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Research Update:

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

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Overview

- We expect Kuwait to continue to hold extremely large government and external net asset positions, allowing the authorities space to gradually implement reforms.
- We are therefore affirming our 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Kuwait.
- The outlook is stable.

Rating Action

On July 20, 2018, 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 next two years, backed by a significant stock of financial assets. We expect these strengths to offset risks related to volatile oil prices, Kuwait's undiversified economy, and rising geopolitical tensions in the region.

We could lower the ratings if we lower our assessment of monetary flexibility in the country. We could also lower the ratings if Kuwait's domestic political stability deteriorated, or if geopolitical risks were to significantly escalate.

We could raise the ratings if political reforms enhanced institutional effectiveness and improved long-term economic diversification, although we think such a scenario is unlikely over the forecast horizon.

Rationale

The ratings on Kuwait continue to be supported by the sovereign's high levels of accumulated fiscal and external buffers. The ratings are constrained by the concentrated nature of the economy and regional geopolitical tensions. Kuwait derives around 55% 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.

The sharp fall in oil prices since 2014 caused some deterioration in Kuwait's income levels as well as in its fiscal and external metrics, similar to other large oil exporters. However, large fiscal and external assets that were accumulated owing to past oil windfalls have afforded policymakers the space to phase in fiscal reforms gradually and counter the decline in the hydrocarbon sector by increased spending under the Kuwait National Development Plan, particularly on infrastructure projects.

Institutional and Economic Profile: Economic activity to pick up over the next four years after contracting in 2017

- We expect rising oil production from the second half of 2018 and public investment to drive real GDP growth of 2.8% on average over 2018-2021.
- Domestic politics remains contentious, with strong parliamentary opposition to fiscal austerity, but we do not anticipate any significant risk to the management of public finances or the economy.
- We expect Kuwait's foreign policy to continue to be aligned with the U.S. and Saudi Arabia, and we expect limited spillover to Kuwait from regional geopolitical conflicts.

We assume oil prices (Brent) will average US$65 per barrel (/bbl) in 2018, before falling to $60/bbl in 2019 and $55/bbl over 2020-2021 (see "S&P Global Ratings Raises 2018 Brent And WTI Oil Price Assumptions And 2019 Brent Price Assumptions," published May 7, 2018, on RatingsDirect). Kuwaiti crude oil trades at about a $5 discount to Brent.

Despite higher oil prices of $55/bbl in 2017 relative to the previous year, Kuwait experienced a large contraction in real GDP growth of 2.9%. The decline was mainly due to a 5% decrease in oil production implemented under the Organization of the Petroleum Exporting Countries (OPEC) agreement. We expect growth to return to positive territory in 2018 on the back of some recovery in oil production expected in the second half of the year (following an agreement reached by OPEC on June 22, 2018), and steady public spending on infrastructure projects. Higher oil prices in 2018-2019 and the delay of the introduction of value added tax (VAT) will also likely support private and public consumption.

Over the medium term, we anticipate that Kuwaiti oil output will rise to over 3 million barrels per day (bpd) by 2020, from around 2.7 million bpd currently. Kuwait Petroleum Corporation plans to raise oil production capacity to 4 million bpd by 2020. This ambitious target would be supported by recent news that Kuwait and Saudi Arabia plan to resume oil production at their shared neutral zone from 2019. Production at the jointly operated Khafji and Hout oil fields was suspended in 2014.

Over the next few years, we also expect several projects in power, infrastructure, and housing, currently in various stages of implementation, to be launched and completed. Although the tendering process of several public-private partnership (PPP) projects had stalled in 2017, we understand that the authorities plan to award two PPP projects this year--a waste treatment project and a sewage plant. While these large-scale PPPs and planned privatization of assets will support economic diversification and private sector engagement, we believe that progress will be slower than anticipated due to likely delays in implementation.

Kuwait's political system is characterized by a powerful cabinet appointed by the Emir and a democratically elected parliament. The relationship between the two has been historically confrontational. Parliamentary opposition has led to delays in economic and fiscal reforms, with Kuwait lagging behind other Gulf Cooperation Council (GCC) countries such as the United Arab Emirates and Saudi Arabia in its response to lower oil prices. However, we also note Kuwait's track record of prudent fiscal policy that has focused on creating large fiscal assets and saving windfalls for future generations via mandatory transfers from government revenues.

