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Ratings

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Research Update:

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

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Ratings:
Foreign and Local Currency: AA/Stable/A-1+

For further details see ratings list.

Overview

- Kuwait's large government and external net asset positions will continue to afford the authorities space to gradually consolidate government finances.
- 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, reflecting our expectation that Kuwait's key credit metrics will remain relatively close to current levels.

Rating Action

On Feb. 2, 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 forecast horizon, backed by a significant stock of financial assets. We expect these strengths to offset risks related to lower oil prices, Kuwait's undiversified economy, and rising geopolitical tensions in the region.

We could lower the ratings if the policy response to lower oil prices failed to lift income levels over the forecast horizon amid weaker fiscal and external finances, or 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, 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 and external buffers, despite the subdued--albeit recently 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 will be supported by public investment spending and gradual fiscal consolidation

- We estimate that oil production cuts under the OPEC agreement have weighed on Kuwait's growth in 2017.
- Moderately higher oil prices in 2018 and rising oil production from 2019 onward, combined with a broad public investment program, will support growth momentum over the forecast period.
- We expect Kuwait's foreign policy to continue to be aligned with the U.S. and Saudi Arabia, and we assume limited spillover to Kuwait from regional geopolitical conflicts.

The sharp fall in oil prices since 2014 has caused a significant deterioration in Kuwait's income levels as well as in its fiscal and external metrics, similar to 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 the decline in the hydrocarbon sector by increased spending under the Kuwait National Development Plan, particularly on infrastructure projects.

We assume oil prices (Brent) will average US$60 per barrel (/bbl) in 2018, before falling to $55/bbl in 2019 and beyond (see "S&P Global Ratings Raises 2018 Brent And WTI Oil Price Assumptions," published Jan. 18, 2018, on RatingsDirect). Kuwaiti crude oil trades at about a US$5 discount to Brent.

Despite higher oil prices of $55/bbl in 2017, we expect that Kuwait experienced a contraction in real GDP growth of 2.3%, mainly due to a 5%-6% decline in oil production implemented under the Organization of the Petroleum Exporting Countries (OPEC) agreement. While the non-oil sector saw growth during the first three quarters of 2017, the sharp contraction in oil sector activity was unable to offset the growth in public investment.

Although the oil production cuts under the OPEC agreement have been extended until end-2018, we expect that higher oil prices will support rising consumption and investment during 2018. The steady growth in the non-oil sector, supported by public spending on infrastructure projects, should see a return to growth of around 2.5%. We expect growth to average around 3% over 2019-2021 on the back of rising oil production and investment projects. Over the medium term, we anticipate that Kuwaiti oil output will rise to over 3 million barrels per day (bpd) by 2021, from around 2.7 million bpd currently. Production could increase further if an ongoing dispute with Saudi Arabia over their shared neutral zone is fully resolved.

Over the next few years, we expect several projects in power, infrastructure, and housing, currently in various stages of implementation, to be launched and completed. The first public-private partnership (PPP) project has been completed since the PPP law came into force in 2015. The government plans to re-launch the tender of the Az-Zour North Phase II power plant during early 2018 after cancelling it in August 2017. While we expect these large scale PPPs and privatizations to support growth in the non-oil sector, implementation delays would likely derail the push toward more private sector-led growth.

Kuwait's political system is characterized by a powerful cabinet appointed by the Emir and a democratically elected parliament, and the relationship between the two has been historically confrontational. On Oct. 30, 2017, the Kuwaiti cabinet resigned after opposition members of parliament filed a vote of no-confidence against a minister. A new cabinet, with new finance, defense, and oil ministers, was announced in December. Decision-making ultimately rests in the hands of the Emir, who can dissolve the parliament. This limits institutional checks and balances, in our view.

Geopolitical tensions in the region are likely to persist and perhaps increase due to rising tensions between the Gulf Cooperation Council (GCC) countries and Iran, along with the ongoing proxy war in Yemen. Kuwait has traditionally taken a neutral position in regional conflicts and is playing the role of mediator between Qatar and other GCC members, with minimal success thus far. Relations soured within the GCC when Saudi Arabia, the United Arab Emirates, and Bahrain imposed a boycott on Qatar in June 2017. We anticipate the risk of negative spillover effects from this crisis on Kuwait to be fairly low. Nonetheless, if the conflict were to escalate, financial and investment flows to the region could be disrupted, prior investment decisions reversed, and financing lines withdrawn, including those to financial institutions. We expect Kuwait's foreign policy to 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 anticipate gradual fiscal consolidation through 2020, with the likely introduction of spending caps and the value added tax (VAT) in 2019.
- The government plans to meet its financing needs by increasing the proportion of debt and reducing the proportion of asset drawdowns.
- Kuwait 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.

