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Kuwait
Top Economic & Investment Themes
2016

Analysis of the top themes that would influence the Kuwaiti economy in 2016

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Top Economic & Investment Themes for 2016

Kuwait

January 2016

Research Highlights:
Analysis of the top themes that would influence the Kuwaiti economy in 2016

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Economic Themes & Impact on Investments

Key Themes	Rationale	Stock Market	Bonds	Real Estate	SMEs
Lowest Fiscal Breakeven Price (BEP) Among GCC Countries	Kuwait has the lowest BEP among GCC countries which it should use as an advantage to enact long-term reforms	Positive Impact	Negative Impact	Neutral Impact	Positive Impact
Creation of a Local Debt Market in Kuwait	Creating a local debt market is of prime importance to diversify capital source and lessen stress on bank's	Neutral Impact	Positive Impact	Positive Impact	Positive Impact
Introduction of Taxes	Introducing taxes would aid the Kuwaiti government to diversify revenue sources	Negative Impact	Neutral Impact	Negative Impact	Negative Impact
Subsidy Rationalization	Kuwait must capitalize on the opportunity offered by low oil prices to contain current expenditures, especially subsidies	Negative Impact	Positive Impact	Neutral Impact	Negative Impact
Accelerated Implementation of KDP	Fast tracking implementation of the KDP would aid in diversifying sources of revenue generation	Positive Impact	Positive Impact	Positive Impact	Positive Impact
Improving Business Environment	Kuwait should work on improving its Doing Business rankings which would aid in foreign investments	Positive Impact	Positive Impact	Positive Impact	Positive Impact

Source: Marmore; Legend for color codes: Positive Impact | Neutral Impact | Negative Impact

Prices for crude oil have fallen by over 65% since mid-2014. With most investment banks and internationalagencies, including World Bank and IMF, expecting the lower oil prices to persist throughout 2016, the prized surplus of fiscal and current account positions is expected to detriorate to low single digits for Kuwait. Kuwait continues to be extremely reliant on oil for revenues. On an average, hydrocarbon revenues accounted for c.80% of overall revenues in the past five year period (2009-2014). While part of the oil revenue is saved as sovereign wealth fund, most is channelled to the local economy in the form of wages for public sector employees, large scale subsidies (energy, electricity and water), capital transfers and generous grants for its citizens. The deteriorating fiscal situation amid the lower oil price environment warrants relook at ways to augment revenue streams and curb wasteful expenditures.The slump in oil prices, has renewed focus on containing current expenditures, prioritizing capital expenditures and introducing measures to rationalize subsidies. Job creation for nationals and the need to increase the role of private sector in the economy, is also widely stressed.

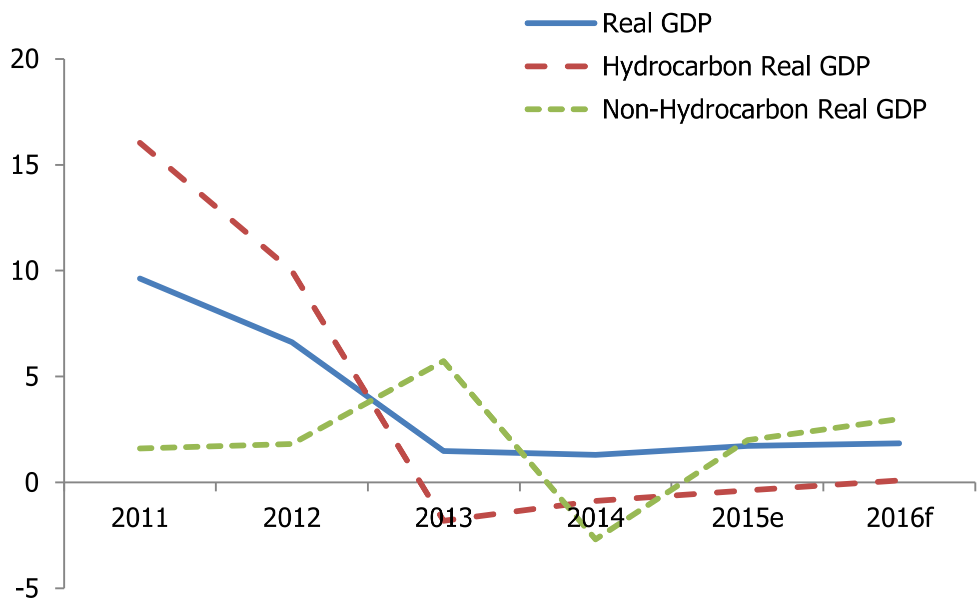
Kuwait, with a low fiscal breakeven oil price of USD 51.8/barrel in 2016, is expected to weather the environment of lower oil prices better than its GCC peers. This is also, in part, due to the presence of ample fiscal reserves and buffers which stands at 323% of GDP. Kuwait, with low debt and higher fiscal reserves, accumulated during periods of elevated oil prices, could resort to raising debt in the domestic market, international market or draw down on its buffers or a mixture of both. The actions of the government, in this regard, in the coming months will be keenly watched as it would have wider implications on the economy.

Economic activity in Kuwait, as indicated by real-GDP growth, has been subdued in the recent years.

Theme 1: Lowest Fiscal Breakeven Price Among GCC Countries

Economic activity in Kuwait, as indicated by real-GDP growth, has been subdued in the recent years. Hydrocarbon activity which accounts for c.50% of overall economic activity (in nominal terms) has languished due to marginal decline in oil production on account of partial closure of oil fields in second half of 2014 and temporary suspension of operations due to technical reasons in May, 2015[1].

Economic Activity, Real GDP (in %)



Source: IMF, IIF

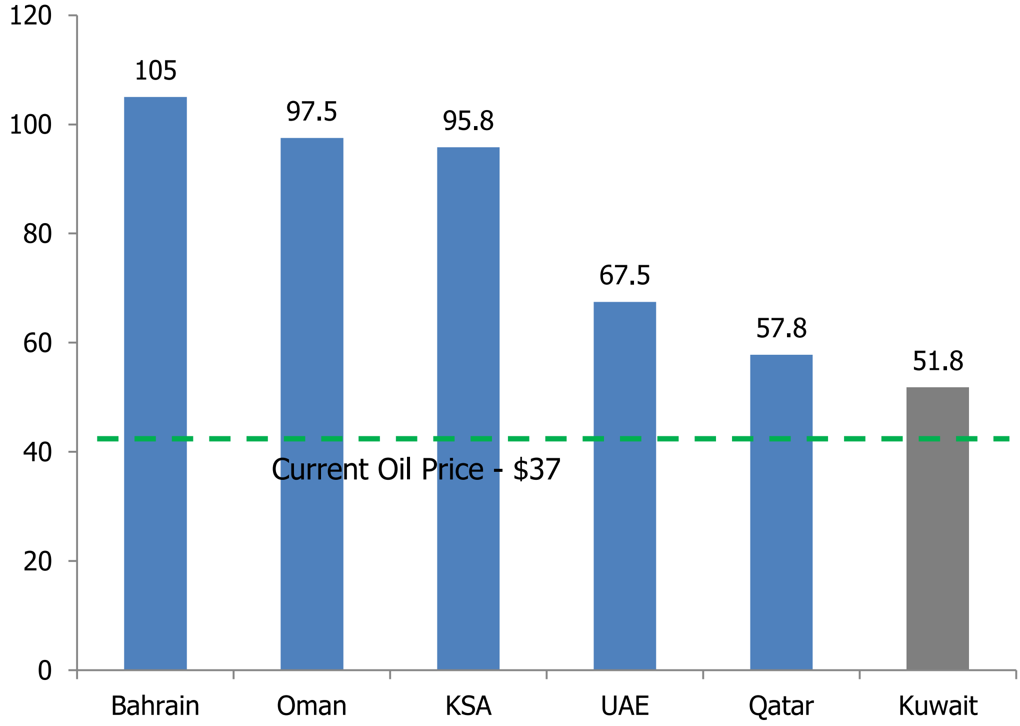
While hydrocarbon output is expected to be stable, non-hydrocarbon activity is expected to inch up in the coming year on account of execution of various infrastructure projects

While hydrocarbon output is expected to be stable, non-hydrocarbon activity is expected to inch up in the coming year on account of execution of various infrastructure projects after a series of project awards in 2014 & 2015.

