MENA in the Summer

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Kuwait: New budget, same old issues

The recent increase in the price of oil to over USD 70 pb is expected to provide Kuwait with some much-needed relief. However, the country's high rates of spending suggest that the budget deficit will persist unless oil prices rise even further and stay there. Without the passage of the debt law, deficit financing will be challenging; additional drawdowns from sovereign assets will be inevitable.

- Three months after FY 2021/22 began in March, Kuwait's parliament approved the government's expansionary budget.
  - Although the budget deficit is anticipated to narrow in FY 2021/22, it continues to be extremely high, accounting for around 23% of GDP. In the medium term, a recovery in oil receipts will help to improve the fiscal position, but this will not be enough to create a surplus.
  - The government is budgeting for a YoY deficit of around USD 40B in FY 2021/22, compared with almost USD 46B in FY 2020/21 (32% of GDP).
  - The new budget assumes there will be no transfers to the Future Generation Fund (FGF) following a law introduced last year which precludes transfers to the FGF in deficit years.
- Revenues and expenditures are both expected to rise. Estimated revenues of about USD 10.9B in FY 2020/21 represent a 45% YoY increase, while expenditures (around USD 76.5B) are up by 7% from the previous year.
  - Based on an average price of USD 45 pb, oil proceeds are expected to remain the primary source of government financing, representing 83% (~USD 30B) of total revenue, a 62% YoY increase.
  - Non-oil revenue is expected to decline by 3.8% to nearly USD 6B, with its share making up around 17% of the budget. This compares with 25% during the previous FY.
  - CAPEX is expected to post a big boost in 2022 with spending planned at USD 2.5B, a 25% YoY increase.
    - Public sector salaries are expected to increase by 4.2% YoY in 2021 compared with an expected increase of 1% in the current fiscal year.
  - The estimates for FY 2020/21 reveal the impact of last year's spending exigencies. Total revenues plunged by 56.4% in 2020, with 64% of this driven by oil revenues. Non-oil revenues, meanwhile, increased marginally by 1.3% to USD 6.2B.
- Besides halting the 10% revenue transfer to the FGF, Kuwait's large deficit in the previous fiscal year has forced the government to swap assets with the FGF worth around USD 25B to ensure the availability of liquidity.
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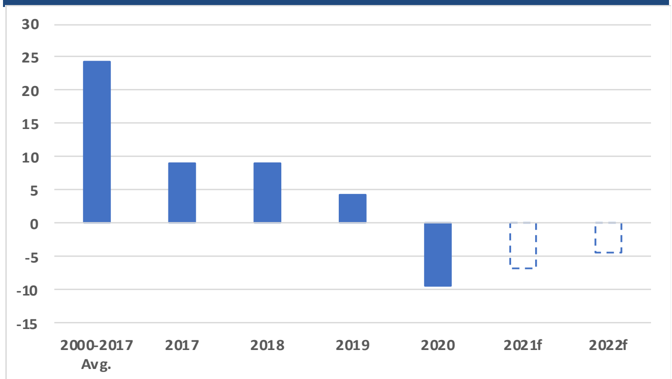
Table 1 – MENA Dashboard[1]

MENA Oil Exporters	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021f	2020	2021f
Algeria	-6.0	2.9	-12.7	-18.4
Bahrain	-5.4	3.3	-18.3	-9.1
Iran	1.5	2.5	-8.4	-6.8
Iraq	-10.9	1.1	-18.3	-9.2
KSA	-4.1	2.4	-11.1	-3.8
Kuwait	-8.1	0.7	-9.4	-6.9
Libya	-59.7	131.0	-103.0	0.3
Oman	-6.4	2.5	-17.3	-4.4
Qatar	-2.6	2.4	1.3	1.4
UAE	-5.9	3.1	-7.4	-1.3
Yemen	-5.0	1.2	-9.6	-6.1
Average	-12.2	8.1	-19.4	-11.8
Average Ex-Yemen	-12.9	9.6	-20.4	-12.4

Figure 3 - Kuwait Fiscal Balance (% of GDP)[5]



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  - The latest government figures reveal that net assets in the General Reserve Fund (GRF, the government's main fiscal liquidity buffer) reached around USD 32.2B by the end of December 2020, a 58% YoY drop from 2019. Liquid assets reached USD 5.1B in March.
  - Still, the government is facing severe liquidity constraints with the almost complete depletion of the GRF. This means that passing a new debt law is an urgent priority.
- Risks to fiscal sustainability were reiterated by S&P Global Ratings' recent downgrade of Kuwait's credit rating (the second downgrade in as many years) to A+ from AA-.
  - The new rating is now two marks lower than Fitch Ratings, and on par with Moody's Investors Service, which lowered its own assessment of Kuwait for the first time in September 2020.
- Besides passing a debt law, Kuwait needs to implement deeper structural reforms to fix its fiscal imbalances.
  - For instance, the introduction of VAT will be a major addition to the state's fiscal toolkit and will support ambitions to diversify fiscal revenues.
  - However, Kuwait's parliament once again pushed back the implementation date in April, with no clear view as to when it plans to take effect. We expect it to be introduced by 2022.
- In addition, Kuwait's Minister of Finance, Khalifa Hamada, recently announced that the government may impose

[1] Arabia Monitor; Central Bank of Egypt.

selective taxes on luxury goods, as well as products that are harmful to public health and the environment.

- Whether this will go ahead is yet to be seen; successful reform implementation remains subject to the government working with parliament to agree a mechanism for securing bridge funding.

