Economic Research

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Country Update: Kuwait

MALAYSIAN RATING CORPORATION BERHAD
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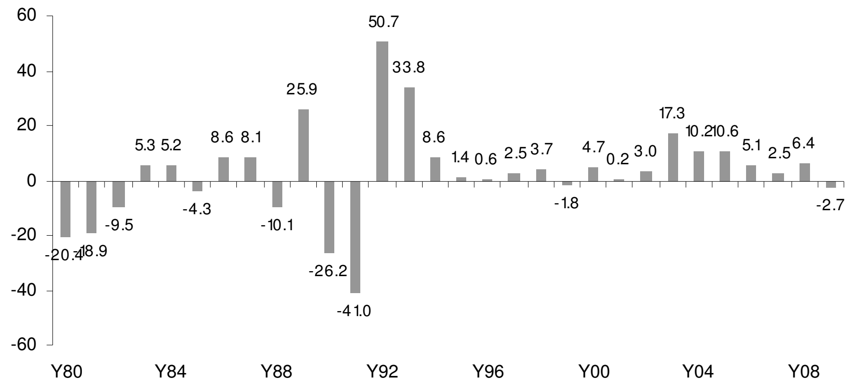
Overview

Kuwait, although geographically small in relation to other Gulf Cooperation Council (GCC) members, is endowed with sizeable crude oil reserves that account for some 8.1% of total world reserves as at 2008 and is the fourth-largest on a global scale. The oil and gas industry is thus naturally the key sector that the country's economic activities revolve around, with 58% of total output produce contributed by the sector alone. On the same note, oil is the main export product with its share of total exports registering at 92.7% in 2009, and the bulk of government revenue also comes from oil (approximately 95% of total revenue). The country survived the economic crisis with GDP only suffering a 2.7% contraction in 2009 (2008: 6.4% growth). This was made possible on the back of continued fiscal surpluses generated by high oil prices.

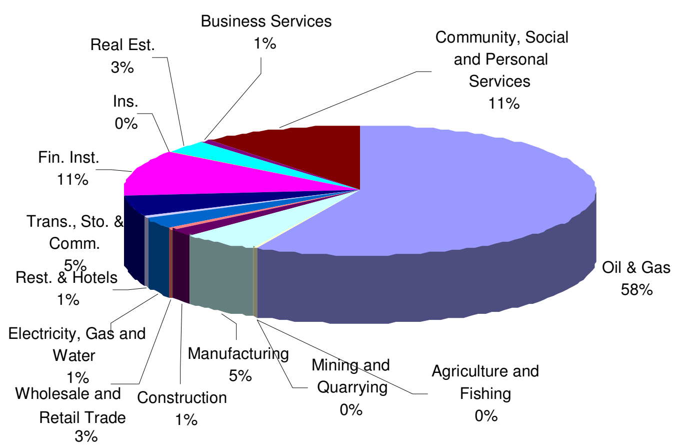
Chart 1: Historical GDP performance (%)



Source: The International Monetary Fund

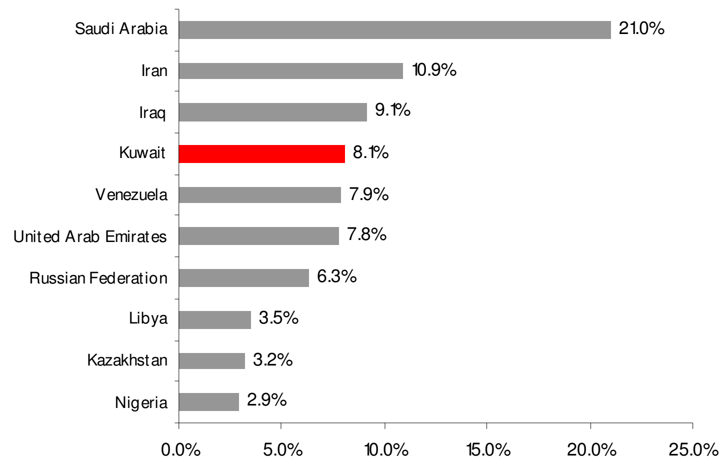
However, there are some structural issues facing the country, primarily its high dependence on its finite resource of crude oil. In this respect, Kuwait has done little to diversify its economy, possibly due to complacency amid positive fiscal balances (brought about by high oil prices), the poor business climate as well as the acrimonious relationship between the National Assembly (parliament) and the executive branch, which presents a stumbling block to economic reforms. Nonetheless, the parliament approved the economic development plan in February this year that pledges to spend up to US$104 billion in five years to diversify the economy away from oil, attract more investment, and boost private-sector participation in the economy.

