soft but spending starting to pick up.**
- **Oil receipts remained depressed by low oil prices and cuts in oil production – though both should rise in the final quarter.**
- **Capital spending regained some of its momentum in Q420, but overall performance remains weak.**
- **The budget deficit for FY2020/21 could be around KD10 billion, lower than the official estimate of KD14.1 billion, though larger than most previous deficits.**

Kuwait's fiscal deficit reached KD5.4 billion, or around 22% of pro-rated GDP, during the first 9M of FY2020/21 (April-December), according to the latest data released by the Ministry of Finance. (Chart 1.) This was larger than the KD1.0 billion deficit recorded during the same period in FY2019/20, with the widening caused by still-soft oil prices. Spending remained well down on last year's level however, reflecting both cuts to budget outlays but also likely virus-linked delays in capital spending. (See below.) While we expect the deficit to widen further in the final quarter as spending rises, the recent rally in oil prices has caused us to trim our expectations for the full-year deficit to around KD9.8 billion (30% of GDP) from KD10.5 billion before. However, uncertainty over the spending outcome still allows for a significant margin of error.

Chart 1: Fiscal Balance

(% of GDP)



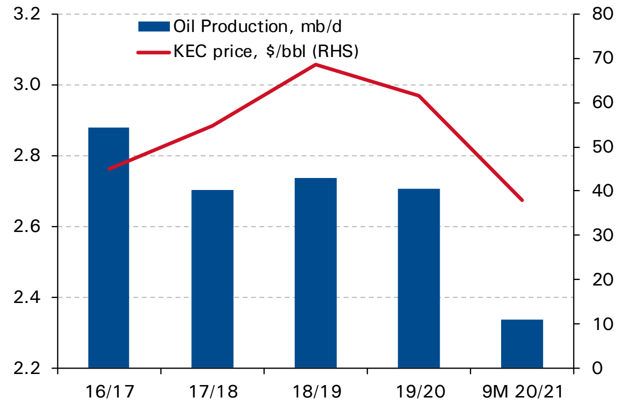
Source: Ministry of Finance, NBK estimates

Oil revenues surpass budget estimates on higher oil prices

Total revenues fell by 46% y/y during the first 9M, with oil revenues depressed by both weak oil prices (-42%) and cuts in oil production (-13%). (Chart 2). However, it is worth noting that oil revenues already surpassed government's full-year budget projections as the actual oil price ($38) turned out to be higher the oil price ($30) assumed in the budget. Moreover, during the final quarter we expect oil revenues to increase as oil prices have crossed the $50/bbl threshold, while oil production has also crept up due to a slight easing in OPEC+ output cuts.

Chart 2: Oil production and KEC price

(mb/d, $)



Source: OPEC

Non-oil revenues – worth around 15% of all revenues to date – were still down year-on-year but the decline has eased markedly compared to earlier in the year, now just -4% (versus -12% after 6M). This is a reasonable outcome given the very challenging broader economic context of 2020, and owed to a notable recent rise in 'other revenues', partially reflecting a rise in utility receipts. Revenues of 'taxes and fees' were down

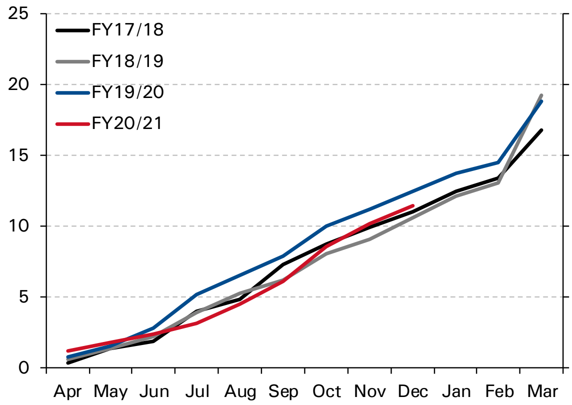
15.9%, more in line with the decline in imports as this item mostly represents customs proceeds.

Drop in spending eases versus previous months

The year-on-year drop in spending eased to 10.1%, with outlays at 57% of full-year allocations in the budget. Current spending, which constitutes the vast majority, fell 8.5% y/y to KD11.4 billion, while capital spending continued its weak performance, declining 27% to KD 0.9 billion. (Chart 3.) The fall in spending partly reflects government efforts to curb outlays to address the deficit and current liquidity constraints, but perhaps also delays in reporting in the provisional data.

