Kuwait

Oil price rally in Q2 and lockdown easing see economic conditions improve

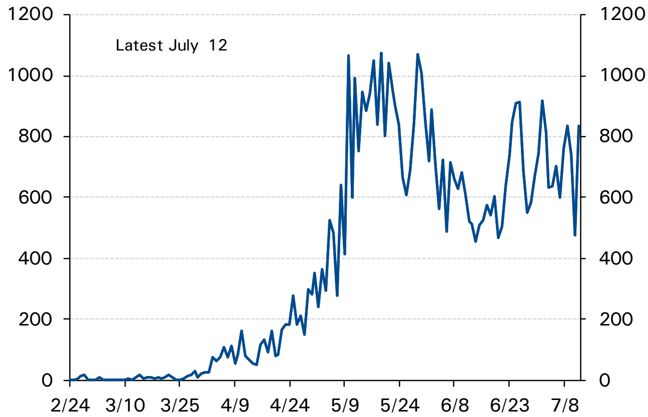
Highlights

- **A rise in oil prices and gradual opening of businesses and malls have improved economic conditions somewhat in recent weeks.**
- **Brent crude rallied 80% in Q2 to above $40/bbl, while Kuwait's oil production was cut to a 16-year low of 2.2 mb/d in May.**
- **Higher oil prices will trim the fiscal deficit this year, but it will remain large and financing arrangements are now more urgent.**
- **Encouragingly, consumer spending was down only 2.6% y/y in June, exhibiting a strong rebound from earlier months.**
- **Inflation was steady at 1.9% in May, though data collection was affected by the nationwide lockdown.**
- **Credit growth softened to 4.5% y/y in May despite a further strong rise in lending to the trade sector.**
- **The All-Share index rose 6% q/q in Q2 helped by higher oil prices and easing lockdown restrictions.**

A recovery in oil prices, an easing of lockdown measures and the gradual reopening of businesses and malls have somewhat improved Kuwait's economic conditions over recent weeks. Nevertheless, with a partial curfew still in place, many businesses operating at below capacity and international travel heavily restricted, the economy still has a long way to go before a return to more 'normal' pre-virus levels of activity. The authorities are also fighting a renewed climb in Covid-19 cases since mid-June that could – if unchecked – slow the pace of reopening and delay the recovery in business and consumer confidence crucial for a strong economic revival. (Chart 1.)

Chart 1: Confirmed Covid-19 cases in Kuwait

(Number per day)



Source: MoH

Some economic data is holding up reasonably well in the circumstances. This includes both bank credit and consumer spending, with the latter rebounding close to pre-crisis levels in June, albeit likely given a temporary boost from pent-up demand and loan repayment deferrals. But overall, we continue to expect GDP to contract sharply by around 6% this year in the context of both virus-related lockdown measures and OPEC+ policy, which has seen local oil output cut to levels not seen since 2004. Non-oil GDP could contract by at least 4% in 2020, with the drop likely to be bigger in the private sector. A decent recovery is expected in 2021 so long as the virus is effectively contained and oil prices recover to around $50/bbl. Meanwhile the oil price rally has caused us to trim our projection for the budget deficit this year. But at more than 30% of GDP it remains very large and financing arrangements are becoming an increasingly urgent issue with discussions with parliament on a new debt law ongoing.

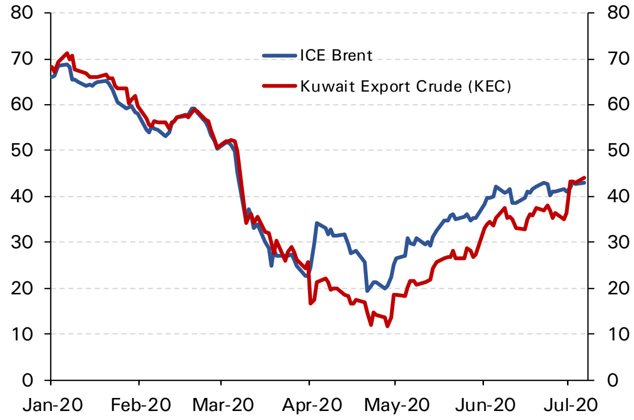
Oil prices rebound in 2Q20; Kuwait reduces crude output

