Institute of Banking Studies Research »

What is the Impact of Lower Oil Prices in Kuwait and on the Kuwaiti Banks?

Research Unit - IBS

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EXECUTIVE SUMMARY

Since peaking at $128.14 in March 2012, the Brent crude oil price has fallen dramatically, hitting a low of $45.13 in January 2015; a decline of 65 percent. This study finds that:

- Government expenditure in fiscal years 2014/15 and 2015/16 should remain largely unaffected. Over the past 20 years, year-over-year changes in government spending have remained largely insensitive to annual changes in the average Brent oil price.
- We estimate that the fiscal surplus in 2014/15 will be KD 8.3 billion or 18.1 percent of gross domestic product (GDP), down from KD 12.9 billion or 26.3 percent of GDP in 2013/14. This incorporates our estimate that nominal GDP will fall by 6.3 percent in fiscal year 2014/15 year-over-year.
- Were the government to spend KD 21 billion in 2015/16 (an increase of 4.5 percent over our 2014/15 forecast) and the Brent oil price to average $60 per barrel, we estimate GDP would be KD 38.8 billion (a decline of 15 percent from our 2014/15 forecast), and that the government would run a small and entirely manageable fiscal deficit of 2.6 percent of GDP.
- Given that changes in the oil price determine the government's fiscal balance, we conclude that oil price movements do have a material impact on system-wide bank deposits. All the same, 'excess' funding among the Kuwaiti banks suggests that slower deposit growth, caused by lower oil prices, should have little effect on the provision of credit.
- We see no particular risk to loan book quality from the recent decline in the oil price. The level of non-performing loans to gross loans is correlated to activity in the real-estate market and more volatile elements of private non-oil output.

Overall, we believe that the oil price can remain below fiscal breakeven for a period of up to two years without greatly affecting domestic spending or the banking sector. Were the oil price to remain at or below fiscal breakeven for over two years, the government may look to alter its spending plans accordingly. In the context of the last 20 years, the Kuwaiti economy would be in uncharted territory and our benign conclusions could need revisiting.

INTRODUCTION

This study examines the effects of lower oil prices on the Kuwaiti economy and on the banking system. It uses historic data going back to the mid-1990s to estimate the impact of current events. In Section 1, we address the potential impact on the economy and government expenditure; specifically, we project a range of possible economic outcomes for fiscal year 2015/16 given different potential average oil prices. In Section 2, we look at the likely impact of lower oil prices on loan growth, loan quality, and deposit funding.

It goes without saying that the Kuwaiti economy is heavily reliant on oil. In 2013, for instance, the hydrocarbon industry accounted for 55.9 percent of total output and 93.6 percent of government revenue. Changes in the oil price will most certainly have a material impact on gross domestic product or GDP.

All the same, in 2013, government and private sector consumption expenditure represented only 41 percent of GDP, with net exports and fixed capital formation accounting for the remaining 45 percent and 14 percent respectively. With such high levels of savings there exists a huge buffer to absorb falling oil revenue without levels of domestic spending decreasing; the recent decline in the oil price does not therefore necessarily imply less consumption in the domestic economy.

However, high savings rates are not, in themselves, proof that there will be little or no impact from lower oil prices on domestic spending. Indeed, this study has been written for the purpose of investigating three possible effects:

- That lower oil prices lead to a freeze or reduction in government spending.
- That lower oil prices lead to lower spending in the private sector, with ramifications for the quality of each bank's loan book.
- That lower oil prices lead to lower growth in deposits, which in turn could lead to slower loan growth.

Unless otherwise stated and cited, data in the body of the text is sourced from the Central Bank of Kuwait.[1]

SECTION 1: The Economic Impact of Lower Oil Prices

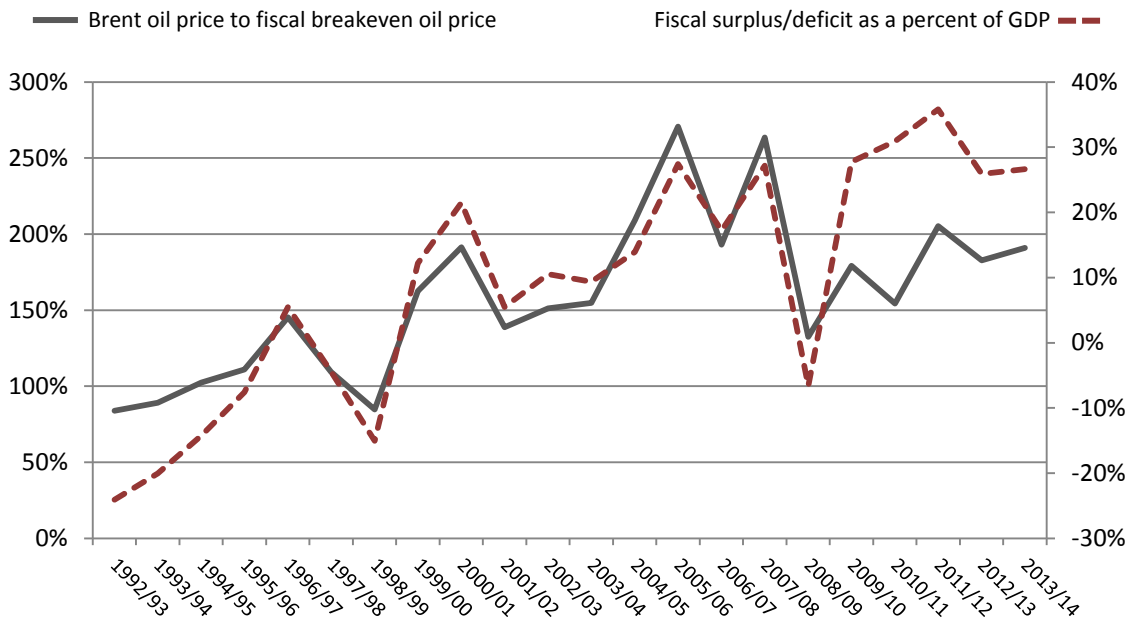
This section examines the likely impact on government and private spending given a range of possible oil price scenarios. It includes GDP forecasts for fiscal years 2014/15 and 2015/16.

