Research Update:

Kuwait Ratings Lowered To 'AA-' On Lower Oil Prices And Slow Reform Progress; Outlook Stable

March 26, 2020

Overview

- Materially lower oil prices in 2020 and 2021 will have negative economic and fiscal implications for Kuwait, given the country's high reliance on hydrocarbon exports.
- The oil price drop is happening alongside Kuwait's slow reform momentum, which has generally lagged that of other regional countries in recent years.
- We are consequently lowering our long-term ratings on Kuwait to 'AA-' from 'AA'.
- The outlook is stable because we believe Kuwait's sizable fiscal and balance-of-payments buffers provide the government with headroom for policy measures over the next two years.

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Rating Action

On March 26, 2020, S&P Global Ratings lowered its long-term foreign- and local-currency sovereign credit ratings on Kuwait to 'AA-' from 'AA'. The outlook is stable.

At the same time, we affirmed our 'A-1+' short-term foreign and local currency sovereign credit ratings on Kuwait.

We revised our transfer and convertibility assessment for Kuwait to 'AA' from 'AA+'.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Kuwait are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2020 EMEA Sovereign, Regional, And Local Government Rating Publication Dates," published Dec. 20, 2019, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the reason for the deviation is S&P Global Ratings' revision of its hydrocarbon price assumptions for 2020 and beyond. The next scheduled publication on the sovereign rating on Kuwait will be on July 17, 2020.

Outlook

The stable outlook reflects the balance between risks from Kuwait's high reliance on the hydrocarbons sector and delays to structural reforms, against the country's sizable accumulated fiscal and balance-of-payments buffers, which provide the authorities policy space to maneuver over the short to medium term.

Downside scenario

We could lower the ratings over the next two years if reform efforts, such as taxation and labor market changes, and measures to diversify the economy remain sluggish, increasing the burden on Kuwait's fiscal and balance-of-payments metrics. We could also lower the ratings if we considered that Kuwait's monetary policy flexibility had reduced or regional geopolitical tensions materially deteriorated, with potential disruptions to key trade routes.

Upside scenario

We could raise the ratings if wide-ranging political and economic reforms enhanced institutional effectiveness and improved long-term economic diversification, although we think such a scenario is unlikely over our forecast horizon 2020-2023.

Rationale

On March 19, 2020, S&P Global Ratings materially lowered its oil price assumption for 2020. This follows an earlier significant downward revision of its price assumptions on March 9, 2020. Prices for crude oil in spot and futures markets are more than 55% lower than levels observed during the summer of 2019 when prices increased due to rising geopolitical tensions. When we last reviewed Kuwait ("Summary: Kuwait," published Jan. 17, 2020), we expected Brent oil prices to average $60 per barrel (/bbl) in 2020 and to gradually decline to $55/bbl from 2021. We now assume an average Brent oil price of $30/bbl in 2020, $50 in 2021, and $55/bbl from 2022 (see "S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure," published March 19, 2020).

Oil prices plummeted following OPEC's failure to agree on further production cuts during meetings on March 6. OPEC+ did not agree to a proposed reduction of 1.5 million barrels per day (mmbbl/d) to address an expected significant drop in global demand partly due to the spread of the coronavirus. The proposed reduction was in addition to the current 2.1 mmbbl/d production decrease set to expire at the end of March. Shortly after the meetings, Saudi Arabia announced that it was immediately slashing its official selling price and would increase its production to over 12 mmbbl/d in April after the current production cut expires. These actions possibly signal that, despite a collapse in global demand and shrinking physical markets, Russia and OPEC have engaged in a price war to try and maintain market share and market relevance. Oil markets are now heading into a period of a severe supply-demand imbalance in second-quarter 2020. In line with our economic outlook, we anticipate a recovery in both GDP and oil demand through the second half of 2020 and into 2021 since the most severe effects from the coronavirus outbreak moderate (see "Economic Research: COVID-19 Macroeconomic Update: The Global Recession Is Here And Now," published March 17, 2020).