Spurred on by OPEC+ output cuts and an improving oil demand outlook as economies emerged from Covid-19 lockdowns, Brent oil prices staged a remarkable 80% q/q recovery in 2Q20 to settle at a three-month high of $41.0/bbl. (Chart 2.) Kuwait's main KEC blend closed up 41% at $36.3/bbl and recently topped $44/bbl on the back of higher premiums for medium sour crude grades. Indeed, Kuwait has raised the official selling price of its crudes (in effect a reduction of the discount to other crude benchmarks) four months in a row since April's record discounts.

In May, the first month of OPEC+ cuts, Kuwait recorded a compliance rate of 95%, bringing output down from April's record high of 3.12 mb/d to 2.20 mb/d – just short of its 2.17 mb/d target. June should see Kuwait's output fall further to 2.09 mb/d on additional voluntary cuts of 80 kb/d that the country signed up to along with Saudi Arabia, the UAE and Oman. From July, Kuwait will revert to the OPEC+ cuts schedule, in effect raising output to its quota level of 2.17 mb/d. (Chart 3.)

Chart 2: Oil prices

($/bbl)

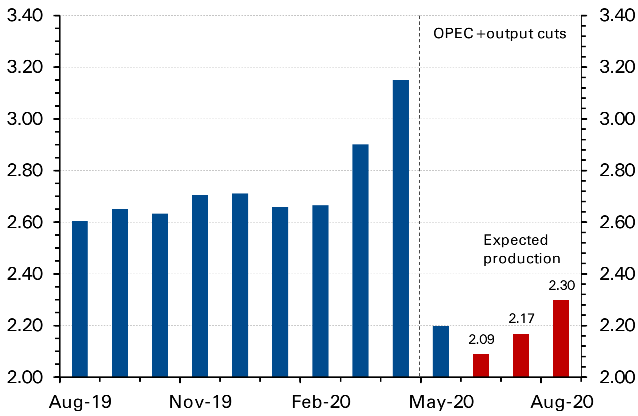


Source: Refinitiv, KPC

Contributing to this increase will be oil supplies from the Neutral Zone's Khafji and Wafra fields, the latter back online in July for the first time since 2015. Oil began flowing from the 250 kb/d offshore Khafji field in February after more than five years offline; Kuwait was pumping about 100 kb/d before the field was shuttered in time for June's supply cuts. Prior to 2015, the onshore Wafra field was producing around 200 kb/d of very heavy sour crudes. With refineries in Asia especially in need of heavy crude grades – and therefore willing to pay a premium over lighter, sweeter grades – restarting neutral zone oil production makes economic sense at this juncture.

Chart 3: Kuwait crude oil production

(mb/d)



Source: JODI (up to April 2020), OPEC secondary sources (from May 2020)

Fiscal deficit to remain large despite higher oil price

In light of the recent pick-up in oil prices we have revised up our forecast for year-average Brent prices to $40/bbl from $35/bbl before. Nevertheless, the government's fiscal position will remain under major pressure. The dual impact of low oil prices and production cuts, as well as the impact of Covid-19 on the economy, could reduce oil revenues to 16-year lows, while government spending will remain relatively high if lower than budgeted due to efforts to curb spending. Although official data for last year (FY19/20) have not yet been released, the deficit may have reached KD3.7 billion, or 9% of GDP before transfers to the Future Generations Fund (FGF). The General Reserve Fund (GRF) has depleted the majority of its liquid assets, and the government cannot issue new debt pending parliamentary approval of the debt law. Other options being discussed to help finance the deficit are said to include loans from the FGF and pausing fresh transfers into the fund.