The persisting lower oil price has presented a challenging operating environment for all oil exporters and Kuwait is no exception. However, the lower fiscal break even oil price (BEP) for Kuwait at USD 51.8/barrel in 2016 will help to continue posting surplus, though it represents a sharp fall from the robust fiscal balances registered prior to the oil fall.

[1] IMF

GCC Fiscal Breakeven Prices (USD – 2016e)



Source: IMF, Reuters; Oil Price as on Dec 20th 2015

Although Kuwait's BEP is higher than the current oil price, it is the lowest among oil exporters in the region. Kuwait should however make use of this advantageous position to fast-track reforms to ensure tha the situation does not further deteriorate. Reforms should be both in the form of revenues by diversifying away from oil and in the form of expeneses through subsidy rationalization. More on this will be discussed in the following sections.

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stock Market	Positive
Bond Market	Negative
Real Estate	Neutral
SME	Positive

Source: Marmore Analysis

Looking at the past few years, the corporate earnigns growth for Kuwait has been extremely flat and swift implementation of KDP could be the positive trigger for earnings growth in the near future.

Stock Market: A low fiscal breakeven price is, theoretically, a positive for the stock market since when compared to other economies in the GCC, Kuwait would be in a favourable position to continue investing in infrastructure to diversify its sources of revenue. This would have an impact on corporate earnings due to increasing economic activity. However, it remains to be seen how much of this translates to action on the ground. Looking at the past few years, the corporate earnigns growth for Kuwait has been extremely flat and swift implementation of KDP could be the positive trigger for earnings growth in the near future.

Bond Market: Bond markets would have a negative impact due to lower breakeven prices since it does not provide the impetus for the government to initiate action on creating a local debt markets. In other countries in the region such as KSA, the strain on liquidity is evident with rising government borrowings and falling government deposits. Hence developing an active secondary debt market is an imperative for KSA unlike Kuwait.

Kuwait's high dependence on oil has led to the country to look for options to diversify its economy on the back of low oil prices

Real Estate: The recent oil price decline, while alarming, is not expected to have too adverse an effect on the Kuwait real estate market, as the country has accumulated large oil surpluses over the past decade. Hence, the plunging oil prices will not curtail government spending, unless the low oil price is sustained over a long period of time. Development plans in Kuwait that had been stalled are expected to be put back on track which will aid commercial as well as residential real estate projects. However, we may witness only a flat growth in the demand and prices of real estate and hence we feel that real estate would have a neutral impact due to low breakeven prices.

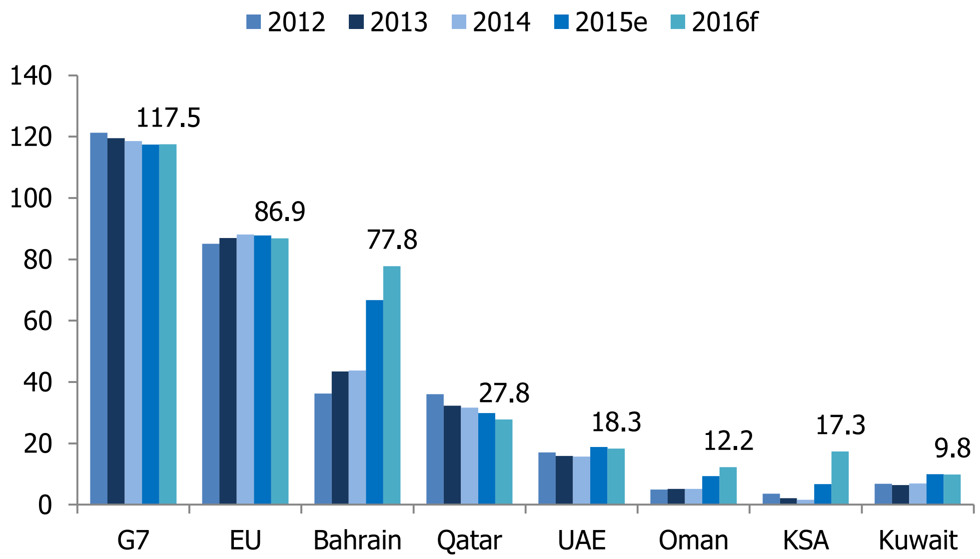
SME: Kuwait's high dependence on oil has led to the country to look for options to diversify its economy on the back of low oil prices. Hence, the promotion of SMEs for the twin purpose of diversifying the economy and creating employment is paramount. In this regard, the SME Fund with a capital of KD 2 billion was setup to provide funding for the SMEs in Kuwait. The low breakeven price would imply that the country would be able to continue providing the much needed funds for the sector. Hence we have a positive view on the impact on SMEs in Kuwait.

Theme 2: Creation of a Local Debt Market in Kuwait

Uncertain outlook for oil prices places greater emphasis on the need for fiscal consolidation to ensure government expenditures are sustainable in the long run.

Uncertain outlook for oil prices places greater emphasis on the need for fiscal consolidation to ensure government expenditures are sustainable in the long run. Kuwait with low debt and higher fiscal reserves, accumulated during periods of elevated oil prices, could resort to raising debt in the domestic market, international market or draw down on its buffers or a mixture of both.

Government Gross Debt (as % of GDP)



Source: IMF; G7 Countries consists of Canada, France, Germany, Britain, Italy, Japan & U.S

Kuwait's sovereign debt commands an investment grade rating of Aa2 (Moody's), AA (Standard & Poor's) and AA (Fitch) with a stable outlook for the year 2016.

Kuwait's sovereign debt commands an investment grade rating of Aa2 (Moody's), AA (Standard & Poor's) and AA (Fitch) with a stable outlook for the year 2016. Rating agencies cite the rating is underpinned by the presence of large scale fiscal buffers which could help it to weather the current environment of lower oil prices. Further, the low levels of debt which stands at 7% of GDP (2014) could be increased, if required, to sustain government spending. Consequently, Kuwait could raise debt in domestic market by placing bonds with the local banks. Raising debt in the domestic market, if done in a measured way, could help in the establishment of an active and liquid debt market.

Development of local debt markets could provide an additional source of avenue for capital raising on a long-term basis. Creation of local debt market would also help in establishing the much needed yield curve, which could help in better pricing of risk for future issues. In this context, establishment of local debt markets, in addition to deepening the financial market, could help create financial hubs in the GCC region. Debt markets in the GCC region have remained smaller in size and underdeveloped. Based on IMF data, Debt market to GDP ratio for Kuwait stands at mere 3.2%, which is lower than Japan (230%), United States (103%) and United Kingdom (89%). Though the small size offers scope for growth, primary market issues which are meagre and skewed towards long-term maturities often promote buy and hold strategies – and has resulted in shallow secondary markets devoid of liquidity.

In Kuwait, the largest issuer of bonds both in terms of volume and value has been the Central Bank of Kuwait

In Kuwait, the largest issuer of bonds both in terms of volume and value has been the Central Bank of Kuwait (84% of total issuances by value since 2011). The crowding out effect of government is quite pronounced in the region. Corporate debt market was highly sophisticated in Kuwait well before it was introduced in other neighboring countries. Currently, however, corporate houses rely on bank debt and internal funding for funding their business operations. Excessive reliance on bank funding, however, may not be sustainable in the long run. Deleveraging acts, introduction of Basel-III norms entailing additional capital needs may stress banks and their lending might be constricted, as business cycle changes. Declining trend of long-term deposits (less than 5 years) globally could exacerbate the maturity mismatch, if banks continue to fund long-term loans. Issuance of corporate bonds would also be advantageous from investor's perspective, as it would provide a steady stream of predictable income in the form of coupon payments, while retaining capital value.