However, before considering expected outcomes in 2015 and beyond, we provide historic context for recent oil price movements, focusing on the precipitous oil price decline in 1997 and 1998. In particular, we examine the effect of those declines on government and private spending and ask what that this may imply in the present context.

Section 1.1: Historic Precedent

Chart 1 below demonstrates the strong relationship since the early 1990s between Kuwait's annual fiscal surplus or deficit expressed as a percent of GDP (right-hand axis), and the average annual Brent oil price expressed as a percent of Kuwait's fiscal breakeven oil price (left-hand axis). The fiscal breakeven oil price for each year was estimated by multiplying government revenue per barrel (translated into U.S. dollars at the average exchange rate for each year) by the ratio of oil financed expenditure to government oil revenue.

Chart 1: Kuwait's Fiscal Position Heavily Determined by the Oil Price



Sources: Central Bank of Kuwait, U.S. Energy Information Administration, Platts, IBS data, calculations and estimates

Following the red-dotted line (right-hand axis), Chart 1 demonstrates that over most of the period, the government has run a large fiscal surplus. A deficit was run in the early 1990s, as part of post-war reconstruction efforts; in 1997/98 and 1998/99, due to the low oil price; and in 2008/09 due to fiscal transfers made in response to the financial crisis. Chart 1 also shows that for much of the period, there has been a strong correlation ($R^2 = 0.73$, $F(1,20)=53.75$, $p<0.001$) between the government's fiscal position and the ratio of the breakeven oil price to the actual oil price (left-hand axis). This tells us that the oil price is a key determinant of the government's fiscal position. This relationship was less pronounced in the early 1990s, again due to post-war reconstruction, and in recent years, due to increased levels of government saving.

Why might the oil price determine the size of the government's surplus or deficit? Because while government revenue is driven by oil revenue (which has accounted for, on average, 90 percent of total government revenue in the past 20 years), expenditure is not adjusted to target a particular fiscal deficit or surplus. Instead, the fiscal position is an outcome of fluctuating oil-based revenue and expenditure items that are undertaken without reference to annual changes in the oil price.

Indeed, most government spending relates to public services of various forms, transfers, subsidies and wages, to which it is, in the main, committed. Some subsidies have been reduced, for instance on kerosene and diesel fuel at service stations starting in January 2015, but these reductions are not likely to have a material impact on total spending. Moreover, in fiscal year 2014/15, only KD 674 million or 3 percent of total budgeted expenditure of KD 23.2 billion related to new capital projects, that is spending that could, in theory, be easily shelved.[2] In short, finding ways to reduce government spending could prove challenging.

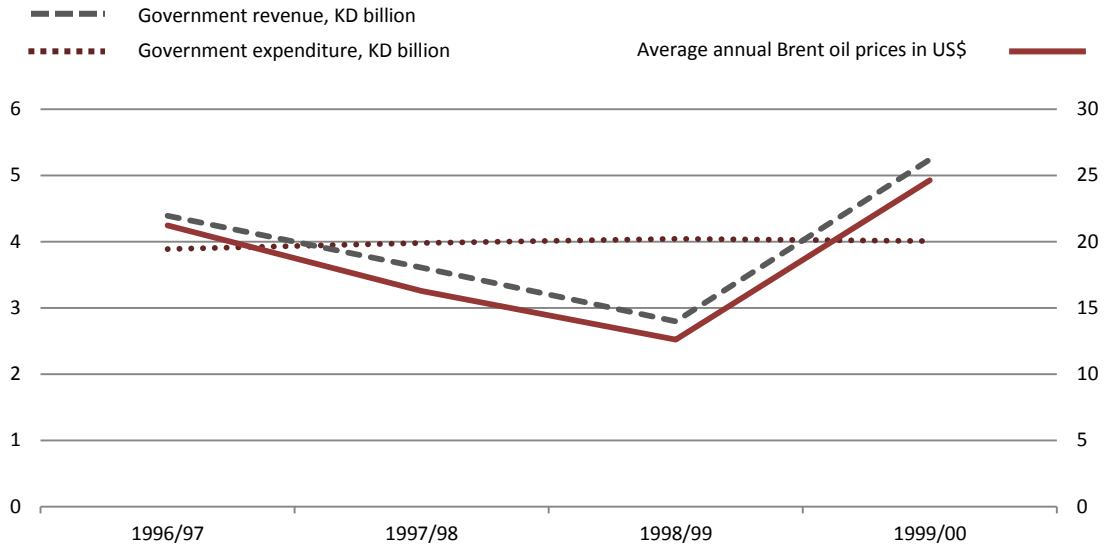
That government revenue is largely determined by oil sales, while expenditure is not, is supported by statistical findings. For instance, IBS ran two regressions: one in which we regressed annual changes in government expenditure for each year from 1995 to 2013 against changes in the average annual oil price, controlling for changes in average annual oil output; the other in which we regressed annual changes in total government revenue for the same years against changes in the average annual oil price, again controlling for changes in average annual oil output.