Our baseline scenario suggests that even tough measures to curb fiscal spending in FY20/21 (that could be announced when the budget is finalized soon) will not be enough to return the fiscal position to a sustainable path in the near term. The fiscal deficit will reach KD10.3 billion, or 32% of GDP (KD11.3 billion, or 35% GDP after FGF transfers), including spending cuts worth KD1.5 billion or 7%. This includes the impact of the lower cost of fuel purchases, but also likely cuts in capex (including due to lockdown-related delays) and other savings. The table below shows two other scenarios based upon alternative assumptions. If oil prices average $50 this year and the government were able to push through larger spending cuts of KD3 billion, the deficit would be reduced to KD6 billion, or 18% of GDP, before FGF transfers. However, no spending cuts and an oil price of $30/bbl would push the deficit to KD14 billion, or 49% of GDP before transfers to the FGF.

Table: Fiscal balance scenarios, FY20/21

Item		Low case	Base case	High case
Oil price	$/bbl	30	40	50
Spend. cuts	KD bn	…	1.5	3.0
Fiscal bal,	KD bn	-14.4	-10.3	-6.3
before FGF	% GDP	-49.0	-32.3	-18.1
Fiscal deficit,	KD bn	-15.1	-11.3	-7.5
after FGF	% GDP	-51.5	-35.4	-21.7
NGDP	KD bn	29.4	32.0	34.6

Source: NBK projections

These scenarios reflect the considerable uncertainties surrounding the outlook on both oil prices and spending, the outcomes of which will have a large impact on the government's financing requirements this year and beyond. But even if oil prices edge higher and the debt law is approved, there remains a clear need for an ambitious fiscal reform program to put the finances on a more stable long-term path. This would include subsidy cuts, careful management of the public sector wage bill, implementation of revenue-boosting measures including an excise tax and VAT and perhaps even the introduction of medium-term rules or targets for spending and or/the deficit.

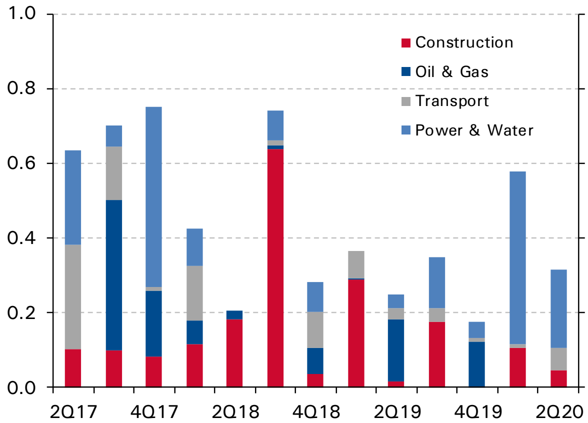
Project awards decline in Q2 amid lockdown

The pace of project awards in 2Q20 understandably slowed amid government measures to slow the spread of Covid-19. According to the latest figures from MEED Projects, the value of projects awarded in the first half of the year totaled KD895 million, with

KD578 million and KD317 million in 1Q20 and 2Q20, respectively. (Chart 4.) The major project kicking off in 2Q20 was the Kabd Municipal Solid Waste Project (KD211 million) under the auspices of the Kuwait Authority for Partnership Projects. Looking ahead, MEED figures show a rebound in expected project activity in 2H20, with an estimated KD2.9 billion worth of awards planned. This may be optimistic given recent execution rates though a lesser pick-up may be plausible given the gradual easing of restrictions.

Chart 4: Project awards

(KD billion)



Source: MEED Projects (accessed 5 July 2020); data is provisional.

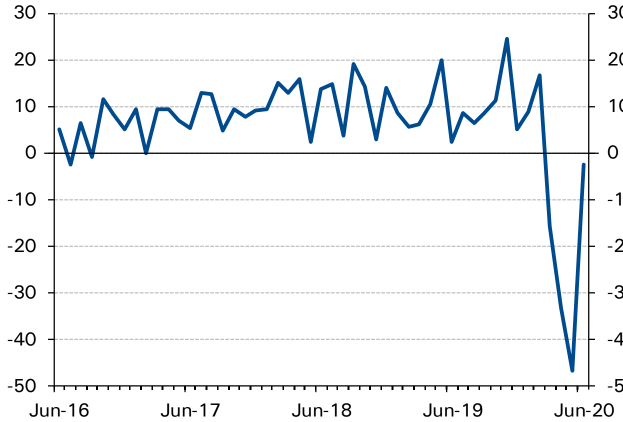
Consumer spending sees strong recovery at end of Q2

