Kuwait

Oil revenues ensure solid fundamentals

Real GDP growth will remain weak this year due to expected cut in oil production. Non-oil GDP should get a boost from public expenditure, especially investment spending, and from a slight growth in private consumption. Inflationary pressures could increase slightly but will remain moderate. High fiscal surpluses are funnelled into the sovereign funds, which guarantee the Emirate's long-term solvency. Faced with this situation, the government has little incentive to set up fiscal consolidation measures. High and recurrent trade and current account surpluses ensure the stability of the dinar.

Moderate rebound in non-oil activity

Economic activity has been sluggish since 2017. The main reasons are the oil sector's weighting as a share of GDP (about 60% of total GDP) and the constraints squeezing domestic consumption. A few signs of a rebound in non-oil GDP can be seen in 2019.

As an OPEC member[1], Kuwait is bound to follow the cartel's production policy. In 2018, crude oil production averaged 2.74 million barrels/day (mb/d), compared to 31.8 mb/d for the OPEC countries as a whole. In 2019, oil production should decline slightly to an average of 2.71 mb/d. After increasing 1.3% in 2018, oil GDP should fall by almost 1% this year. At last December's meeting, the OPEC+ group, which is comprised of the cartel members plus other oil producing countries, mainly Russia, decided to reduce oil production to boost prices and limit the risk of an oil supply glut at the global level. Oil production is expected to increase in the medium term, even though the national oil company KOC's plan to develop production capacity seems difficult to meet. The plan calls for production capacity to be increased to 3.65 mb/d in 2023, from the current level of 3.15 mb/d. Refining capacity might also be increased by more than 30% by 2025.

The main growth engines of non-oil activity are public expenditure (which largely determines household consumption), infrastructure projects and the real estate sector (about 11% of non-oil GDP). After two years of relatively tighter fiscal policies in 2016 and 2017, non-oil activity rebounded mildly in 2018 (+2.5% in real terms). In 2019, a moderate increase in current fiscal spending (+2.5% in value) should continue to boost private consumption (30% of GDP). Major transport and energy sector projects are slated to begin in 2019. Moreover, after a depressed period, the real-estate business seems to have picked up again since mid-2018, even though this trend has yet to be confirmed. All in all, real non-oil GDP growth is estimated at 3% this year, up from 2.5% in 2018.

Assuming that oil prices decline slightly, total GDP growth could reach an estimated 0.7% in 2019 before accelerating to more than 2.5% in 2020 and 2021, thanks to an upturn in oil production, a mild rebound in investment and the support of public and private consumption.

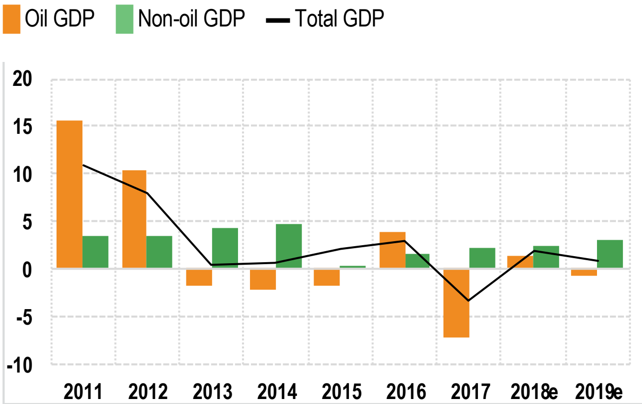
[1] Kuwait has the world's 6th largest proven oil reserves.

1-Forecasts

	2017	2018e	2019e	2020e
Real GDP growth (%)	-3.4	1.8	0.7	2.6
Inflation (CPI, year average, %)	1.2	0.5	1.5	2.0
Budget balance / GDP (%)	8.8	12.3	6.2	4.9
Gross government debt / GDP (%)	21.0	14.0	19.0	23.0
Current account balance / GDP (%)	5.9	12.9	6.0	4.5
Forex reserves (USD bn)	34	38	38	41
Forex reserves, in months of imports	7.0	7.6	7.3	7.5
Exchange rate USDKD (year end)	0.3	0.3	0.3	0.3

e: estimates and forecasts BNP Paribas Group Economic Research

2- Real GDP growth (%)



Source: BNP Paribas

Subdued inflation

Consumer price inflation has been subdued since 2017, due notably to depressed real-estate prices. The sector's weighting on the consumer price index exceeds 30%. In 2018, prices rose 0.5% on average, while the index's real estate component has contracted by an average of 1.1%. In the recent period, the main source of price increases can be directly linked to fiscal policy. The cut in energy subsidies in 2017 triggered a significant increase in transport costs. The quasi-peg of the Kuwait dinar to the US dollar severely restricted monetary policy and the range of tools available to fight inflation.