Chart 2: GDP breakdown by industry (2008)



Source: Central Bank of Kuwait (CBK)

Chart 3: Oil proved reserves (% of world's) in 2008



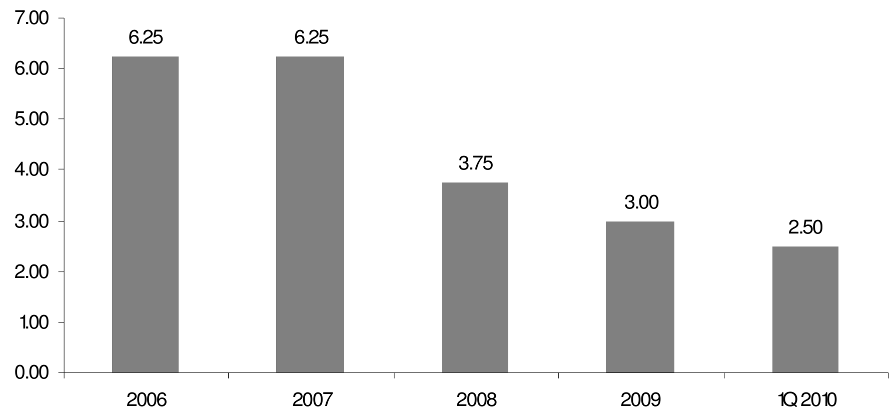
Source: BP Statistical Review 2009

Current developments

i) Monetary policy – discount rate trends downward

The Central Bank of Kuwait (CBK) cut its discount rate by another 50 basis points (bps) on February 8 this year, marking its sixth rate reduction since October 7, 2008. CBK governor Sheikh Salem Abdulaziz Al-Sabah indicated that the goal of the reduction was to establish an appropriate atmosphere to reinforce growth in non-oil sectors in the national economy (by the slashing of credit costs), especially when inflationary pressures remain moderate hitherto. The move also suggests that the CBK continues to be cautious about the strength of the global economic recovery, particularly when the European debt woes have roused jitters aplenty in the financial markets. All this will have direct implications on crude oil prices with heightened risk aversion. This can be seen from the recent appreciation of the US dollar as well as the rise in gold prices, suggesting that global investors are still wary about the sustainability of the recovery worldwide.

Chart 4: Discount rate (%)



Source: The Central Bank of Kuwait

ii) Inflation is expected to rise

The ongoing global economic recovery appears to have positive ripple effects on Kuwait's domestic economy, particularly on the inflation front. Crude oil prices have risen from a low of US$32.3 per barrel in December 2008 to hover around US$70 per barrel, after lingering at more than US$80 per barrel in April this year. This has resulted in increased production activities in the oil and gas sector, leading to more jobs being created and greater consumer spending.

In 2009, the consumer price index (CPI) rose, albeit moderately at 4.0% (2008: 10.6%), led by higher housing services (27.0% of CPI) which posted a 5.1% increase against 12.8% in 2008. Similarly, food prices (18.3% of CPI) also saw an uptick of 3.2% (2008: 11.6%). Although the CPI only rose moderately in 2009, one should take note that the 4.0% increase came after the 10.6% appreciation in 2008.

It is also interesting to note that property market activities have witnessed a sizeable growth in terms of the number of transactions, with total sales of units as of March rising 97% y-o-y, while sales value jumped a remarkable 130% as a result of the low base of last year. In a nutshell, general prices are rising as the government and the central bank are committed to implementing their economic stimulus programs, the reversal of which is unlikely to happen in the near term.

Table 1: Consumer Price Index (CPI)

Year	Food	Beverages & Tobacco	Clothing & Footwear	Housing Services	Household Goods & Services	Transport & Communications	Education & Medical Care	Other Goods & Services	General Index
	By Items of Expenditure								
2004	3.2%	3.4%	2.8%	0.8%	-4.3%	6.4%	3.7%	-3.5%	1.3%
2005	8.5%	0.9%	6.4%	0.7%	3.6%	0.9%	5.7%	7.8%	4.1%
2006	3.9%	1.9%	4.0%	2.6%	2.7%	1.9%	2.4%	4.8%	3.0%
2007	4.8%	7.0%	4.7%	7.5%	3.5%	7.4%	4.6%	2.5%	5.5%
2008	11.6%	19.1%	7.2%	12.8%	15.9%	4.4%	9.9%	8.4%	10.6%
2009	3.2%	9.3%	4.9%	5.1%	5.9%	-0.1%	4.3%	3.8%	4.0%

