Rating Action: **Moody's affirms Kuwait's Aa2 rating; maintains stable outlook**

02 May 2019

New York, May 02, 2019 -- Moody's Investors Service ("Moody's") has today affirmed Government of Kuwait's long-term issuer ratings at Aa2, the outlook is stable.

The rating affirmation is underpinned by Moody's view that Kuwait's exceptionally large wealth, with sovereign wealth fund assets estimated at around 370% of GDP and vast hydrocarbon reserves, will continue to support the sovereign's fiscal strength and creditworthiness.

The stable outlook reflects Moody's expectation that Kuwait's extremely high fiscal strength will be largely preserved through oil price fluctuations and long-term demographic pressure. In particular, it assumes that the authorities overcome the current legislative hurdles and pass a debt law that allows the government to finance its deficit without depleting its most liquid assets.

Kuwait's long-term and short-term foreign-currency bond and deposit ceilings remain unchanged at Aa2 and Prime-1, respectively. Kuwait's long-term local-currency bond and deposit ceilings also remains unchanged at Aa2.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION OF THE RATING AT Aa2

EXCEPTIONALLY LARGE WEALTH IN SOVEREIGN WEALTH FUND, HYDROCARBON RESERVES

The decision to affirm Kuwait's Aa2 rating is underpinned by the government's and country's exceptionally large wealth, which Moody's expects to be maintained despite very slow fiscal and economic reforms and persistent large budget deficits.

Kuwait's fiscal position is one of the strongest among the sovereigns rated by Moody's. Moody's estimates that the sovereign wealth fund (SWF) assets amounted to around 370% of GDP at the end of fiscal year 2018/19, 27 times the government's debt. Although the government will likely continue to run large fiscal deficits, under Moody's assumptions that oil prices fluctuate between $50-70/barrel in the medium term and that these deficits will lead to a gradual increase in the debt burden, it will be from a very low base. And while, in the near term at least, the deficits will be financed by drawdowns from the General Reserve Fund (GRF), the country will continue to accumulate wealth in the Future Generations Fund (FGF) which forms the majority of the country's SWF assets, reflected in broadly stable SWF assets relative to GDP at extremely high levels.

Moody's estimates that the budget deficit (post-FGF transfers, excluding investment income) narrowed to 5.2% of GDP in the fiscal year 2018/19 due to windfall oil revenues from higher than budgeted oil prices, which averaged $71/barrel in 2018. In the last two years, higher oil prices coincided with diminished reform momentum. Moody's expects only a few fiscal consolidation measures to be implemented in the next few years, possibly an introduction of Value-Added Tax as implemented in the Government of United Arab Emirates (Aa2 stable), Government of Saudi Arabia (A1 stable) and Government of Bahrain (B2 stable), and higher excise taxes on tobacco and sugary drinks. More significant measures including steps to contain the increase in the public sector wage bill (payrolls account for around 41% of government expenditure) are unlikely and not part of Moody's baseline assumptions. Instead, the track-record of the last two years indicates that, unless significantly lower oil prices raise pressure on parliament to agree to meaningful reforms, progress will be very slow, materially slower than elsewhere in the region. As a result, the budget deficit will widen again with lower oil prices on average this year. Moody's expects the deficits to average around 9% of GDP in the next few years.

At the moment, the deficits are fully financed through drawdowns of the GRF, which Moody's estimates has been reduced to 54% of GDP as of March 2019, compared to 70% of GDP in March 2018, with the liquid portion of the GRF comprising around two-thirds of total assets. Without legal authorization to issue new debt, the deficits will continue to be financed from the GRF which will shrink further. Moody's expects that the fund will decline to 26% of GDP by the end of fiscal year 2020/21.

However, Moody's assumes that, as the GRF's size diminishes rapidly, Kuwait will pass a debt law allowing the issuance of new debt. As a result, Moody's projects gross government debt to rise 38.8% of GDP by fiscal year 2023/24, from 13.8% at the end of fiscal year 2018/19. Still, at these levels, Kuwait's government debt burden would remain below the Aa-rated median, and its debt affordability would remain significantly stronger than that of most Aa-rated peers.

Moreover, while the GRF is eroded and gross government debt will rise if legislation is passed, Kuwait continues to accumulate 10% of its government revenue and all investment income in the FGF, whose assets are estimated at $442 billion, maintaining the overall SWF assets broadly stable in relation to GDP.

