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Ratings

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Research Update:

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

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Research Update:

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

Overview

- We forecast that the government of Kuwait will remain in a substantial net asset position over the medium term, which should provide a safety buffer against external shocks.
- We are affirming our 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Kuwait.
- The outlook is stable.

Rating Action

On Jan. 18, 2019, 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 next two years, primarily underpinned by sizable foreign assets accumulated in the country's sovereign wealth fund. This should partially mitigate risks related to Kuwait's undiversified oil-dependent economy, and rising geopolitical tensions in the region.

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 the forecast horizon.

We could lower the ratings on Kuwait if we observed a sustained decline in economic wealth levels, for example due to a fall in oil prices beyond our current expectations or materially weaker rates of economic growth. We could also lower the ratings if Kuwait's domestic political stability deteriorated, or if regional geopolitical risks were to significantly escalate.

Rationale

The ratings on Kuwait remain supported by the country's high levels of accumulated fiscal and external buffers. The ratings are constrained by the concentrated nature of the economy and comparatively weak institutional settings compared with those of nonregional peers in the same rating category. Kuwait derives around 55% 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: Sluggish growth in 2019 owing to OPEC oil production cuts

- Kuwait's economy remains almost entirely dependent on oil, which accounts for an estimated 90% of exports and government revenues.
- Given the oil production cuts announced by OPEC (of which Kuwait is a member) in December 2018, we have lowered our 2019 GDP growth forecast for Kuwait to 1.0% (we forecast 3.2% previously).
- Despite the economic diversification and reform efforts announced by the government, we expect progress to be only gradual. This carries downside risks if oil prices turn out weaker than expected.

Kuwait's economy remains almost entirely dependent on oil, which accounts for an estimated 90% of exports and government revenues. The oil sector directly comprises over 50% of the country's GDP, although if other related activities are taken into account, that proportion is even higher. As of 2017, Kuwait was the world's ninth-largest crude oil producer, with the seventh-largest oil reserves. Assuming current production levels, Kuwait's total proven oil reserves are equivalent to about 100 years.

Given this high concentration, Kuwait's economic performance will remain largely determined by oil industry trends. We assume oil prices (Brent) will average US$55 per barrel (/bbl) over 2019-2022, which is lower than our previous oil price projections for these years (see "S&P Global Ratings Lowers Brent And WTI Oil Price Assumptions For 2019 Through 2020; Natural Gas Price Assumptions Are Unchanged," published Jan. 3, 2019). This is also lower than the average 2018 Brent price of US$72/bbl.

According to high frequency official data, output grew by 0.6% over the first nine months of 2018 year-on-year. We have accordingly revised our growth estimate for the year down to 1% from 2% previously. We estimate that growth picked up in the second half of the year following OPEC's decision to increase oil production in the summer.

However, we expect this pick-up in economic activity to prove temporary given OPEC's December 2018 agreement to once again cut production for an initial period of six months starting January 2019. According to the agreement, production will reduce by 0.8 million barrels per day (mb/d) from October 2018

levels of around 32 mb/d, which represents a roughly 2.5% decrease. Although the exact allocation of cuts between various member countries is not clear, we assume that for full-year 2019 Kuwait's production will decline by 1.5% based on our expectation that the cuts will be discontinued at some point before year-end. Importantly, we don't expect a repeat of the outright contraction in output that happened in 2017 during the previous round of cuts. This is mainly due to the firming of non-oil GDP growth alongside a gradual increase in gas production, which is not subject to OPEC agreement. Overall, we expect real GDP growth of 1% in 2019, compared to our previous forecast of 3.2%.

Beyond 2019, we expect growth rates to accelerate to an average 2.5% over 2020-2022. This is due to:

- December 2018 OPEC oil cuts coming to an end;
- Gradually increasing oil production capacity. Kuwait intends to increase the maximum oil production capacity toward 4 mb/d over the medium term from about 2.7 mb/d currently. This should be achieved through both new oil site discoveries as well as enhancing output at the already existing mature fields. An additional boost could come from restarting production within the so-called Partitioned Neutral Zone (PNZ) between Kuwait and Saudi Arabia, which was previously halted due to a number of disagreements between the two countries. We understand that restarting the PNZ production could alone add around 0.3 mb/d to daily output. Although it remains to be seen whether the 4 mb/d target is realistic, our baseline forecast assumes a steady increase in production levels over 2020-2022.
- Several investment projects planned by the government. These target an expansion of Kuwait's refining capacities including the completion of the large Al-Zour refinery as well as the so-called Clean Fuels Project aimed at modernizing existing refineries. We note, however, that various investment projects have faced delays in Kuwait in the past and this could persist in the future.