In 2019 and 2020, inflation could rise slightly (estimated at 1.5% and 2%, respectively), stimulated by a mild recovery in the real estate sector. In 2021, prices could accelerate towards 2.5% with the possible introduction of VAT. A substantial increase in oil prices could also trigger an acceleration in inflation in the medium term, by stimulating private consumption via the intermediary of public spending. For the moment, we have not integrated this scenario into our forecasts.

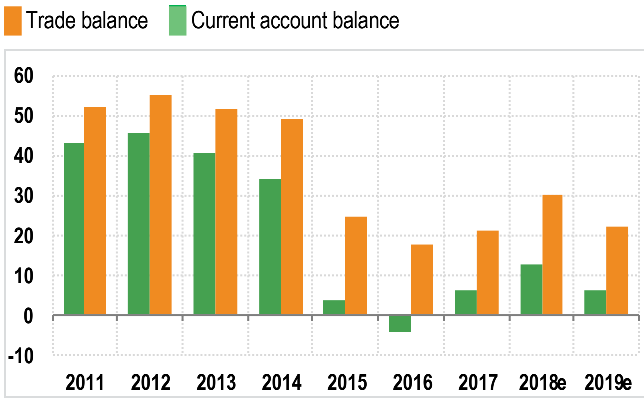
A very comfortable fiscal situation despite the lack of reforms

Public finances are highly dependent on oil revenues, and this situation is unlikely to change in the medium to long term. Oil revenues account for about 75% of total fiscal revenues, while investment-related revenue (sovereign funds) accounts for about 20%. Non-oil tax revenues are very low. Kuwait was the Gulf country hit the least hard by the decline in oil prices in 2015-2016. Given the size of oil revenues with regard to spending, the fiscal breakeven oil price (Brent reference) is among the lowest in the region (roughly USD 55/b). After the country swung into a fiscal deficit in 2015/2016[2] (-1.3% of GDP), fiscal consolidation efforts have been fairly limited, primarily for political reasons. For the year 2019/2020, the fiscal surplus is expected to swell to 6.1% of GDP, and to average 4.8% of GDP in 2020 and 2021.

Despite a very high fiscal surplus, which averaged 12% of GDP between 2013 and 2017, government debt has risen since 2015. It is expected to rise to 19% of GDP at year-end 2019/2020, compared to 4.7% of GDP in 2015/2016. This debt reflects the government's willingness to continue accumulating public assets while benefiting from favourable interest rates in the international markets. The government calculates its overall fiscal balance after allocating 10% of total revenues to sovereign funds. Moreover revenues generated by sovereign fund investments are not taken into account in the calculation of fiscal revenues. The adjusted fiscal balance shows a significant deficit (12% of GDP in 2017/2018). Since 2015, the fiscal deficits, calculated according to the government's definition, have been financed through bond issues on the local and international markets (a total of USD 8 bn in international bonds were issued in 2017), as well as through withdrawals from sovereign funds.

Given the amount of government assets, Kuwait's fiscal solvency is very comfortable. KIA manages these assets, which the IMF estimates at USD 403 bn in 2018/2019, a little more than 3 years of GDP. KIA supervises two distinct funds: the reserve fund for future generations (with about USD 346 bn in assets), which is funded via the annual transfer of 10% of fiscal revenues, and the reserve fund (with USD 57 bn in assets), which collects any fiscal surpluses.

3- External accounts (% of GDP)



Source: BNP Paribas

High trade surpluses

Export revenues are mainly made of oil export revenues (90% of the total). Kuwait has a recurrent and high trade surplus (16% of GDP between 2013 and 2017). In 2018, the current account surplus is estimated at 12.8% of GDP. Given the less favourable prospects for oil prices relative to 2018, the current account surplus could drop to 6% of GDP in 2019. Capital flows are dominated by the reinvestment of oil revenues in the international financial markets. The Kuwaiti economy attracts little foreign direct investment given the lack of opportunities. Between 2013 and 2017, FDI averaged the equivalent of 0.5% of GDP.

The central bank had foreign reserves of USD 37 bn in 2018, the equivalent of 7.4 months of imports of goods and services. The coverage ratio has been relatively stable over time at more than 6.5 months, even when the oil cycle is less favourable. As a consequence foreign liquidity is very comfortable and external solvency is solid, the external debt is moderate (43% of GDP in 2018) and largely offset by the amount of public assets in foreign currency.

All in all, the Kuwait economy is still highly dependent on the oil cycle and fiscal expenditure. The solidity of public finances and the external accounts is holding up well in a more uncertain oil environment.

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[2] The fiscal year ends in March.