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To: Members of the Executive Board

From: The Secretary

Subject: **Kuwait—Staff Report for the 2020 Article IV Consultation—Supplementary Information**

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Questions:	Mr. Sadikov, MCD (ext. 37984) Ms. Guscina, MCD (ext. 34836)
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INTERNATIONAL MONETARY FUND

KUWAIT

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

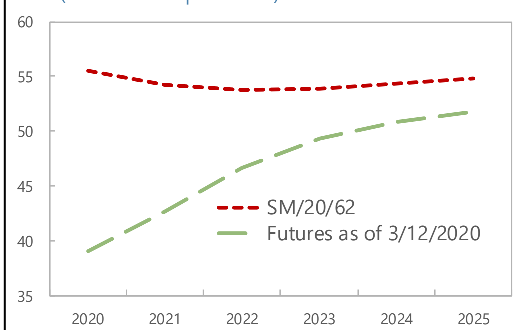
March 18, 2020

Prepared By | Middle East and Central Asia Department

This supplement provides an update to the Staff Report (SM/20/62) based on developments that took place since the issuance of report. The update does not alter the thrust of the staff appraisal.

1. **Oil prices fell sharply on March 8 after OPEC+ talks to cut production fell through.** Although oil prices have since recovered somewhat, they are measurably lower than price assumptions underpinning the macroeconomic projections in the staff report (Figure 1). This is especially true for the short end of projections, where the average price in 2020 is now projected US$16.5 per barrel less than assumed in the staff report. For the long end, the difference is much smaller and narrows to about US$3 per barrel by 2025. Oil markets remain highly unsettled reflecting supply uncertainty and concerns over the impact of the COVID-19 outbreak on global oil demand.

Figure 1. APSP Oil Price
(In US dollars per barrel)



Source: WEO and Bloomberg.

2. **Kuwait has also been affected by the COVID-19 outbreak.** The number of cases reached 123 as of March 16. To contain the spread of the virus, the authorities halted commercial flights, closed schools and universities, and banned social gatherings. On March 11, they declared March 12-26 an official holiday and reduced staffing to essential personnel in all governmental entities, except those tasked with emergencies; salaries will continue to be paid to all Kuwaiti and non-Kuwaiti employees. While most bank branches have been closed, the Central Bank of Kuwait (CBK) is working with commercial banks to ensure uninterrupted access to financial services, including online banking, payment, settlement and electronic clearing systems, and access to disinfected banknotes. Following the U.S. Fed's decision to cut interest rates to zero, the CBK

reduced interest rates on all monetary policy instruments by 1 percentage point and committed to provide liquidity as needed. The CBK also set up a KD10 million fund, funded by Kuwaiti banks, to support government efforts in combatting the virus.

3. These developments have worsened the near-term outlook and heightened uncertainty compared to the staff report (Table 1). The COVID-19 outbreak and measures to contain it will weigh on economic activity, but it is difficult to quantify the magnitude of the impact as the depth and duration of the shock itself is still unknown. For the time being, staff has assumed a slowdown in the nonoil sector in 2020 followed by a rebound in 2021. Accordingly, staff revised the nonoil growth projection to 2 percent in 2020 and 4 percent in 2021, compared to 3 and 3.5 percent respectively in the staff report. Given heightened uncertainty with respect to the oil output, staff has left it broadly unchanged.[1] The revised oil price assumptions imply a sharper deterioration in fiscal and external balances than projected in the staff report. A $16.5 per barrel lower oil price in 2020 implies 12 and 13 percentage points of GDP worsening of Kuwait's fiscal and external balances, translating into correspondingly higher financing needs and thus a faster drawdown of buffers than envisaged in the staff report.

4. The thrust of staff appraisal remains unchanged. Ambitious medium-term fiscal adjustment and growth-enhancing structural reforms proposed in the staff report to close the intergenerational savings' gap and reduce dependence on oil have become more pressing. Fiscal consolidation however should not start until the effects of the COVID-19 outbreak fully abate. This would be consistent with the fiscal policy path in the staff report which assumed that no fiscal adjustment measures could be approved until after the November 2020 elections. The immediate priority should be on containing the spread of the virus and mitigating its economic impact. To that end, the spending envelope in the budget allows sufficient room to accommodate additional healthcare spending, including by realizing savings through better procurement and delaying some capital projects through reprioritization. The authorities should ensure adequate liquidity in the banking sector and may need to provide temporary and targeted support to hard-hit but viable companies, especially SMEs. The sharp drop in oil prices once again underscores the need for a fiscal rule to insulate the economy from excessive oil price fluctuations while ensuring adequate savings for the future.