While the regression for government revenue produced an outcome in which variability could be explained to a reasonable level (adjusted $R^2 = 0.15$, $F(2,16)=10.55$, $p=0.001$), there was no equivalent statistical relationship for government expenditure (adjusted $R^2 = 0.06$, $F(2,16)=1.61$, $p=0.231$).

Of course, over the long term higher oil revenue has supported increased government spending; but we can, nonetheless, say that between 1995 and 2013, government decisions on year-on-year changes to expenditure appear to be unrelated to annual changes in the average oil price.

This finding is further confirmed by examining the years 1997 through 1999, when oil prices fell below the fiscal breakeven oil price. IBS estimates, for instance, that in fiscal year 1998/99 the average price of Brent crude oil was 85 percent of the price needed for the government to balance its books. During that fiscal year, the government ran a deficit of 15 percent of GDP, because, as Chart 2 below shows, expenses remained largely unaffected.

Chart 2: The Government Keeps Spending Regardless of Revenue

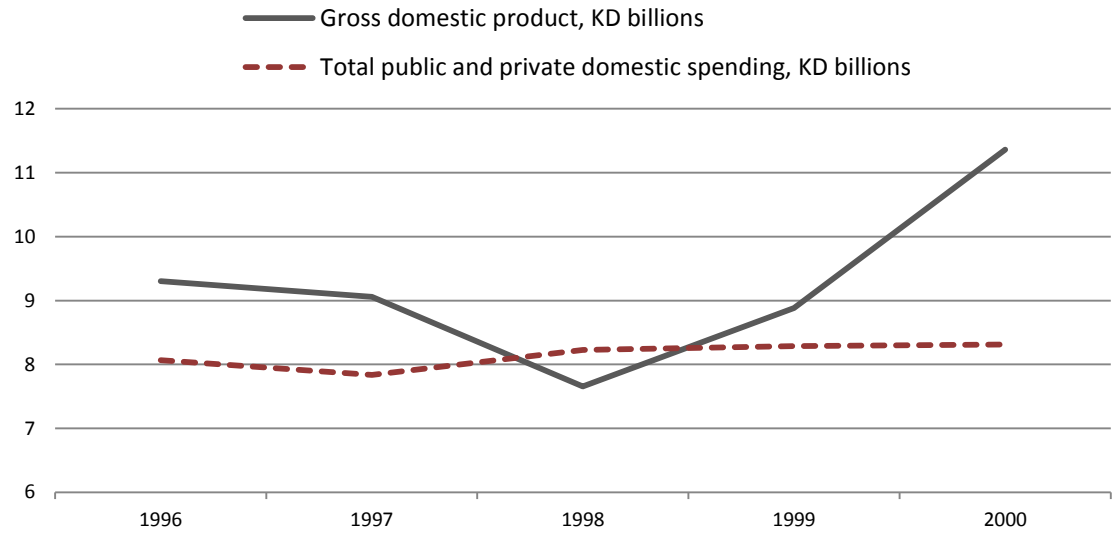


Sources: Central Bank of Kuwait, IBS data and calculations, U.S. Energy Information Administration

The decline in oil prices during this period mirrors recent falls. Oil peaked at $25.2 per barrel in October 1996, falling to $9.10 in December 1998, a decrease of 64 percent. The oil price peaked at $128.14 per barrel in March 2012 falling to $45.13 in January 2015, also a decrease of 65 percent.[3] Given the near- identical level of decline, in addition to suggesting a muted impact on government spending, the fiscal years 1997/98 and 1998/99 also provide pointers to considering the impact on non-oil private sector consumption expenditure from lower oil prices.

The picture that emerges is clear. Chart 3 shows that while government revenue and GDP declined significantly as the oil price fell, total government and private domestic spending (GDP less exports) actually rose, driven by private consumption expenditure which expanded at a compound annual growth rate of 5.0 percent during the five years covered in the chart. More generally, IBS could find no statistical relationship between year-on-year changes in private consumption expenditure and changes in the annual average oil price, whether coincident or with a one-year lag, in the years 1995 to 2013.

Chart 3: Oil Price Declines in the Late 1990s Had No Effect on Total Domestic Spending



Sources: Central Bank of Kuwait, IBS data and calculations, U.S. Energy Information Administration

To sum up, GDP contracted sharply by 15 percent between 1997 and 1998 as the value of oil production fell; and this resulted in a sharp decline in government revenue and a deficit of 15 percent in fiscal year 1998/99; yet non-oil related output, both government and private, remained largely unaffected. During this period of low oil prices, residents would have felt little effect of the oil price falling below fiscal breakeven.

As long as the oil price remains below the fiscal breakeven price for no more than two years, we feel comfortable in concluding that the same dynamic will play out now as it did in the late 1990s: expenditure, whether government or private, will remain largely unaffected by declines in the oil price.