In our view, the terms-of-trade shock will hamper Kuwait's economy. We have previously highlighted that Kuwait's trend real GDP growth is below that of countries at a comparable level of economic development. We now consider that the risks for Kuwait have increased further. Although it remains unclear whether Kuwait will follow Saudi Arabia to the same extent in ramping up oil production, we expect an increase in output to above the budgeted levels of 2.8 mmbbl/d, which should provide some short-term economic support. Nevertheless, we anticipate this boost may be offset by lower oil prices pushing down domestic consumption and investments, as companies reevaluate potential projects, including in the oil and related sectors.

Beyond the direct impact of the drop in oil prices, Kuwait's economic prospects remain vulnerable to a sharp downturn. This is because around 80% of its exports are destined for Asia, where several countries have already been substantially affected by the coronavirus outbreak, leading to a contraction in oil demand. Additionally, the spread of coronavirus will likely hit Kuwait's domestic economy directly, constraining growth in non-oil sectors. So far, close to two hundred cases of COVID-19 have been recorded in Kuwait and the government has ordered businesses to shut down for several weeks, alongside a partial curfew.

Overall, adjusted for population growth, we project Kuwait's trend economic growth will remain negative over the medium term. We now forecast GDP per capita at just under $22,000 for 2020, down from almost $29,000 previously. Although Kuwait remains a wealthy economy, this forecast represents a material downward revision of relative income levels and consequently the country's aggregate debt-bearing capacity.

Apart from lower growth, we note that Kuwait's reform momentum has been slow in recent years, even compared with other states in the Gulf Cooperation Council. Beyond some expenditure adjustments following the previous drop in oil prices in 2014, progress has been limited. Specifically, the introduction of taxes has long been delayed, while reforms to diversify the economy and modernize the labor market have achieved limited results. This presents medium-term risks, in our view, since there is typically a substantial time lag between reform implementation and results, particularly in sectors like education.

Kuwait has also yet to pass a revised debt law authorizing the government to borrow, raising questions about how future central government deficits will be financed. Although the sovereign wealth fund is substantial at about 500% of GDP, the portion of it readily available for budgetary needs--the so-called General Reserve Fund (GRF)--is much smaller, estimated at around 50% of GDP, and is continuously being used. Kuwait's use of the GRF will likely accelerate, since we project deficits will widen in line with the decrease in oil prices. Absent passage of the debt law, it remains unclear whether Kuwait could face a hard budget constraint or start drawing on assets in the Future Generations Fund, which happened only once before, during the Gulf War. Drawings from this fund require special legislation.

We forecast that, in line with lower oil prices, Kuwait's general government balance will be in deficit exceeding 10% of GDP in 2020 before gradually returning to surpluses over the medium term. Our fiscal projections include investment returns generated through managing the sovereign wealth fund but we recognize downside risks to 2020 investment returns due to ongoing market volatility.

Importantly, our ratings on Kuwait remain supported by the country's substantial amounts of accumulated fiscal and external buffers, which we project will average close to 500% of GDP over the next four years and afford the authorities room for a policy response. The ratings are constrained by the concentrated nature of the economy and relatively weak institutional settings compared with nonregional peers in the same rating category. We don't expect this to change over the medium term.

