MOODY'S
RATINGS

# Rating Action: Moody's Ratings affirms Kuwait's A1 rating; maintains stable outlook

16 May 2024

New York, May 16, 2024 -- Moody's Ratings (Moody's) has today affirmed the Government of Kuwait's long-term local and foreign currency issuer ratings at A1. The outlook remains stable.

The rating affirmation reflects Moody's assessment that Kuwait's balance sheet and fiscal buffers will remain extremely strong for the foreseeable future and preserve macroeconomic and external stability. Balanced against this key credit strength is the lack of progress in reforms that would reduce the vulnerability of the economy and government finances to oil market volatility and long-term carbon transition risks, which reveals underlying and persistent institutional constraints. While the government aims to address the institutional impediments, how effective it will be is highly uncertain at this stage.

The stable outlook reflects balanced risks to the ratings. Progress in economic and fiscal diversification away from hydrocarbons not currently factored into Moody's baseline assumptions may reduce Kuwait's exposure to oil price fluctuations and long-term carbon transition. The recent dissolution of parliament and temporary suspension of related constitutional articles aimed at overcoming institutional constraints has the potential to accelerate reforms. By contrast, increasing global momentum towards carbon transition that significantly lowers the demand for and price of oil would likely weigh on Kuwait's credit metrics and weaken the credit profile in the absence of fiscal and economic reforms. Moody's baseline scenario assumes that there is no significant escalation of the geopolitical conflict in the Middle East region into a full-scale multifront conflict that involves Iran, which could have significant negative implications for sovereigns in the region depending on transmission channels, exposures and buffers.

Kuwait's local and foreign currency country ceilings have been raised to Aa1 from Aa2. The three-notch gap between the local currency ceiling and the sovereign rating reflects the country's stable balance of payments through episodes of oil price volatility, against the economy's exposure to a key revenue source and a challenging domestic political environment that constrains reform and diversification prospects. The zero-notch gap between the foreign currency ceiling and local currency ceiling reflects very low transfer and convertibility risks, given the country's very large net external creditor position that includes ample foreign exchange reserves held by the central bank.

RATINGS RATIONALE

RATIONALE FOR THE RATING AFFIRMATION

Kuwait's sovereign balance sheet and fiscal buffers will remain extremely strong for the foreseeable future, anchoring the sovereign credit profile. However, lack of progress in reforms that is largely the result of underlying and persistent institutional constraints exposes the government to oil market volatility and long-term carbon transition risks. In the past week the sovereign took the extraordinary step to temporarily suspend parliament for up to four years in an attempt to address the institutional impediments to reform, but building a track record of credible and effective policies is likely to take time.

Moody's expects Kuwait's government financial assets (GFA) to remain very large over the coming years. Moody's estimates that the country's GFA, which mainly comprise assets in the Future Generations Fund (FGF), exceeded 400% of GDP at the end of 2023 – among the highest across rated sovereigns. Since there is no mechanism to transfer funds or income from FGF into the government's budget or the General Reserve Fund (GRF, the government's treasury account), Moody's expects the size of FGF will continue to grow in tandem with global asset prices.

At the same time, Kuwait's debt burden is extraordinarily low, in part due to the expiration of the previous public debt law in 2017 preventing debt issuance despite some years of sizeable deficits since then. Government debt was less than 3% of GDP as of the end of fiscal 2023 (ending March 2024), which is among the very lowest globally and also results in very strong debt affordability. Moody's assumes that a new law allowing the government to incur new debt will eventually be passed, which will mean a higher debt burden based on the rating agency's fiscal deficit forecasts of 4-7% of GDP over fiscal years 2024-27. That said, the debt burden will remain low and Kuwait's net asset position will remain very large in the coming years.

Kuwait's very large fiscal buffers preserve macroeconomic and external stability. Moody's estimates that Kuwait runs a very large net international investment position because of FGF. The very sizeable stock of foreign assets which also includes foreign exchange reserves at the Central Bank of Kuwait significantly lowers external vulnerability risk by supporting the credibility of Kuwait's currency basket peg and deterring speculation against the Kuwaiti dinar, even during periods of lower oil prices. In turn, the monetary policy regime – with the currency as the nominal anchor – has been effective in maintaining price stability and limiting inflation volatility.

Counterbalancing these credit strengths, Kuwait is one of the sovereigns most dependent on the hydrocarbon sector. Hydrocarbons account for more than 90% of the country's exports and government revenue, exposing it to fluctuations in oil prices and long-term carbon transition. There has been limited progress in economic and fiscal diversification away from hydrocarbons in large part due to an unproductive relationship between the government and parliament that has thus far impeded reforms.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects balanced risks to the rating.

