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IMF Executive Board Concludes 2009 Article IV Consultation with Kuwait

On April 10, 2009 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kuwait.[1]

Background

The 2009 consultation discussions were held against the backdrop of the global financial crisis and the ensuing economic slowdown. Kuwait's economy continued to perform strongly in 2008, although signs of weakness emerged in the second half of the year. The authorities' key challenge in the near term is to preserve financial stability and cushion the impact of the global slowdown.

Real GDP is estimated to have picked up to 6.4 percent in 2008, up from 2.5 percent in 2007, reflecting both higher oil production and robust non-oil GDP growth. Inflation peaked at 11.6 percent (on a year-on-year basis) in August and started to moderate toward the end of 2008 on weaker domestic demand and lower import prices.

High average oil prices contributed to substantial current account and fiscal surpluses in 2008. Despite rising imports, the estimated current account recorded a surplus of 45 percent of GDP and the budget surplus for 2008/09 is estimated at 26 percent of GDP, notwithstanding a large transfer to recapitalize the pension fund (10.5 percent of GDP).

Broad money and credit growth declined in 2008, owing to the Central Bank of Kuwait's (CBK) measures to contain credit growth in the first half of 2008 and tight liquidity conditions in the second

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

half of the year. After switching back from a dollar to a basket peg in May 2007, the authorities let the Kuwaiti dinar (KD) appreciate against the US dollar in order to slow inflation. This, along with high inflation, led to a 7 percent appreciation in the real effective exchange rate (REER) in 2008.

The global financial crisis has affected adversely Kuwait's financial system. Liquidity conditions tightened in the second half of 2008, reflecting capital outflows and rising concerns about counterparty risk. Consequently, the KD interbank rate spiked in October 2008, prompting swift intervention by the authorities through large liquidity injections to stabilize the market. Since the deepening of the global crisis after the fall of Lehman Brothers, the Kuwait Stock Exchange (KSE) index fell by 50 percent. In October 2008, the third largest bank lost $1.4 billion, mostly on derivative transactions, leading the authorities to guarantee customer deposits at local banks and implement a successful recapitalization plan. In December 2008, the largest investment company in Kuwait defaulted on most of its $3 billion debt obligations and has been negotiating a debt restructuring.

The economic outlook for 2009 will be driven largely by the fallout from the global slowdown. Real GDP is projected to contract by 1.2 percent in light of lower oil production and a decline in non-oil growth, reflecting weak activity particularly in the financial and construction sectors. Lower import prices, weaker domestic demand, and a moderation in rents should bring inflation down to 6 percent. The fiscal and current accounts surpluses are projected to decline significantly owing to lower oil revenue.

The medium-term outlook will depend largely on developments in the global oil market and progress in the implementation of structural reforms to promote private investment. The fiscal and current account positions should improve gradually over the medium-term in line with the projected increase in oil prices.

The major risks to the economic outlook are a rapid deterioration in the balance sheet of financial institutions and a prolonged global recession that could maintain oil prices below $50. These risks would affect adversely investor and consumer confidence, limit fiscal space, and worsen the growth outlook.

Executive Board Assessment

Directors commended the Kuwaiti authorities' prudent macroeconomic policies, which have contributed to robust economic growth, strong fiscal and external positions. Looking ahead, Directors indicated that the key challenge faced by the authorities is to preserve financial stability and support economic activity in the face of the global financial and economic crisis.

While the medium-term outlook remains positive, Directors foresaw important challenges ahead for the Kuwaiti authorities. In the near term, the sharp decline in oil prices would affect adversely the fiscal and external balances, large oil production cuts and weaker activity in the non-oil sector are expected to slow real GDP growth, and the credit squeeze and asset price deflation could pose significant risks to the financial system. In the medium term, a key challenge is to use the oil wealth to diversify the economy and boost non-oil GDP growth through private investment.

Directors welcomed the financial system's strength and resilience, while observing that risks have emerged because of the global financial crisis. They commended the Kuwaiti authorities' proactive measures to safeguard financial stability and sustain economic growth, including through the injection of liquidity into the financial system and the adoption of a financial stability law. They stressed that financial sector policies should continue to encourage consolidation and restructuring of financial institutions, upfront recognition of losses, and participation of private investors in the recapitalization of financial institutions.

