Kuwait Markets pulled down by Coronavirus hurdle despite strong corporate earnings

Oil demand forecast revised downwards by agencies

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Kuwait and other GCC markets were affected by jittery investor sentiments surrounding the spread of Novel Coronavirus despite posting strong corporate earnings for the full year 2019. GCC markets ended the month in negative territory with Bahrain and Oman posting mild gains. Coronavirus, which originated in China, has spread further across the world, causing panic in Global markets, triggering a sell-off across asset classes.

We see the following issues as key developments during the month of February:

1. **BK Main 50: Kuwait's new index for Main Markets –** BK Main 50 Index comprises of the 50 most liquid stocks in Kuwait's Main market. These stocks contribute significantly to main market's liquidity and also present a broader sector spread than the premier market, thereby better reflecting the underlying stocks' price movements.

2. **2019 Corporate Earnings Analysis for Kuwait Premier Market Stocks -** In 2019, Kuwait markets outperformed the rest of the GCC indices. While prospective MSCI inclusion was seen as the major reason, the strength in corporate fundamentals also support the gains. We discuss the corporate earnings numbers reported by five of the premier market stocks and analyse the reasons supporting these figures.

3. **Sustainability of Kuwait's Fiscal policy and the road ahead-** IMF's projections of Kuwait requiring USD 180 billion of financing over the next six years and its estimation that Kuwait's wealth would deplete by 2052 has turned heads. Gradual but brisk fiscal consolidation measures would ensure long term fiscal sustainability of the country.

GCC Market Commentary

GCC Market Trends – February 2020

Index	M. Cap (USD Bn)	Last close	2019 %	Feb'20	YTD %	S&P correlation**	ADVT* (USD mn)	P/E TTM	P/B TTM	Div. Yield
S&P GCC	404.6	107	8.3	-7.4	-8.2	0.153	N.A	14.8	2.0	3.4
Saudi Arabia	2,245.9	7,628	7.2	-7.5	-9.1	0.130	966.7	17.3	1.9	N.A
Qatar	132.0	9,490	1.2	-9.1	-9.0	0.075	64.3	13.5	1.2	4.2
Abu Dhabi	139.7	4,901	3.3	-4.9	-3.4	0.103	39.3	12.4	1.3	5.1
Kuwait (All Share PR)	114.8	6,072	23.7	-4.0	-3.3	0.023	101.1	14.5	1.4	3.5
Dubai	76.6	2,590	9.3	-7.2	-6.3	0.138	48.7	6.6	0.8	4.8
Bahrain	27.3	1,660	20.4	0.2	3.1	0.052	2.2	12.5	0.9	4.6
Oman	13.4	4,131	-7.9	1.3	3.8	0.011	5.6	8.7	0.7	6.8

Source: Refinitiv, Zawya, Note: * Average Daily Value Traded ** - 3-year daily return correlation with S&P 500 index

S&P GCC composite index declined by 7.4% for the month, with all markets except Bahrain and Oman posting losses. Qatar registered highest loss, declining by 9.1%. With a supply glut in liquefied natural gas pushing prices down, Qatar has delayed partnerships for its natural gas expansion plans. Saudi Arabia ended the month in negative territory, losing 7.5%. There is wide consensus on decrease in oil demand and multiple agencies have revised down their oil demand forecasts. Oman was the top performer in February, gaining 1.3%, followed by Bahrain, which gained 0.2%. S&P has cautioned that if coronavirus outbreak is not contained in the first quarter, GCC economies would be particularly affected as China contributes about 4% to 45% of the countries' exports.