On the upside, material progress in economic and fiscal reforms (not currently factored into Moody's baseline assumptions) can have a ripple effect through the economy, raising economic competitiveness from a low base and incentivising domestic and foreign private investment. Faster implementation of projects can also encourage economic diversification, particularly in industries where Kuwait has demonstrated some potential such as transport and logistics, downstream petrochemicals, data centres, and solar and wind energy. The temporary suspension of parliament provides a window for the government to push through credit-enhancing reforms given the institutional impediments Kuwait has faced, albeit with a risk of undermining the credibility of the country's institutional and governance framework if not used effectively.

On the downside, weakness in global demand or accelerating momentum in carbon transition weighing on oil prices and oil production in Kuwait would weaken the government's credit profile over time in the absence of fiscal and economic reforms, despite large fiscal buffers.

Moody's baseline scenario assumes that there is no significant escalation of the geopolitical conflict in the Middle East region into a full-scale multifront conflict that involves Iran. For Kuwait, the most pertinent channel is a potential shipping disruption through the Strait of Hormuz, since all of Kuwait's oil exports pass through the strait and the country's maritime ports lie within the Gulf. Such a disruption would affect government revenue, economic activity, and inflation. However, Kuwait's very large fiscal buffers can meet the government's financing needs for some time depending on the duration of the disruption. Such an escalation scenario remains a tail risk due to the economic disincentives for the parties involved.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Kuwait's ESG credit impact score of CIS-3 indicates that ESG considerations are having some impact on the rating, with greater potential for future negative impact over time given the country's ESG risk exposures. Kuwait is negatively exposed to environmental risks, particularly long-term global carbon transition, and social risks to a lesser extent. Institutional challenges constrain the government's ability to respond to shocks.

Kuwait's exposure to environmental risks (E-4 issuer profile score) primarily stems from carbon transition as the economy and government finances are highly susceptible to a global transition away from hydrocarbon fuels over the longer term, although low oil production costs provide a degree of insulation to this long-term risk. While less pertinent than carbon transition, Kuwait is also susceptible to water management risks as it is one of the world's ten most arid states, although the use of desalination plants reduces water supply challenges.

The exposure to social risks (S-3 issuer profile score) is driven mainly by the country's young demographics, which will drive rapid growth in the labour force over the coming decades. The challenge in keeping unemployment low among citizens is more relevant in Kuwait than some of its regional peers because its private sector is relatively underdeveloped. However, the country's financial wealth places it in a position of comparative strength to manage the social challenges.

The influence of governance (G-3 issuer profile score) in Kuwait largely reflects underlying and persistent challenges in the institutional framework, exemplified by the fractious relationship between the government and parliament, that have impeded effective policy formation and constrained the sovereign's ability to implement longer term reforms and respond to shocks. The sovereign is aiming to raise policy effectiveness through the temporary suspension of parliament and eventual constitutional reform, albeit with a risk of undermining the credibility of the country's institutional and governance framework if not used effectively.

GDP per capita (PPP basis, US$): 53,171 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 6.1% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.2% (2022)

Gen. Gov. Financial Balance/GDP: 11.4% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: 46.3% (2022) (also known as External Balance)

External debt/GDP: 27.8% (2022)

Economic resiliency: baa1

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 13 May 2024, a rating committee was called to discuss the rating of the Kuwait, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's governance and/or management, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The systemic risk in which the issuer operates has not materially changed. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The rating may be upgraded if prospects for fiscal and economic diversification away from oil were to significantly improve, in turn raising Moody's assessment of the sovereign's resilience to longer-term carbon transition risks. Indications of greater policy effectiveness that increased the government's ability to respond to shocks, including through a more productive institutional framework over time, would also exert upward pressure on the rating.

The rating may be downgraded if the government's fiscal strength were likely to substantially weaken over the medium term, potentially in a scenario where the inability to implement reforms led to wide fiscal deficits as oil prices decline, and accompanied by markedly higher debt (should a new debt law be passed) and/or lower fiscal buffers. While unlikely in the near term, renewed government liquidity risk, particularly if assets in GRF were to be significantly drawn down because of persistently wide fiscal deficits, would also exert downward pressure on the rating.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

The local market analyst for this rating is Christian Fang, +971 (423) 795-34.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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