[1]The uncertainty stems from a combination of risks to the oil output. On the upside, Kuwait has significant spare capacity to ramp up production and could gain a market share as one of the lowest cost producers globally. On the downside, leading oil producers could agree to cut output in the face of falling demand due to the economic impact of the COVID-19 outbreak. There have been no signs of the supply side disruption in Kuwait thus far.

5. Kuwait can withstand the latest shocks from the position of strength. Ample assets of the KIA and central bank reserves (435 percent of GDP), substantial borrowing space, and well-capitalized banking sector underpin Kuwait's resilience. Despite recent market volatility, bond yields remain low (Figure 2). If parliament's authorization to borrow is not forthcoming or tail risks—even lower oil prices, more severe fallout from the COVID-19 outbreak, and higher borrowing costs—materialize, the authorities could consider temporarily tapping the Future Generations Fund, with an explicit promise to replenish it once the situation normalizes anchored on a credible medium-term fiscal adjustment path.

Figure 2. Yield to Maturity on International Bonds
(in percent)

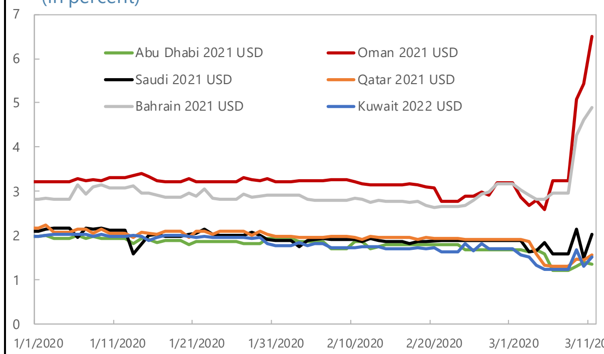


Table 1. Kuwait: Selected Economic Indicators, 2014–25

						Est.	Projections					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Oil and gas sector												
Total oil and gas exports (billions of U.S. dollars)	97.6	48.5	41.5	49.6	65.4	58.2	37.8	42.0	46.6	50.0	52.4	54.2
Average crude oil export price (U.S. dollars/barrel)	95.2	47.8	39.5	51.6	68.8	61.8	39.3	43.0	47.0	49.7	51.2	52.1
Crude oil production (millions of barrels/day)	2.87	2.86	2.95	2.70	2.74	2.70	2.70	2.76	2.81	2.87	2.93	2.99
	(Annual percentage change, unless otherwise indicated)											
National accounts and prices												
Nominal GDP (market prices, in billions of Kuwaiti dinar)	46	34	33	37	42	41	36	39	42	44	47	49
Nominal GDP (market prices, in billions of U.S. dollars)	163	115	109	121	141	137	118	128	138	147	155	163
Real GDP [1]	0.5	0.6	2.9	-4.7	1.2	0.7	1.0	2.9	2.7	2.7	2.7	2.7
Real oil GDP (including refineries)	-2.1	-1.7	3.9	-9.0	0.2	-1.0	0.3	2.0	2.0	2.0	2.0	2.0
Real nonoil GDP [1]	4.9	4.2	1.4	1.8	2.7	3.0	2.0	4.0	3.5	3.5	3.5	3.5
CPI inflation (average)	3.1	3.7	3.5	1.5	0.6	1.1	1.2	2.3	2.5	2.5	2.5	2.5
CPI inflation (eop)	3.0	3.0	2.6	1.1	0.4	1.5	2.0	2.5	2.5	2.5	2.5	2.5
Unemployment rate (Kuwaiti nationals)	5.0	4.7	3.3	3.3	…	…	…	…	…	…	…	…
	(Percent of GDP at market prices)											
Budgetary operations [2]												
Revenue	67.4	52.3	52.7	58.3	60.9	58.0	47.6	49.4	50.2	50.8	50.2	49.4
Oil	51.9	35.4	34.4	37.8	43.7	38.0	28.9	30.3	31.6	32.1	32.0	31.6
Nonoil, *of which:*	15.4	16.9	18.2	20.5	17.2	20.0	18.7	19.0	18.7	18.7	18.3	17.8
Investment income	10.6	13.3	14.6	16.2	12.2	14.5	12.5	12.9	12.8	13.0	12.7	12.3
Expenditures [3]	48.8	52.7	52.2	50.7	51.6	54.7	60.6	58.9	57.6	56.8	56.3	55.7
Expense	43.3	45.0	45.6	44.2	45.4	49.3	54.5	52.8	51.8	51.1	50.7	50.3
Capital	5.4	7.7	6.5	6.6	6.2	5.4	6.2	6.1	5.8	5.7	5.5	5.4