Bond Issuances in Kuwait (2011-2015) (USD Mn)

Issuers	2011	2012	2013	2014	2015	Total	% of Total
Central Bank of Kuwait	5,601.9	5,404.2	4,011.9	3,987.2	3,954.3	**22,959.4**	**84%**
Burgan Bank		329.5		500.0		**829.5**	**3%**
Gulf Investment Corporation G.S.C.		802.3				**802.3**	**3%**
Kuwait Projects Company Holding K.S.C.P.		263.6		500.0		**763.6**	**3%**
NBK Tier I Financing					700.0	**700.0**	**3%**
National Bank of Kuwait Group					411.9	**411.9**	**2%**
Kuwait Energy Company K.S.C. (Closed)				250.0		**250.0**	**1%**
United Real Estate Company SAK			197.7			**197.7**	**1%**
Commercial Facilities Company - S.A.K.P.	164.8					**164.8**	**1%**
ALARGAN International Real Estate Company K.S.C.		87.3				**87.3**	**0%**
Kuwait Financial Centre K.P.S.C.	72.5					**72.5**	**0%**
Total	**5,839.1**	**6,886.9**	**4,209.6**	**5,237.2**	**5,066.2**	**27,239.1**	**100%**

Source: Zawya

Kuwait has delayed tapping the debt markets, hoping the conditions would improve; it may not be a prudent strategy, as the existing historic low level of interest rates may not last forever.

While the direct impact on the banking sector due to the fall in oil prices is minimal due to its low direct exposure to petrochemical sector, prolonged environment of lower oil price could impact the banking sector through indirect channels such as reduced government spending, lower consumer confidence and subdued economic growth. Reduced opportunities to lend amidst environment of increasing short-term rates and an impeding rate hike would constrain net interest margins, and subsequently lower profitability for Kuwaiti banks.

Kuwait has delayed tapping the debt markets, hoping the conditions would improve; it may not be a prudent strategy, as the existing historic low level of interest rates may not last forever. The US Fed rate hike of 25 bps on 16 December, 2015 was followed up by the Kuwaiti Central Bank increasing its discount rate by 25 bps to 2.25%.

Incorporating debt would instil disciplined spending by the government as it entails frequent and regular interest payments.

While the steep fall in fiscal surplus position can't be managed by placing bonds with the domestic banks alone, as it would lead to liquidity squeeze and crowds out the private sector for their credit needs, a part could be issued domestically and part could be done internationally. As oil revenues are denominated in dollars, servicing them may not entail currency risk. In such context, the prevailing low interest rates in the global economy supports a favourable case for raising debt.

While some advocate partial draw down of reserve buffers, we feel that the opportunity costs for Sovereign Wealth Funds (SWFs) are much higher than the rate with which Kuwait could raise debt. Moreover, incorporating debt would instil disciplined spending by the government as it entails frequent and regular interest payments.

Factors That Argue for Raising Debt

Higher Sovereign Ratings	• GCC Sovereigns command higher credit rating • Rating on par with most Developed economies.
Low Debt Levels	• Current government debt levels are low (GCC, Total debt: 9% of GDP) compared with G7 economies (117% of GDP)
Record Low Interest Rates	• External economic environment is supportive • Record low interest rates could be utilized to borrow.
Help Establish Debt Market	• Debt market could alleviate pressure on local bank financing methods • Subsequently, benchmark 'yield curve' could be established
Opportunity Cost of SWF is much Higher	• SWF being long-term in nature should ideally earn higher returns , esp. against cost of government debt.
Ensures Disciplined Spending	• Adding on debt would also ensure disciplined spending , going forward, as it entails regular interest payments.

Source: Marmore

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stock Market	**Neutral**
Bond Market	**Positive**
Real Estate	**Positive**
SME	**Positive**

Source: Marmore Analysis

Creation of a local debt market would provide alternative financing options, alleviate pressures in the banking system and consequently reduces the cost of capital for firms

Stock Market: While creation of a local debt market is a positive sign for the economy, it may not affect stock markets to a huge extent. Capital allocations (which are predominantly equity) from a fund perspective may start moving to the debt markets but given the fact that the Kuwait stock market is more retail oriented, the impact may not be too large. For listed companies, it is a positive step since it diversifies their funding sources, thereby gaining access to much needed capital. Hence we feel that creating a debt market would have a neutral impact on the local stock market.

Bond Market: Creation of a local debt market would provide alternative financing options, alleviate pressures in the banking system and consequently reduces the cost of capital for firms. This could alternatively enable firms to accelerate their growth plans that hitherto might have been on hold due to lack of funding or higher capital costs.

SMEs in Kuwait face a major problem to obtain funds due to high collateral requirements of banks and the absence of a debt market.

Real Estate: Creation of local debt markets would be a positive development for real estate sector. Private real estate players looking to diversify their funding sources can use the debt market to raise additonal capital to fund projects. While the domestic banking sector is not facing a liquidity crunch, the lower oil price environment and implementation of basel III norms could constrain liquidity. In such context, debt markets could would be a positive development for real estate sector.

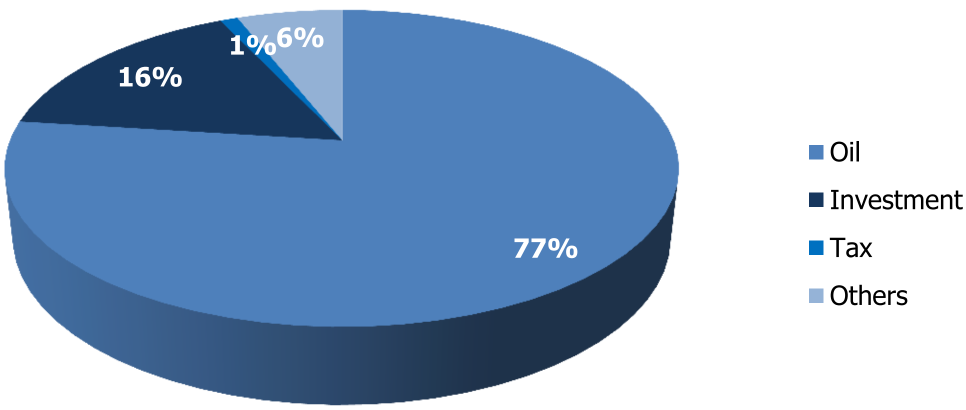
SME: SMEs in Kuwait face a major problem to obtain funds due to high collateral requirements of banks and the absence of a debt market. The SME Fund is aimed at alleviating the problems but it remains to be seen what on-the-ground impact it is going to have. The creation of a debt market would aid SMEs to gain access to much needed liquidity. However, the benefits might be limited as they might find the process of raising debt cumbersome. The SME Fund can act as an advisory for SMEs looking at raising capital through the debt route.

Theme 3: Introduction of Taxes

On an average, hydrocarbon revenues accounted for c.80% of overall revenues in the past five year period

Kuwait continues to be extremely reliant on oil for revenues. On an average, hydrocarbon revenues accounted for c.80% of overall revenues in the past five year period (2009-2014). While part of the oil revenue is saved as sovereign wealth fund, most is channelled to the local economy in the form of higher wages for public sector employees, large scale subsidies (energy, electricity and water), capital transfers and generous grants for its citizens. Though some measures was warranted in part to mitigate the effects of global financial crisis and alleviate the rising social pressures, the deteriorating fiscal situation amid the lower oil price environment warrants relook at ways to augment revenue streams and curb wasteful expenditures.

