FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Kuwait at 'AA-'; Outlook Stable

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Fitch Ratings - London - 15 Mar 2024: Fitch Ratings has affirmed Kuwait's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA-' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Fundamental Rating Strengths and Weaknesses: Kuwait's 'AA-' rating is supported by its exceptionally strong fiscal and external balance sheets. The rating is constrained by Kuwait's heavy dependence on oil, its generous welfare system and large public sector that could be challenging to sustain in the long term, and a political context that hampers efforts to tackle consistent fiscal and economic rigidities and approve legislation to allow debt issuance and clarify government financing sources.

Exceptionally Strong External Assets: Kuwait's fiscal and external balance sheets remain among the strongest of Fitch-rated sovereigns. We forecast Kuwait's sovereign net foreign asset position will average 529% of GDP in 2024-25, remaining one of the highest among Fitch-rated sovereigns and more than 10x the 'AA' median. The bulk of the assets are held in the Future Generations Fund managed by the Kuwait Investment Authority (KIA), which also manages the assets of the General Reserve Fund (GRF), the government's treasury account.

Political Divisions Hinder Reform: Conflicts between the elected parliament and the 15-member cabinet, are a recurring feature of Kuwaiti politics, resulting in frequent resignations of ministers and dissolutions of parliament, with the most recent dissolution in February leading to elections scheduled for 4 April. We assume that elections will result in a parliament composition similar to previous ones (following elections in September 2022 and June 2023), where politicians critical of government policies held the majority of the 50 electable seats. We assume that political divisions will continue to constrain policy-making in Kuwait.

Familiar Reform Challenges: The incumbent government appointed in January 2024 before the dissolution of parliament by the new Emir, Sheikh Meshal Al-Ahmed Al-Jaber Al-Sabah, included a new prime minister and a largely technocratic cabinet. The government's published four-year programme (2024-2027) focused on initiatives to enhance non-oil revenue, restructure subsidies and encourage private sector participation to create jobs for Kuwaitis and reduce the fiscal burden. The plan also included passing a new liquidity law that would allow the government to relaunch debt issuance following expiry of the previous authorisation in 2017.

However, these plans are similar to objectives of previous governments that failed to be implemented due to gridlock with parliament and we remain sceptical that this will change.

Liquidity Law Assumed but Uncertain: After the election, the government will aim to pass a liquidity law (as previous governments have), but parliamentary approval remains highly uncertain. However, our forecasts, notably for government debt, are based on the assumption that a liquidity law is passed in the fiscal year ending March 2026 (FY25). The assumption illustrates that Fitch considers the rating to be resilient to a moderate rise in government debt. In the absence of a liquidity law, Fitch believes the government would still be able to meet its limited debt service obligations in the coming years, given the assets at its disposal.

Low Debt, Likely to Rise: Gross government debt/GDP remains low, estimated at 3.1% of GDP in FY23. Assuming the passage of a liquidity law in FY25, limited fiscal consolidation and lower oil prices, we forecast government debt will rise to 11% of GDP in FY25 and further in subsequent years. Nonetheless, during the forecast period, we expect debt levels to remain well below the projected 2025 'AA' median of 48.4% of GDP.

Budget Balance to Deteriorate: Under the government's reporting convention, which does not include KIA's investment interest income in revenue (and reflects the financing needs of the government), Fitch estimates that the government balance returned to a deficit in FY23 (5.0% of GDP), after recording its first surplus (about 12% of GDP) in nearly a decade in FY22. Our estimated deficit is smaller than the government's original FY23 budget deficit projection of 13.2% of GDP, due to a higher-than-budgeted oil price and lower-than-budgeted spending. Significant one-off expenditures on arrears on subsidies and unused vacation allowances were offset by underspending in areas such as capex.

Under the government's convention, we forecast deficits of 6.5% of GDP and close to 10% of GDP in FY24 and FY25, respectively, as oil prices fall, spending pressures persist, and progress with fiscal reforms remains limited. Our overall fiscal balance numbers include our estimate for investment income, which is not officially disclosed. On this basis, we forecast the budget to post surpluses of 5.2% in FY24 (from an estimate of 5.7% in FY23) and 0.7% of GDP in FY25.