Balance	18.6	-0.3	0.5	7.5	9.3	3.3	-13.0	-9.5	-7.4	-6.0	-6.0	-6.3
Balance (after transfer to FGF and excl. investment income)	2.3	-17.5	-17.9	-12.9	-7.7	-15.6	-29.1	-26.1	-23.9	-22.8	-22.4	-22.3
Domestic financing (net)	-0.7	-1.2	6.5	1.8	-2.7	-3.5	4.5	4.7	4.4	5.4	5.2	4.1
External borrowing and drawdown on GRF (net)	-1.6	18.8	11.4	11.0	10.5	19.1	24.5	21.3	19.5	17.4	17.3	18.2
Nonoil balance excl. investment income (percent of non-oil GDP) [4]	-102.5	-88.3	-83.5	-85.5	-90.2	-86.0	-83.0	-81.7	-81.4	-80.6	-79.8	-78.8
Excluding oil-related subsidies and benefits (percent of non-oil GDP)	-81.2	-77.5	-74.5	-76.6	-81.6	-78.8	-77.9	-76.3	-75.7	-74.8	-74.0	-73.0
Total gross debt (calendar year) [5]	3.4	4.7	10.0	20.5	14.8	11.6	17.7	33.2	44.0	57.2	68.2	78.0
Estimated KIA assets	345.6	456.3	476.6	460.4	398.2	406.4	474.2	442.6	417.9	400.1	386.1	372.3
Net government financial assets	342.1	451.7	466.6	439.9	383.3	394.7	456.6	409.4	374.0	342.9	317.9	294.3
	(Percent change; unless otherwise indicated)											
Money and credit												
Net foreign assets [6]	3.7	-2.1	8.7	-3.1	10.0	6.2	-3.6	1.2	0.5	0.7	0.0	0.7
Claims on nongovernment sector	5.2	7.9	2.5	2.8	3.9	4.4	4.3	6.8	6.4	6.3	6.3	6.3
Kuwaiti dinar 3-month deposit rate (year average; in percent)	0.8	0.8	1.1	1.5	2.3	2.8	…	…	…	…	…	…
Stock market unweighted index (annual percent change)	-3.8	-16.5	-0.2	12.8	11.8	23.2	…	…	…	…	…	…
	(Billions of U.S. dollars, unless otherwise indicated)											
External sector												
Exports of goods	104.5	54.5	46.5	55.2	72.3	64.6	43.0	47.9	53.3	57.2	60.1	62.2
Of which: nonoil exports	7.0	6.0	5.0	5.6	6.9	6.3	5.2	5.9	6.6	7.2	7.7	8.0
Annual percentage change	-2.8	-14.1	-15.7	11.7	22.3	-8.0	-17.3	12.4	12.5	8.7	6.7	4.0
Imports of goods	-27.0	-26.5	-27.0	-29.5	-31.3	-32.0	-31.5	-32.7	-33.8	-35.3	-36.9	-38.2
Terms of Trade (ratio, annual percent change)	-12.2	-42.5	-12.5	27.1	19.9	-11.1	-27.9	4.7	8.4	4.0	1.7	1.1
Current account	54.4	4.0	-5.1	9.6	20.4	12.1	-11.9	-8.7	-4.2	-0.6	0.3	1.0
Percent of GDP	33.4	3.5	-4.6	8.0	14.5	8.8	-10.1	-6.8	-3.0	-0.4	0.2	0.6
International reserve assets [7]	32.3	28.3	31.2	33.6	37.2	39.6	39.2	40.8	42.3	43.9	45.2	46.9
In months of next year's imports of goods and services	7.4	6.5	6.6	6.4	6.8	7.6	7.0	7.0	7.0	7.0	7.0	7.0
Memorandum items:												
Exchange rate (U.S. dollar per KD, period average)	3.52	3.32	3.31	3.29	3.29	3.29	…	…	…	…	…	…
Nominal effective exchange rate (Percentage change)	1.1	1.5	1.8	0.4	0.2	2.6	…	…	…	…	…	…
Real effective exchange rate (Percentage change)	1.5	2.9	3.2	0.5	-1.9	1.4	…	…	…	…	…	…

Sources: Data provided by the authorities; and IMF staff estimates and projections.

[1] Calculated at market prices.

[2] Based on fiscal year cycle, which starts on April 1 and ends on March 31.

[3] Starting FY2016/17, there has been a reclassification of expenditure items.

[4] Excludes pension fund recapitalization.

[5] Excludes debt of Kuwait's SWF related to asset management operations.

[6] Excludes SDR holdings and IMF reserve position.

[7] Does not include external assets held by KIA.