Government Revenues Split, 2014

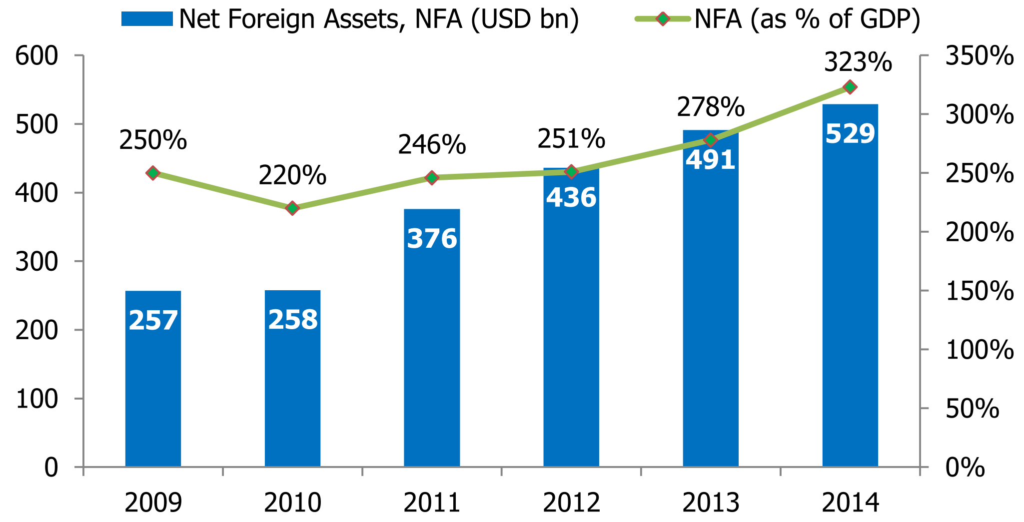


Source: IMF

Although Kuwait maintains a high level of sovereign assets, dipping into it will only result in a short term fix

In this regard, introduction of taxes – direct (personal tax, business tax) as well as indirect (service tax, consumption tax), raising costs of government services in a gradual and phased manner could be considered. Although Kuwait maintains a high level of sovereign assets, dipping into it will only result in a short term fix and implementing a long term solution such as introduction of taxes seem more prudent.

Sovereign Assets

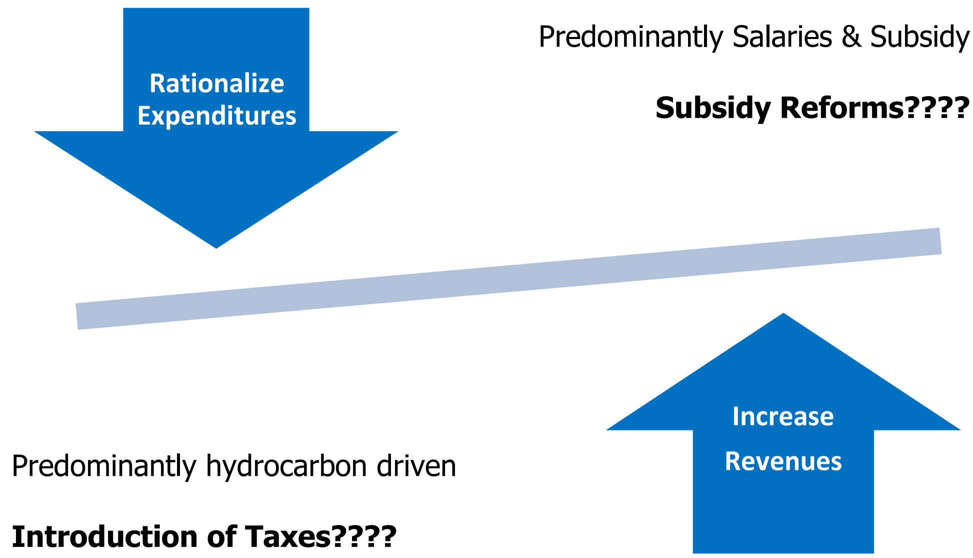


Source: IIF, NBK, Marmore

Business taxation and subsidy rationalization should not be seen as mutually exclusive actions to ease the fiscal situation.

Business taxation and subsidy rationalization should not be seen as mutually exclusive actions to ease the fiscal situation. If business taxation is being seen as a route towards furnishing the revenue side of the budgetary equation, then it would make for poor policy to divest it of any linkages with subsidies reform. It is, indeed, the case that subsidies' reform can prove to be sensitive among several stakeholders; however, increasing the tax burden on the private sector in lieu of gains from subsidies reform can harm the long term prospects in terms of economic diversification. The measures, if done in tandem, could help avoid subsidy leakages, ensure continued infrastructural spending and help improve competitiveness of Kuwait economy.

Revenues Augmentation, Expenditure Rationalization



Source: Marmore

International authorities such as IMF and World Bank have been vocal about introduction of taxes in a steady manner.

In the current scenario, wherein expenditures could possibly be reined in only over the long-term and gradually, steps to increase non-hydrocarbon revenues should be devised. International authorities such as IMF and World Bank have been vocal about introduction of taxes in a steady manner. Taxes can be both direct and indirect. Direct taxes entail imposing taxes on income, salaries, wages, profits and wealth. Introduction of direct taxes could have wide spread implication as it could dent the "tax-free" image of the Gulf, in general, and Kuwait, in particular - a significant pull factor for expatriates. IMF in its recent assessment proposed introduction of blanket 10% tax rate on all corporate profits to replace the current tax structure, as a step towards tax harmonization. The additional tax burden on enterprises at a time when corporate earnings are stagnant and corporate investments are weak could further deteriorate the business environment. Moreover, direct taxes can only augment the revenue side of the equation and will have no effect on rationalizing expenditure.

Indirect taxes that levy a charge on consumption such as Value Added Tax (VAT) or excise tax could be handy.

Under this context, indirect taxes that levy a charge on consumption such as Value Added Tax (VAT) or excise tax could be handy. Data from OECD member countries reveals that VAT component accounted for 20% of total tax revenues as against corporate taxes which accounted for 9% of total tax revenues. VAT is also efficient, cheaper to operate, less susceptible to fraud and less likely to distort investment decisions (Deloitte). However, considering the fact that introduction of VAT could affect consumption of lower income households than higher income groups, targeted subsidies for lower income households could be made. Introduction of VAT also helps in curbing excess consumption of services, a key factor that could help in controlling current expenditures of government in the form of subsidies and alternatively could aid in revenue generation too. Care should be taken for region-wide implementation of VAT, as introduction of VAT in one country alone could lead customers to bargain hunt in others. Reports indicate that Kuwait intends to introduce a value added tax (VAT), which however hinges on a GCC-wide decision. The GCC countries are said to be a joint initiative to develop a federal tax code, which involves both VAT and corporate tax[2].

In the interests of long-term sustainability, the policy debate around tax reforms should not be limited to simply adopting the easier option of increasing the tax burden on companies to support government revenues; but should extend thought to what kind of reforms on the subsidies front can support the expense side of the equation, as well.

[2] Khaleej Times

Current taxes facing companies in Kuwait

Tax Type	Tax Rate
Corporate income taxes for foreign corporations	Flat tax rate of 15% on taxable income
Social security	The employer has to make social security contributions based on the salary of the employee (up to a ceiling of KD2,750 per month). The contribution rate is 11.5% of the employee's salary for the employer.
Kuwait Foundation for the Advancement of Science (KFAS) tax (to support scientific progress)	1% of profits
National Labor Support Tax (levied on shareholding companies)	2.5% on net profits
Zakat (levied on shareholding companies, listed and unlisted; but excluding government companies)	1% on net profits

Source: U.S. Department of Commerce's Trade Information Center; Deloitte

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stock Market	Negative
Bond Market	Neutral
Real Estate	Negative
SME	Negative

Source: Marmore Analysis

Introduction of corporate taxes would be a dampener for businesses while indirect taxes such as VAT could curb excessive consumption of goods and services.

Stock Market: Introduction of taxes such as corporate taxes and VAT could have a double whammy impact on the stock markets. Introduction of corporate taxes would be a dampener for businesses while indirect taxes such as VAT could curb excessive consumption of goods and services. Direct taxes such as personal taxes, if introduced, could lower the discretionary income and thus affect the spending power of consumers. As consumer expenditures moderate, service sectors such as hotels, restaurants and retail could be affected. The decreasing discreationary income might lead to lower investment in the stock market given that the stock market is dominated by retail investors.

Bond Market: Since Kuwait currently does not have an active bond market, the impact of taxes, both direct and indirect, would be minimal. However, the resultant tax shield for interest payments could spur corporates to consider debt funding for their long-term needs rather than relying entirely on bank loans.

Offering subsidies in the form of tax cuts and establishing free trade zones for SMEs might help in negating the problem of inroduction of taxes.