In Kuwait's case, the central government deficit informs the central government's financing requirements. At the general government level, we include all potential sources of revenue and savings including the investment income of the Kuwait Investment Authority (KIA) and the mandatory 10% transfers of total central government revenue to the KIA's Future Generations Fund (FGF). For the fiscal year (FY) ending March 31, 2018, we estimate that Kuwait will run a fiscal surplus of 8% of GDP (compared to a deficit of nearly 16% 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 13.7% of GDP in FY 2021/22 (albeit well below an average surplus of 31% between 2009-2014, due to the lower oil price environment).

In our calculation of central government fiscal deficits, we treat as expenditure the mandatory transfers to the FGF (10% of revenues) and do not include investment income earned on the KIA's assets. Lower oil prices have caused Kuwait's central government balance (which was in surplus in 2013/14) to remain deep in deficit since the 2014 oil price drop. During 2017/18, we estimate that the central government deficit will widen to 16% of GDP from close to 14% in 2016/17. While the government has taken measures to cut current expenditures, it has used its substantial fiscal flexibility to ramp up capital expenditures, and consolidation will be slow. With our revised oil price assumptions and our expectations for oil production, we forecast the central government deficit will narrow only gradually to around 11.3% of GDP by 2021/22.

The government's fiscal policy response to lower oil prices has been fairly limited and gradual given the large fiscal buffers, opposition in the parliament, and the political will to maintain the social contract with its population by preserving the welfare state. Since the drop in oil prices, the government has increased fuel prices, introduced electricity and water tariff hikes, and implemented measures to moderate growth in the wage bill. Going forward, the key non-oil revenue-enhancing measure will be the introduction of the VAT of 5%, which has been delayed from January 2018 and will likely only be implemented by 2019, subject to parliamentary approval. The government also plans to focus efforts on improving revenue collection, divesting underutilized assets such as land, and implementing its privatization program over the next five years. Although the government was previously looking at introducing a 10% corporate profit tax, it has shelved this measure given the expected negative impact on growth and private sector activity. On the expenditure side, the government is planning to introduce spending caps over the next three years at similar levels to 2017/18 spending.

Although the central government has primarily financed its fiscal deficit through the KIA's General Reserve Fund (GRF) along with some debt, the government intends to follow a balanced strategy going forward, with a shift toward more debt issuances. These plans are contingent on the parliament passing a new debt law after the current one expired in October 2017. The new law proposes to raise the debt ceiling to KWD25 billion (US$83 billion) from KWD10 billion currently (around US$33 billion), and to increase the maturity limit to 30 years from 10 years. Kuwait issued its first sovereign international bond in 2017, and will likely continue to tap external bond markets given current favorable rates, particularly compared to external asset returns. We anticipate that general government debt will rise to about 41% of GDP by end 2021/22 from an estimated 19.1% in 2017/18. 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 lower oil prices. The Kuwaiti government, via the KIA, has accumulated substantial assets through savings from oil and gas production over the years. Although the government is drawing down on the assets of the GRF to finance deficits, it continues to build its external assets at the FGF through annual transfers from revenue and growing investment income. We estimate total KIA assets at about 3.9x of GDP at end-2017. 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 Dec. 14, 2017; use the free interactive tool on www.spratings.com/sri).

The government does not publicly disclose the size and structure of the KIA's funds. However, authorities have shared that about 75% of the assets are in the FGF and the rest are in the GRF, primarily held in cash and deposits. While the FGF is designed to assist future generations, ostensibly after oil supplies have run out, the GRF can be used (and has been) to meet present-day fiscal needs. 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 need to be approved by the Emir and the parliament, however.

Weaker oil prices resulted in a halving of current account receipts in 2015 and eventually led to the country's first current account deficit of 4.5% of GDP in 2016, compared with an average surplus of nearly 40% of GDP over 2010-2014. The deficit was primarily financed by the liquidation of assets held abroad. We expect the current account to return to a surplus of 0.1% in 2017 and 2.0% in 2018, on the back of higher oil prices. However, we forecast small deficits averaging 0.9% over 2019-2021 mainly because of expected growth in imports for investment projects and rising interest payments on external debt.

Even then, we estimate that Kuwait's net external asset position will remain very strong at more than 6x current account payments in 2017. Moreover, we project that gross external financing needs will remain manageable, averaging about 110% of current account receipts 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 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 slightly 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 two most recent hiking cycles by the US Federal Reserve, where the Central Bank of Kuwait decided to leave the key discount rate unchanged and lift only the deposit rate.

We view Kuwait's financial system as stable; its banks are 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 on Sept. 29, 2017).

