Economic Update

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Balance of Payments

Kuwait: Current account surplus narrows further in 2Q20 on oil price plunge

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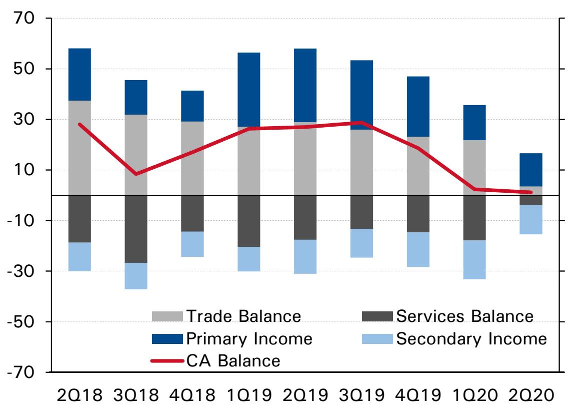
Highlights

- **The current account surplus narrowed to KD0.1 billion in 2Q20 on a low trade balance surplus, mainly due to falling oil exports, although imports declined by 18% q/q.**
- **The services account deficit also fell on low outbound tourism due to pandemic-related travel restrictions.**
- **The CBK's international reserves increased to KD14 billion, covering around 10.8 months of imports.**

Kuwait's current account surplus continued to narrow in 2Q20, registering KD0.1 billion (1.2% of estimated GDP in Q2) compared with a revised surplus of KD0.2 billion in 1Q20 (2.4% of GDP). This was due to a collapsing trade surplus after the slump in oil prices in 2Q20, and despite the steep decline in imports, outbound tourism, and workers' remittances. (Chart 1.) On the other hand, the financial account registered a net outflow of KD0.7 billion compared with a net inflow of KD0.7 billion in the previous quarter.

Chart 1: Current account main components

(% of GDP)



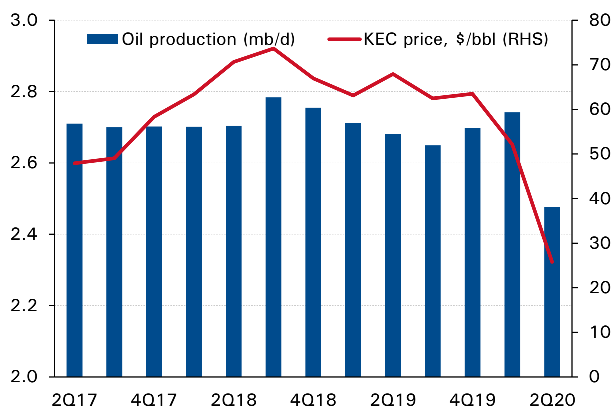
Source: Central Bank of Kuwait, CSB, NBK estimates

Oil price collapse narrowed trade surplus

The surplus in the goods trade balance contracted to only KD0.3 billion in 2Q20. Oil export revenues, which usually constitute around 89% of total exports, almost halved to KD1.8 billion compared with Q1 due to the plunge in crude oil prices following the impact of Covid-19 on oil markets. The price of Kuwait Export Crude fell to $25.8/bbl in 2Q20, from $52.1/bbl in Q1. Moreover, oil production plummeted to a (quarterly average) nine-year low of 2.48 mb/d in 2Q20 due to OPEC supply cuts.

Chart 2: KEC price and production

($/bbl., mb/d)



Source: OPEC

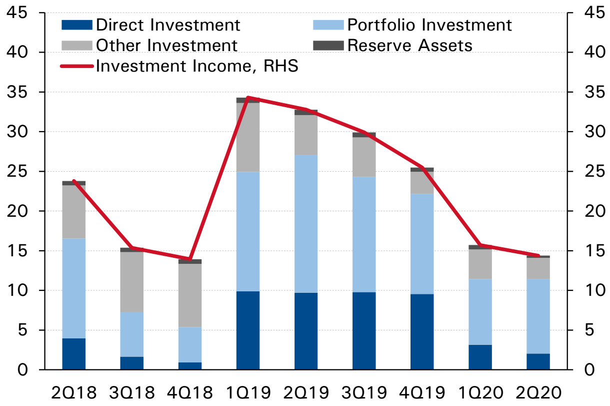
At the same time, imports continued their downward trend, declining by 17.7% q/q, which helped partially offset the impact of low oil exports on the trade balance. Imports of consumption goods (constituting around 48% of total imports) plummeted by 12.5% while intermediate goods (36% of total imports) saw a steeper fall of 18.6% q/q. In addition, capital goods (including industrial and transport equipment) declined by 19.9% q/q. These developments were the byproduct of trade disruptions and the impact of the pandemic on business activities. Moreover, flight cancelations and the lockdown cut outbound tourism spending by KD1.1 billion in 2Q20, which greatly reduced the deficit in the services balance to KD0.4 billion (3.9% of GDP).

Investment income remained stable

Meanwhile, the primary income surplus, which registers net income from labor and financial assets, was relatively stable at KD1.2 billion, or 13.1% of GDP. (Chart 3.) The decline in income of direct investments and "other investments" abroad was counter-balanced by the notable rise in portfolio investment income from abroad (dividends and interest on traded financial instruments) as well as the lower return on all non-resident investments in Kuwait. Much of the income in this category is the return on government overseas assets.