Real Estate: Direct taxes such as corporate taxes might impact the real estate players by reducing their profit margins. This might lead to lowering investments in new projects thereby impacting the real estate sector. Since Kuwaiti's purchase real estate property from an investment point of view, the lower disposable income due to indirect taxes might impact investments in residential real estate (second house).

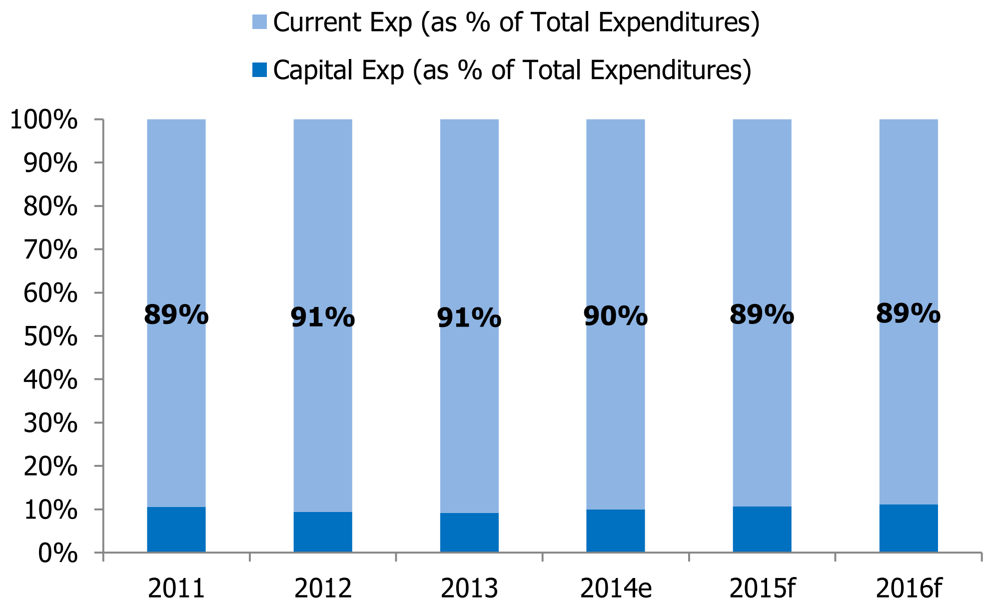
SME: Introduction of corporate taxes would be negative for SMEs in the country since it would reduce earnings and might be a deterrant for prospective entrepreneurs to start new ventures. Indirect taxes might also affect SMEs in reducing demand for products manufactured by SMEs. Offering subsidies in the form of tax cuts and establishing free trade zones for SMEs might help in negating the problem of inroduction of taxes.

Theme 4: Subsidy Rationalization

The Government of Kuwait must capitalize on the opportunity offered by low oil prices to contain expenditures, which are skewed towards current expenditures

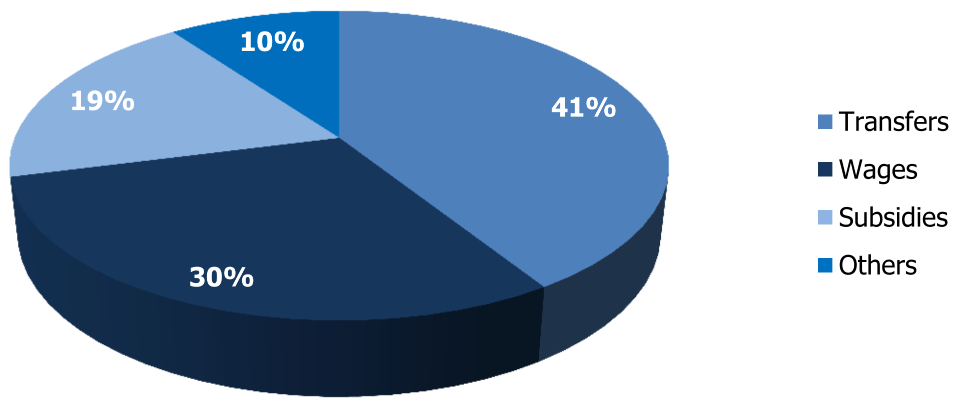
The Government of Kuwait must capitalize on the opportunity offered by low oil prices to contain expenditures, which are skewed towards current expenditures (c.90% of expenditures have been current in nature) rather than the productive capital investments, by introducing appropriate reforms in labour market, energy market and by focusing on removing subsidies in a phased manner.

Government Expenditure Split



Source: IIF

Government Current Expenditure Structure, 2014



Source: IMF

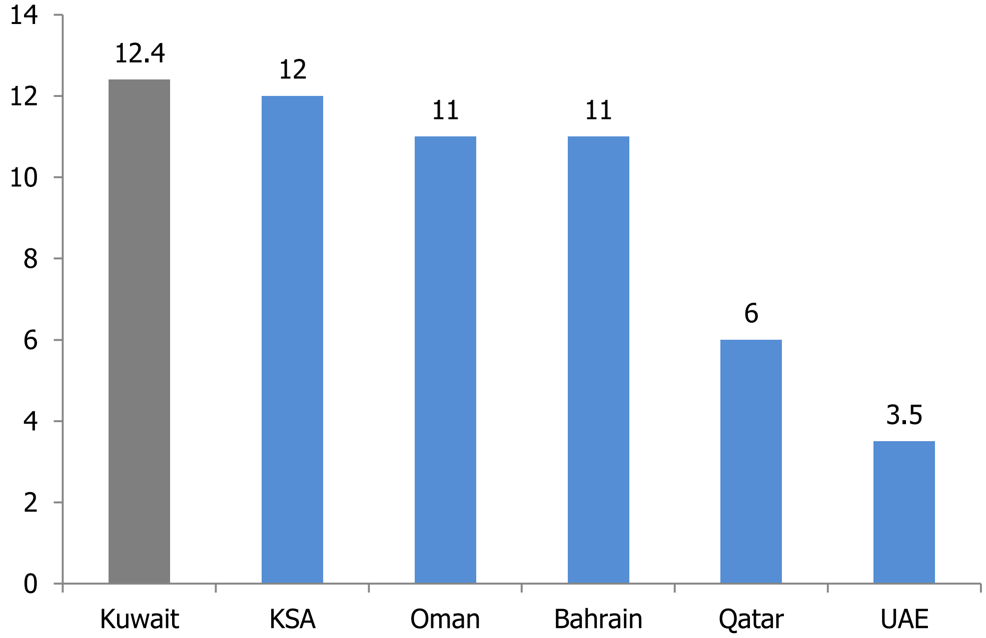
According to the IMF, the Kuwaiti government employs more than 85% of the national population which has resulted in a high wage expenditures

According to the IMF, the Kuwaiti government employs more than 85% of the national population which has resulted in a high wage expenditures at 12.4% of GDP for 2014. Kuwait features as the highest in GCC in this metric. IMF argues that this number can be as high as 15-18% of the GDP due to wrong classifications of certain wages in the budget. With riding labor participation rates and work-age

Prices of fuel, water and electricity are heavily subsidised and they remain much lower than the world average.

population, Kuwait needs to boost its private sector to absorb new and exiting labor force in order to reduce its wage bill.

Government Wage Bill, 2014 (% of GDP)



Source: IMF; Note: Approximate numbers

Prices of fuel, water and electricity are heavily subsidised and they remain much lower than the world average. The price of petrol (KD 0.06/litre) in Kuwait is cheaper than water (KD 0.10/litre) and electricity prices have remained unchanged for nearly 50years. Electricity prices in Kuwait were last revised in 1966 and it is currently offered at less than 5% of the production cost. At the rate of KWf 2/kW against a production cost KWf 41.4/kW remains among the lowest globally.

The policymakers having realised the problem of burgeoning subsidies undertook efforts to increase the price of diesel.

The policymakers having realised the problem of burgeoning subsidies undertook efforts to increase the price of diesel. Starting from 2015, the market price was raised to KWf 170/liter from KWf 55/liter. However, the move was retracted and prices were cut back following political pressures. Diesel prices for wholesalers were back at KWf 55/liter while retail prices was fixed at KWf 110/liter. Prevailing low market prices has led to undesirable consequences, such as wasteful consumption patterns. For instance, per capita energy consumption stood at 10 tonnes of oil equivalent against world average of 4 tonnes of oil equivalent.