Geopolitical tensions in the region are likely to persist and perhaps increase due to ongoing tensions between the GCC countries and Iran and the re-imposition of sanctions on Iran by the U.S. We anticipate the risk of negative spillover effects on Kuwait from geopolitical risks to be fairly low at this point.

Relations have also soured within the GCC since Saudi Arabia, the United Arab Emirates, and Bahrain, along with some other countries in the region, imposed a boycott on Qatar in June 2017. Kuwait has traditionally taken a neutral position in regional conflicts and continues to play the role of mediator, with minimal success thus far. We expect Kuwait's foreign policy will remain aligned with its strategic partners, the U.S. and Saudi Arabia.

Flexibility and Performance Profile: Kuwait's sizable fiscal and external buffers remain key rating strengths

- We expect the government to delay some fiscal reforms in light of higher oil prices, particularly the introduction of VAT, leading to continued central government budget deficits.
- The government plans to meet its financing needs by balancing debt issuances and asset drawdown, subject to parliamentary approval.
- Kuwait still maintains one of the largest pools of liquid external assets of all the sovereigns we rate and, in a stress scenario, we believe it would be able to defend its currency peg.

Lower oil prices since 2014 have caused Kuwait's central government balance to remain deep in deficit (having been in surplus in the fiscal year ended March 31, 2014 or fiscal 2013). During fiscal 2017, we estimate that the central government deficit narrowed to 14.6% of GDP, from close to 18% in fiscal 2016, owing to higher oil revenues. We estimate that temporarily higher oil prices in 2018 will support a further reduction in the deficit to 10.6% of GDP in fiscal 2018.

The government's policy response to lower oil prices has been fairly limited and gradual given the large fiscal buffers, opposition in parliament, and the political will to maintain the social contract with its population and preserve the welfare state. We expect reform momentum aimed at diversifying revenues will slow further in the context of higher oil prices during 2018. For example, the government plans to further postpone the implementation of VAT from 2019 due to a delay in parliamentary approval. Instead, we expect the government to focus on moderating expenditure growth by somewhat limiting new employees in the public sector, strictly enforcing current welfare policies to reduce overspending, and charging nominal fees to cover the cost of providing services to its citizens. The authorities also plan to introduce excise taxes on certain goods in 2019, subject to parliamentary approval. The government intends to divest underutilized assets and privatize around 40 assets over the next 25 years. It is currently studying the feasibility of privatizing the North Shuaiba power plant, fixed line and broadband telecoms infrastructure, the Ministry of Electricity and Water Central Workshop, and the national stock exchange.

At the general government level, we incorporate all potential sources of revenue and savings. This includes our estimates of the investment income of the Kuwait Investment Authority (KIA) and excludes from expenditures the mandatory 10% transfers from central government revenue to the KIA's Future Generations Fund (FGF). During fiscal 2017, we estimate that Kuwait ran a fiscal surplus of 8% of GDP. We anticipate that recurrent investment income will allow the general government budget to remain in surplus over the forecast horizon, with the surplus averaging more than 10% of GDP over fiscal 2018-2021 (albeit well below an average surplus of 31% between fiscal 2009 and 2014).

Despite fiscal surpluses at the general government level, the central government's deficit informs the government's financing requirements. The parliament has delayed the passing of a new debt law after the previous one expired in October 2017, obstructing any debt issuance thus far in 2018. As a result, the government has resorted to drawing down from the KIA's General Reserve Fund (GRF) to meet its funding needs. The new debt law proposes a rise in the debt ceiling to Kuwaiti dinar (KWD)25 billion ($83 billion) from KWD10 billion currently (around $33 billion), and an increase in the maturity limit to 30 years from 10 years. It has met with some resistance in parliament. We expect the government to pursue a more balanced financing strategy between new debt and asset drawdown from 2019, subject to parliamentary approval of the debt law. Kuwait issued its first sovereign international bond of $8 billion in 2017, and will likely continue to tap external bond markets given current favorable rates, particularly compared with external asset returns. Even then, we project the government will remain in a comfortable net asset position when we account for its assets at the KIA.