Monthly returns heat-map of S&P GCC Composite index

S&P GCC	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2014	3.4%	3.7%	2.7%	2.8%	3.2%	-7.4%	8.1%	6.4%	-1.4%	-6.8%	-10.9%	-4.4%	-2.6%
2015	2.8%	4.4%	-6.9%	10.1%	-2.3%	-3.5%	0.1%	-13.2%	-1.1%	-2.7%	-2.3%	-2.4%	-17.3%
2016	-10.7%	3.7%	1.9%	5.7%	-5.1%	1.1%	-0.1%	-1.2%	-3.9%	2.2%	7.9%	4.2%	4.3%
2017	1.6%	-0.8%	-1.5%	-0.4%	-1.4%	3.2%	-0.4%	0.9%	-0.6%	-2.7%	-1.5%	3.4%	-0.4%
2018	5.3%	-2.5%	3.4%	2.9%	-0.4%	1.1%	2.2%	-2.5%	0.2%	0.1%	-2.0%	0.7%	8.4%
2019	6.8%	-1.0%	2.8%	4.4%	-5.6%	2.5%	1.1%	-5.8%	-0.7%	-2.6%	1.3%	5.9%	8.3%
2020	-0.9%	-7.4%											-8.2%

Source: Refinitiv

Kuwait All Share index registered a loss, decreasing by 4.0% in February. Among Kuwait's Blue Chip companies, Kuwait Finance House (KFH), Zain and Boubyan Bank came out with impressive results during the month for the full year 2019. All three companies witnessed double-digit growth in their yearly net profits for the second consecutive year, growing by 10.6%, 10.4% and 11.7% respectively in 2019. Despite the positive earnings momentum, widespread global investor panic has affected market sentiment, due to which Kuwait markets witnessed a fall. Kuwait's oil and gas sector was the best performer in February, with the sector index rising by 1.1% while the Technology sector was the top loser, falling by 9.5%. Of the 13 sectors, 10 sectors have registered losses.

Among the GCC Blue Chip companies, DP World was the top gainer for the month with its stock price rising by 16.1%. The company has announced its delisting from Nasdaq Dubai with each share to be bought back at USD 16.75 per share.

Global Market Trends – February 2020

Equity	Last close	February change (%)	2020 change (%)
S&P GCC	107	-7.4	-8.2
MSCI World	2,141	-8.6	-9.2
S&P 500	2,954	-8.4	-8.6
MSCI EM	1,006	-5.3	-9.8
MSCI FM	935	-5.7	-5.6
Commodities			
IPE Brent($)	50.5	-13.1	-23.5
Gold($)	1,585	-0.3	4.5

Source: Refinitiv

The performance of Global equity markets was negative with the MSCI World Index losing 8.6% for the month. U.S. equities (S&P 500) fell by 8.4% in February. While U.S corporate earnings were better than the expectations, concerns over spread of coronavirus have pushed the markets down. Terming the virus as a health emergency, IMF has cut global economic growth to 3.2% from the earlier 3.3%. The UK market (FTSE 100 index) closed 9.7% lower during February. Britain's economy showed no growth in Q4 2019 compared to Q3. It recorded an annual growth rate of 1.4% for 2019. Emerging markets ended the month in negative, with the MSCI EM posting monthly loss of 5.3%.

Oil prices closed at USD 50.5 per barrel at the end of February 2020, which is 13.1% lower than January 2020. As coronavirus spreads further, and the number of infected cases and deaths continue to increase, its effect on global economy is becoming more worrisome. This has put a downward pressure on oil prices. World Economic Forum has cited decrease in oil demand as one of the biggest economic effects of the coronavirus outbreak. IEA, OPEC and EIA revised their earlier demand forecast downwards. Decrease in Libya's oil production to less than 300,000 bpd last week, from over 1 million bpd following a blockade of its main oil export terminals and current OPEC+ production cuts are rendering some support to the prices. While equities and oil continued to decline, gold, as a safe haven asset gained earlier this month. But due to profit booking, it fell on the last day of the month, posting a monthly loss of 0.3%.

1. BK Main 50 – Kuwait's new index for Main Markets

Boursa Kuwait has undertaken several measures to improve the standards of Kuwait's stock market to stay on par with those of developed nations. The most recent of these measures is the launching of BK Main 50 Index. The index consists of the fifty most liquid stocks in the Main Market.