Kuwait Budgeted Government Subsidies (USD mn)

Subsidies in Kuwait	2012	2013	2014	2015*
Electricity & Water	11,221	9,914	8,347	6,762
Petroleum Products	2,267	2,199	4,402	1,230
Food	374	464	827	1,230
Total Subsidies Offered	13,862	12,577	13,576	9,221
Total Subsidies, as % of GDP	**8.1%**	**7.2%**	**8.1%**	**7.5%**

Source: Ministry of Finance, IMF, Marmore; *- Budgeted number – actuals may vary

Recommended steps to tackle the burgeoning subsidies:

Introducing innovative strategies, such as "tiered subsidies", where subsidies are linked to consumption, can reduce wasteful consumption

a. Finding alternate methods of wealth distribution, such as direct cash transfer, which would shift the burden of decision making from the state to the individuals and families, directly.

b. Introducing innovative strategies, such as "tiered subsidies", where subsidies are linked to consumption, can reduce wasteful consumption, "targeted subsidies", which can be used to promote certain sectors, and "smart subsidies", where subsidies are linked to to certain Key Performance Indicators (KPIs) like employment etc., can produce better results.

c. Improving production efficiency by reducing cost of production, and develop alternate energy sources to reduce reliance on fuel.

d. Effectively communicating the disproportionate burden that falls on future generations and how subsidies crowd out investment in infrastructure can help the populace understand and appreciate the steps taken by the governments to reduce subsidies.

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stock Market	Negative
Bond Market	Positive
Real Estate	Neutral
SME	Negative

Source: Marmore Analysis

Increasing household expenses could curb excess consumption of good and services.

Stock Market: Removal of subsidies for water, fuel and electricity would lead to increased operating costs for businesses and additional expenses for households. Companies with energy intensive operations, especially those in manufacturing and in transport/logistics sector would feel the heat in the short-term. Increasing household expenses could curb excess consumption of good and services. One may expect earnings to be downgraded for these sectors, including consumer durables, in the short-term. Furthermore, reducing subsidies might reduce disposable income for investors, which might affect stock market liquidity.

Government of Kuwait has often injected capital to recapitalize firms or to lend support to sectors that are in distress.

Bond Market: Capital transfers to government realted entities account for 41% of current expenditures. Government of Kuwait has often injected capital to recapitalize firms or to lend support to sectors that are in distress. Curbing such spending would push these firms to seek other sources of funding. In this light, bond markets could be handy. Thus we view curbing current spending to be a positive for bond markets.

Capping salary rises could partially affect the installment paying capacity at the individual level.

Real Estate: The effect of rationalizing subsidies may not affect activity in real estate in a major way. Capping salary rises could partially affect the installment paying capacity at the individual level. However, we feel the impact may not be much and thus we view it as Neutral.

SME: Rise in charges for electricity, water and energy would increase the operating expenses for SMEs. Higher operating expenses could deter new entrants and could limit margins for existing SMEs. SME specific subsidies and incentives could be limited. Hence, we rate this factor as Negative for SMEs.

Theme 5: Accelerated Implementation of KDP

The KDP is a series of 5 year plans aimed to transform Kuwait into a regional financial and commercial hub.

The hitherto lag in capital expenditures should be effectively addressed as the economic growth prospects, especially in the non-hydrocarbon sector are largely reliant on the accelerated implementation of Kuwait Development Plan (KDP), which envisages investment to the tune of USD 110bn over the period (2015-19).

The KDP is a series of 5 year plans aimed to transform Kuwait into a regional financial and commercial hub. Kuwait vision 2030 was first envisioned by the government of Kuwait and Tony Blair consultancy agency. The first of the series had a budget of USD 70.62 bn (KWD 21.4 bn) and was supposed to be completed between 2010/2014. Despite starting with the best of intentions, the KDP 2010-2014 has not achieved many of its development objectives. The previous plan did not enjoy a successful implementation rate with many of the previous plan's projects having been moved to the current 2015-2020 plan. The 2010-2014 recorded sluggish progress, with only about 60% of the allocated budget having been spent on projects[3]. If FDIs can be measured as a metric for tracking business confidence and private sector performance, then, it depicts Kuwait's private sector performance during the 2010-2014 period in not very good light. For instance, at around the midway point of the plan, FDI flows into Kuwait were estimated to have decreased by 41% in 2013, after having touched record highs in 2012 due to a one-off acquisition deal worth about USD 1.8 billion[4].

A new Kuwait Development Plan (KDP) for 2015-2020 was announced in August 2014, with a focus on economic reform and the implementation of several long-stalled mega strategic projects.

A new Kuwait Development Plan (KDP) for 2015-2020 was announced in August 2014, with a focus on economic reform and the implementation of several long-stalled mega strategic projects. The earlier iteration of the KDP is now widely considered as having run into several problems of implementation. In December 2014, the National Assembly's Financial and Economic Affairs Committee looked into the obstacles that the KDP faced during the 2010-2014 plan[5]. A committee was formed under the Supreme Council for Planning and Development (SCPD) to investigate the matter further. The KDP 2015-2020 plan has two distinct articulated objectives: "to address the imbalances in the economic reforms through giving a free rein to the private sector to play a bigger role in development; and realize the country's strategic vision through the implementation of mega projects,"[6]

Some of the 2015-2020 summarized highlights are:

- 429 projects from the previous plan and 92 new projects from the current plan to be executed over the next five years
- Construction and Development of the USD 3.35 Bn Metro rail project
- Developing another rail network at a cost of USD 27.8 Bn which is part of the larger GCC wide rail network
- Development of the Mubarak Al Kabeer port on Boubyan Island
- Privatization of selected public schools and universities
- Increase private sector jobs for Kuwaiti nationals from 92,000 to 137,000 over the development period

The KDP 2015-2020 has vital ramifications for Kuwait's oil sector, as well. If implementation moves ahead as per the vision, then Kuwait would produce its first batch of 60,000 barrels of heavy oil a day by the year 2018, with the potential that

[3] Zawya
[4] Kuwait Times
[5] KUNA
[6] Ibid.

the output can be ramped up to about up to 270,000 barrels a day by 2030[7]. The KDP, as a concept, is part of the Kuwaiti State's targeted development plans to diversify national income sources through promotion of private sector's investments and elevation of the competitiveness of multiple sectors, including education, health, infrastructure, etc.

KDP 1 vs. KDP 2

KDP 2010 - 2014	KDP 2015 - 2020
Overall budget of KD21.42bn	Overall budget of KD34.15bn
Actual spending achieved was 59% of budget	N/A
Focus more on government led infrastructure build-up	Focus more on private sector led diversification through public-private partnerships and foreign direct investment
Plagued by poor implementation due to policy paralysis and operational sluggishness	More attention geared towards projects' implementation, with many projects carrying over from the previous plan
Not infused with multidimensional metrics to monitor and track progress	Six strategic and 105 short-term goals for monitoring progress

Source: Marmore Research

In the second half of 2014, 22 projects were awarded with a total value of KWD 392 mn while in 2015 up to November 62 projects were awarded with a value of KWD 6.2 Bn. Projects awarded in 2015 were heavily debated, tendered and retendered over the duration of the first KDP. The inflection point will be in 2016 if the same value of projects is awarded we could safely say that the development plan is gaining traction.

KDP Sector-wise projects & value

	Number of Projects		KWD MN	
Sector	2014	2015	2014	2015
Energy	5	29	216.2	3,946
Agriculture	1	1	1	1
Athletics	NA	1	NA	8
Aviation	NA	3	NA	1,328
Defense	NA	3	NA	34
Education	1	3	3.2	180
Fire	NA	2	NA	5
Healthcare	5	4	128.5	94
Infrastructure	3	8	19.4	536
Other	1	3	3.1	10
Professional Services	NA	1	NA	3
Retail	NA	1	NA	NA
Telecommunications	NA	1	NA	3
Water	3	2	6.5	126
Security	2	NA	11.6	NA
Automotive	1	NA	3	NA
Grand Total	**22**	**62**	**389.5**	**6,274**

Source: Markaz Investment Banking & Markaz Research

Note: Grand total will not match since some awarded projects have no KWD value

[7] Ibid

On a positive note, better coordination between the legislature and executive body has resulted in a series of contract awards in 2014 & 2015. To expedite the execution process, projects are being monitored on a monthly basis at the cabinet level and payments to contractors are monitored to avoid unnecessary delays[8]. Introduction of a new Public Private Partnership (PPP) law bodes well in this regard. As most the big tickets projects are in Oil & Gas sector involving expansion of upstream and downstream facilities, persistent lower oil prices could act as a risk, unless the markets stabilize and oil prices recover.

