Kuwait's Economic Outlook- Spring 2016

The latest MENA Economic Monitor Report - Spring 2016, expects Kuwait's growth to recover to 1.3% in 2016 and to gradually firm up in the medium term.

Kuwait's GDP contracted by an estimated 1.3 % in 2015, following a 1.6 % decline in 2014. Oil production dropped by 1.7 % in 2015. Growth in the oil sector, which accounts for two-thirds of GDP, was affected by an ongoing dispute with Saudi Arabia over shared resources, leading to the closure of a neutral zone oilfield in mid-2015. Growth in the non-oil sector also moderated further in 2015 as the slump in global oil prices took a toll on sentiment and activity, particularly in real estate and construction. Inflation remains muted, averaging just 3.3 % in 2015.

Fiscal and current account pressures are increasing. Oil revenues, which have contributed three-quarters of government income in recent years, fell by nearly 50 % during 2015 in line with oil prices. With spending adjusting more slowly, Kuwait is expected to record its first fiscal deficit since 1999, of 3.6 % of GDP in FY2015/16 (on a general government basis, including investment income and transfers to the SWF). The current account surplus has narrowed significantly from over 30 % of GDP in 2014, but remains at 9.6 % of GDP in 2015. With the Kuwaiti dinar pegged to a basket of currencies dominated by the US dollar, the central bank raised its policy rate by 25 basis points to 2.25 % following the rate increase by the US Federal Reserve Bank in December 2015. Private sector credit is growing at a moderate pace, mitigating concerns about financial risks.

Fiscal reforms remain limited. With current spending amounting to 90 % of total spending, cutting expenditures has proved challenging. Electricity and fuel subsidy cuts have been proposed, but face strong opposition in Parliament. In mid-March, the Cabinet approved a reform package focused on public sector and expenditure reforms, PPP and privatization, SME development, labor market and investment climate reforms, but these still need to be approved by Parliament. Under the 2015-19 Development Plan, the government has accelerated efforts to implement major projects including modernization of existing refineries, a new refinery, and major transport projects. Implementation is critical for laying the foundations for a post-oil economy, and for raising hydro-carbon output in the near to medium term.

The outlook is for growth to recover to 1.3 % in 2016 and to gradually firm up in the medium term. Activity should be supported by rising oil output (due to recent discoveries, improved production efficiencies, and as production from the Neutral Zone oilfield resumes in 2017). After years of stalled projects and delays, prospects for investment have also improved, with major infrastructure and development projects awarded in 2015. Growth in the non-oil sector should accelerate in parallel. Also, fiscal and current account positions should gradually strengthen in line with a modest recovery in oil prices and output. Public finances should also be supported by the gradual implementation of spending and revenue reforms, including the implementation of a VAT (expected in 2017). Risks are tilted to the downside. External risks include spillovers from geo-political tensions and conflict, protracted weakness in global oil prices, and global financial volatility that dampens appetite for private sector investment in PPPs, which the government is increasingly likely to rely on given fiscal constraints. Key domestic risks include slow implementation of infrastructure projects and parliamentary gridlock that delays critical fiscal reforms. The banking sector is well capitalized, yet has exposure to the real estate sector.

Key Economic Indicators

	2014	2015e	2016p	2017p
Real GDP Growth (%)	-1.6	-1.3	1.3	1.6
Inflation Rate (%)	2.9	3.3	3.0	3.0
Fiscal Balance (% of GDP)	18.7	-3.6	0.5	4.0
Current Account Balance (% of GDP)	36.9	9.6	3.3	11.3