Section 1.2: Effects of the Current Oil Price in Fiscal Year ending March 31, 2015

Even with oil prices falling precipitously in late 2014, the government is still likely to run a large budget surplus in fiscal year 2014/15. Table 1, below, sets out basic data for fiscal years 2011/12 through 2013/14, and also shows the IBS forecast for 2014/15. We expect the fiscal surplus to fall from 26.3 percent of GDP in 2013/14 to 18.1 percent in 2014/15. In making this forecast it is assumed that:

- Government spending rises to KD 20.1 billion in 2014/15. This assumes that the increase of KD 1.2 billion over 2013/14 reported in the interim report after seven months of the fiscal year is maintained for the whole year.[4]

- The average oil price was $89 per barrel, down from $107.5 in fiscal year 2013/14; oil production will be stable at 2.8 million barrels a day and the average exchange rate is 0.28449 dinar to the dollar.
- In line with IMF forecasts[5], we assume growth in the non-oil economy of 3.6 percent in 2014/15 (versus 9.5 percent in 2013 and 8.7 percent in 2012), reflecting much lower increases in government spending in calendar year 2013 of 1.5 percent, versus increases of 12.2 percent and 11.4 percent in 2011 and 2012 respectively. This also assumes prices increase by 2.7 percent (the same as consumer price inflation in 2013).

Table 1: Fiscal Surplus in 2014/15 Still Likely to be High, KD billions (current prices)

Note: GDP numbers have been adjusted to align with fiscal year

	2011/12	2012/13	2013/14	2014/15 Est.
Gross domestic product	44.1	49.0	49.0	45.9
Government Revenue	32.8	32.0	31.8	28.4
Revenue as a percent of GDP	74.4%	65.3%	64.9%	61.9%
Government expenditure	17.0	19.3	18.9	20.1
Government expenditure as a percent of GDP	38.6%	39.4%	38.5%	43.8%
Fiscal surplus	15.8	12.7	12.9	8.3
Fiscal surplus as a percent of GDP	35.8%	25.9%	26.3%	18.1%
Fiscal breakeven oil price	$55.8	$60.2	$56.3	$60.5
Average Brent oil price	$114.6	$110.0	$107.5	$89.0

Sources: Central Bank of Kuwait, IBS calculations and estimates, U.S. Energy Information Administration

In short, while in our estimates nominal GDP will decline in fiscal year 2014/15 versus fiscal year 2013/14 by 6.3 percent, there should be little impact on domestic spending; the adjustment instead will be absorbed by a lower savings, in the form of a lower government fiscal surplus.

Section 1.3 Looking Further Ahead to Fiscal Year 2015/16

Even though oil prices collapsed during fiscal year 2014/15, the average price for the year has remained well above breakeven levels; consequently for the year, we can still expect a large fiscal surplus. The same may not be true for 2015/16. Table 2 below shows IBS estimates for a range of possible outcomes for the fiscal deficit/surplus next year, depending on two factors: the average oil price for the year and the level of government spending. For instance, were oil prices to average $60 per barrel and the government to spend KD 21 billion, we estimate a fiscal deficit of KD 1 billion.

In making these estimates, we assume that oil production will be 2.8 million barrels a day and that non-oil government revenue remains at the 2013/14 level of KD 2.52 billion.

Table 2: Deficit or Surplus Next Year? It's finely balanced

	Government expenditure in 2015/16, KD billions				
	KD 19 billion	KD 20 billion	KD 21 billion	KD 22 billion	KD 23 billion
$50 per barrel	-1.9	-2.9	-3.9	-4.9	-5.9
$60	+1.0	0.0	-1.0	-2.0	-3.0
$70	+3.9	+2.9	+1.9	+0.9	-0.1
$80	+6.8	+5.8	+4.8	+3.8	+2.8

Sources: Central Bank of Kuwait, IBS calculations and estimates

Tables 3 and 4 translate the outcomes shown in Table 2 into a forecast for GDP and a forecast for the fiscal deficit as a percent of GDP. The estimates for non-oil GDP output growth in 2015/16 depend on the level of government spending as follows: KD 19 billion: 0 percent; KD 20 billion: 3 percent; KD 21 billion: 6 percent; KD 22 billion: 9 percent; KD 23 billion: 12 percent. This reflects the assumption that 50 percent of government spending is related to transfers and similar items, and that there is a negligible multiplier effect from government investment. In addition, we assume a stable currency and that consumer prices will continue to increase at 2.7 percent per annum.

Table 3: GDP Lower in Fiscal Year 2015/16 versus IBS Forecast of KD 45.9 billion in 2014/15

	Government expenditure in 2015/16, KD billions				
	KD 19 billion	KD 20 billion	KD 21 billion	KD 22 billion	KD 23 billion
$50 per barrel	34.9	35.4	35.9	36.4	36.9
$60	37.8	38.3	38.8	39.3	39.8
$70	40.7	41.2	41.7	42.2	42.7
$80	43.6	44.1	44.6	45.1	45.5

Sources: Central Bank of Kuwait, IBS calculations and estimates

As Table 3 shows, our estimate of 2015/16 GDP varies widely depending on the oil price and government spending. In the worst case, GDP will fall 24.0 percent from our estimate for 2014/15. In the best case scenario, GDP would fall 0.9 percent year-on-year.