Key Statistics

Table 1

State of Kuwait Selected Indicators

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	49	49	46	34	34	37	40	40	42	43
Nominal GDP (bil. $)	174	174	163	115	111	121	132	133	139	145
GDP per capita (000s $)	51.3	48.4	43.0	29.1	27.4	29.0	30.9	30.5	31.0	31.7
Real GDP growth	6.6	1.1	0.5	0.6	3.5	(2.3)	2.5	3.2	3.0	3.0
Real GDP per capita growth	0.2	(4.6)	(4.4)	(3.3)	0.6	(5.1)	(0.0)	0.9	0.7	1.0
Real investment growth	5.1	8.9	4.5	15.5	2.0	4.0	4.5	5.0	3.5	3.7
Investment/GDP	12.8	14.4	16.3	25.4	27.0	26.0	25.5	27.3	27.5	27.6
Savings/GDP	58.3	54.3	49.5	28.9	22.5	26.0	27.6	26.4	26.6	26.6
Exports/GDP	74.7	70.9	68.5	53.8	48.2	50.2	50.9	48.4	48.1	47.8
Real exports growth	7.7	(4.0)	1.4	(0.9)	1.8	(5.8)	0.0	5.0	3.0	3.0
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	39.9	33.2	3.5	(4.5)	0.1	2.0	(0.9)	(0.9)	(1.0)
Current account balance/CARs	55.5	50.9	42.4	5.5	(7.6)	0.1	3.3	(1.5)	(1.4)	(1.7)
CARs/GDP	81.9	78.4	78.2	63.8	59.0	60.7	61.0	59.7	59.5	58.7
Trade balance/GDP	54.8	51.8	47.6	24.4	18.1	21.0	22.0	18.8	18.5	18.2
Net FDI/GDP	(2.2)	(8.7)	(7.8)	(4.4)	(3.7)	(3.0)	(3.0)	(3.0)	(2.0)	(2.0)
Net portfolio equity inflow/GDP	(4.2)	(11.1)	(17.6)	(23.6)	(15.0)	(12.0)	(10.0)	(10.0)	(10.0)	(8.0)
Gross external financing needs/CARs plus usable reserves	50.1	51.6	60.5	89.9	106.1	98.4	100.2	107.2	114.7	119.6
Narrow net external debt/CAPs	(584.8)	(612.2)	(593.8)	(630.7)	(650.8)	(634.4)	(616.9)	(614.6)	(617.8)	(626.8)
Net external liabilities/CARs	(322.6)	(371.9)	(410.1)	(716.6)	(850.2)	(772.5)	(725.0)	(755.6)	(750.3)	(750.0)
Short-term external debt by remaining maturity/CARs	14.6	13.1	15.9	32.3	40.7	36.8	36.9	42.1	45.2	47.1
Usable reserves/CAPs (months)	4.8	5.1	4.4	5.2	4.4	4.7	4.1	4.0	3.3	2.9
Usable reserves (mil. $)	28,346	27,151	30,061	26,033	28,565	26,899	27,122	22,916	20,714	20,344
FISCAL INDICATORS (%, General government)										
Balance/GDP	35.0	35.7	19.2	3.7	4.9	8.0	11.5	11.4	12.6	13.7
Change in net debt/GDP	(28.5)	(26.1)	(22.0)	(23.3)	(15.3)	(2.7)	(9.4)	(11.4)	(12.6)	(13.7)
Primary balance/GDP	35.1	35.8	19.2	3.8	5.0	8.1	11.6	11.7	13.0	14.4
Revenue/GDP	74.1	74.0	65.4	56.6	57.8	54.6	55.5	56.2	56.2	56.2
Expenditures/GDP	39.1	38.3	46.3	52.9	52.8	46.6	44.0	44.8	43.6	42.5
Interest /revenues	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.5	0.8	1.2

Table 1

State of Kuwait Selected Indicators (cont.)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Debt/GDP	6.8	6.5	7.6	11.0	18.6	19.1	23.5	30.5	35.9	41.2
Debt/Revenue	9.2	8.8	11.6	19.4	32.2	35.0	42.3	54.2	63.9	73.3
Net debt/GDP	(221.4)	(244.4)	(282.8)	(403.0)	(429.9)	(395.6)	(373.6)	(383.5)	(381.2)	(379.4)
Liquid assets/GDP	228.2	250.9	290.4	413.9	448.6	414.8	397.1	413.9	417.1	420.5
MONETARY INDICATORS (%)										
CPI growth	3.2	2.7	2.9	3.3	3.2	1.5	2.5	3.5	2.2	2.5
GDP deflator growth	7.5	0.2	(6.8)	(26.0)	(6.1)	12.0	6.0	(2.7)	1.0	1.2
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	2.5	2.0	5.0	3.0	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	59.6	63.0	70.7	102.4	108.0	100.7	97.3	99.8	98.8	97.7
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	6.2	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. 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	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 And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 18,2017
- 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

- Sovereign Ratings History - Jan. 5, 2018
- Middle East And North Africa Sovereign Rating Trends 2018 - Jan. 10, 2018
- Banking Industry Country Risk Assessment Update: January 2018 - Jan. 4, 2018
- Sovereign Risk Indicators - Dec. 14, 2017. An interactive version is also available at http://www.spratings.com/sri
- Banking Industry Country Risk Assessment: Kuwait - Sept. 29, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions - April 3, 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 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

	Rating	
	To	From
Kuwait		
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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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.