Key Statistics

Table 1

Kuwait Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. LC)	46	34	33	37	42	41	31	38	41	42
Nominal GDP (bil. $)	163	115	109	121	140	136	104	126	136	142
GDP per capita (000s $)	39.7	27.0	24.8	26.8	30.3	28.8	21.6	25.6	27.2	27.8
Real GDP growth	0.5	0.6	2.9	(4.7)	1.2	0.5	0.0	1.5	2.5	2.5
Real GDP per capita growth	(2.6)	(2.9)	(1.1)	(6.6)	(1.4)	(1.5)	(2.0)	(0.5)	0.5	0.5
Real investment growth	4.5	15.5	11.6	1.3	4.7	3.0	(6.8)	1.0	3.0	3.0
Investment/GDP	16.3	25.4	30.0	27.7	25.2	27.1	33.7	28.9	28.1	28.4
Savings/GDP	49.7	28.9	25.3	35.7	39.7	47.6	17.8	25.7	27.4	27.3
Exports/GDP	68.5	53.8	47.6	51.2	56.7	52.1	39.3	47.8	49.8	49.1
Real exports growth	1.4	(0.9)	2.5	(4.8)	(4.8)	(1.0)	4.5	2.0	2.7	2.7
Unemployment rate	2.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
External indicators (%)										
Current account balance/GDP	33.4	3.5	(4.6)	8.0	14.5	20.5	(15.9)	(3.2)	(0.7)	(1.1)
Current account balance/CARs	42.8	5.2	(7.2)	11.6	20.2	25.8	(26.4)	(5.0)	(1.1)	(1.7)
CARs/GDP	78.1	67.2	64.1	68.7	71.9	79.5	60.2	63.9	64.4	64.0
Trade balance/GDP	47.7	24.4	17.8	21.3	29.1	24.5	4.6	16.7	19.7	19.3
Net FDI/GDP	7.0	(4.4)	(3.8)	(7.2)	(2.4)	(4.5)	0.0	0.0	0.0	0.0
Net portfolio equity inflow/GDP	(30.1)	(23.6)	(15.2)	(12.5)	(3.8)	(10.0)	12.0	2.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	67.2	124.6	143.2	118.6	110.7	109.6	161.3	140.9	144.1	152.3
Narrow net external debt/CARs	(413.8)	(633.3)	(682.1)	(601.2)	(518.5)	(511.9)	(875.3)	(685.9)	(639.0)	(628.3)
Narrow net external debt/CAPs	(723.6)	(668.1)	(636.1)	(680.1)	(649.5)	(689.9)	(692.5)	(653.3)	(632.1)	(618.1)
Net external liabilities/CARs	(488.5)	(759.3)	(827.0)	(731.1)	(626.9)	(595.4)	(1,002.7)	(784.4)	(728.7)	(714.2)
Net external liabilities/CAPs	(854.3)	(801.0)	(771.3)	(827.0)	(785.3)	(802.6)	(793.4)	(747.1)	(720.8)	(702.6)
Short-term external debt by remaining maturity/CARs	12.6	41.8	52.1	45.2	44.7	47.7	68.0	55.4	59.8	68.6

Table 1

Kuwait Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Usable reserves/CAPs (months)	0.8	1.2	1.3	1.7	1.9	1.8	1.9	1.6	1.4	1.4
Usable reserves (mil. $)	7,415	7,909	10,491	12,597	12,126	12,835	11,095	10,224	10,689	11,182
Fiscal indicators (general government; %)										
Balance/GDP	23.2	11.3	10.3	12.6	16.6	10.4	(10.5)	2.1	7.5	8.0
Change in net debt/GDP	(46.0)	11.0	9.7	(8.6)	(21.7)	(16.2)	16.1	(2.1)	(7.5)	(8.0)
Primary balance/GDP	23.2	11.4	10.5	13.0	17.1	10.9	(10.0)	2.5	8.3	9.1
Revenue/GDP	69.4	64.3	63.9	65.2	68.1	65.0	62.5	64.1	65.9	65.0
Expenditures/GDP	46.3	52.9	53.6	52.6	51.4	54.6	73.0	62.0	58.4	57.0
Interest/revenues	0.1	0.1	0.2	0.7	0.8	0.8	0.8	0.6	1.1	1.6
Debt/GDP	3.4	4.6	9.9	19.6	14.0	10.9	12.7	23.4	31.4	39.8
Debt/revenues	4.9	7.2	15.5	30.0	20.6	16.7	20.2	36.5	47.7	61.2
Net debt/GDP	(364.9)	(479.0)	(489.8)	(450.8)	(410.3)	(439.2)	(560.3)	(469.1)	(440.1)	(431.0)
Liquid assets/GDP	368.4	483.6	499.7	470.4	424.3	450.1	573.0	492.6	471.5	470.8
Monetary indicators (%)										
CPI growth	3.1	3.7	3.5	1.5	0.6	1.1	1.2	2.0	2.2	2.2
GDP deflator growth	(6.8)	(26.0)	(6.8)	16.2	14.6	(3.5)	(23.8)	18.2	5.8	1.5
Exchange rate, year-end (LC/$)	0.29	0.30	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Banks' claims on resident non-gov't sector growth	4.3	7.4	2.8	2.3	3.1	4.4	0.0	2.6	3.0	3.5
Banks' claims on resident non-gov't sector/GDP	73.7	106.3	113.9	105.2	93.5	100.7	132.1	113.0	107.3	106.8
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	7.7	9.2	7.2	6.5	6.0	5.8	N/A	N/A	N/A	N/A