Directors called for strengthening oversight of risk management practices by ensuring adequate policies and procedures for identifying, monitoring, and controlling systemic risk in the financial system. They emphasized the importance of restructuring the investment companies sector, and welcomed the authorities' interest in undertaking a Financial Sector Assessment Program update. Directors urged the authorities to speed up reform of money laundering and terrorism financing legislation to make it conform to international standards.

Directors commended the authorities' commitment to fiscal prudence and medium-term fiscal sustainability. A number of Directors encouraged a fiscal stimulus to complement the financial stability package, given the expected slowdown in economic activity, Kuwait's strong fiscal position, and the positive effect of a stimulus on investor confidence and private investment. A number of Directors, however, noted the authorities' concerns regarding a fiscal stimulus, including Kuwait's limited absorptive capacity, uncertainty regarding future oil prices, and the possible limited effectiveness of a stimulus due to significant leakages through remittances and imports.

Directors saw a continued need for medium-term fiscal reform aimed at reducing dependence on oil revenue and rationalizing fiscal spending. They encouraged accelerated introduction of a value added tax in coordination with other Gulf Cooperation Council (GCC) countries. They supported the authorities' intention to maintain capital spending while containing current spending, including by curbing large subsidies and transfers, reforming the pension system, and moving to merit-based public sector salaries and benefits.

Directors stressed the importance of expediting the structural reforms that are vital to boosting private sector investment, including enactment of key laws the capital markets, companies, competition, public-private partnership, and privatization laws; streamlining of business registration and other administrative barriers to investment; and enhancement of access to land by private businesses and individuals.

Directors concurred that the pegged exchange rate regime remains appropriate for Kuwait in the run up to the GCC monetary union, and that the recent move to a basket peg may have been helpful in containing inflation. They noted the staff's finding that the Kuwaiti dinar is broadly in line with economic fundamentals. In light of weakening inflationary pressures and the downside risks to economic growth, Directors supported the recent easing of monetary policy.

Directors welcomed the authorities' intention to improve economic statistics, and encouraged them to adopt a program toward subscription to Special Data Dissemination Standard. To address some data weaknesses, Directors advised conducting a comprehensive review of the role and resources of the General Statistical Office.

Directors commended the authorities for their generous substantial development foreign assistance to low-income countries in and outside the region and their active support for the Heavily Indebted Poor Countries (HIPC) Initiative, and urged the authorities to continue providing debt relief to all eligible-HIPC countries.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Kuwait: Selected Economic Indicators, 2004–09