Latest data show that Knet point-of-sale (POS) transactions, online payments and ATM withdrawals – a measure of consumer spending – declined by only 2.6% y/y in June, a strong improvement from the 47% steep decline in May and the 16% drop at the end of Q1. (Chart 5.) The improvement comes amid an ease in pandemic-induced lockdown measures, including the reopening of malls and retail stores more generally, at the end of June. The recovery in spending was likely assisted by significant pent-up demand after months of weak purchases due to business closures, as well as the boost to disposable incomes from the six-month loan payment deferral in place from April. On a more granular level, point of sale transactions declined by 35% in June versus the 76% plunge in May and almost on par with the 34% drop seen in March, pre-lockdown measures. Meanwhile, growth in online spending surged to 170% y/y in June from 73% in March, reflecting an already accelerated shift in consumer behavior that was accentuated by the lockdown.

Meanwhile, consumer confidence trended lower in Q2 (as of May). According to Ara's consumer confidence index, confidence slipped to a multi-year low of 96 in May from 102 in April, on the back of drops in the 'current economic situation' (91 from 105) and 'current employment opportunity' (99 from 112) subcomponents and as the durable goods segment came in at a record low of 52. It is worth noting however, that sampling may have been difficult during the month of May.

Chart 5: Consumer spending

(% y/y)



Source: Knet

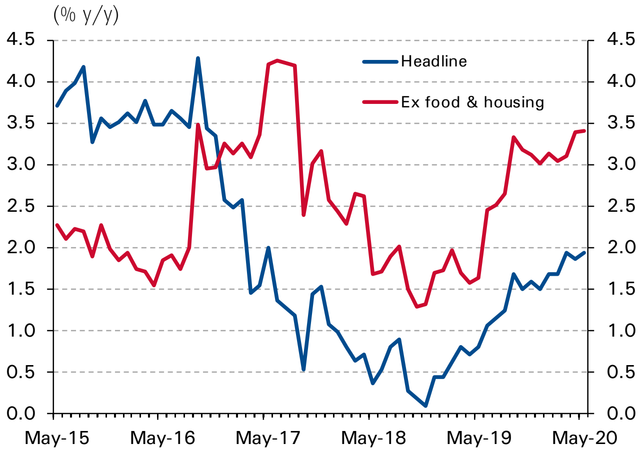
Estimates of job losses remain uncertain but more than 150,000 expatriates have reportedly left Kuwait since the start of the Covid-19 pandemic, as some lost their jobs, some were merely on visit visas and as some 30,000 availed the amnesty program. The recent approval of a draft expat quota bill by a parliamentary committee would – if implemented – add further downward pressure on the number of expat workers. The bill comes as part of government efforts to address the demographic 'imbalance' in the country by reducing the number of expats, who numbered 3.3 million at the end of last year, or 70% of the total population.

Inflation steady at 1.9% in May

Consumer price inflation stood pat at 1.9% y/y in May, unchanged from the previous month and the end of Q1, as inflation across most components came in broadly steady. (Chart 6.) That said, food price inflation rose to 1.9% from 1.3% in April, perhaps on the back of supply-side disruptions. One version of 'core' inflation, which excludes both food and housing, held strong in May at 3.4%. It is worth noting, however, that the quality of the data was heavily affected in May by sampling issues due to the Covid-19 pandemic-induced nationwide full lockdown. Indeed, the Central Statistical Bureau noted that due to missing prices for a majority of the subcomponents (including clothing, household equipment and miscellaneous goods), prices were calculated using an average of historical data.

