S&P Global
Ratings

RatingsDirect®

Research Update:

State of Kuwait Ratings Affirmed At 'AA/A-1+'; Outlook Stable

Primary Credit Analyst:
Aarti Sakhuja, London (44) 20-7176-3715; aarti.sakhuja@spglobal.com

Secondary Contact:
Benjamin J Young, Dubai (971) 4-372-7191; benjamin.young@spglobal.com

Research Contributor:
Shruti Ramakrishnan, Mumbai (91) 22-3342-1966; shruti.ramakrishnan@spglobal.com

Table Of Contents

Research Update:

State of Kuwait Ratings Affirmed At 'AA/A-1+'; Outlook Stable

Overview

- We anticipate Kuwait's large government and external net asset positions will continue to afford the authorities space to gradually consolidate government finances without weighing on growth.
- We are therefore affirming our 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Kuwait.
- The stable outlook reflects our expectation that Kuwait's public and external balance sheets--backed by sizeable financial assets--will remain strong over the forecast horizon, offsetting risks related to lower oil prices, Kuwait's undiversified oil economy, its relatively nascent parliamentary system, and regional geopolitical tensions.

Rating Action

On Aug. 4, 2017, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Kuwait. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Kuwait's public and external balance sheets will remain strong over the forecast horizon, backed by a significant stock of financial assets. We expect these strengths to offset risks related to the current low oil price, Kuwait's undiversified oil economy, and what we assess as its relatively nascent parliamentary system, in addition to geopolitical tensions in the region.

We could lower the ratings if:

- The policy response to low oil prices failed to lift growth over the forecast horizon amid weaker fiscal and external finances;
- Kuwait's domestic political stability deteriorated; or
- Geopolitical risks were to significantly escalate.

We could raise the ratings if political reforms enhanced institutional effectiveness and improved long-term economic diversification, or if prospects for the oil sector improved significantly, though we think such scenarios are unlikely over the forecast horizon.

Rationale

The ratings on Kuwait continue to be supported by the sovereign's high levels of accumulated fiscal, external, and household wealth, despite the subdued--albeit improved--oil price environment. The ratings are constrained by the concentrated nature of the economy and regional geopolitical tensions. Kuwait derives about 60% of GDP, more than 90% of exports, and about 90% of fiscal receipts from hydrocarbon products. Given this high reliance on the oil sector, we view Kuwait's economy as undiversified.

Institutional and Economic Profile: Economic resilience is boosted by public investment spending and gradual fiscal consolidation

- Despite lower oil prices, growth momentum will be maintained thanks to a broad public investment program.
- Decision-making ultimately rests with the Emir.
- The alignment of Kuwait's foreign policy with the wider Gulf Cooperation Council (GCC) will limit spill-over effects of the Qatari crisis.

The sharp fall in oil prices since 2014 has caused a significant deterioration in Kuwait's income levels--as measured by GDP per capita--as well as in its fiscal and external metrics, as has happened with other large oil exporters. However, the creation of large fiscal and external assets via the transfer of past oil windfalls has afforded Kuwaiti policymakers the space to counter slowing growth by increased spending, particularly on infrastructure projects.

As a result, the economy has remained relatively resilient and job losses, particularly in the public sector, have been minimal. We estimate that real GDP grew by 3% in 2016 supported by public investment growth. Over 2017-2020, we expect the economy to grow at a similar pace on average supported by public spending on infrastructure projects.

The first public-private partnership (PPP) projects have been completed since the PPP law came into force in 2015. Over the next few years, other projects in power, infrastructure, and housing, currently in various stages of implementation, are likely to be completed. This will help maintain economic growth, offsetting the effects of low oil prices.

We also expect a boost to growth as increased capacity from investments in gathering centers and upgrades to existing oil fields gradually come on stream, over the forecast horizon. We expect Kuwait will remain compliant with its commitment to OPEC to cut production to 2.7 million barrels per day (bpd) until the end of 2017. From then on, we anticipate that Kuwaiti oil output will rise to over 3 million bpd in 2020. Production could increase further if an ongoing dispute in the shared neutral zone with Saudi Arabia is fully resolved.

We assume oil prices (Brent) will average US$50 per barrel (/bbl) in 2017 and 2018, and $55/bbl in 2019 and beyond (see "S&P Global Ratings Raises Its Oil and Natural Gas Price Assumptions For 2017," published Dec. 14, 2016, on RatingsDirect). Kuwaiti crude (KEC) trades at about a US$5 discount to Brent.

Kuwait's political system is characterized by a powerful cabinet appointed by the Emir and a democratically elected parliament with limited authority over ministerial decisions. Decision-making ultimately rests in the hands of the Emir, who can dissolve parliament. This limits institutional checks and balances, in our view.