Nevertheless, in line with trends in recent years, we believe Kuwait's economic growth on a per capita basis will remain below peer sovereigns at a comparable level of economic development. While headline growth rates were modest, the country's population has grown over the last five years at an average annual rate of 3%, boosted by an increase in the amount of expats--currently comprising just over 60% of the population. Most expats take up jobs in the private sector. In contrast, Kuwaitis primarily work for the public sector, which is characterized by overemployment and comparatively low productivity levels. Despite the economic diversification and reform efforts announced by the government, we expect progress to be only gradual. This carries downside risks if oil prices turn out weaker than expected.

Kuwait's political system features a powerful cabinet appointed by the Emir, and a democratically elected parliament. In our view, the country's institutional arrangements are generally more balanced compared to other Gulf Cooperation Council (GCC) countries, with the parliament providing at least

some checks and balances regarding government activities. Nevertheless, ultimate power is concentrated with the Emir. This reduces the predictability of decision-making and poses succession risks (the Emir is 89).

Historically, the relationship between the government and parliament has been confrontational, resulting in frequent government reshuffles. The latest round took place in December 2018 when four government officials resigned. The parliament has also opposed some reforms such as those introducing VAT and excise taxes in Kuwait. Importantly, despite these disagreements, Kuwait has managed to consistently pursue a prudent fiscal policy mostly saving its large oil profits as a buffer against potential future shocks.

Geopolitical tensions in the region are likely to persist and perhaps increase due to ongoing tensions between the GCC countries and Iran and the re-imposition of sanctions on Iran by the U.S. Relations have also soured within the GCC since Saudi Arabia, the United Arab Emirates, and Bahrain, along with some other countries in the region, imposed a boycott on Qatar in June 2017. Regional dynamics have become more complicated following the October 2018 killing of journalist Jamal Khashoggi in the Saudi embassy in Istanbul, which could lead to a deterioration in relations between Saudi Arabia and its traditional western allies. We expect Kuwait will maintain its traditional neutral/mediating role in regional disputes and would not be immediately affected by the above developments.

Flexibility and Performance Profile: Kuwait's sizable fiscal and external buffers remain key rating strengths

- We estimate Kuwait's net general government assets at 400% of GDP as of end-2018, which is the highest ratio of all the sovereigns we rate.
- Despite our projection of lower oil prices, the general government budget will post surpluses underpinned by investment returns on accumulated sovereign wealth fund assets.
- We expect the Kuwaiti dinar (KWD) will remain pegged to a USD-dominated currency basket and that the Central Bank of Kuwait's (CBK) monetary policy will continue to be closely aligned with that of the U.S. Federal Reserve.

Kuwait's very large government assets, as a percentage of GDP, remain a key ratings strength. These result from historical savings of oil profits and are accumulated in the Kuwait Investment Authority (KIA), the sovereign wealth fund. KIA comprises the General Reserve Fund (GRF) and the Future Generations Fund (FGF). GRF contains government holdings in several domestic enterprises alongside some portfolio and cash investments that can be deployed for general budget use by the government. In contrast, FGF is intended as a buffer for future generations when the oil runs out. 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, however, require specific legislation to be introduced. By law, at least 10% of government revenues must be transferred to the FGF annually and funds have

never been drawn from the FGF since its inception in 1976.

There is no official data available on the total amount of KIA assets. Moreover, KIA by law is prohibited from discussing the exact size of its holdings. Nevertheless, there are several methods that can be used to indirectly estimate the size of the sovereign wealth fund. These include summing up the government's historical fiscal surpluses or outward financial account flows in the country's balance of payments, the data for which is publicly available. The latter approach, for example, results in an estimate of over 400% of GDP as of end-2018.

In our calculations, we currently mainly rely on IMF data. These lead us to estimate the size of the oil fund at 420% of GDP as of end-2018. As a percentage of GDP, this is the largest sovereign wealth fund of all sovereigns that we rate, affording Kuwait significant buffers to respond to any potential future shocks. Given the only limited general government leverage, we estimate that Kuwait's net general government asset position amounted to about 400% of GDP at the end of last year.