Looking forward, we expect inflation to decelerate in 2H20 mainly on the back of a fresh wave of declines in rents. As such, we see headline inflation edging down to around 1.0% on average in 2020 from 1.1% in 2019. In contrast, core inflation is projected to remain relatively higher in the range of 2-3%, as soft demand growth is somewhat offset by supply shortages given the impact of lockdown measures on logistics services.

Chart 6: Consumer price inflation

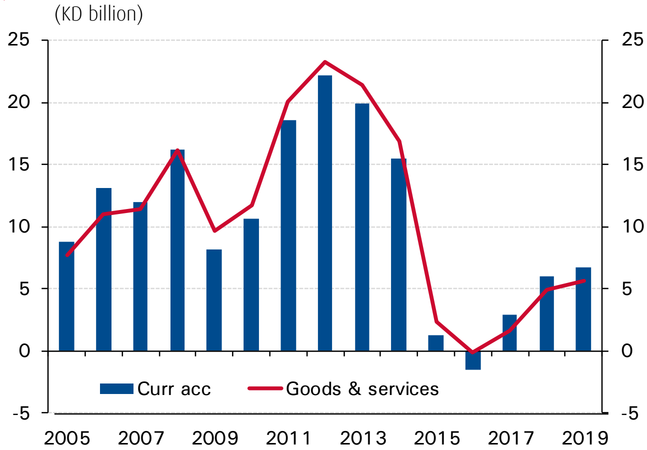


Source: Refinitiv / NBK

Current account surplus rises in 2019

The current account registered a surplus of KD6.7 billion, or 16% of GDP, according to the Central Bank of Kuwait (CBK), higher than the surplus of KD6.0 billion in 2018. (Chart 7.) This was despite a decline in the Kuwait Export Crude oil price in 2019 by 6% to $64/bbl. A narrowing of the services deficit by KD2.3 billion to KD5.1 billion was an important factor that boosted the current account surplus. On the other hand, the financial account of the balance of payments, which measures changes in residents and non-residents' net overseas assets holdings, witnessed a net outflow of KD7.4 billion in 2019 versus a KD6.6 billion outflow in 2018. The rise in outflows was influenced by a significant increase of portfolio investments in equities abroad.

Chart 7: Current account



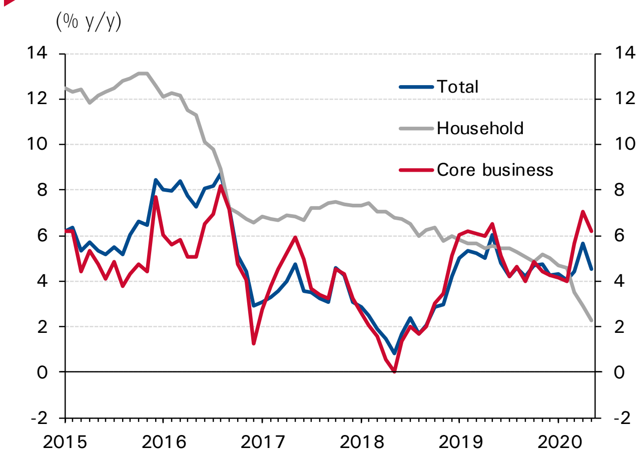
Source: Refinitiv / CBK

Portfolio investments registered a net outflow as equity and debt investments abroad increased by KD10.5 billion and KD2.6 billion, respectively. This came amid the strong performance of international equity and debt markets, the Aramco IPO, and the positive performance of GCC stock markets. On the other hand, direct Investments registered a net inflow of KD0.8 billion as equity investments abroad declined by KD0.7 billion, reversing its trend for the first time since 2014. Finally, the CBK's gross international reserves reached KD12.1 billion (29% of GDP, around 8.7 months of imports) at the end of 2019. These reserves are complimented by the large buffers held by the Kuwait Investment Authority, that are estimated at least 400% of GDP.

Credit growth softens in May amid lockdown

Following a relatively solid increase in 1Q2020, domestic credit expansion softened in April and May (for much of the latter a full national virus-related lockdown was in place), resulting in growth of 2.2% YTD by May, or 4.5% y/y. (Chart 8.) Credit expansion in April and May was driven by lending to businesses and non-bank financial institutions (i.e. investment firms).