In a scenario in which government expenditure is KD 21 billion (an increase of 5 percent on our estimate for 2014/15), an oil price just over $63 would be sufficient to balance the government's books. In the most extreme scenario, in which oil prices average $50 per barrel for the entire fiscal year and the government spends KD 23 billion, we estimate a fiscal deficit of KD 5.9 billion (as per Table 2 above) or 16.0 percent of GDP (as per Table 4 below).

Table 4: Fiscal Deficit Very Unlikely to Exceed 1998/99 Level of 15 percent of GDP

	Government expenditure in 2015/16, KD billions				
	KD 19 billion	KD 20 billion	KD 21 billion	KD 22 billion	KD 23 billion
$50 per barrel	-5.4%	-8.2%	-10.9%	-13.5%	-16.0%
$60	2.6%	0.0%	-2.6%	-5.1%	-7.5%
$70	9.6%	7.0%	4.6%	2.1%	-0.2%
$80	15.6%	13.1%	10.7%	8.4%	6.1%

Sources: Central Bank of Kuwait, IBS calculations and estimates

In general, this should be taken as good news. The government has over KD 5 billion on deposit with the local banks. In addition, the Kuwait Investment Authority has approximately US $550 billion or KD 155 billion under management.[6] In theory, a deficit of up to KD 6 billion could be easily funded by these large pools of savings assuming they could be made available to the Ministry of Finance.

However, it should also be noted that aside from the years immediately following the Gulf War, the government has only run a deficit for relatively short periods of time. For instance, as discussed previously, there was a fiscal deficit in 1997/98 of 4 percent of GDP and 1998/99 of 15 percent GDP due to the low oil price. This was quickly reversed when oil prices rebounded. The government also ran a fiscal deficit in 2008/09 of 6.7 percent of GDP. This reflected increased spending to offset the effects of the global financial crisis; the oil price remained favorable to Kuwait.

Were oil prices to remain at current levels for a protracted period of time (two or more years), the chances of the government responding by lowering expenditure, or at least freezing it at current levels, increases. One can imagine, for instance, that the government would soon baulk at the prospect of drawing down KD 5 billion annually from its savings.

Thus, in conclusion, while current oil prices pose no particular threat to expectations of rising domestic spending in the next 12 to 24 months, were they to persist it is possible to envisage a scenario in which domestic spending stalls at current levels, led by a government unwilling to run persistent fiscal deficits.

SECTION 2: The Effects on the Banking Sector of Lower Oil Prices

In Section 1, we assumed that the banking sector is a passive actor in the economy, i.e. that the supply of credit will remain unaffected by oil price movements. In Section 2, we relax this assumption by investigating whether a lower oil price could impact the banks in ways that may inhibit the flow of credit.

In Section 2.1 we assess the likelihood that funding sources become scarcer thereby limiting capacity for the banks to meet the demand for credit. In Section 2.2, we look at the prime causes of loan impairment among conventional Kuwaiti banks and ask whether oil price changes are one of the key determinants.

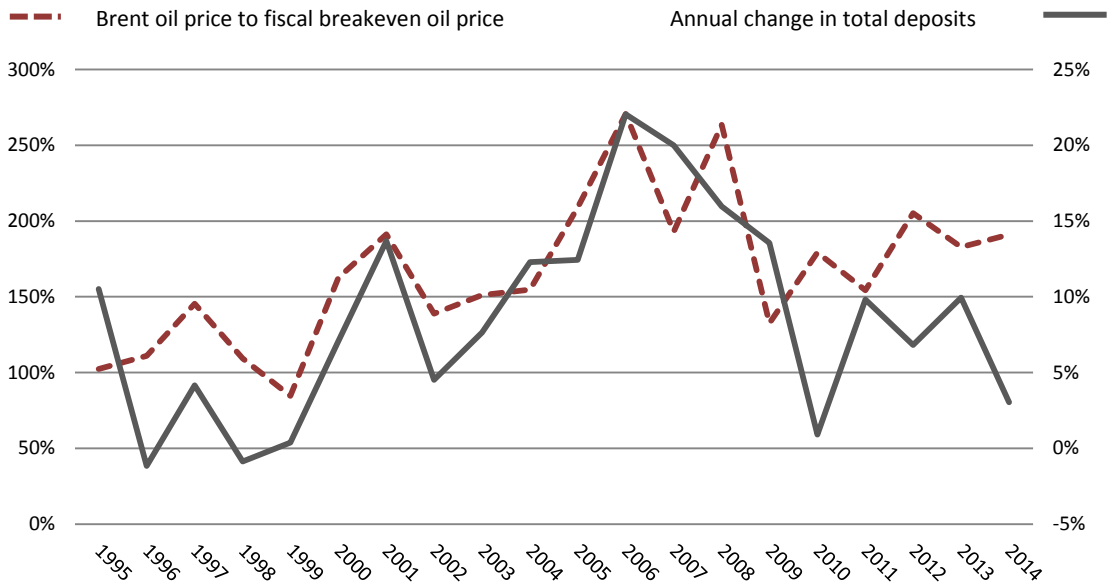
Section 2.1 Possible Effects of Lower Oil Prices on Funding and Loan Growth

As already discussed in the introduction, Kuwait has a very high national savings rate, with total domestic private and government consumption expenditure representing only 41 percent of GDP in 2013. This is a direct result of Kuwait exporting the vast majority of its oil output. At the same time, as already established, the level of domestic spending has not, at least in the past 20 years, been affected by oil price fluctuations. These findings would suggest that while the rate of the deposit growth in the banking system may be correlated with oil price fluctuations, the rate of loan growth may be less affected.