Kuwait was the best performing market in 2019 among GCC countries, riding on the positivity of expected upgrade to MSCI Index. While Kuwait's Premier Market index gained 32.4 per cent last year, Main Market index only increased 3.6 per cent. The average value traded in the Premier Market consisting of 18 stocks was about 84 million whereas that in the Main Market consisting of 156 stocks was about 20 million. Given the number of stocks, the volume seems low. This highlights the need and scope for improving participation in the main market, as greater participation enhances market efficiency.

Liquidity of a stock is a key factor for investors. It determines how quickly one can open and close positions. A liquid market is generally associated with less risk, as there is usually always someone willing to take the other side of a given position. Wider trading of a stock helps in better pricing. It also reduces the scope for market manipulation. In a way, liquidity reflects the popularity of a stock. By providing an index for such stocks, their visibility increases and their price movements are better captured, enhancing their liquidity further.

Main market comprises of those companies whose free float shares had a value of KD 15 million and three years of operations. However, not all of them are actively traded. The average daily value traded for the stocks in BK Main 50 constitutes 89 per cent of the average daily value traded of all the stocks in the main market.[1] Thus, they contribute a major portion. This highlights a need for a separate index based on these stocks as it would capture their price movements better, enable tracking and easier comparison between actively traded stocks.

While banks make up 75 per cent of the Premier Market by market capitalization, they contribute only 46% of the BK Main 50, indicating better spread across other sectors and less dependence on a single sector. While Premier Market comprises of seven sectors, BK Main 50 covers only five sectors – banks, consumer services, financial services, industrials and real estate. Given that these stocks' liquidity set them apart significantly, an index on these stocks is a welcome move.

About the Index

The denomination of the Index is Kuwaiti Dinars. The Index utilizes a market cap weighted price return methodology, where in the stock price and outstanding shares are used to arrive at the index value.

Characteristics of Boursa Kuwait indices

Index Name	Boursa Kuwait Premier Market Index	Boursa Kuwait Main Market 50 Index	Boursa Kuwait Main Market Index
Market Capitalization (KD Mn.)	25,905	5,604	9,235
P/E (x)	16.25	10.67	10.59
P/B (x)	1.74	0.85	0.83
Dividend Yield (%)	3.39	3.90	3.92
No. of Constituents	18	50	156
Top 3 sectors by weightage	• Banks (75%) • Telecom (13%) • Real Estate (4%)	• Banks (46%) • Financial Services (24%) • Industrials (13%)	• Banks (23%) • Financial Services (21%) • Industrials (14%)
Largest stock (% weightage)	National Bank of Kuwait (26%)	Commercial Bank of Kuwait (18%)	Commercial Bank of Kuwait (11%)

Source: Refinitiv

[1] Average Daily Value Traded of last 52 weeks as on 25th Feb

To qualify for the BK Main 50 Index, companies must be a part of the Main Market and one of the top 50 companies in terms of Average Daily Value Traded (ADVT). The Index will be reviewed annually for inclusions and exclusions on the last trading day of December. The review will be announced on the second Sunday of January and take effect on the second Sunday of February.