Chart 3: Current spending

(KD billion)



Source: Ministry of Finance, NBK estimates

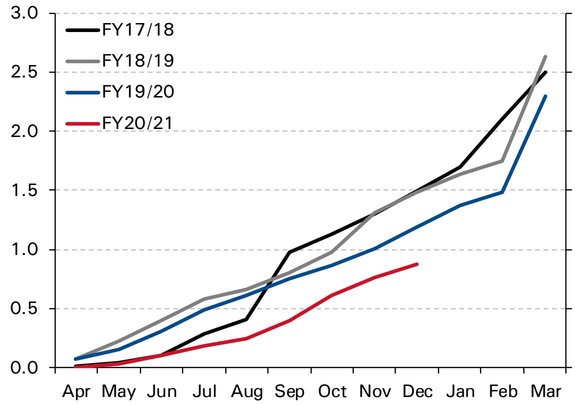
Most current spending components witnessed significant declines. 'Compensation of employees' fell 7.9% y/y to KD4.3 billion, on delayed reporting and perhaps reflecting expat job losses. Meanwhile, the decline in oil prices reduced government purchases of fuel, reflected in lower spending on goods and services by 19% to KD1.9 billion. The 'subsidies' bill (which includes cost of living allowances and petrol subsidies) was also cut by the plunge in oil prices, by 19% to KD0.4 billion. 'Social subsides', which mostly represent healthcare to retirees and healthcare abroad, fell by 39% to KD0.4 billion, while 'Miscellaneous transfers', which contain scholarships and the wages of the judicial system, fell by 25%. However, outlays could still be boosted by the provision of KD0.5 billion in urgent funds to contain the spread of Covid-19. Finally, the large 'grants' category, which includes transfers to independent entities including the pension fund, rose 8.9% to KD3.9 billion.

Sluggish capital spending

On the other side, capital spending continued at a weak pace, declining by 27% y/y to KD0.9 billion, and realizing only 38% of its full-year budgetary provision, impacted by pandemic fallout as well as a lower budget compared to the previous year. (Chart 4.) Nonetheless, looking at the third quarter (October to December), capex regained some of its momentum compared to the corresponding period of the previous year as it increased by 6.9% mainly on relaxing health containment measures. However, we still believe that capex for the current year will remain weak, as it shoulders the burden of liquidity constraints that are currently facing the government.

Chart 4: Capital Spending

(KD billion)



Source: Ministry of Finance, NBK estimates

Uncertainty is clouding the scene

It is not clear how the recent resignation of the newly–formed cabinet will impact the country's fiscal reform path this year and over the medium term. Continued legislative gridlock–including mainly the passing of the debt law and the possible approval of any revenue-enhancing or spending rationalization measures–would complicate government efforts to address the severe liquidity constraints it faces brought about by low oil prices, Covid-19 fallout, and a dwindling of assets in the General Reserve Fund. We do believe that short-term obstacles to funding the deficit will be overcome. But the two-notch downgrade to Kuwait's credit rating to A1 by Moody's in September, and the warning of more downgrades to come if reforms are not put in place, highlight the growing risks of failing to address Kuwait's long-term fiscal challenges, especially if oil prices remain low.

The government recently put forward an expansionary draft budget proposal for FY2021/22. There are no obvious signs of reform in the headline figures, but it does suggest that the government's focus will be on supporting the economy's recovery from the pandemic and avoiding any fresh pressures on services or citizens' incomes in the short term. Spending is targeted to rise nearly 7% on the FY20/21 budget to KD23.0 billion, with capex rebounding 20% and wages & salaries up 4.2% after almost stagnating last year. Based upon an oil price of $45/bbl and oil production of 2.4 mb/d, total revenues are projected up at KD10.9 billion. The resulting official deficit is KD12.1 billion or 34% of (NBK) GDP, smaller than the budgeted KD14.1 billion for FY20/21. However, with expected higher oil prices in both fiscal years, the deficits could end up at about KD 10 billion. These deficits are large by historical standards, entailing serious financing challenges.

Table 1: Public finances, KD million unless otherwise stated

	First 9M			% y/y	
	FY2018/19	FY2019/20	FY2020/21	FY2019/20	FY2020/21
Revenues	15,686.5	12,675.5	6,906.5	-19.2	-45.5
Non-oil	1,027.0	1,087.9	1,042.0	5.9	-4.2
Oil	14,659.5	11,587.6	5,864.4	-21.0	-49.4
Total Expenditures	12,108.9	13,684.5	12,303.1	13.0	-10.1
Current Expenditures	10,620.8	12,491.0	11,433.5	17.6	-8.5
Compensation of Employees	3,466.0	4,612.8	4,250.1	33.1	-7.9
Goods & Services	2,037.4	2,321.3	1,873.1	13.9	-19.3
Subsidies	324.4	508.7	413.1	56.8	-18.8
Grants	3,398.0	3,570.9	3,887.1	5.1	8.9
Social Subsidies	518.6	710.9	436.5	37.1	-38.6
Miscellaneous & Transfers	876.3	766.3	573.6	-12.6	-25.2
Capital Expenditures	1,488.1	1,193.5	869.6	-19.8	-27.1
Budget Balance	3,577.6	-1,009.0	-5,396.7	...	...

Source: Ministry of Finance

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