Chart 4 below demonstrates the correlation between average annual oil prices expressed as a percentage of the fiscal breakeven oil price each year, and the annual change in total system deposits (measured from end-December to end-December each year). In a simple linear regression, a change in the average annual oil price expressed as a percentage of the breakeven price each year from 190 percent to 100 percent reduced deposit growth from 10.7 percent to 2.8 percent (R^2 = 0.43, F(1,18)=13.48, p=0.002).[7]

Intuitively, our findings make sense as the average annual oil price expressed as a percentage of the fiscal breakeven price each year reflects the level of government and state-owned-enterprise savings generated by oil production each year; the higher oil revenues are relative to government spending, the more savings will be placed on deposit. We assume that these savings would show up in the Kuwaiti banking system as deposits made by state-owned-enterprises, such as the Kuwait Petroleum Corporation, which get booked as 'customer deposits' on each banks' balance sheet. The high level volatility of oil-generated savings compared to non-oil related growth in deposits may explain the pronounced effect on deposit growth that we have recorded in our regression.

Chart 4: Annual Deposit Growth Related to Fiscal Breakeven Oil Price



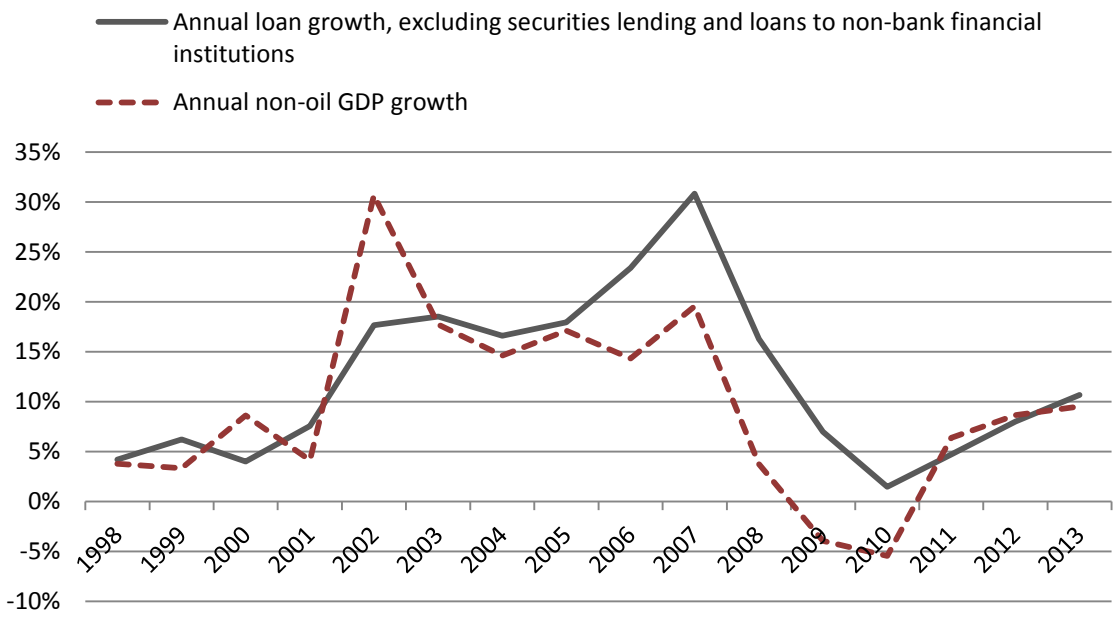
Sources: Central Bank of Kuwait, U.S. Energy Information Administration, Platts, IBS data, calculations and estimates

But while deposits appear to be affected by savings generated from oil production, the same cannot be said for loan growth; a similar exercise, this time regressing annual December to December loan growth against the average annual oil price expressed as percentage of the fiscal breakeven oil price each year produced no statistically significant relationship. Nor was there any discernable correlation between annual loan growth and 1) changes in the average annual oil price or 2) annual oil-related GDP.

Instead, loan growth appears to be related to growth in non-oil GDP; the latter, as we have already established, being largely unrelated to movements of the oil price. Chart 5 below shows this relationship quite clearly. Specifically, annual non-oil GDP growth explained a significant proportion of variation in annual loan growth excluding loans to non-bank financial institutions for securities purchases (R^2 = 0.52, F(1,14)=15.41, p=0.002).

Please note in the regressions to estimate annual loan growth we have used data starting in 1998 as loan growth in the preceding years was exceptionally high, averaging over 30 percent, due to post-war reconstruction.

Chart 5: Loan Growth and Non-Oil GDP Growth Move in Tandem



Sources: Central Bank of Kuwait

Our conclusion, that oil price movements affect rates of deposit growth in Kuwait while having little or no impact on loan growth, is reflected in the allocation of assets in the local banking system. For instance, it may well be thought that lending could be constrained when funding growth, in the form of deposits, slows. However, for this to be the case, domestic lending would have to constitute a high proportion of system-wide assets. In fact, as of December 31, 2014, the provision of credit only constituted 55.4 percent of system-wide assets. In other words, a slow-down in the growth of funding would most likely lead to slow down in money-market placements and other short-term investments rather than to a deceleration in loan growth.