Table 1

Kuwait Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real effective exchange rate growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Sources: Central Bank of Kuwait, Central Statistical Bureau (Economic Indicators); International Monetary Fund, Central Bank of Kuwait (Monetary Indicators), Ministry of Finance, Central Bank of Kuwait (Fiscal Indicators), Central Bank of Kuwait, Ministry of Finance,International Monetary Fund (External Indicators).
Adjustments: Usable reserves adjusted by subtracting monetary base from reported international reserves. General government revenues adjusted by including investment incomes from Sovereign Wealth Fund. Liquid assets include the liquid assets of the General Reserve Fund and the Future Generations Fund.
Definitions: 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. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. 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	Score	Explanation
Institutional assessment	4	Reduced predictability of future policy responses because of an uncertain or untested succession process and moderate challenges to political institutions due to highly centralized decision-making. Ultimate power is concentrated with the Emir. At the same time, Kuwait has managed to consistently pursue a prudent fiscal policy.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1 .
		Weighted average real GDP per capita trend growth over a 10-year period is below sovereigns in the same GDP category
External assessment	1	Based on narrow net external debt and gross external financing needs/(CAR + useable reserves) as per Selected Indicators in Table 1 .
		We estimate the sovereign’s net external liability position is more favorable than the narrow net external debt position by 100% of CAR, as per Selected Indicators in Table 1.
		Kuwait's external data lacks consistency as there is no full published international investment position or disaggregation of external debt. This could lead to an underestimation of credit risk
Fiscal assessment: flexibility and performance	1	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1
		Substantial savings accumulated within the sovereign wealth fund, Kuwait Investment Authority, of over 500% of GDP.
		Kuwait has a volatile revenue base, since 90% of general government revenue is based on hydrocarbon production
Fiscal assessment: debt burden	1	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.

Table 2

Kuwait Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Monetary assessment	3	The Kuwaiti dinar is pegged to a basket of currencies. There is monetary independence, but it is less secure than at better assessments. CPI as per Selected Indicators in Table 1.
Indicative rating	a	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	2	We estimate Kuwait's government assets are exceptionally large, substantially more than the 100% of GDP. They are also high in an international comparison: KIA is among the biggest sovereign wealth funds globally, even though Kuwait is a country with a comparatively small population.
Final rating		
Foreign currency	AA-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
Local currency	AA-	

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 Dec. 18, 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

- S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure, March 20, 2020
- Economic Research: COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020
- Sovereign Ratings History, March 13, 2020
- Sovereign Ratings List, March 13, 2020
- Unrestrained Supply Swamps Oil Outlook: S&P Global Ratings Revises Oil & Gas Assumptions, March 9, 2020
- Sovereign Ratings Score Snapshot, March 3, 2020
- Sovereign Debt 2020: Global Borrowing To Increase To $8.1 Trillion Amid Favorable Financing Conditions, Feb. 20, 2020

- Banking Industry Country Risk Assessment Update: February 2020, Feb. 21, 2020
- Global Sovereign Rating Trends 2020: Sovereign Debt Buildup Continues, Jan. 29, 2020
- Summary: Kuwait, Jan. 17, 2020
- Sovereign Risk Indicators, Dec. 12, 2019. An interactive version is also available at http://www.spratings.com/sri
- Global Sovereign Rating Trends: Midyear 2019, July 25, 2019
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

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

Downgraded; Ratings Affirmed

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