Top 10 companies in the BK Main 50 weighted by Market Capitalization

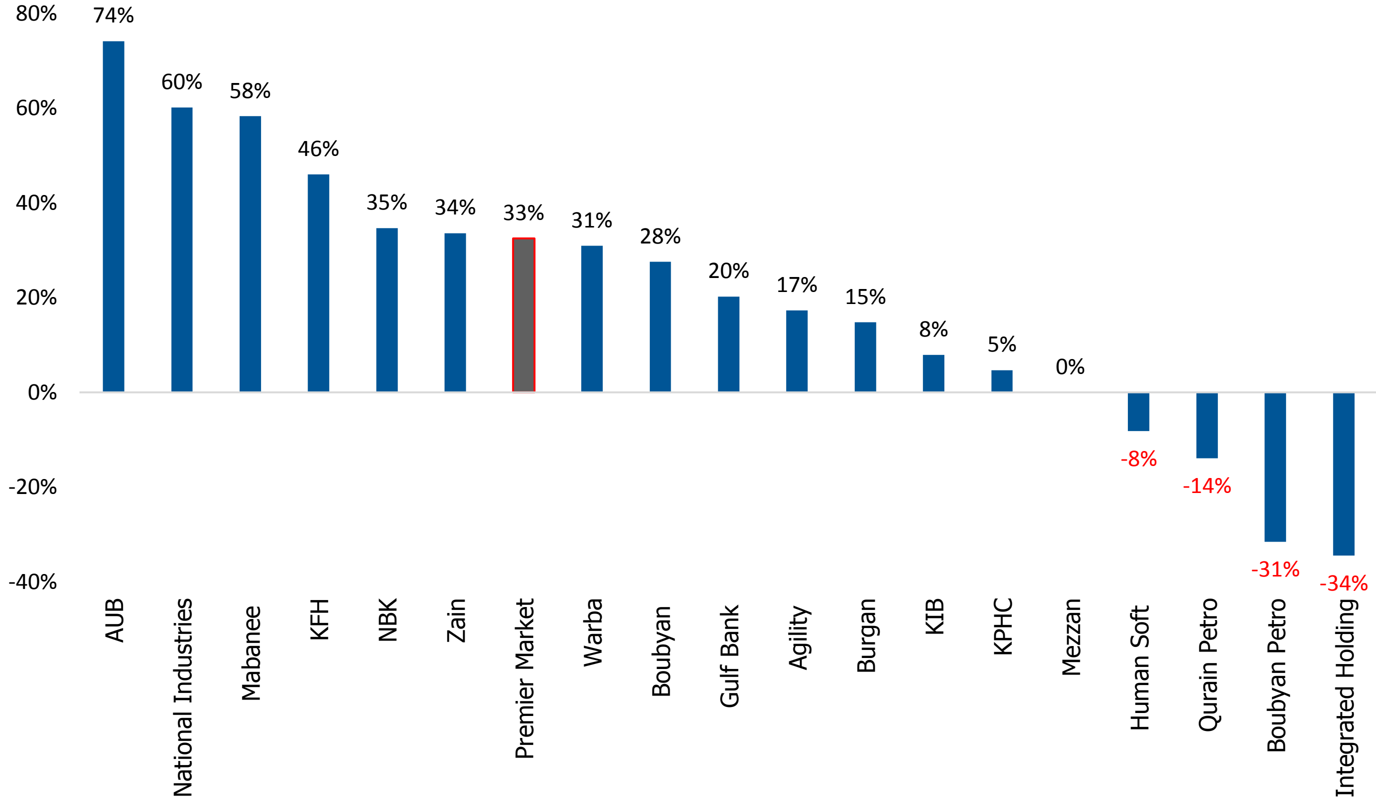
	Company	Weightage		Company	Weightage
1	Commercial Bank of Kuwait	18%	6	GFH Financial Group	5%
2	Ahli United Bank Kuwait	12%	7	ALAFCO Aviation Lease & Finance	4%
3	Al Ahli Bank of Kuwait	8%	8	Salhia Real Estate Co	4%
4	Kuwait Telecommunications	7%	9	Jazeera Airways Co	4%
5	National Mobile Telecom. Co.	7%	10	Commercial Real Estate Co	3%

Source: Refinitiv

2. 2019 Corporate Earnings Analysis for Kuwait Premier Market Stocks

The year 2019 was very positive for Kuwaiti equities, with the Kuwait All Share Index and Premier Market index gaining 23.7% and 32.5% respectively in 2019, outperforming the rest of the GCC indices. MSCI's confirmation to include Kuwait equities to its emerging market indices in May 2020 provided the impetus for Kuwaiti stocks to rally as Kuwait could now expect a sizeable passive and active foreign inflows into its equity markets. The outperformance by Kuwait Blue chip stocks in 2019 was also backed by strength in their fundamentals.

Kuwait Premier Market Stocks Performance in 2019



Source: Refinitiv

Below we discuss the corporate earnings numbers reported by five of the premier market stocks and analyse the reasons supporting these figures.