We forecast that as oil prices reduce from 2018 levels, Kuwait's central government deficit will rise from 6.5% of GDP last year to an average of 19.5% over the next four years. The general government budget (which excludes mandatory annual transfers to the FGF and includes the estimates for investment returns on existing stock of KIA assets) will remain in surplus, averaging 7% of GDP over the same period. This mostly reflects investment returns from managing the KIA. Despite the surplus general government budget, the authorities still plan to borrow to cover deficits at the central government level. We estimate that future central government deficits will be financed via both asset drawdowns from the GRF as well as debt issuance. Accordingly, we project general government debt will rise above 50% of GDP in 2022 from less than 20% in 2017 reflecting a combination of both domestic and international issuance. This is based on our expectation that the government will pass the new debt law soon, raising the debt ceiling and authorizing extra borrowing.

Largely mirroring its fiscal position, Kuwait's external balance sheet also remains very strong. We note that despite the detailed public data on Kuwait's balance of payments performance, there is no official international investment position statistics. This hampers our full assessment of external risks.

Nevertheless, based on available data, we estimate that the country is in an external asset position of around 450% of GDP. With the exception of 2016, Kuwait has consistently run current account surpluses--reflecting large volumes of oil exports, favorable prices, and low production costs. We estimate the current account surplus was 14% of GDP in 2018. Taking into account our projections of oil prices staying at $55/bbl on average over the medium term, we anticipate that current account surpluses will moderate, reaching balance toward 2022 as the import bill continues to grow. We believe there is upside potential to this forecast--say if oil production grows faster than we currently anticipate.

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 somewhat more flexible than the foreign exchange regimes in most other GCC countries that maintain a peg to the dollar alone. This is evident, for instance, in CBK's decision to hike the key interest rate only once, compared to four recent U.S. Fed hikes. In our view, some degree of monetary-policy divergence between the Fed and CBK is possible, in part due to the limited amount of portfolio flows between Kuwait and the rest of the world.

Despite the challenging operating environment, the Kuwaiti banking sector remains resilient with stable profitability and improved asset quality. In our view, concentration in the commercial real estate segment remains a key credit risk for banks. For more information on Kuwait's banking system, see the latest BICRA report (see "Banking Industry Country Risk Assessment: Kuwait," Dec. 20, 2018).

Key Statistics

Table 1

Kuwait Selected Indicators

KWD Mil.	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. LC)	49	46	34	33	36	42	39	40	42	44
Nominal GDP (bil. $)	174	163	115	109	120	141	129	135	141	147
GDP per capita (000s $)	43.9	39.7	27.0	24.8	26.6	30.6	27.5	28.2	28.9	29.6
Real GDP growth	1.1	0.5	0.6	2.9	(3.5)	1.0	1.0	2.5	2.5	2.5
Real GDP per capita growth	(2.4)	(2.6)	(2.9)	(1.1)	(5.4)	(1.0)	(1.0)	0.5	0.5	0.5
Real investment growth	8.9	4.5	15.5	11.6	5.2	5.5	5.0	5.0	5.0	4.0
Investment/GDP	14.4	16.3	25.4	30.0	29.1	26.7	31.2	32.0	32.9	33.5
Savings/GDP	54.7	49.7	28.9	25.3	35.0	40.3	34.0	33.5	33.3	33.2
Exports/GDP	70.9	68.5	53.8	47.6	50.4	54.3	47.6	46.3	45.4	44.6
Real exports growth	(4.0)	1.4	(0.9)	2.5	(3.3)	0.5	0.0	2.0	2.5	2.7
Unemployment rate	N/A	2.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
External indicators (%)										
Current account balance/GDP	40.3	33.4	3.5	(4.6)	5.9	13.6	2.8	1.5	0.4	(0.3)
Current account balance/CARs	51.4	42.8	5.2	(7.2)	8.7	19.6	4.3	2.4	0.7	(0.5)
CARs/GDP	78.4	78.1	67.2	64.1	68.2	69.6	65.8	64.5	63.5	62.7
Trade balance/GDP	51.8	47.7	24.4	17.8	21.4	27.7	18.4	17.5	16.7	16.3
Net FDI/GDP	(8.7)	7.0	(4.4)	(3.8)	(6.5)	-5	(4.5)	(4.5)	(3.0)	-3
Net portfolio equity inflow/GDP	(11.1)	(30.1)	(23.6)	(15.2)	(20.8)	-10	(5.0)	(5.0)	(5.0)	(5.0)