Selected Mega Projects in Kuwait

Project	Sector	Value	Status
Khairan City	Housing	KD 4.2bn	**Planning**: Awarded consultancy contract (USD 10.2mn) to McKinsey to carry out feasible study
New Refinery Project	Oil & Gas	KD 3.9bn	**Awarded**: Signed on Oct, 2015
Clean Fuels Project	Oil & Gas	KD 3.7bn	**Underway**: Phase expected to be complete by Jan, 2018
Airport Expansion	Transport	KD 1.7bn	**Awarded**: Construction of new terminal building to commence in 3months
Shiekh Jaber Al Ahmed Al Sabah Causeway	Transport	KD 0.7bn	**Underway**: Progress at 44%

Source: NBK

[8] IMF

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	**Positive**
Bonds	**Positive**
Real Estate	**Positive**
SME	**Positive**

Source: Marmore Analysis

Accelerated implementation of KDP, by way of project awards and subsequent execution of contracts, would brighten prospects for construction contractors and basic materials suppliers.

Stock Market: Accelerated implementation of KDP, by way of project awards and subsequent execution of contracts, would brighten prospects for construction contractors and basic materials suppliers. Upgraded infrastructure being a key enabler of growth would improve the overall business environment in Kuwait. While previous attempts to kick starting the projects were met with impediments, better relations this time between the parliament and executive council offers hope of revival. As awarded projects enter implementation phase, corporate earnings could accelerate and thus we believe this is a positive for Kuwaiti stocks.

Real estate sector would be the primary beneficiary of improved infrastructure in Kuwait.

Bond Market: Value of various projects envisaged as part of KDP is estimated at over USD 100bn. With the Kuwait government pushing for greater private sector involvement through Public Private Partnership (PPP) model, financing the projects would assume prime importance. In this regard, additional source of financing through bonds and debt market could be useful. Project financing and the need for long-term funding could lead to establishment of infrastructure bonds. These measures in addition to providing multiple options could enhance the depth of financial system in Kuwait.

Involvement of SMEs by including mandatory clauses in project contracts to either source materials or in execution of the same could drive growth and development of SMEs.

Real Estate: Real estate sector would be the primary beneficiary of improved infrastructure in Kuwait. Major transport projects envisioned as part of KDP include airport expansion and development of Kuwait Metro which could help connect distant parts of city to central business districts. Additionally, it would cut short travel time through development of efficient public transport system. This would unlock real estate value near the stations. Establishment of a Khairan City would alleviate shortage of housing pressures.

SME: Involvement of SMEs by including mandatory clauses in project contracts to either source materials or in execution of the same could drive growth and development of SMEs. SMEs, by collaborating with international organizations, would stand to gain on technical expertise and best practices to execute projects.

Theme 6: Improving Business Environment

Kuwait fares poorly in the rankings and is the lowest among GCC countries at 101 compared to UAE which features as the best in the rankings at 31.

The Ease of Doing Business rankings, published every year by the World Bank, measures how easy or difficult it is for a citizen of a country to start and run a small- or medium-sized enterprise, while following the relevant local regulations. It measures changes in regulations in 11 spheres affecting the life cycle of a business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency and labour market regulation. Kuwait, which has a GNI per capita of USD 47,639, falls in the High Income category among the 189 economies that were considered for the rankings. However, Kuwait fares poorly in the rankings and is the lowest among GCC countries at 101 compared to UAE which features as the best in the rankings at 31.

GCC Ease of Doing Business and components, 2015 Rankings

Economy	UAE	KSA	Qatar	Bahrain	Oman	Kuwait
Ease of Doing Business Rank	31	82	68	65	70	**101**
Starting a Business	60	130	109	140	149	**148**
Dealing with Construction Permits	2	17	8	9	46	**133**
Getting Electricity	4	24	111	77	60	**128**
Registering Property	10	31	28	25	33	**68**
Getting Credit	97	79	133	109	126	**109**
Protecting Minority Investors	49	99	122	111	134	**66**
Paying Taxes	1	3	1	8	10	**11**
Trading Across Borders	101	150	119	85	69	**149**
Enforcing Contracts	18	86	112	101	70	**58**
Resolving Insolvency	91	189	51	85	105	**122**

Source: World Bank Doing Business

Ranking of economies is determined by arranging the list of economies in accordance with their distance to frontier (DTF) scores, which benchmarks economies with respect to regulatory practice, and shows the absolute distance to the best performance in each Doing Business indicator. Distance to frontier score is measured on a scale from 0 to 100, where 0 represents the worst performance and 100 the frontier. Kuwait DTF score has improved marginally during the last three years, as seen in the table below.

Kuwait Ease of Doing Business and Starting a Business, 2014-16 Rankings

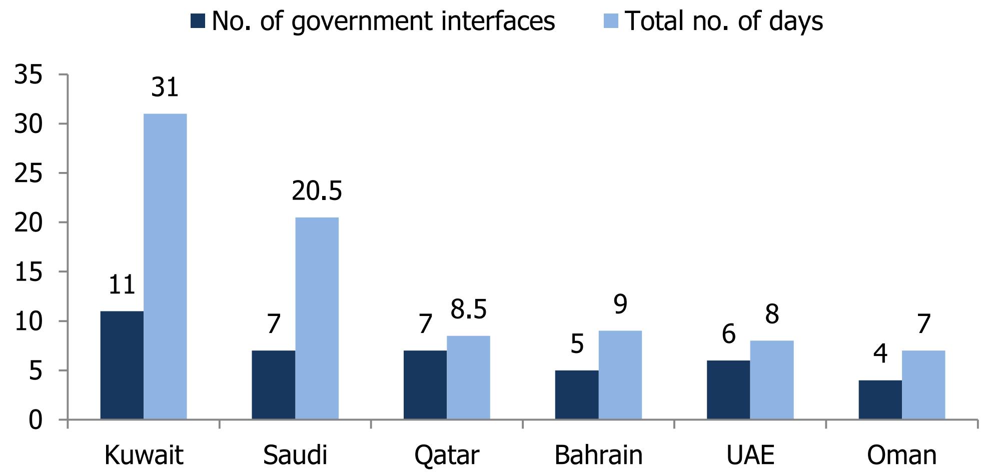
	Year	Ease of Doing Business Rank	Overall DTF	Starting a Business					
				Rank	DTF	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in min. capital (% of income per capita)
Kuwait	2014	…	61.24	..	70.89	12	32	1.2	77.9
	2015	100	59.77	150	71.28	12	31	2	74
	2016	101	60.17	148	75.37	12	31	2.3	8.2

Source: World Bank Doing Business

In Kuwait an entrepreneur has to deal with 11 government interfaces to start a business, while other GCC peers have interfaces ranging from 4 to 7.

In Kuwait, an entrepreneur has to deal with 11 government interfaces to start a business, while other GCC peers have interfaces ranging from 4 to 7. The number of interfaces has a visible correlation with the number of days to complete the procedure of setting up a business. In Kuwait, the registration process involves registering with five different government agencies, the most in the GCC. Reserving a unique company name takes a day in Kuwait and UAE, whereas in Saudi Arabia and Qatar, the process is completed online. The process in Kuwait also involves receiving inspection of company premises by the Municipality, something which is unique to Kuwait (in the GCC), and takes up to 5 days.

Number of government interfaces vs. number of days to complete all procedures



Source: World Bank, Markaz Research

In terms of easing bottlenecks to starting a business in Kuwait, it is clearly evident that land reforms have to take place in order to allow for easier licensing of plots to entrepreneurs.