Kuwait Premier Market Corporate Earnings

Company	Market Cap (KD Million)	Last Close (KD)	2019 Stock Performance	Revenue (KD Million)			Net Profit (KD Million)		
				2019	2018	% Change YoY	2019	2018	% Change YoY
National Bank of Kuwait	6,702	1,024	35%	935	923	1.3%	401	371	8.2%
Kuwait Finance House	5,657	806	46%	814	748	8.8%	251	227	10.6%
Mobile Telecommunications Co	2,498	577	34%	1,661	1,318	26.1%	217	197	10.4%
Boubyan Bank	1,872	647	28%	155	148	4.6%	63	56	11.7%
Mabanee Company	923	871	58%	96	85	12.8%	56	53	7.4%

Source: Refinitiv; Note: As of 23rd Feb 2020, Latest available data

National Bank of Kuwait

National Bank of Kuwait, the biggest lender in the country by assets, reported a net profit of KD 401.3 million for the 12 months ending December 31 2019, a rise of 8.2% year-on-year. This was made possible due to higher revenue, which climbed due to higher **non-interest income** and falling **provisions for bad loans**.

Key Financial Indicators for 2019:

- The bank reported operating revenue of KD 895.5 million, a 1.4% year-on-year increase in 2019 while non-interest income increased by 7.0% to KD 206.3 million.
- However, net operating profit before credit and impairment losses dropped 2.6% to KD 591.2 million, due to a volatile oil prices environment.
- NBK's total assets climbed 6.7% to reach KD 29.3 billion, while its liabilities rose 5.4% to KD 25billion.
- Customer deposits increasing by 10.7% to reach KD 15.9 billion and customer loans and advances growing by 6.8% to KD 16.6 billion.
- The bank's board recommended a cash dividend of 35 fils per share, representing 35% of the nominal value of its stocks. It also recommended shareholders approve distribution of bonus shares of 5% from the bank's issued and paid-up capital.
- NBK's asset quality metrics remained strong with non-performing loans (as a % of gross loans) at 1.10%, compared with 1.38% in 2018, and an NPL coverage ratio of 272.2%, compared with 228.1% in 2018.
- The Bank maintained healthy levels of capitalization, with a capital adequacy ratio of 17.8% at year-end, compared with 17.2% in 2018.

One of the most important event of the year was the issuance of the USD 750 million perpetual Tier 1 capital securities, which was more than 3-times oversubscribed, reflected strong investor confidence in the company. In 2019, Global Finance and The Banker recognized NBK as the "Best Bank in Kuwait" and it ranked in the World's 50 Safest Banks list by Global Finance for the 14th time in a row.

Kuwait Finance House

Kuwait Finance House (KFH), considered a pioneer in the Islamic banking in Kuwait, recorded a net profit of KD 251 million for the year 2019, marking an increase of 10.4% year-on-year. As a result of this, earnings per share for 2019 reached 36.45 fils compared to 33.06 fils in 2018.

Key Financial Indicators for 2019:

- The bank reported financing income of KD 931.6 million, an increase of 8.1% year-on-year.
- Net operating income of the bank increased to KD 510.1 million, a growth of 12.5% compared to 2018.
- Cost to income ratio dropped to reach 37.36% for the year 2019, compared to 39.20% last year.
- The Board of Directors has proposed a 20% cash dividends to shareholders and 10% bonus shares subject to general assembly and concerned authorities' approval.
- The bank's total assets increased to KD 19.4 billion, a rise of 9.1% compared to 2018.
- Financing portfolio increased to reach KD 9.4 billion, a rise of 1.6% compared to 2018.
- Investment in Sukuk reached KD 2.3 billion in 2019, an increase 45.6% compared to 2018, where the majority of the balance represents sovereign sukuk.
- CASA deposits represents 44.3% of total group deposits as at the end of 2019, maintaining the same level during the past years. KFH Kuwait dominates the saving accounts with the market share of 41.2% (as per CBK latest published reports, Nov-19).
- KFH's capital adequacy ratio (CAR) reached 17.67%, (after the proposed dividends) i.e. higher than the required limit of 15%.