Chart 8: Bank credit



Source: Refinitiv / CBK / NBK

After growing 3.4% q/q in 1Q2020, credit to businesses gradually weakened leading to a 4.5% YTD increase by the end of May (+6.2% y/y). We note that the trade sector has witnessed the highest increase so far this year at nearly 15% YTD, accounting for 50% of the increase in business lending in the same period. On the other hand, real estate, the largest component of business lending, was nearly flat for the second consecutive month, recording a limited 2.3% YTD increase.

After decreasing slightly in 1Q2020, household credit continued to be on a downtrend leading to a 0.6% YTD drop by the end of May (+2.3% y/y). Both components of household credit were muted in April and May, with housing loans down 0.5% YTD while consumer loans increased by only 1.5% YTD compared with a 36% surge in 2019.

After decreasing by 0.4% q/q in 1Q2020, resident deposit growth was robust for the second month in a row leading to a 2.5% YTD increase. This was mainly driven by private sector deposits which increased in April and May by the fastest rate in nearly a year, resulting in 2.4% YTD growth while government deposits are up by 3.1% YTD. After surging by nearly 15% q/q in 1Q2020, non-resident deposits decreased to reflect a 7.7% YTD increase by the end of May accounting for around 8% of total sector deposits.

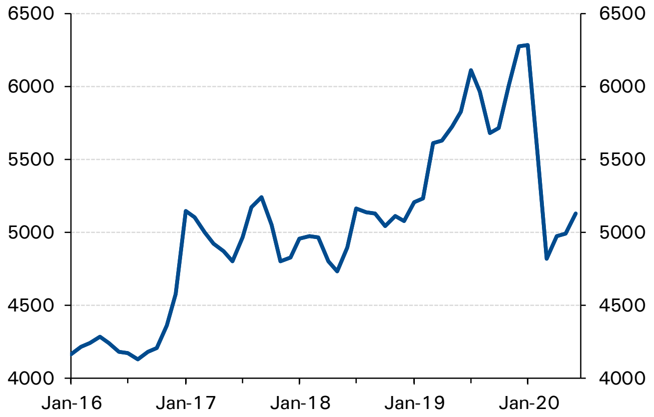
Meanwhile, the simple loans-to-deposits ratio stood at 86.5% in May, compared with 88% in March and 87% in December 2019, indicating a generally stable level of liquidity.

Boursa Kuwait partly recoups losses in 2Q20

After a severe slump extending from March well into the second quarter, equity price losses had been partially recouped by the end of June thanks to the easing of lockdown restrictions and higher oil prices. A rally in June led to a notable rise of 6% q/q in Boursa Kuwait's All-Share index, lifted mostly by a broad surge in Premier Market shares, though prices were still down 18% year-to-date at the end of Q2. (Chart 9.) The recovery has lifted market capitalization to KD29.2 billion from a low of around KD20 billion in April, almost pre-pandemic levels.

Chart 9: Boursa Kuwait All-Share index

(Index, end month)



Source: Refinitiv

Foreign investment, which was negative for three consecutive months, made a resurgence in June, with net inflows of KD3.4 million signaling renewed foreign investor interest in Kuwaiti equities, albeit still below pre-pandemic levels. This was likely helped by MSCI's recent confirmation of the market's upgrade to Emerging Market status in November this year (previously scheduled for May), thereby curbing some market uncertainty about future, upgrade-related portfolio (passive) inflows which could be worth $2-3 billion. Further, market turnover by volume has risen to KD3.6 billion shares in June, up 38% y/y reflecting a healthy level of liquidity.

Despite various signs of improvement, there is some potential downside risk given the uncertainty surrounding both the coronavirus and oil prices, and the increasingly concerning issue of strained government finances. Also, an expected drop in the expatriate population as jobs are lost and as the government discusses potential immigration quotas, will affect demand for goods and services and in turn could affect the profitability and growth of listed companies. Global factors, such as a possible resurgence of trade tensions and a slower-than-expected global economic recovery may also negatively influence local equities.