Additionally, Kuwait's low external breakeven, which Moody's estimates at around $51/barrel, will ensure that the country continues to accrue wealth through sustained current account surpluses under our $50-70/barrel oil price range assumption. The country's hydrocarbon reserves are plentiful and at the current rate of production, proven reserves of oil and gas would last around 90 years, providing a significant source of wealth for the foreseeable future.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Kuwait's extremely high fiscal strength will be largely preserved through most plausible scenarios. This wealth provides ample capacity and time to absorb potential shocks, in the short to medium term related to oil price fluctuations and, in the longer term, related to demographic pressure on demand for employment.

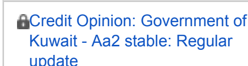
In particular, Moody's assumes that the Kuwaiti authorities will overcome the hurdles to passing legislation from a very fractious parliament and be able to agree on a debt law in the next couple of years and before depletion of the liquid assets in the GRF and/or mobilise more of their vast resources in order to finance the fiscal deficits.

For the foreseeable future, Kuwait's fiscal exposure to lower oil prices will remain very high. However, the net credit implications of a potential fall in oil prices will be mitigated by the country's large wealth which Moody's expects to be made accessible in case of need and sizeable current account surpluses. While oil production is currently constrained by the OPEC production cuts, Moody's expects that output will increase slightly towards current production capacity of 3.15 million barrels per day (mbpd) once these are lifted. A resumption of Neutral Zone production could add an additional 0.25 mbpd in capacity, although the sovereignty issues with Saudi Arabia that halted production remain unresolved. Together with oil prices in a $50-70/barrel range, this will maintain very large current account surpluses at around 8% of GDP.

Related Issuers

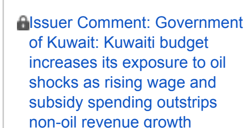
Kuwait, Government of

Related Research



Credit Opinion: Government of Kuwait - Aa2 stable: Regular update

Announcement of Periodic Review: Moody's announces completion of a periodic review of issuers including Kuwait, Government of



Issuer Comment: Government of Kuwait: Kuwaiti budget increases its exposure to oil shocks as rising wage and subsidy spending outstrips non-oil revenue growth

Announcement: Moody's: Stable outlook for GCC sovereigns but fiscal reforms, geopolitics, unemployment pose challenges

Outlook: Sovereigns – Gulf Cooperation Council: 2019 outlook is stable, but fiscal reform, geopolitics and unemployment pose challenges

Longer term, Kuwait faces a large and sustained increase in demand for jobs from its young and fast-growing population, which under a system that favours entry into the public sector will inflate the government's wage bill. Moody's estimates that the demographic pressure will be intense, only somewhat less intense than for Saudi Arabia and Government of Oman (Ba1 negative) in the region. However, the government's much stronger fiscal position gives Kuwait more time to implement reforms that very gradually rebalance the incentives between public and private sector employment.

WHAT COULD MOVE THE RATING UP/DOWN

Over the long term, positive rating pressures would arise from measures that reduce the direct exposure of the government's finances to oil price declines. Such measures would involve a diversification of government revenue and a reduction and improvement in the flexibility of government expenditure.

Conversely, signs that the ongoing political gridlock is not resolved, and in particular that the sources of financing of the budget deficits become increasingly uncertain as the GRF shrinks, would likely lead to a negative rating action. More generally, evidence of a weakening in Kuwait's institutional strength so that the government's fiscal strength would become less resilient to a fall in oil prices would put negative pressure on the rating. Finally, a sustained drop in oil prices below Moody's medium-term forecast range and/or a significant fall in oil production levels would also be credit negative.

GDP per capita (PPP basis, US$): 66,197 (2017 Actual) (also known as Per Capita Income)

Real GDP growth (% change): -3.5% (2017 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 1% (2017 Actual)

Gen. Gov. Financial Balance/GDP: -12.8% (2017 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 5.9% (2017 Actual) (also known as External Balance)

External debt/GDP: 45.2% (2017 Actual)

Level of economic development: High level of economic resilience

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 29 April 2019, a rating committee was called to discuss the rating of the Kuwait, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed.

The principal methodology used in these ratings was Sovereign Bond Ratings published in November 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

The local market analyst for this rating is Thaddeus Best, +971 (423) 795-06 .

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