In 2019, KFH opened 10 Digital Self-Banking Stations "KFH Go" Located in different prominent areas, which won the "Best Product in the Middle East" Award from EMEA Finance magazine in recognition of KFH's services in response to customer expectations. In Jan of 2020, Kuwait Finance House confirmed its intention to buy Bahrain's Ahli United Bank following its general assembly meeting. Studies prepared by consultants have shown that the expected increase in future earnings per share as a result of this merger will be the highest amongst acquisition deals in the Gulf region and the Middle East. The deal will also generate the largest and best Islamic bank in the world in terms of assets, with a value of assets of about USD 101 billion.

Mobile Telecommunications Company

Mobile Telecommunications Company (Zain Group), the leading mobile voice and data services operator in Kuwait generated a consolidated revenue of KD 1.66 billion for the full-year 2019, a 26.1% year-on-year growth. Consolidated net income reached KD 217 million, up 10% reflecting Earnings per Share of 50 Fils. Throughout 2019, Zain Group invested over USD 1 billion in CAPEX, predominantly for the expansion of Fiber-to-the-Home infrastructure; spectrum fees; 4G upgrades, new network sites across its markets, as well as 5G rollouts in Kuwait and Saudi Arabia inclusive of 5G roaming.

Key Financial Indicators for 2019:

Zain Group -

- Zain Group consolidated data revenue grew 36% Y-o-Y to reach USD 2 billion, representing 36% of the Group's revenue for 2019.
- The Board of Directors of Zain Group recommended a cash dividend of 33 fils per share for 2019, and as a first by a corporate entity in Kuwait, made another recommendation to implement a minimum cash dividend policy of 33 fils for the forthcoming two years, both subject to the Annual General Assembly and statutory approvals.
- There was a notable 46% increase in net income at Zain Saudi Arabia, 28% net income growth at Zain Iraq and 11% net income growth in Sudan in USD terms.

Zain Kuwait -

- Maintaining its market leadership, Zain Kuwait operation saw its customer base increase 7% to serve 2.8 million.
- Revenue and net income both increased by 1% year-on-year to KD 333 million and KD 83 million respectively.
- Zain Kuwait reported an EBITDA margin of 38%, with data revenue growing 7% year-on-year, to form 37% of total revenue.
- Notably, as the first operator to launch 5G services in the country in June 2019, Zain attained the largest market share of 5G customers in Kuwait.

During 2019, Zain Kuwait launched numerous applications and operational efficiency initiatives to support the expansion of 25 smart branches and further enhancement of its interactive zBot chat digital channel on the WhatsApp platform that reduced customer-waiting times by 90%. With respect to developments in the digital space, the company is setting up structures and entering into key partnerships in the FINTECH and e-Health arena, and opening APIs across key markets to offer appealing entertainment and gaming services. Zain also became a member of the Climate Disclosure Project, in order to pave the way to a structured reduction in environmental footprint.

Boubyan Bank

Boubyan Bank, the Sharia-compliant financial institution in Kuwait, reported an 11.7% increase in net profit to KD 62.7 million in 2019 year-on-year, resulting in earnings per share of 20.4 fils compared to 19.2 fils in 2018. The board has recommended the distributions of 9% in cash dividends and 5 % in bonus shares to the General Assembly.

Key Financial Indicators for 2019:

- Total assets increased to KD 5.3 billion at a growth rate of 22%
- Customers' deposits increased by 17%, to reach KD 4.3 billion
- The bank recorded a 14% increase in its financing portfolio to KD 3.7 billion, and a 17% growth in its corporate credit portfolio in 2019.
- The total equity of the bank increased from KD 408 million to KD 575 million in 2019.
- The operating income increased from KD 140 million to KD 146 million.
- The market share in financing increased to approximately 9.3% from 8.6% in 2018, while share of the retail finance remained consistent at approximately 12%.
- Standard & Poor's Global rating agency confirmed its Long-Term Issuer Credit Rating at "A/Stable", ranking the Bank as the second highest credit rating among local banks.