Algeria: Hirak here to stay

Last month's elections saw the Algeria's lowest voter turnout at 23%. This not only reflects public distrust of the country's electoral process and institutions; it demonstrates the momentum of the Hirak protest movement, which urged people to boycott the elections.

- The polls were the country's first parliamentary elections since the former president Abdelaziz Bouteflika stepped down in 2019, and a test of legitimacy for the incumbent President Abdelmadjid Tebboune.
  - Protesters have been demonstrating against corruption and other political failings, hoping for reform and, in the words of President Tebboune, a 'new Algeria'.
    - The Hirak movement became increasingly active in the lead-up to the elections and their aftermath. The government has been cracking down and banning protests in response.
    - Such a reaction clearly demonstrates the threat which it sees in the Hirak movement.
- The results were as expected. The National Liberation Front (FLN), Algeria's historically illustrious party, received the most votes overall, but lost 58 seats (36% less than it held in the previous parliament) to end up with 98. This is left it well short of a parliamentary majority (204).
- The former prime minister, Abdelaziz Djerad, resigned following the results. He was succeeded by Aymen Benabderrahmane.
  - Benabderrahmane served as the minister of finance before his new appointment and also had a short stint as the governor of the central bank. He has now been tasked with forming a new government, which also means that the FLN will need to receive parliamentary support from two other parties.
  - The timeline will be a drawn-out affair, which will delay the implementation of any reforms promised by Tebboune.
- The new government has to regain trust in its institutions and fix an economy that has suffered from falling oil prices amid the COVID-19 pandemic, two tall orders.

Energy Outlook: Sigh of relief as OPEC+ reaches an agreement[3]

A hasty pre-Eid holiday deal has put an end to an unprecedented gridlock between Saudi Arabia and the UAE that began in early July.

- On July 18, the OPEC+ cartel agreed to a full end of their existing oil production cuts (5.8M bpd) by end-2022, alongside new production baselines from May 2022 off which subsequent cuts will be based.

Table 2 – OPEC+ New Production Baselines (K, bpd)[7]

Country	Current Baselines till April 2022	Baselines effective May 2022	August 2021 cuts based on current Baselines	Share of 400K bpd monthly increase Jul 2021-Apr 2022	Share of 400K bpd monthly increase May-Dec 2022
Algeria	1057.0	1057.0	135.0	10.0	9.7
Angola	1528.0	1528.0	195.0	14.5	14.0
Congo	325.0	325.0	41.0	3.1	3.0
Equatorial Guinea	127.0	127.0	16.0	1.2	1.2
Gabon	187.0	187.0	24.0	1.8	1.7
Iraq	4653.0	4803.0	592.0	44.2	43.9
Kuwait	2809.0	2959.0	358.0	26.7	27.1
Nigeria	1829.0	1829.0	233.0	17.4	16.7
Saudi Arabia	11000.0	11500.0	1400.0	104.5	105.2
UAE	3168.0	3500.0	403.0	30.1	32.0
Russia	11000.0	11500.0	1400.0	104.5	105.2
Other OPEC+	4417.0	4417.0	562.0	42.0	40.4
Total	42100.0	43732.0	5359.0	400.0	400.0

  - Abu Dhabi, who had categorically rejected an earlier plan led by Saudi Arabia and Russia to extend current cuts to December 2022 due, in part, to an "unfair" baseline that did not reflect its actual production capacity, has now been accorded a baseline of 3.5M bpd up from the current 3.16M bpd, though short of the 3.8M bpd it had initially been demanding.
- The baseline increases have been accorded to the UAE, Kuwait, Saudi Arabia, Russia, and Iraq, the largest producers of the cartel.
  - The UAE's production baseline has been increased by 10.5%, Kuwait's by 5.3%, and Iraq's by 3.2%.
  - More crucially, Saudi Arabia and Russia have got larger increases of 500K bpd each, bringing their baselines to 11.5M bpd.
  - Other members have not been given higher baselines due to limited spare capacities and depleting assets.
  - The group's estimated production capacity has been increased by 1.63M bpd.
- The agreement has put back the cartel in control of the market for now, after speculations that the alliance could unravel.
  - The pact allows for supply hikes of 400K bpd each month starting August 2021, with most observers agreeing that the market can easily absorb these volumes.
  - Industry estimates expect the new OPEC+ production targets will still keep the market in deficit through the end of the year, signalling a tighter oil market structure, and lifting short-term uncertainty over a potential deal collapse similar to March 2020.
- In the short-term, some weakness is expected as investors unwind positions on prospects of higher supply.
  - For example, immediately the day after the deal was announced, the front-month September contract for ICE Brent fell by USD 4.97 pb to finish the session at a

[2] Arabia Monitor; IMF.
[3] This section is a guest author contribution courtesy of Robin Mills & Maryam Salman, Energy Analysts.
[4] Qamar Energy.

nearly two-month low of USD 68.62 pb, while the August contract for WTI dropped 7.5% to USD 66.4 pb.

- The sell-off comes amid a broader drop in equities as investors turn to traditional safe havens on concerns over COVID-19 variants denting global economic recovery but is expected to be short-lived.

➢ The truce has eased risks of an inflationary oil price spike. With assets like benchmark government bond prices rallying alongside the US dollar and the Japanese yen in recent months, the risk of oil becoming less affordable could have led to a demand collapse.

➢ The deal has returned stability to the market while also putting an end to the Saudi-UAE spat that had unnerved traders.
  - The baseline adjustments are unlikely to alter the pace of the 400K bpd monthly output increases.
  - OPEC+ will continue holding talks each month including a review of the market in December, where a readjustment of the schedule for the unwinding of cuts could take place if required.
  - The cartel will continue to exert control over how the market unfolds for the next year and a half.

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