Chart 3: Investment Income

(% of GDP)



Source: Central Bank of Kuwait, CSB, NBK estimates

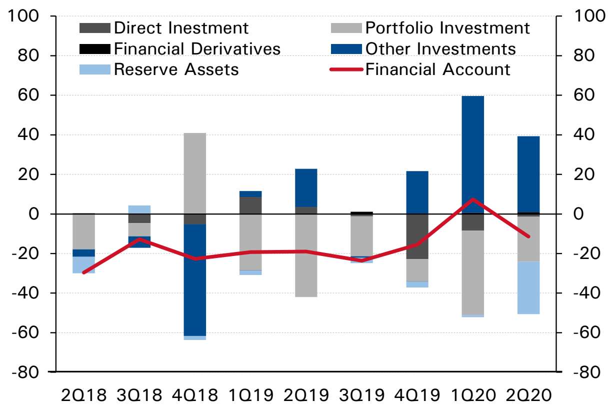
Furthermore, the secondary income deficit, which measures transfers (mainly foreign aid and workers' remittances), witnessed a fall of 22% to KD1.1 billion. The plunge in workers' transfers can be attributed to the impact of the pandemic on economic activity, which pushed firms to cut their overheads and direct costs through lower staffing and delayed wage payments. In addition, grants to other government and international institutions reached an almost complete halt in 2Q20 at a time when the fiscal balance came under pressure on low oil prices.

Declining financial flows

The financial account of the balance of payments, which covers financial claims on or liabilities to nonresidents, reversed its trend and registered an outflow of KD0.7 billion in 2Q20, or 8.1% of GDP, compared with a net inflow of a similar amount in the previous quarter. (Chart 4.)

Chart 4: Financial account

(% of GDP)



Source: Central Bank of Kuwait, CSB, NBK estimates

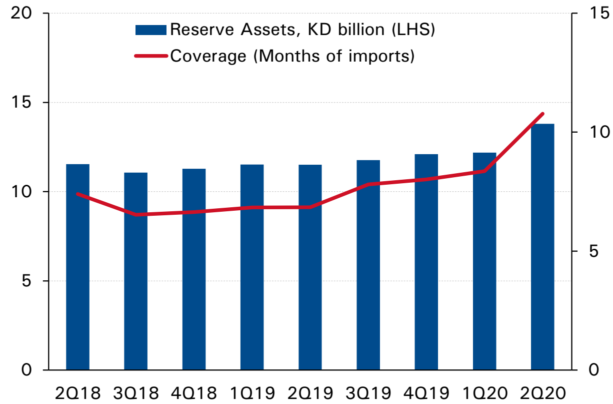
Several factors contributed to the reversal, including the increase in the CBK's reserve assets by KD1.7 billion in 2Q20. Moreover, the allocation of portfolio investments abroad shifted more toward debt instruments, which increased by KD1.8 billion, and less toward equities (fell by KD0.4 billion). Furthermore, the net inflows of "other investments" declined mainly on account of the drop in government deposit inflows to KD2.6 billion compared with KD4.6 billion in Q1, while non-resident deposits at local banks plummeted by KD1.3 billion in 2Q20.

A significant increase in reserve assets

The CBK's gross international reserves increased by around KD1.7 billion in 2Q20 to KD14.0 billion by the end of June, which constitutes around 38% of GDP or 10.8 months of imports of goods & services. (Chart 5.) The increase in CBK reserves could be attributed to the decline in government deposits abroad. Moreover, the CBK monthly data up to October showed that CBK reserves reached KD14.7 billion. Foreign reserves may also have benefitted from portfolio inflows linked to the MCSI upgrade of Boursa Kuwait (attracting inflows of $3.1 billion in 4Q20), which may have left local banks with FX holdings to sell to the CBK.

Chart 5: Reserve assets

(KD billion)



Source: CBK, NBK estimates

Looking forward

The preliminary data showed a significant decline in the current account surplus in 2Q20, which summarized the impact of the twin shocks represented by lower oil prices and the pandemic's fallout on economic activity. We expect that the current account surplus will continue to rise gradually toward the end of the year as oil prices recover modestly, while weak economic activity will pressure expatriate numbers, disposable incomes and transfers, and outbound travel will remain limited, if any. Meanwhile, imports of consumption and intermediate goods will also remain soft, reflecting the weak business environment. On the other side, Kuwaiti investments abroad echoed the impact of the policy changes in the US and Europe and the escalation of the Covid-19 pandemic on economic activity. However, we expect Kuwaiti investments abroad in subsequent quarters to benefit from improved optimism on the global economic outlook.

Table 1: Summary of Kuwait's Balance of Payments

	KD billion		% q/q	% GDP	
	1Q20	2Q20	2Q20	1Q20	2Q20
Current account	0.2	0.1	-50.9	2.4	1.2
Goods (net)	2.0	0.3	-84.1	21.8	3.5
Exports	4.0	2.0	-50.7	43.8	21.6
Oil Exports	3.6	1.8	-51.2	39.3	19.2
Imports (FOB)	2.0	1.7	-17.7	22.0	18.1
Services (Net)	-1.6	-0.4	-78.5	-17.9	-3.9
Primary Income (Net)	1.3	1.2	-5.4	13.9	13.1
Investment Income (Net)	1.3	1.2	-5.6	13.9	13.2
Secondary Income (Net)	-1.4	-1.1	-24.5	-15.3	-11.6
Workers remittances	1.4	1.1	-22.0	14.7	11.5
Capital Account	-0.1	0.0	...	-0.6	-0.1
Financial Account	0.7	-0.7	...	7.4	-8.1
Direct Investment (Net)	-0.8	-0.1	-88.2	-8.4	-1.0
Portfolio Investment (Net)	-3.9	-1.5	-62.1	-42.8	-16.2
Financial Derivatives (Net)	0.1	0.1	24.1	0.5	0.7
Other Investments (Net)	5.4	2.5	-53.8	59.0	27.3
Reserve Assets	-0.1	-1.7	...	-1.0	-18.9
Errors & Omissions	-0.8	0.7	...	-9.2	7.1

Source: Central Bank of Kuwait, NBK estimates

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