We view the government's large net asset position as a significant ratings strength that provides a substantial buffer against volatile oil prices. The Kuwaiti government, via the KIA, has accumulated substantial assets through savings from oil and gas production over the years. We estimate total KIA assets at about 3.6x of GDP at end-2018. 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 5, 2018; see the free interactive tool on www.spratings.com/sri).

Although the government is drawing down on the assets of the GRF to finance deficits, it continues to build its external assets in the FGF through annual transfers from revenue and growing investment income. The FGF is designed to assist future generations, ostensibly after oil supplies have run out. We include both the FGF and GRF in our estimate of government liquid assets because, if needed, we believe the government may consider authorizing drawdowns from the FGF. This action would, however, need to be approved by the Emir and the parliament.

We estimate that Kuwait's net external asset position will remain very strong at more than 6x current account payments over 2018-2021. Moreover, we project that the current account receipts plus usable reserves will cover the country's gross external financing needs over the next four years. We now project an improved current account position compared with our previous forecasts, owing to our higher oil price assumptions for 2018-2019. On its external accounts, Kuwait's metrics remain stronger than most 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 the external liabilities of the private 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. In our view, Kuwait's regime is somewhat more flexible than the foreign exchange regimes in most other GCC countries, which maintain a peg to the dollar alone. We see evidence of this in the recent hiking cycles by the U.S. Federal Reserve, where the Central Bank of Kuwait decided to leave the key discount rate unchanged and lift only the deposit rate.

Key Statistics

Table 1

Kuwait Selected Indicators

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	49	49	46	34	34	36	41	42	43	44
Nominal GDP (bil. $)	174	174	163	115	111	120	136	139	142	148
GDP per capita (000s $)	51.3	48.4	43.0	29.1	27.4	29.0	32.2	32.3	32.3	33.0

Table 1

Kuwait Selected Indicators (cont.)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth	6.6	1.1	0.5	0.6	3.5	(2.9)	2.0	3.2	3.0	2.5
Real GDP per capita growth	0.2	(4.6)	(4.4)	(3.3)	0.6	(4.8)	0.0	1.2	1.0	0.5
Real investment growth	5.1	8.9	4.5	15.5	2.0	3.3	5.5	4.5	3.4	3.4
Investment/GDP	12.8	14.4	16.3	25.4	27.0	26.7	25.7	27.3	28.2	28.6
Savings/GDP	58.3	54.7	49.7	28.9	22.4	32.6	35.3	33.4	31.3	31.1
Exports/GDP	74.7	70.9	68.5	53.8	48.2	51.0	53.7	51.3	49.4	48.5
Real exports growth	7.7	(4.0)	1.4	(0.9)	1.8	(5.1)	0.5	2.5	2.0	1.5
Unemployment rate	1.7	1.8	2.9	2.2	2.2	2.0	2.0	2.0	2.0	2.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	45.5	40.3	33.4	3.5	(4.6)	5.9	9.6	6.2	3.1	2.5
Current account balance/CARs	55.5	51.4	42.8	5.2	(7.2)	8.7	14.0	9.3	4.7	3.9
CARs/GDP	81.9	78.4	78.1	67.2	63.2	67.9	68.7	66.7	65.2	63.8
Trade balance/GDP	54.8	51.8	47.7	24.4	17.6	21.3	24.9	22.2	20.0	19.4
Net FDI/GDP	(2.2)	(8.7)	7.0	(4.4)	(3.7)	(6.5)	(3.6)	(3.6)	(3.5)	(3)
Net portfolio equity inflow/GDP	(4.2)	(11.1)	(30.1)	(23.6)	(15.0)	(20.7)	(10)	(10.0)	(8)	(7.5)
Gross external financing needs/CARs plus usable reserves	50.1	51.1	60.2	90.2	105.9	92.2	90.1	97.0	102.8	105.9
Narrow net external debt/CARs	(260.1)	(300.7)	(342.4)	(566.8)	(650.6)	(573.9)	(524.4)	(551.1)	(574.4)	(589.3)
Narrow net external debt/CAPs	(584.8)	(618.7)	(598.8)	(598.0)	(606.8)	(628.6)	(609.8)	(607.3)	(603.0)	(613.4)
Net external liabilities/CARs	(322.6)	(371.9)	(410.6)	(681.3)	(790.2)	(697.1)	(634.0)	(662.3)	(685.8)	(697.5)
Net external liabilities/CAPs	(725.4)	(765.2)	(718.1)	(718.8)	(737.0)	(763.6)	(737.2)	(729.8)	(720.0)	(726.0)
Short-term external debt by remaining maturity/CARs	14.6	13.1	15.9	30.7	38.0	33.1	34.2	36.4	39.2	41.5
Usable reserves/CAPs (months)	4.8	5.1	4.5	4.9	4.2	4.6	4.7	4.1	3.9	3.7
Usable reserves (mil. $)	28,346	27,151	30,061	26,033	28,565	31,117	28,865	28,380	28,188	27,113
FISCAL INDICATORS (%, General government)										
Balance/GDP	35.0	35.7	19.2	3.7	4.9	8.0	11.9	10.0	9.5	9.9
Change in net debt/GDP	(28.5)	(26.1)	(22.0)	(23.3)	(11.4)	(5.8)	(9.7)	(10.8)	(10.3)	(10.8)
Primary balance/GDP	35.1	35.8	19.2	3.8	5.0	8.3	12.2	10.5	10.1	10.6
Revenue/GDP	74.1	74.0	65.4	56.6	57.8	61.2	64.5	63.2	62.1	61.5
Expenditures/GDP	39.1	38.3	46.3	52.9	52.8	53.2	52.6	53.2	52.6	51.6
Interest /revenues	0.1	0.1	0.1	0.1	0.2	0.6	0.6	0.7	0.9	1.2
Debt/GDP	6.8	6.5	7.6	11.0	18.6	18.9	19.8	25.2	32.2	39.1
Debt/revenue	9.2	8.8	11.6	19.4	32.2	30.9	30.7	39.8	51.9	63.5
Net debt/GDP	(221.4)	(244.4)	(282.8)	(403.0)	(426.0)	(397.6)	(364.1)	(367.9)	(370.4)	(366.8)
Liquid assets/GDP	228.2	250.9	290.4	413.9	444.6	416.5	383.9	393.1	402.6	405.9