Nevertheless, as with Section 1, it should be noted that while these findings are relatively benign, we cannot say for certain that they would stand if the oil price remained below the fiscal breakeven price for an extended period of time, such as over two years. The history, for instance, on which we have based our analysis, includes only a relatively short period, around 18 months, in which the oil price was below fiscal breakeven. If oil prices remain around current levels for an extended period, then the government may need to revisit much of its long-term spending plans and commitments. In that situation, the prospects for local banks could be significantly diminished, given the knock-on effect on private sector spending and investment.

Section 2.2 Possible Effects on Loan Book Quality

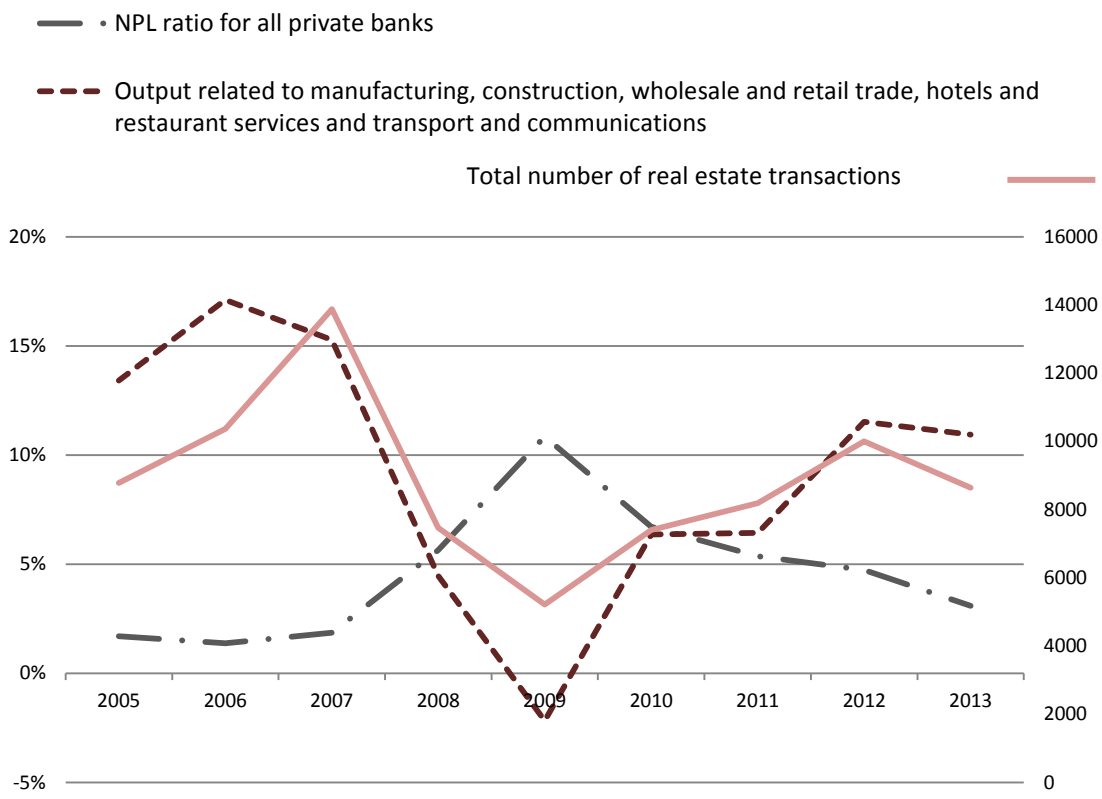
Given our belief that domestic spending, both government and private, will remain largely unaffected by lower oil prices over the next 12 to 24 months, over this same time period we would not necessarily expect to see any significant deterioration in loan book quality. Indeed, we have found no statistical correlation between oil price movements and the level of non-performing loans in the years 2005 to 2013 (the full extent of IBS's data). This should come as no surprise given that we had previously failed to find evidence to link average annual changes in the oil price to annual changes in government expenditure.

In fact, as Chart 6 below demonstrates the level of non-performing loans to gross loans is associated with the condition of the real estate market (as measured by the total volume of transactions – there is no price index of Kuwaiti properly values available) and the more volatile elements of non-oil output that make up GDP (manufacturing, construction, wholesale and retail trade, hotels and restaurant services and transport and communications).

Not surprisingly, there are clear correlations (again covering the years 2005 through 2013) between non-performing loans to gross loans and 1) year-over-year changes in the parts of GDP listed above ($R^2 = 0.92$, $F(1,7)=76.65$, $p<0.001$); and 2) the volume of real estate transactions ($R^2 = 0.52$, $F(1,8)=8.67$, $p=0.019$).

Our findings neither imply an increase nor decrease in the level of non-performing loans next year. Instead, we merely suggest that any view on that would be determined by other factors, not associated with the oil price; vis-à-vis activity in the real estate market and certain other areas of domestic economic activity.

Chart 6: Loan Quality Related to Real Estate and Domestic Activities, Not Oil



Sources: Central Bank of Kuwait, Bank annual reports, IBS data and calculations

It should also be noted that oil price declines may have an indirect effect on loan book quality and, more generally, bank profitability via movements in the stock market. The market index, for instance, fell 20 percent from its close of 7,661 on September 28 2014, hitting a low of 6,116 on December 17.[8] This decline appears to have been a reaction to the fall in oil prices. The potential impact on the banks, however, is difficult to assess.