Kuwait has been playing the role of mediator after several GCC members boycotted Qatar (see "Research Update: Qatar Long-Term Rating Lowered To 'AA-'; On Watch Negative After Six Arab Countries Sever Ties," published on June 7, 2017). Efforts to broker a solution have not yielded results. However, we anticipate the risk of negative spillover effects from this crisis on Kuwait to be fairly low. Kuwait's foreign policy is aligned to that of the other GCC countries and is based around its strategic alliance with the U.S. and Saudi Arabia.

Geopolitical tensions persist, with the IS militant group in Iraq and Syria, as well as the ongoing war in Yemen, posing a threat to the wider region and Kuwait.

Flexibility and Performance Profile: Kuwait's sizeable fiscal and external buffers remain key ratings strengths

- We anticipate gradual fiscal consolidation through 2020 and general government financing needs being met via a mix of debt issuance and asset drawdowns.
- We expect the current account deficit to be financed via asset drawdowns and sovereign debt issuance until 2018.
- Kuwait maintains one of the largest pools of liquid external assets of all sovereigns we rate and,in a stress scenario we believe it would be able to defend its currency peg.

In Kuwait's case, the central government deficit informs the central government's financing requirement while the overall general government balance includes all levels of government including flows related to the Kuwait Investment Authority (KIA). At the general government level, we consider mandatory transfers to the Reserve Fund for Future Generations (RFFG) as savings rather than expenditure, and we add investment income earned on the government's large stock of assets at the KIA. At the general government level, we estimate that Kuwait ran a small surplus in fiscal year 2016/17 (ended March 31) of 0.1% of GDP (compared to a deficit of nearly 18% of GDP at the central government level). We anticipate that recurrent investment income will allow the general government to remain in surplus over the forecast horizon, with the surplus widening to 13.5% of GDP in fiscal year 2020/21.

In our calculation of central government fiscal deficits, we treat as expenditure the mandatory transfers to the RFFG (10% of revenues) and do not include investment income earned on the government's substantial fiscal assets, managed by the Kuwait Investment Authority. As a result of the fall in oil prices, Kuwait's central government fiscal surplus narrowed considerably and then turned into a deficit in fiscal year 2014/15. In fiscal 2016/17, we estimate that the central government deficit widened slightly to 17.66% of GDP from 17.32% in fiscal 2015/16. While the government has taken measures to cut current expenditures--for instance by cutting subsidies and hiking fuel and electricity prices--it has used its substantial fiscal flexibility to ramp up capital expenditures. With our revised oil price assumptions and our expectations for oil production, we forecast the central government deficit will narrow to around 7% of GDP by 2020/21.

The central government fiscal deficit is likely to close faster if some of the measures the government is currently considering, such as the introduction of a flat corporate tax and a value-added tax, are implemented. However, we do not anticipate that these are likely to come into force before 2019 at the earliest. We therefore anticipate that revenues will continue to be concentrated on oil, a volatile base. On the expenditure side, the government has tried to restrain spending on goods and services, though the wage bill is estimated to have increased. The biggest savings have been on fuel subsidies, which automatically fell after the fall in the oil purchase price. Electricity tariff increases have also been implemented. Wage freezes and the repricing of public services are being considered, but are likely to face significant opposition.

Over our forecast horizon through 2020, we expect the central government to finance deficits through a mix of KIA asset drawdowns and debt issuance. Kuwait undertook its first sovereign international bond issuance in March 2017, raising US$8 billion (6.5% of estimated 2017 GDP). We anticipate general government debt to rise to about 22% of GDP in 2020/21 from an estimated 18.61% in 2016/17. Even then, we project the government will remain in a comfortable net asset position when we account for its assets at the KIA.

The Kuwaiti government, via the KIA, has accumulated substantial assets through savings from oil and gas production over the years. The size of assets managed by the KIA is available only as a range of unofficial estimates of up to 5x of 2017 GDP. We take a conservative approach and give the government credit for about 3.5x of GDP in assets. Kuwait ranks the highest among all the sovereigns rated by S&P Global Ratings in terms of net general government assets (see "Sovereign Risk Indicators," published July 6, 2017; use the free interactive tool on www.spratings.com/sri).

By law, the Kuwaiti government has to allocate at least 10% of its annual revenues to the RFFG, managed by the KIA. Therefore, we consider that Kuwait has preserved its oil wealth in what we consider to be a prudent manner and the government's large net asset position is a significant ratings strength that provides a substantial buffer against lower oil prices.