In terms of implementing changes in order to improve the business climate, it is suggested that the reforms be approached through the two-pronged framework of transformative reforms and enabling reforms. Transformative reforms are those steps that will have to be definitely taken in order to boost competitiveness, but are usually very difficult and sensitive to chalk out and implement. Enabling reforms are those items that do not shape fundamental structural differences, but are akin to value add-ons. At times, governments can be tempted to use enabling reforms for their symbolic value to portray the image of ongoing reforms.

For instance, in terms of easing bottlenecks to starting a business in Kuwait, it is clearly evident that land reforms have to take place in order to allow for easier licensing of plots to entrepreneurs. However, it is a topic of acute sensitivity and debate. In effect, it is a transformative reform. On the other hand, the government may pass regulations that would allow for the absorption of losses by the government, in terms of the first attempt to start a business by an entrepreneur. It is an easier step to implement as it would not spark friction with multiple stakeholders.

Transformative Reforms

Transformative Reforms	Steps Taken
Having a sole authority for facilitating setting up of business	None
Removal of paid-in capital	None
Adoption of ICT for online registration	None
Land reforms for supporting the private sector	None
Allowing foreign majority ownership so that JVs can commence more easily	None
Comprehensive educational reforms for creating a new generation private sector ready workforce	In 2010, Kuwait, in cooperation with the World Bank, started the Education Technical Cooperation Program (2010-2014). Curricular modernization was one of the key focus areas of the programme

Source: Various, Marmore

Enabling Reforms

Enabling Reforms	Steps Taken
Early attempt loss write-off	None
Partial funding of employee skill development programme	None
Export subsidies	None

Source: Various, Marmore

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	**Positive**
Bonds	**Positive**
Real Estate	**Positive**
SME	**Positive**

Source: Marmore Analysis

Currently in Kuwait the legal rights for a creditor remains weak. In most cases, secured creditor aren't protected under existing bankrupcty laws

Stock Market: Advancements in ease of doing business would augur well for corporates by facilitating a conducive environment for conduct of business. Enhanced environment for doing business would entice enterprises to expand their scope of operations and geographies. This in turn, would reduce costs of doing business and the benefits would accrue in earnings. This we believe could increase earnings and thus act as a boost for the stock market.

Bond Market: Currently in Kuwait the legal rights for a creditor remains weak. In most cases, secured creditor aren't protected under existing bankrupcty laws. For instance, when the businesses liquidate or when the debtor defaults, secured creidtors arent paid first. Credit information available in credit registries and bureaus are also under utilized. However, improvements on these fronts could minimize the risk in financial instruments such as bonds, and make them an attractive proposition for investors.

Real Estate sector suffers from lack of robust facilities in land administartion department

Real Estate: Improving business enviroment would act as a catalyst, especially for commercial real estate, as they would faciliate start-ups and expansion of existing businesses. However, the Real Estate sector suffers from lack of robust facilities in land administartion department. Non-existence of online databases to check encumbrances (mortgages, liens etc), land boundaries and plans; non-availability of national database to check the accuracy of documents and lack of official statistics to track the number of transactions at the property registeration agency remain sore spots. Addressing this would boost the confidence of investors in this sector.

In Kuwait, to ease availability of credit for SMEs, SME Fund with a capital base of KD 2 billion was setup

SME: Improved business environment pertaining to ease of starting business, obtaining construction permits, electricity, credit and uncomplicated process of winding up in case of insolvency could spur establishment of Small and Medium-sized Enterprises (SMEs). In Kuwait, to ease availability of credit for SMEs, SME Fund with a capital base of KD 2 billion was setup. Additional measures such as improving financial infrastructure by enhancing the coverage of credit registries and credit bureaus and utilizing them to assist in assessing the credit worthiness of borrowers could facilitate easier access to credit. Continual steps to improve the business environment would be a positive for SME development in Kuwait.

Reform Matrix

Pillar	Current Situation	Policy Recommendations
Subsidy Reforms	Fuel, electricity and water largely underpriced, leading to excessive consumption and subsidy leakages	Fuel prices to be deregulated in a phased manner and market linked.
Wage Reforms	Huge disparity between public and private sector wages leading to disincentives to work in private sectors	Public wage rises should be capped and based on inflation level; Subsidies could be directed to make private salaries on par with public wages
Tax Reforms	Revenues largely dependent on oil, tax revenues (direct & indirect) are meagre	Corporate tax could be introduced; Expedite implementation of VAT
SME Reforms	Unable to create job opportunities for growing population leading to largescale youth population unemployment	Ease licensing procedures and improve business environment; Business incubators should be started
Labour Market	Nationals prefer public jobs where productivity is low and wages are high	Educational system should be revamped with more emphasis on skill oriented courses to create industry ready workforce

Source: Marmore

A Selection of Key Reforms in Kuwait: 2013-Q2 2015

Sector	Highlights
Real Estate	The government increased the maximum amount of home loans available to Kuwaiti women to KWD 70,000 from KWD 45,000, while the renovation amount that can be financed was increased to KWD 35,000 from KWD 30,000.
	The Cabinet instructed the Credit and Savings Bank to amend its legislation, allowing maximum home loan amounts to jump to KWD 500,000 from KWD 300,000.
FDI	Law No. 116 for the year 2013 was passed for promoting direct investment in the State of Kuwait.
	The Council of Ministers Decision No. 946 for the year 2013 was issued to appoint the members of the Board of Directors for Kuwait Direct Investment Promotion Authority (KDIPA) for duration of 4 years.
	Kuwait's offset programme was suspended in order to remove bottlenecks for foreign companies attempting to do business in Kuwait. A new set of guidelines are expected in early 2015.
Capital Markets	The Kuwait Capital Markets Authority ("CMA") came out with a set of rules for corporate governance framework.
Economic Reforms	Kuwait is working with the International Monetary Fund (IMF) to discuss introducing a corporate tax for Kuwaiti companies.
Private Enterprise	Kuwait considers new insolvency legislation.

Source: Marmore

Appendix

Key Economic Indicators	2012	2013	2014	2015e	2016f
Real GDP (KD Billion)	38.7	39.1	38.5	38.7	39.2
Real GDP Growth (%)	6.6	1.1	-1.6	0.6	1.3
Hydrocarbons real GDP Growth (%)	10.0	-1.8	-0.9	-0.4	0.1
Non-Hydrocarbons real GDP Growth (%)	1.8	5.7	-2.7	2.0	3.0
Hydrocarbons exports (USD Billion)	112.9	108.6	97.5	53.8	53.2
Current Account Balance (% GDP)	45.2	40.9	32.5	9.7	7.8
Fiscal Balance (% GDP)	34.6	36.1	20.9	7.0	10.6
Hydrocarbons real GDP (% of Total)	60.7	59.0	59.4	58.9	58.2
Total Foreign Assets (USD Billion)	496.3	624.9	665.4	677.7	688.4
Inflation (%)	3.2	2.7	2.9	3.3	3.3
Central government revenue (KD Billion)	36.2	36.5	30.6	21.7	23.6
Hydrocarbon revenue (KD Billion)	30.0	29.3	22.5	13.9	13.9
Hydrocarbon revenue (% of Total)	82.8	80.3	73.5	64.2	58.9
Central government expenditure (KD Billion)	19.3	18.9	21.4	19.2	19.6
Current Expenditure (KD Billion)	17.5	17.2	19.7	17.3	17.5
Current Expenditure (% of Total)	90.6	90.8	92.1	90.2	89.7
Capital Expenditure (KD Billion)	1.8	1.7	1.7	1.9	2.0
Population (Million)	3.8	4.0	4.1	4.2	4.3
Unemployment Rate, %	2.1	2.1	2.1	2.1	2.1
Per capita $ GDP	45,515	43,927	39,977	28,798	28,852
Crude oil production (barrels/day thousand; average)	2,977	2,922	2,893	2,878	2,878
Consumption of oil (b/d thousand; average)	476	500	499	524	550

Source: IMF, IIF

Disclaimer

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