Boubyan indicated its intention to continue with its plans that focus on the local market, along with plans to expand internationally, which started with the announcement during December 2019 of an offer to acquire the Bank of London and Middle East.

The year 2019 witnessed the introduction of several services and products. Prominent among them was the launch of the all-new smart phones App in addition to the issuance, activation and use of the virtual prepaid card through Boubyan App, which enables customers to instantly use the card for online shopping and purchases in a secure and convenient manner. Boubyan also signed an agreement with Ripple.Net to facilitate in making international remittances faster and cheaper for its customers. In addition, the entire bank's POS with all merchants and economic sectors are now directly linked, and the bank further launched a corporate Petty Cash card to manage corporate petty cash on a daily basis. During the past year, Global Finance awarded Boubyan Bank with the Best Islamic Digital Bank Award for the fifth year in a row.

Mabanee Company

Kuwait-based real estate developer and shareholding company Mabanee reported net profits of KD 56.4 million in the fiscal year ended 31 December 2019, a 7.4% rise year-on-year. Earnings per share amounted to 54.2 fils, up from 50.6 fils in 2018.

Key Financial Indicators for 2019:

- The higher annual profits were backed by a gradual increase in the occupancy rate of Phase IV and benefits resulting from economies of scale, which have resulted in the bottom-line performance.
- The company's board recommended a cash dividend distribution of 14 fils per share or 14% of the share's nominal value for 2019 as well as a bonus shares distribution of 6% of the capital.
- Net revenue from investment properties increased 9.0% to KD 64 million in 2019.
- Total Assets of the company increased 11.8% from KD 863 million to KD 965 Million in 2019.

In March 2019, Hilton and Shomoul Holding Company, a unit of Mabanee, announced the signing of a landmark agreement to develop and operate four hotels in The Avenues – Riyadh, the largest mixed-use development project in the Kingdom of Saudi Arabia. The USD 3.4 billion development will include one of the world's largest malls, along with five multi-purpose towers consisting of hotels, exhibition, conference halls, residential apartments, offices and medical facilities. In Jan 2020, Mabanee, among a consortium of Kuwaiti companies, received a letter of notification from the Public Authority for Housing Welfare awarding the investment opportunity "J3" in Jaber Al Ahmad Residential City in Kuwait.

3. Sustainability of Kuwait's Fiscal policy and the road ahead

While Kuwait's record budget deficit of USD 30.3 billion made headlines last month, IMF's projections of Kuwait requiring USD 180 billion of financing over the next six years and it's prediction that GCC wealth would deplete by 2034 has turned heads. There was some respite for Kuwait though. Owing to its large sovereign wealth fund, its net financial wealth is estimated to be positive until about 2052, which is longer than its GCC peers. That said, a slightly longer time frame only provides some room in terms of corrective action. It does not mitigate the exigency of the issue.

Oil forms a major part of Kuwait's revenue, forming 89% of the total government revenue in 2018-19. Oil price crash of 2014, move towards cleaner energy sources etc. have raised questions of the sustainability of oil as a source of revenue. This in turn has brought sustainability of financial wealth in Kuwait under the radar.

Net financial wealth is measured by the sum of publicly available estimates of Sovereign Wealth Fund (SWF) assets and central bank reserves less government debt.[2] While income and savings enhance wealth, expenditure and indebtedness drain it. Thus, fiscal balance (net of government income and expenditure), government debt and savings are key determinants of wealth building.

Fiscal Deficit and Depleting Financial Wealth

Kuwait's Finance Ministry reported a fiscal deficit of USD 15.3 billion (KD 5.2 billion) post FGF[3] transfer for the first time in sixteen years in 2015-16 and has posted a deficit since. The deficit for 2018-19 was USD 11 billion (KD 3.3 billion) and 2019-20 is expected to be USD 22 billion (KD 6.7 billion).

A brief on IMF's projections for Kuwait's fiscal deficit and financial wealth:

Kuwait's Fiscal Balance (% of GDP)

% of GDP	Fiscal Balance (Excluding Investment Income)	
	2019	2025
Before transfer to FGF	5.5%	-4.8%
After transfer to FGF	-13.1%	-21.4%

Source: IMF

This widening deficit would require financing needs of about USD 180 billion over the next six years. This is under the assumption of USD 62 per barrel in 2019 to about USD 56 per barrel in 2023.