The government does not publicly disclose the size and structure of the RFFG and information on KIA's assets is limited. However, we estimate that about 80% of the assets are in the RFFG and the rest in the General Reserve Fund (GRF). While the RFFG is designed to assist future generations, ostensibly after oil supplies have run out, the GRF can, and has, been used to meet present-day fiscal needs. We include both the RFFG and GRF in our estimate of government liquid assets because, if needed, we believe the government may consider authorizing drawdowns from the RFFG.

Weak oil prices prompted Kuwait's first current account deficit of 4.5% of GDP in 2016 compared to a surplus of 3.5% in 2015 and an average surplus of nearly 40% over 2010-2014. The deficit was financed by the liquation of assets held abroad. We project that the current account will return to a surplus in 2019 in line with our assumptions on oil prices and production. Until then we anticipate deficits will be financed by a mix of external borrowing--primarily via sovereign debt issuance--and the liquidation of external assets.

Even then we estimate that Kuwait's net external asset position will remain very strong at 7.5x current account receipts (CARs) in 2017. Moreover, we project that gross external financing needs will remain relatively low, averaging about 100% of CARs plus usable reserves over the next four years. On its external accounts, Kuwait's metrics are very strong, and stronger than those of almost all peers, including in the GCC. We note, however, that Kuwait does not publish an international investment position, restricting our visibility on external risks, for instance on liabilities of the nonbank sector and the foreign exposure of its banking system.

Kuwait's exchange rate is pegged to an undisclosed basket of currencies; this basket is dominated by the U.S. dollar, the currency in which the majority of Kuwaiti exports are priced and transacted. We view Kuwait's regime as slightly more flexible than the foreign exchange regimes in most other GCC countries, which maintain a peg to the dollar alone. That said, we acknowledge that the exchange rate regimes for all GCC countries are consistent with a reliance on U.S. dollar-based oil export revenues and that Kuwait has sufficient resources to defend the peg.

We view Kuwait's financial system as stable; its banks are reasonably well capitalized, with ample liquidity as per Basel III standards, and operate in a reasonably strong regulatory environment. Our Banking Industry Country Risk Assessment for Kuwait is '4', on a scale of '1' (strongest) to '10' (weakest) (see "Banking Industry Country Risk Assessment: Kuwait," published June 2, 2016).

Key Statistics

Table 1

State of Kuwait Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	43	49	49	46	34	34	37	39	43	44
Nominal GDP (bil. $)	154	174	174	163	115	111	123	129	142	147
GDP per capita (000s $)	47.6	50.9	48.5	43.3	29.4	27.7	30.0	30.7	33.1	33.4
Real GDP growth	9.6	6.6	1.1	0.5	1.8	3.0	3.0	3.5	3.2	3.2
Real GDP per capita growth	3.5	1.0	(3.8)	(3.8)	(1.8)	0.3	0.5	1.2	0.9	0.9
Real investment growth	(2.3)	5.1	8.9	4.5	13.0	15.0	20.0	4.0	3.0	5.0
Investment/GDP	13.5	12.8	14.4	16.3	25.4	27.0	29.1	29.4	27.7	28.6
Savings/GDP	56.5	58.3	54.3	49.5	28.9	22.5	26.1	26.7	30.1	32.0
Exports/GDP	73.2	74.7	70.9	68.5	53.8	48.2	46.5	47.7	50.9	50.7
Real exports growth	14.3	7.7	(4.0)	1.4	1.0	(3.5)	(4.4)	6.3	6.0	2.8
Unemployment rate	2.1	1.7	1.8	2.9	1.1	1.1	1.5	1.7	1.7	1.7
EXTERNAL INDICATORS (%)										