Source: The Central Bank of Kuwait

iii) Budget 2010/11 - more mega projects in the pipeline

The 2010/11 budget, which was unveiled in February this year, expects fiscal deficits to be in the region of KD7.4 billion. The fiscal shortfall was on the back of lower revenue for the financial year (at KD9.7 billion) against the KD12.9 billion registered in the previous year, while expenditure is expected to amount to KD16.1 billion for 2010/2011, representing an increase of 184% from the 2009/2010 fiscal year. Apart from the annual budget, the government also announced the Kuwait Economic Development Plan, the first of its size since 1986, which runs until 2014 to promote primarily the non-oil sector of the economy.

Among the salient points of the 2010/11 budget:

- Capital expenditure amounting to KD30 billion for mega projects under the Kuwait Economic Development Plan 2013/14 that will include Silk City with its estimated cost of US$77 billion, a major container harbour and a 25km causeway, as well as a railway and metro system, whilst KD25 billion in oil-sector investments will be made to raise production capacity and modernize current facilities.
- Development spending worth KD4.78 billion will be disbursed in the first year of 2010/11 budget.
- Oil revenue streams are pegged to the Kuwait Export Crude (KEC) of US$43 per barrel, representing an increase of 22.9% from the previous budget.
- Spending on education, healthcare, as well as water and electricity are estimated at KD1.92 billion, KD1.13 billion and KD3.39 billion respectively.

Table 2: Public revenue and expenditure

KD Million	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Revenue								
Oil Revenues	5,499	6,150	8,171	12,956	14,512	17,720	19,711	6,925
Other Receipts	721	786	792	773	998	1,303	1,295	1,150
Sub-total 1	**6,219**	**6,936**	**8,962**	**13,728**	**15,509**	**19,023**	**21,006**	**8,075**
Expenditure								
Wages and Salaries	1,542	1,637	1,754	1,931	2,226	2,477	3,039	3,476
Requirements of Goods and Services	582	668	870	1,058	1,373	1,768	3,002	2,355
Means of Transport & Equipment	24	41	45	59	77	90	122	344
Construction & Land Acquisition	461	570	678	751	990	1,206	1,358	1,265
Miscellaneous Expenditure & Transfer Payments	2,319	2,608	2,968	3,064	5,642	4,157	10,741	4,676
Sub-total 2	**4,927**	**5,523**	**6,315**	**6,862**	**10,307**	**9,698**	**18,262**	**12,116**
Overall Balance	**1,292**	**1,414**	**2,647**	**6,866**	**5,203**	**9,325**	**2,744**	**(4,042)**
% of GDP	**11.1%**	**9.9%**	**15.1%**	**29.1%**	**17.7%**	**28.6%**	**6.9%**	N/A

Sources: The Central Bank of Kuwait & MARC Economic Research

Key risk areas

- **Oil-price gyration**

  In the near term, economic prosperity will continue to be dependent on oil prices, given the nation's heavy reliance on fossil fuel to rev up its economic activities. While we applaud the move by the government to promote the non-oil sector, we believe that the success of such measures will only be evident in the long run. This is particularly true given that the sustainability of the ongoing economic recovery hinges precariously on ever-shifting sentiments and volatility in the financial markets. Issues on rising public debt and fiscal deficits in the European continent are likely to have negative repercussions on the global economy should they not be promptly and properly addressed. Risk aversion, as evidenced by the rise in the USD and gold prices, may cause the real economy to shift into lower gear, resulting in lower employment and spending abilities.

- **Volatility in economic growth**

  Volatility in growth performance is a key feature of the Kuwait's economy. Based on statistics provided by the IMF, growth rates in the late-1980s and early-1990s were extremely volatile due to drastic movements in oil prices. Notwithstanding that, since 1995, the volatility in growth has declined from previous periods. Going forward, the government is banking on its success in diversifying the economy away from the oil sector. If such efforts bear fruit, the volatility in economic growth will continue to decline, simplifying policymakers' planning for long-term national development.

- **Lack of political coordination**

  Political debates between the executive authority (the Emir) and the parliament have been deemed to be delaying some economic reforms as well as other policies. Several conflicts have emerged in the past, leading to the suspension of the National Assembly. While there is no certainty as to what may evolve in the future, we do believe that the risk of another stand-off should not be taken lightly.

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