Oil Assumptions and Dependence: Our forecasts assume an average oil price of USD79.8/bbl for FY24, down 5% from FY23, while oil output is likely to be broadly unchanged at 2.55mmbbl/d given OPEC+ constraints. In FY25, we assume Kuwait's average oil price will fall to USD71/bbl and that its crude output will rise to 2.66mmbbl/d, assuming that OPEC+ loosens production constraints somewhat. Kuwait Petroleum Corporation aims to boost capacity to 3.2mmbbl/d by FY27, with increases both onshore and in the neutral zone.

Budget outcomes are highly sensitive to changes in oil price and production. A USD10/bbl change in our oil price assumption for 2024 would affect the budget by close to 4% of GDP, all other things equal. A change of 100,000bbl/d of production affects the budget by 1.4% of GDP. The fiscal break-even oil price (excluding investment income) will remain high (averaging USD93/bbl in FY24-FY25) and the non-oil primary deficit/non-oil GDP is weak at 81%, significantly worse than regional peers.

ESG - Governance: Kuwait has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Kuwait has a medium WBGI ranking at 53, reflecting low scores for voice and accountability, and middling scores across other governance indicators.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-**Structural Features/Public Finances:** Signs of sustained pressure on GRF liquidity, for example, due to the continued absence of a new liquidity law and of alternative measures to ensure that the government can continue to make good on its payment obligations, including but not limited to debt service.

-**Public and External Finance:** Significant deterioration in fiscal and external positions, for example, due to a sustained period of low oil prices or an inability to address structural drains on public finances.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Structural Features/Public Finances: Strong evidence that Kuwait's institutions and political system are able to tackle long-term fiscal challenges, for example, through actions to implement a clear deficit reduction plan that is resilient to lower oil prices, as well as adopt a transparent and sustainable government funding strategy.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Kuwait a score equivalent to a rating of 'AA+' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

- Structural Features: -1 notch, to reflect the frequency of political standoffs and constraints on enacting key economic and fiscal reforms, and the lack of meaningful progress on addressing structural public finance challenges stemming from heavy oil dependence, a generous welfare state and a large public sector.

-Public Finances: We have introduced a -1 notch on public finances after the SRM output improved to 'AA+' from 'AA' at the time of the previous review, to reflect our expectation of large budget deficits and rising debt over the medium to long term, due to persistent difficulties of reining in a generous public employment and welfare system that could pose challenges if oil revenues decline for a sustained period of time, even as the large government assets provide an important buffer.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Kuwait is 'AA+', two notches above the LT FC IDR. This reflects strong constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting LC into FC and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of two notches above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY

DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

The KIA's assets are not officially reported by the government.

Fitch estimates these assets by compounding the government's transfers into the KIA, using assumptions about returns and asset allocations that are informed by discussions with the KIA. Fitch benchmarks government transfers into the KIA and KIA investment income against the balance of payments.

The data used was deemed sufficient for Fitch's rating purposes because it expects that the margin of error related to the estimates would not be material to the rating analysis.

ESG CONSIDERATIONS

Kuwait has an ESG Relevance Score of '5[+]' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are, therefore, highly relevant to the rating and a key rating driver with a high weight. As Kuwait has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Kuwait has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are, therefore, highly relevant to the rating and are a key rating driver with a high weight. As Kuwait has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Kuwait has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Kuwait has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Kuwait has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Kuwait, as for all sovereigns. As Kuwait has a record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation of the materiality and relevance of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Kuwait	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

	LC ST IDR	F1+	Affirmed	F1+
	Country Ceiling	AA+	Affirmed	AA+
senior unsecured	LT	AA-	Affirmed	AA-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Sovereign Rating Criteria (pub. 06 Apr 2023) (including rating assumption sensitivity)

Country Ceiling Criteria (pub. 24 Jul 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.1 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Kuwait	UK Issued, EU Endorsed

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