The level of the market index is a reflection of trends in the economy and as such should already incorporate views about the direction of spending in Kuwait. That said, stock markets reflect sentiment, and sentiment can diverge from economic reality. In this case, while the economic impact of lower oil prices may be muted, poor sentiment and lower equity prices may feedback negatively on the banks, regardless of broader economic performance.

Each bank reports an estimate of the direct impact that index movements have on earnings and shareholders' funds. The National Bank of Kuwait, for instance, reported at the end of 2013 that a 5 percent movement in the Kuwait stock exchange index would result in a KD 51,000 change in net profit and a KD 1,090,000 change in shareholders' funds.[9] Extrapolating from this, a 20

percent fall in the index results in an effect of less than 20 basis points on NBK's total net profit and shareholders' funds.

Even so, there may be effects that, at the present, remain unquantifiable. In its 2013 Financial Stability Report, for instance, the Central Bank of Kuwait noted that at the end 2013, the banks' equity investments represented 41 percent of Tier 1 capital; that equity collateral made up 31 percent of all collateral; and that loans granted to customers for trading in shares made up 7 percent of the banks gross loan portfolio.[10] Moreover, many of the banks' corporate clients hold relatively large portfolios of equities (held both as trading assets and as available-for-sale); and large declines in the stock market may impact the financial wellbeing of those companies, with knock-on effects to the banking sector.

The threat to the banks from declines in the stock market triggered by oil price movements should not therefore be dismissed, but the scale of declines so far experienced appear reasonably modest. At the very least, we can say that the 20 percent fall that occurred at the end of the 2014 was 'mild' compared to the 60 percent fall in 2008 to 2009 which had a significant impact on investment companies and the banks which had lent extensively to that sector.

CONCLUSION

The stated aim of this study was to investigate the extent to which: 1) lower oil prices could lead to a freeze or reduction in government spending; 2) lower oil prices could lead to lower spending by domestic residents, with ramifications for the quality of each bank's loan book; and 3) lower oil prices could lead to lower growth in deposits, which in turn could lead to slower loan growth.

In our view, over the next 12 to 18 months, were oil prices to remain around the $60 level, we would not expect to see any significant impact on non-oil GDP, loan growth or loan book quality, even though the government would no longer be running a fiscal surplus. These findings are based on analysis of 20 years of Kuwaiti economic and banking data.

Were the oil price to remain at or below fiscal breakeven for more than two years, the government may look to alter its spending plans accordingly. In the context of the last 20 years, the Kuwaiti economy would be in uncharted territory and our benign conclusions could need revisiting.

ENDNOTES

[1] See Central Bank of Kuwait statistical data, monthly and quarterly (dynamic and static), http://www.cbk.gov.kw/en/statistics-and-publication/statistical-releases/monthly.jsp http://www.cbk.gov.kw/en/statistics-and-publication/statistical-releases/quarterly.jsp

[2] Ministry of Finance Macroeconomic and Fiscal Policy Unit, *Citizen Budget: Citizen's Guide to the Kuwaiti Budget for Fiscal Year 2014/2015*, December 1, 2014

[3] Source: U.S. Energy Information Administration, http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RBRTE&f=D

[4] This is in line with the forecast by NBK Capital, see *Economic Update*, December 18, 2014, http://www.kuwait.nbk.com/InvestmentAndBrokerage/ResearchandReports/$Document/MonthlyBriefs/en-gb/MainCopy/$UserFiles/NBKPFBudget7month20141218E.pdf

[5] International Monetary Fund, *IMF Executive Board Concludes Article IV Consultation with Kuwait*, Press Release, December 9, 2014, http://www.imf.org/external/np/sec/pr/2014/pr14557.htm

[6] Source: Sovereign Wealth Fund Institute, http://www.swfinstitute.org/fund-rankings/, retrieved March 17, 2015

[7] In the regression, each 1 percentage point change in the ratio of the annual breakeven oil price to average annual oil price leads to a 0.0883 percentage point change in annual deposit growth; at the 99 percent confidence level. The standard error is 0.0240 percentage points.

[8] Source: Kuwait Stock Exchange

[9] Source: National Bank of Kuwait Annual Report, 2013, http://www.nbk.com/investorrelations/$Document/FinancialResults/en-gb/MainCopy/$UserFiles/AnnualReport2013%20(1).pdf, p. 115

[10] Central Bank of Kuwait, Financial Stability Report 2013, http://www.cbk.gov.kw/en/statistics-and-publication/publications/financial-stability-report.jsp, pp. 17-18

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Dr. Payne joined IBS in September 2014. Previously, he was senior economist at Bloomberg Government, based in Washington D.C., where he authored numerous studies on Dodd-Frank, Basel III, and U.S. monetary and fiscal policy. Prior to that, based in London, he was Vice President of Asian equities for JPMorgan and fund manager of Emerging Market equities at F&C Asset Management. He began his career at PriceWaterhouse Coopers, where he qualified as a chartered accountant. He holds a bachelor's degree from Cambridge University, England, and masters and doctorate degrees from the London School of Economics. His book, "The Consumer, Credit and Neoliberalism: Governing the Modern Economy" relates economic theory to monetary and banking policy in the U.K. and U.S. leading up the financial crisis of 2008.

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Both Fidaa and Naheel have been involved in writing over 50 analytical studies in a number of fields covering finance, credit, marketing, investment, management, organization, economy, human resources development and e-banking.