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Research Update:

Ratings On Kuwait Affirmed At 'AA/A-1+' Despite Low Oil Prices; Outlook Stable

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Overview

- The sharply lower oil price environment since mid-2014 significantly reduced our forecast of Kuwait's fiscal and external surpluses, given the country's high dependence on oil. However, Kuwait has built up very large fiscal and external net asset positions over many years, which will help it weather the current low oil price environment.
- 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 overall fiscal and external positions will remain strong, backed by a significant stock of financial assets. We expect these strengths to offset risks related to the current low oil price environment, Kuwait's undiversified oil economy, and what we assess as a volatile political environment, in addition to geopolitical tensions in the region.

Rating Action

On Aug. 14, 2015, Standard & Poor's Ratings Services affirmed its 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Kuwait. The outlook is stable.

Rationale

Prices for crude oil have fallen by around 50% in the last year. We now forecast an average Brent oil price of $55/bbl in 2015 and $67.5/bbl in 2015-2018. The sharp fall in oil prices over the past year has significantly affected Kuwait's fiscal and current account (flow) positions. Nevertheless, our ratings on Kuwait remain unchanged as they continue to be supported by the sovereign's high levels of accumulated wealth and very strong external and fiscal asset (stock) positions--the Kuwaiti government, via the Kuwait Investment Authority (KIA), has accumulated substantial assets through oil and gas production over the years, saving its oil wealth in what we consider to be a prudent manner. The government's large net asset position, which we estimate at over three times GDP at the end of 2015, is a significant ratings strength providing a substantial buffer to lower oil prices. Nevertheless, the ratings are constrained by a very heavy reliance on oil, as well as domestic political risk and regional geopolitical tensions.

Our base-case scenario assumes that, despite the sharp fall in the oil price, OPEC will chose to broadly maintain its current oil production levels to undermine shale-oil production. Consequently, Kuwaiti oil output will remain at at least 2.7 million barrels per day until 2018. Kuwait's production is also likely to increase if OPEC choses to increase production, and if Kuwait's planned investment in the sector comes to fruition.

The general government budget has averaged a surplus of around 35% of GDP for the past decade, if we include investment income from funds held by the Kuwait Investment Authority (KIA). Fiscal surpluses in past years have contributed to the build-up of the significant net general government (and external) asset stocks. Even in the lower oil price environment, the Kuwaiti government will continue to run surpluses of around 14% of GDP for the budget years 2015-2018, when we include investment income from KIA funds.

The 2015/16 budget has a reduced spending plan of Kuwaiti dinar (KWD) 19 billion (compared to a budgeted allocation of KWD23.2 billion in 2014/15) and a planned deficit of KWD8.2 billion. Kuwait typically spends below its proposed budgetary allocations and with lower average oil prices in 2015/16 onward it will likely generate significant automatic savings on the fuel subsidy bill. In addition, some large one-off costs incurred in 2014/15, such as social security fund top-ups, are unlikely to repeat in 2015/16. When investment income is included, we forecast that Kuwait will still run a surplus in 2015/16.

We estimate that strong oil exports led to current account surpluses averaging more than 37% of GDP in 2008-2014. We forecast these surpluses will fall to an annual average of 15% in 2015-2018. Given the government's policy of investing a large portion of its surpluses abroad, we estimate Kuwait had a net external asset position of more than 300% of current account receipts (CARs) in 2014. We believe the government will maintain this large asset position given ongoing external surpluses and reinvestment--but we note a distortion in the ratio due to a sharp decline in the denominator because of the fall in current account receipts (owing to lower oil prices). At the same time, we project that gross external financing needs will remain relatively low, averaging around 75% of CARs plus usable reserves in the next four years.

Kuwait had increased its annual contributions to the KIA's Future Generations Fund (FGF) from 10% to 25% of total revenues in the last few fiscal years including in 2014/15, because higher oil prices had produced very strong revenues. Now that oil prices are sharply lower, transfers to the fund from 2015/16 are planned to revert back to 10% from 2015/16 onward. The fund will still continue to grow on reinvested earnings and ongoing, albeit lower, contributions. Disclosure about the size and structure of the FGF and KIA's assets is limited but the Sovereign Wealth Fund Institute and other sources estimate total assets at US$592 billion at end-2014.