Table 1

Kuwait Selected Indicators (cont.)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
MONETARY INDICATORS (%)										
CPI growth	3.2	2.7	2.9	3.7	3.5	1.5	1.8	2.5	2.2	2.2
GDP deflator growth	7.5	0.2	(6.8)	(26.0)	(6.1)	11.9	10.0	(1.2)	(0.8)	1.5
Exchange rate, year-end (LC/$)	0.28	0.28	0.29	0.30	0.31	0.30	0.30	0.30	0.30	0.30
Banks' claims on resident non-gov't sector growth	2.8	7.3	5.1	7.9	2.7	3.4	3.0	3.0	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	59.6	63.0	70.7	102.4	108.2	102.9	94.4	95.4	96.2	95.2
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	8.6	7.7	9.2	7.2	6.5	6.0	6.0	6.0	6.0
Real effective exchange rate growth	3.0	2.5	3.0	8.2	2.2	N/A	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. N/A--Not available. 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

Kuwait Ratings Score Snapshot

Key rating factors	
Institutional assessment	4
Economic assessment	3
External assessment	1
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	1
Monetary assessment	3

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Middle East And North Africa Sovereign Rating Trends For Midyear 2018, July 16, 2018
- Global Sovereign Rating Trends Midyear 2018, July 16, 2018
- Sovereign Ratings Score Snapshot, July 10, 2018
- Sovereign Risk Indicators, July 5, 2018. An interactive version is available at www.spratings.com/sri.
- Sovereign Ratings History, July 5, 2018
- Default, Transition, and Recovery: 2017 Annual Sovereign Default Study And Rating Transitions, May 8, 2018
- S&P Global Ratings Raises 2018 Brent And WTI Oil Price Assumptions And 2019 Brent Price Assumptions, May 7, 2018
- Sovereign Ratings List, June 5, 2018
- Banking Industry Country Risk Assessment: Kuwait, September 29, 2017
- Sovereign Debt 2018: MENA Borrowing To Decline By 6% To $181 Billion, February 22, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, February 22, 2018

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

Ratings Affirmed

Kuwait	
Sovereign Credit Rating	AA/Stable/A-1+
Transfer & Convertibility Assessment	AA+
Senior Unsecured	
Foreign currency	AA
Foreign currency	A-1+

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