	2004	2005	2006	Est. 2007	Proj. 2008	2009
Oil and gas sector						
Total oil and gas exports (in billions of U.S. dollars)	27.8	44.1	55.7	60.1	84.1	35.2
Average oil export price (in U.S. dollars/barrel)	34.1	49.1	60.2	67.8	92.4	40.0
Crude oil production (in millions of barrels/day)	2.29	2.57	2.64	2.58	2.68	2.56
	(Annual percentage change, unless otherwise indicated)					
National accounts and prices						
Nominal GDP (market prices, in billions of Kuwaiti dinar)	17.5	23.6	29.5	31.8	42.5	28.1
Nominal GDP (market prices, in billions of U.S. dollars)	59.4	80.8	101.6	111.8	158.1	99.2
Real GDP (at factor cost)	10.2	10.7	5.2	2.5	6.4	-1.2
Real oil GDP	8.1	11.4	2.9	-2.3	4.2	-4.5
Real non-oil GDP	12.1	10.6	8.3	7.8	7.3	1.0
CPI inflation (average)	1.3	4.1	3.1	5.5	10.5	6.0
Unemployment rate (Kuwaiti nationals)	3.9	3.8	4.0	...	...	...
	(In percent of GDP at market prices)					
Investment and savings						
Investment	18.2	16.4	16.2	19.4	17.6	14.7
Public	3.7	3.0	2.8	3.4	3.1	5.2
Private 1/	14.5	13.5	13.4	15.8	14.5	9.5
Gross national savings	48.7	58.9	66.1	64.2	62.2	33.9
Public	36.2	56.2	60.8	57.0	46.3	39.6
Private 1/	12.5	2.7	5.3	7.1	15.9	-5.7
Savings/investment balance	30.6	42.5	49.8	44.7	44.7	19.2
	(In percent of GDP at market prices)					
Budgetary operations 2/						
Revenue	53.8	75.6	67.0	67.8	65.5	48.1
Oil	42.9	51.7	48.3	51.5	52.4	36.8
Non-oil, *of which:*	10.9	23.9	18.7	16.3	13.1	11.4
Investment income	7.5	21.4	15.8	13.0	10.0	7.1
Expenditures and net lending	32.8	27.2	34.2	27.9	39.7	39.2
Current 3/	28.6	23.6	30.1	23.8	35.7	33.3
Capital	4.2	3.6	4.1	4.1	4.0	5.8
Balance	21.0	48.5	32.8	39.9	25.8	9.0
Domestic financing	-5.7	-1.2	-2.8	-3.1	-4.4	-0.8
External financing	-15.4	-47.3	-30.1	-36.8	-21.4	-8.2
Non-oil balance (in percent of non-oil GDP) 4/	-60.3	-57.0	-58.9	-58.9	-61.0	-58.1
Total gross debt (calendar year-end)	17.3	11.8	8.3	6.9	5.3	8.0
	(Changes in percent of beginning broad money stock)					
Money and credit						
Net foreign assets 5/	10.3	3.2	12.5	1.1	10.0	1.2
Net domestic assets	1.8	9.1	9.1	18.2	5.6	7.2
Claims on government (net)	-10.4	-2.6	-6.4	-6.8	-9.0	-1.1
Claims on nongovernment sector	14.5	17.6	24.5	35.6	19.2	6.4
Broad money	12.1	12.3	21.7	19.3	15.6	8.4
Kuwaiti dinar 3-month deposit rate (year average; in percent)	1.6	2.9	5.0	5.2	3.3	1.6
Stock market unweighted index (annual percent change) 6/	33.8	78.6	-12.0	23.6	-37.5	-11
	(In billions of U.S. dollars, unless otherwise indicated)					
External sector						
Exports of goods	30.1	47.0	58.9	63.7	88.2	40.0
Of which: non-oil exports	2.3	2.9	3.3	3.6	4.1	4.7
Annual percentage change	4.6	23.0	14.5	10.3	13.0	16.0
Imports of goods	-11.7	-14.2	-15.4	-18.5	-21.2	-19.7
Annual percentage change	18.1	22.1	8.3	20.0	14.4	-7.1
Current account	18.2	34.3	50.6	50.0	70.6	19.0
In percent of GDP	30.6	42.5	49.8	44.7	44.7	19.2
External debt including private sector	12.1	16.5	26.4	26.3	26.7	...
of which External public and publicly guaranteed debt	0.7	1.8	...	...	...	...
International reserve assets	7.3	8.1	11.8	15.9	17.8	16.9
In months of imports of goods and services	4.6	4.3	5.5	5.7	6.0	6.0
	(Percentage change; unless otherwise noted)					
Memorandum items:						
Exchange rate (U.S. dollar per KD, period average)	3.39	3.42	3.45	3.52	3.72	...
Nominal effective exchange rate (NEER)	-3.9	0.4	0.5	-2.2	0.3	...
Real effective exchange rate (REER)	-5.1	2.0	0.9	0.4	7.2	...
Sovereign rating (S&P)	A+	A+	A+	AA-	AA-	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.
1/ Also includes government entities.
2/ Kuwaiti fiscal year ending March 31, e.g. 2007 refers to fiscal year 2007/2008.
3/ In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund in 2008/09 , KD 5.5 billions are budgeted.
4/ Excluding investment income and pension recapitalization.
5/ Excludes SDRs and IMF reserve position.
6/ Change in the KSE as of February 5, 2009 for 2009.