We estimate real GDP growth to average about 2.1% in 2015-2018, but GDP per capita growth to contract by about 1% annually, partly because of high population growth, which is to an extent linked to large numbers of expatriates. Nevertheless, Kuwait's high wealth--we estimate GDP per capita at $44,500 in 2015--means that its weak economic growth performance (on a per capita basis) does not currently affect our ratings.

Kuwait's exchange rate is pegged to an undisclosed basket of currencies, with a large U.S. dollar component, which limits its monetary flexibility. We view its monetary flexibility as limited although we acknowledge that the exchange rate regime is consistent with Kuwait's reliance on U.S. dollar-based oil revenues and that Kuwait has sufficient resources to defend the peg. Kuwait's financial system remains fairly stable, in our view; its banks maintain healthy capital levels.

Geopolitical risks are high, with the so called IS militant group in Iraq and Syria posing a potential threat to the wider region and Kuwait. In June 2015, an IS militant detonated a bomb at a Shia mosque in Kuwait City; excluding the Gulf war it was the first terrorist attack on Kuwaiti soil since the 1980s. Nevertheless, it has so far not had wider repercussions or fueled tensions between the Sunni and Shia communities.

Domestically, the political system is dominated by a powerful government and vocal parliament, which have previously clashed on many issues. Kuwait held its third parliamentary election in 18 months in July 2013 and, owing to the boycott of the election by several opposition groups, a more government-friendly parliament was elected. Unlike the previous administration, it is more cooperative with the executive and this has led to more progress on long-planned projects. We have factored Kuwait's political and geopolitical framework into the current rating.

Outlook

The stable outlook reflects our expectation that Kuwait's fiscal and external positions will remain strong, backed by a significant stock of financial assets and significant oil reserves. We expect these strengths to offset risks related to the current volatile oil price, Kuwait's undiversified oil economy, and what we assess as an unpredictable political environment, in addition to geopolitical tensions in the region.

We could lower the ratings if a continued fall in oil prices were to undermine Kuwait's wealth levels, if Kuwait's domestic political stability were to significantly deteriorate, or if geopolitical risks were to escalate.

We could raise the ratings if political reforms were to enhance institutional effectiveness and improve long-term economic diversification, if geopolitical risks fade significantly, and prospects for the oil sector improve.