Table 1

Kuwait Selected Indicators (cont.)										
KWD Mil.	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Gross external financing needs/CARs plus usable reserves	57.3	67.2	113.8	126.9	105.8	97.8	122.1	129.2	137.5	144.3
Narrow net external debt/CARs	(360.1)	(426.6)	(658.7)	(708.2)	(628.7)	(548.7)	(655.4)	(656.8)	(657.8)	(660.4)
Narrow net external debt/CAPs	(740.8)	(746.0)	(694.9)	(660.5)	(688.7)	(682.2)	(684.9)	(672.9)	(662.4)	(657.3)
Net external liabilities/CARs	(415.6)	(483.3)	(758.6)	(815.7)	(727.5)	(636.5)	(756.6)	(754.9)	(751.6)	(748.0)
Net external liabilities/CAPs	(855.1)	(845.1)	(800.4)	(760.8)	(796.9)	(791.3)	(790.6)	(773.4)	(756.8)	(744.5)
Short-term external debt by remaining maturity/CARs	11.0	12.6	25.7	29.3	25.4	27.8	35.8	39.5	44.3	47.9
Usable reserves/CAPs (months)	1.0	0.8	0.7	0.8	1.3	1.6	1.0	0.7	0.5	0.3
Usable reserves (mil. $)	5,048	4,497	5,293	8,354	10,471	6,540	5,291	3,980	2,604	1,159
Fiscal indicators (general government; %)										
Balance/GDP	37.8	21.6	8.7	7.7	10.4	17.8	6.8	7.0	7.3	7.8
Change in net debt/GDP	(29.4)	(44.4)	11.0	9.8	(6.4)	(15.5)	(6.8)	(7.0)	(7.3)	(7.8)
Primary balance/GDP	37.9	21.6	8.8	7.8	10.9	18.2	7.3	7.8	8.4	9.1
Revenue/GDP	76.1	67.8	61.6	61.3	63.5	67.4	63.2	62.3	61.5	60.7
Expenditures/GDP	38.3	46.3	52.9	53.6	53.1	49.6	56.5	55.3	54.2	53.0
Interest/revenues	0.1	0.1	0.1	0.2	0.7	0.6	0.8	1.2	1.7	2.3
Debt/GDP	3.1	3.4	4.6	9.9	19.8	16.9	28.5	37.1	45.2	52.8
Debt/revenues	4.1	5.1	7.5	16.1	31.1	25.2	45.1	59.5	73.5	86.9
Net debt/GDP	(300.3)	(364.9)	(479.0)	(489.7)	(452.8)	(403.7)	(449.4)	(436.0)	(424.4)	(413.6)
Liquid assets/GDP	303.4	368.4	483.6	499.6	472.6	420.6	477.9	473.1	469.6	466.4
Monetary indicators (%)										
CPI growth	2.7	3.1	3.7	3.5	1.5	0.6	1.5	2.2	2.2	2.2
GDP deflator growth	0.2	(6.8)	(26.0)	(6.8)	13.7	15.5	(9.7)	2.2	2.0	2.0
Exchange rate, year-end (LC/$)	0.28	0.29	0.30	0.31	0.30	0.30	0.30	0.30	0.30	0.30
Banks' claims on resident non-gov't sector growth	5.9	4.3	7.4	2.8	2.2	3.5	3.5	3.5	3.5	3.5
Banks' claims on resident non-gov't sector/GDP	66.2	73.7	106.3	114.0	106.2	94.2	107.0	105.7	104.6	103.6
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	8.6	7.7	9.2	7.2	6.5	N/A	N/A	N/A	N/A	N/A

Table 1

Kuwait Selected Indicators (cont.)										
KWD Mil.	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
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

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

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 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

- Middle East And North Africa Sovereign Rating Trends 2019 Jan. 15, 2019
- Sovereign Ratings List, Jan. 7, 2019
- Sovereign Ratings Score Snapshot, Jan. 7, 2019
- S&P Global Ratings Lowers Brent And WTI Oil Price Assumptions For 2019 Through 2020; Natural Gas Price Assumptions Are Unchanged, Jan. 3, 2019
- Banking Industry Country Risk Assessment: Kuwait, Dec. 20, 2018
- Sovereign Risk Indicators, Dec. 13, 2018; a free interactive version is available at http://www.spratings.com/sri
- Default, Transition, And Recovery: 2017 Annual Sovereign Default Study And Rating Transitions, May 8, 2018

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

Ratings Affirmed

Kuwait	
Sovereign Credit Rating	AA/Stable/A-1+
Transfer & Convertibility Assessment	AA+

Senior Unsecured	AA

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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.

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