Table 1

State of Kuwait Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Current account balance/GDP	42.9	45.5	39.9	33.2	3.5	(4.5)	(3.0)	(2.7)	2.4	3.4
Current account balance/CARs	53.5	55.5	50.9	42.4	5.5	(7.6)	(5.3)	(4.7)	4.0	5.7
CARs/GDP	80.2	81.9	78.4	78.2	63.8	59.0	56.3	57.4	59.7	59.7
Trade balance/GDP	52.1	54.8	51.8	47.6	24.4	18.1	18.4	19.1	22.8	22.6
Net FDI/GDP	(4.9)	(2.2)	(8.7)	(7.8)	(4.4)	(3.7)	(3.5)	(3.5)	(5.0)	(5.0)
Net portfolio equity inflow/GDP	(5.8)	(4.2)	(11.1)	(17.6)	(23.6)	(15.0)	(10.0)	(10.0)	(12.0)	(11.0)
Gross external financing needs/CARs plus usable reserves	52.9	50.1	51.6	60.5	89.9	106.1	102.2	105.3	100.1	100.0
Narrow net external debt/CARs	(253.6)	(259.6)	(299.7)	(339.9)	(581.0)	(656.8)	(616.5)	(582.4)	(517.6)	(517.0)
Net external liabilities/CARs	(330.8)	(322.1)	(370.9)	(408.1)	(701.5)	(806.5)	(756.6)	(712.5)	(634.9)	(633.9)
Short-term external debt by remaining maturity/CARs	15.5	14.6	13.1	15.9	32.3	40.7	39.0	39.1	38.1	39.6
Usable reserves/CAPs (months)	4.4	4.8	5.1	4.4	5.2	4.4	4.7	4.2	4.3	4.3
Usable reserves (mil. $)	25,466	28,346	27,151	30,061	26,033	28,563	26,992	28,886	29,674	29,801
FISCAL INDICATORS (%, General government)										
Balance/GDP	38.6	35.2	35.1	18.1	0.2	0.1	6.6	8.4	12.9	13.5
Change in debt/GDP	(0.2)	(0.7)	(0.2)	0.7	0.8	7.3	3.3	2.5	1.8	1.3
Primary balance/GDP	38.7	35.3	35.2	18.1	0.3	0.2	6.7	8.5	13.1	13.7
Revenue/GDP	78.7	74.3	73.4	64.4	53.1	53.4	54.6	55.5	56.2	56.2
Expenditures/GDP	40.0	39.1	38.3	46.3	52.9	53.3	48.1	47.1	43.3	42.6
Interest /revenues	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.3
Debt/GDP	8.6	6.8	6.5	7.6	11.0	18.6	20.1	21.9	21.6	22.2
Debt/Revenue	10.9	9.2	8.8	11.8	20.6	34.9	36.7	39.5	38.4	39.4
Net debt/GDP	(220.5)	(221.0)	(243.7)	(281.2)	(393.2)	(410.4)	(371.0)	(370.7)	(354.8)	(364.5)
Liquid assets/GDP	229.1	227.8	250.2	288.8	404.2	429.0	391.1	392.6	376.4	386.7
MONETARY INDICATORS (%)										
CPI growth	4.9	3.2	2.7	2.9	3.3	3.2	3.5	3.7	4.0	4.0
GDP deflator growth	17.2	7.5	0.2	(6.8)	(26.9)	(5.6)	8.0	0.0	7.0	(0.0)
Exchange rate, year-end (LC/$)	0.28	0.28	0.28	0.29	0.30	0.31	0.30	0.30	0.30	0.30
Banks' claims on resident non-gov't sector growth	2.6	2.8	7.3	5.1	7.9	2.5	7.0	7.0	7.0	7.0
Banks' claims on resident non-gov't sector/GDP	66.4	59.6	63.0	70.7	102.4	108.0	103.9	107.4	104.1	107.8

Table 1

State of Kuwait Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	6.8	6.8	8.6	7.7	9.2	7.2	9.5	9.5	9.5	9.5
Real effective exchange rate growth	1.1	3.0	2.5	3.1	8.2	2.4	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

State of Kuwait Ratings Score Snapshot

Key rating factors	
Institutional assessment	Neutral
Economic assessment	Neutral
External assessment	Strength
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Strength
Monetary assessment	Neutral

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23,2014
- General Criteria: Methodology: Criteria For Determining Transfer And

Convertibility Assessments - May 18,2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07,2017

Related Research

- Industry Report Card: GCC Banks Will Show Resilience In The Face Of A Weaker Operating Environment In 2017-2018 - January 23, 2017
- Middle East And North Africa Sovereign Rating Trends 2017 - January 10, 2017
- Sovereign Risk Indicators - July 6, 2017. An interactive version is also available at http://www.spratings.com/sri
- GCC Sovereigns' Financing Needs In 2015-2019 Could Total $560 Billion - October 17, 2016
- Banking Industry Country Risk Assessment: Kuwait - June 2, 2016
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- Middle East And North Africa Sovereign Rating Trends Midyear 2017, July 12, 2017
- Gulf Sovereigns Will Find It Hard To Diversify Away From Hydrocarbons, July 25, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

	Rating	
	To	From
Kuwait (State of)		
Sovereign Credit Rating		
Foreign and Local Currency	AA/Stable/A-1+	AA/Stable/A-1+
Transfer & Convertibility Assessment	AA+	AA+
Senior Unsecured		
Foreign Currency	AA	AA
Foreign Currency	A-1+	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Additional Contact:
SovereignEurope; SovereignEurope@spglobal.com