Key Statistics

Table 1

Kuwait (State of) Selected Indicators											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
ECONOMIC INDICATORS											
Nominal GDP (bil. KWD)	40	30	33	43	49	50	53	43	47	52	56
Nominal GDP (bil. US$)	147	106	115	154	174	176	188	149	164	178	192
GDP per capita (thousand US$)	54.5	37.2	38.6	49.3	53.5	52.2	53.9	41.5	44.4	46.8	49.0
Real GDP growth (%)	2.5	(7.1)	(6.0)	9.6	6.6	1.5	1.8	1.0	2.3	2.6	2.6
Real GDP per capita growth (%)	(3.1)	(11.9)	(10.5)	5.0	2.5	(2.1)	(1.4)	(1.9)	(0.7)	(0.4)	(0.4)
Real investment growth (%)	1.5	(18.9)	0.5	(2.3)	5.1	6.2	3.0	5.0	4.0	3.0	3.0
Gross domestic investment/GDP (%)	17.6	18.0	17.7	13.5	12.8	13.9	14.1	19.7	19.7	19.7	20.4
Gross domestic savings/GDP (%)	58.5	44.7	49.5	56.2	58.1	54.4	42.5	33.3	33.6	34.9	35.6
Exports/GDP (%)	66.8	59.4	66.7	73.2	74.7	71.6	67.5	54.8	55.7	57.0	57.2
Real exports growth (%)	2.2	(6.3)	(0.5)	14.3	7.7	(2.5)	(2.3)	1.5	4.0	4.0	4.0
Unemployment rate (average %)	1.7	1.7	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
EXTERNAL INDICATORS											
Current account balance/GDP (%)	40.9	26.8	31.8	42.7	45.2	40.5	28.4	13.6	14.0	15.2	15.2
Current account balance/CARs (%)	53.4	37.9	42.8	53.2	55.2	52.2	41.8	23.9	24.4	25.8	25.5
Trade balance/GDP (%)	43.4	33.9	41.2	52.1	54.8	51.3	41.3	27.8	28.6	29.4	29.2
Net FDI/GDP (%)	(6.2)	(7.0)	(4.0)	(4.9)	(12.4)	(8.7)	(6.7)	(3.0)	(3.0)	(3.0)	(3.0)
Net portfolio equity inflow/GDP (%)	1.2	(3.2)	(13.8)	(5.8)	(4.2)	(11.0)	(15.3)	(4.0)	(3.0)	(3.0)	(4.0)
Gross external financing needs/CARs plus usable reserves (%)	66.4	82.4	67.0	51.9	49.1	49.1	59.0	74.7	75.1	74.0	73.0
Narrow net external debt/CARs (%)	(194.3)	(315.7)	(310.7)	(255.6)	(261.5)	(301.7)	(354.5)	(547.0)	(509.5)	(472.7)	(448.6)
Net external liabilities/CARs (%)	(305.5)	(480.1)	(438.3)	(353.7)	(344.3)	(388.5)	(424.8)	(741.1)	(695.2)	(647.4)	(618.4)
Short-term external debt by remaining maturity/CARs (%)	30.8	41.6	27.7	15.5	14.6	13.1	15.8	29.6	26.5	25.8	25.7
Reserves/CAPs (months)	4.3	5.0	5.6	5.2	5.6	6.1	5.3	6.5	5.7	5.7	6.0
FISCAL INDICATORS											
General government balance/GDP (%)	15.0	29.6	26.2	41.0	35.3	34.6	31.0	12.0	13.0	14.0	15.0
Change in general government debt/GDP (%)	0.1	(1.6)	1.1	(0.2)	(0.7)	(1.0)	0.2	(1.4)	0.2	0.2	0.1
General government primary balance/GDP (%)	15.2	29.8	26.4	41.1	35.4	34.7	31.0	12.1	13.0	14.0	15.0
General government revenue/GDP (%)	61.1	66.5	75.3	81.0	75.0	72.6	79.0	45.0	52.0	55.0	55.0
General government expenditures/GDP (%)	46.1	36.9	49.0	40.0	39.6	37.9	48.0	33.0	39.0	41.0	40.0

Table 1

Kuwait (State of) Selected Indicators (cont.)											
General government interest expenditure/revenues (%)	0.4	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
General government debt/GDP (%)	9.7	11.0	11.2	8.6	6.8	5.6	5.4	5.2	5.0	4.8	4.6
Net general government debt/GDP (%)	(180.8)	(261.7)	(250.2)	(234.5)	(243.9)	(274.8)	(295.7)	(374.4)	(354.8)	(340.1)	(330.5)
General government liquid assets/GDP (%)	190.5	272.7	261.4	243.1	250.7	280.4	301.1	379.6	359.8	344.9	335.1
MONETARY INDICATORS											
CPI growth (%)	10.6	4.6	4.5	4.9	3.2	2.7	2.9	2.9	2.9	2.9	2.9
GDP deflator growth (%)	18.7	(17.2)	15.4	17.2	7.5	0.8	5.1	(19.5)	7.0	6.0	5.0
Banks' claims on resident private sector growth (%)	16.6	6.2	1.9	2.6	2.8	7.3	5.1	6.0	6.0	6.0	6.0
Banks' claims on resident private sector/GDP (%)	64.2	88.6	83.2	66.4	59.6	62.4	61.3	80.0	77.4	75.5	74.3
Foreign currency share of claims by banks on residents (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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. CARs--Current account receipts. CAPs--Current account payments. FDI--Foreign direct investment. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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	Strength
External assessment	Strength
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Strength
Monetary assessment	Neutral

Standard & Poor's 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 Standard & Poor's "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 Standard & Poor's 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

- Sovereign Rating Methodology, Dec. 23, 2014
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- 2014 Annual Sovereign Default Study And Rating Transitions, May 18, 2015
- Sovereign Risk Indicators, June 30, 2015. An interactive version is available at www.spratings.com/sri
- Kuwait Ratings Affirmed At 'AA/A-1+' Despite Oil Price Drop; Outlook Stable, Feb. 13, 2015

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 that 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

	To	From
Kuwait (State of)		
Sovereign credit rating		
Foreign and Local Currency	AA/Stable/A-1+	AA/Stable/A-1+

Transfer & Convertibility Assessment		
T&C Assessment	AA+	AA+

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.