Delay in passage of debt law has resulted in the continued drawdown from the General Reserves Fund (GRF)[4] for financing fiscal deficit. This has reduced its estimated total and liquid balances to 56% and 24% of GDP respectively by June 2019. Government savings rate dropped from about 50% in 2012 to only slightly greater than 20% in 2017, despite debt issuance of about USD 8 billion in 2017.

This widening of deficit increases financing needs and decreases savings, resulting in wealth depletion. Against this backdrop, IMF estimates Kuwait's financial wealth, currently at about 400% of GDP, to decline and turn negative by 2052. This is under the oil price assumption of USD 55 per barrel.

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[2] IMF

[3] Future Generations Fund (FGF) is one of the two funds managed by the Kuwait Investment Authority (KIA), the sovereign wealth fund of Kuwait. FGF, as the name suggests, is ring fenced future generations. It receives mandatory transfers of funds equivalent to 10% of the government's revenue and there are no withdrawals.

[4] General Reserves Fund (GRF) is the other fund managed by the Kuwait Investment Authority (KIA). It is used to fund the government's finance needs when required.

Reasons for increasing deficit

Lower Revenue: Given its numerous touchpoints, many events, from U.S – China trade war to coronavirus, affect oil prices, making it volatile and vulnerable. The trend of moving away from fossil fuels to cleaner energy sources, increasing shale production, increase in oil production because of technology improvements point to lower demand and increased supply of oil in the long run. This would add downward pressure on oil prices, in turn reducing income.

Higher Spending: High public sector wage bill, large subsidies are major heads of expenditure in Kuwait. In FY 2018-19, wages accounted for KD 11.45 billion, while subsidies came at KD 4.9 billion. They accounted for 75% of the total expenditure.[5] In comparison, in UAE, salary and wages are budgeted to be about 30% of total government spending in 2020.

Towards Fiscal Sustainability

To ensure fiscal sustainability, IMF outlines two fiscal paths for Kuwait - Permanent Income Hypothesis (PIH) and Gradualism. Gradualism is further classified as moderate and extreme to better quantify the impact. Extreme Gradualism is a much slower rate of reduction in expenses than moderate gradualism.

These are studied with their effect on non-oil primary fiscal balance. While primary fiscal balance is the net of fiscal balance excluding interest payments, non-oil primary fiscal balance excludes oil revenue from the calculation. This treats oil income more as a means of finance than as a source of revenue, and is more useful measure while determining fiscal sustainability.[6]

1. PIH – Permanent Income Hypothesis: In this method, expenditure and savings are planned such that wealth is maintained as the current level for the future generations. This would require immediate and drastic measures and is a challenge to implement as fiscal balance adopted currently are less than the savings rate required under this method.

2. Gradualism – In this case, reduction of expenses and increase in savings are more gradually undertaken. This is easier to implement but causes decline in wealth.

Government Wealth and Non-Oil Primary Fiscal Balance (% of Non-Oil GDP)

Values as % of Non-Oil GDP	Government Wealth		Non-oil Primary Fiscal Balance	
	2019	2100	2019	2100
PIH	3,000	3,000	Decrease from -90% to -30%	-30
Moderate Gradualism	3,000	1,500	-90	-15
Extreme Gradualism	3,000	500	-90	-5

Source: IMF

While gradualism seems more plausible, the pace at which corrective action is carried out would determine fiscal sustainability in Kuwait. Measures such as introduction of taxes, investment in sectors that would provide higher returns would increase revenues and reducing public sector wage bills and subsidies would aid in reducing expenditure. Such measures are indispensable in ensuring fiscal sustainability and long term prosperity of the nation.

[5] Kuwait Times https://news.kuwaittimes.net/website/budget-deficit-drops-by-60-on-back-of-higher-revenues/
[6] IMF Finance and Development Magazine

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