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	32.0
Oil (including refining)	32.7	29.2	15.7	13.6	16.2	21.0	19.3	10.1
Non-oil	22.4	23.2	23.9	23.9	25.2	26.1	26.7	25.9
				(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	-2.0	-8.0
Non-oil	4.2	4.8	0.4	1.6	2.6	2.3	1.0	-4.0
Private credit (end-year)	8.1	6.1	8.5	2.9	3.1	4.2	4.3	...
Money supply (M2, end-year)	10	3.4	1.7	3.6	3.8	4.0	-1.2	...
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	0.3
				(percent of GDP)				
Fiscal balance (before FGF transfers)	26.1	7.6	-13.4	-13.9	-8.9	-3.0	-9.0	-32.3
Revenues	64.4	53.9	39.5	39.6	43.7	48.4	44.4	31.3
Oil	59.3	48.6	35.0	35.4	39.0	43.4	39.5	25.6
Non-oil	5.1	5.2	4.5	4.3	4.7	5.0	4.9	5.6
Expenditures	38.3	46.3	52.9	53.6	52.6	51.4	53.4	63.6
Transfers to Future Generations Fund	16.1	13.5	4.0	4.0	4.4	4.8	4.4	3.1
Fiscal balance (after transfers to FGF)	10.0	-5.9	-17.3	-17.9	-13.2	-7.9	-13.5	-35.4
Investment income*	7.0	8.5	12.4	13.4	12.9	11.3	11.9	15.2
Public debt	3.1	3.4	4.6	19.6	19.8	14.5	12.6	24.9
Current account balance	40.3	33.4	3.5	-4.6	8.0	14.1	16.4	-3.0
Goods balance	51.8	47.7	24.4	17.8	21.3	29.2	26.2	8.0
Exports	66.5	64.2	47.5	42.5	45.7	51.3	48.1	34.5
Imports	14.7	16.6	23.2	24.7	24.4	22.1	21.9	26.6
Services (net)	-8.5	-11.1	-17.4	-18.3	-16.7	-17.5	-12.5	-14.1
Investment income (net)	8.0	9.6	11.1	11.7	15.6	13.0	14.4	16.6
Worker remittances	-11.0	-12.7	-14.5	-15.8	-12.2	-10.6	-11.7	-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	39
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-18	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20
Credit	36.9	38.4	38.6	38.6	39.1	39.3	39.3	...
Growth (% y/y)	4.2	4.3	4.3	4.0	4.4	5.6	4.5	...
Money supply (M2)	38.6	38.1	38.1	37.4	38.0	38.8	39.5	...
Growth (% y/y)	4.0	-1.2	-1.4	-3.2	-2.4	-0.1	3.3	...
Inflation (% y/y)	0.4	1.5	1.7	1.7	1.9	1.9	1.9	...
ex food and housing	1.7	3.0	3.1	3.0	3.1	3.4	3.4	...
Real estate sales (KD million)	470	331	302	280	...	...	...	...
Growth (12-month average, % y/y)	56.1	-6.0	-4.9	-7.6	...	...	...	...
Real estate price indices:								
Residential homes	156	164	168	...	...	...	...	...
Residential plots	174	195	197	...	...	...	...	...
Investment buildings	195	193	189	...	...	...	...	...
Consumer confidence (index)	110	105	100	99	104	102	96	...
Kuwait export crude price ($/bbl, avg)	57	66	66	56	35	17	24	35
Stock market – All Share index (end-mth)	5,080	6,282	6,287	5,516	4,823	4,975	4,996	5,131
Growth (% m/m)	-0.6	4.5	0.1	-12.3	-12.6	3.2	0.4	2.7

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 (CBK)	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	2.9	1.9
Exports	3.6	4.1	4.7	5.4	5.0	5.2	4.8	4.7
Imports	2.1	2.1	2.4	2.3	2.2	2.2	2.2	2.3

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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