FITCH AFFIRMS KUWAIT AT 'AA'; OUTLOOK STABLE

Fitch Ratings-London-24 July 2012: Fitch Ratings has affirmed Kuwait's Long-term foreign and local currency Issuer Default Ratings (IDR) at 'AA'. The Outlooks on both ratings are Stable. Fitch has simultaneously affirmed Kuwait's Country Ceiling at 'AA+' and Short-term foreign currency rating at 'F1+'.

Kuwait's 'AA' ratings are primarily supported by its strong sovereign net foreign assets (SNFA), estimated by Fitch at USD323bn in 2011 (equivalent to 191% of GDP). These result from double-digit budget surpluses registered every year since 1999 thanks to receipts from the country's large oil reserves (6.1% of total world oil reserves). However, exposure to the oil sector (half of GDP, 83% of government revenue and 78% of CXR) is a vulnerability, given oil price volatility and regional geopolitical threats. Difficulties in reaching agreement at the political level have frustrated efforts to diversify away from oil.

Fitch projects oil production levels and prices will ensure continuing high budget surpluses at 27% of GDP in financial year 2012/13 (FY12/13) and 22% in FY13/14 after 31% in FY11/12. Fitch expects oil production to average 2.8 million barrels per day in 2012 (2.5mb/d in 2011) and to remain flat in 2013 and 2014. The agency assumes Kuwait's oil price will decrease to USD104/b in 2012 (from USD108/b in 2011) and USD97/b in 2013 and 2014. SNFA will continue to grow as a result over the rating horizon, enhancing its capacity to deal with economic shocks.

Fitch expects tensions between MPs and the government to persist and to continue to constrain reforms. The institutional framework allows elected MPs to challenge government ministers appointed by the Emir. The opposition between MPs and the government has intensified in recent months and harsh disputes have led to two dissolutions of parliament in seven months (five dissolutions since 2006).

Fitch expects non-oil GDP growth to remain at around 5% up to 2014 after 4.5% in 2011. Government spending will be the main support in the form of increased public wages (+19% in FY2011/12) and capital expenditure. Projects from the Development Plan (DP, 84% of GDP over four years) have been delayed so far due to political disputes over implementation. The agency expects capital expenditure to increase slightly from a low starting point (5% of GDP in 2011). A low execution rate of the DP is a key risk to the growth forecast.

The quality of assets held by domestic banks is improving gradually. Bank lending to investment companies, which experienced a major crisis in 2009, has declined to 9% of total lending (vs. 12% in 2009) as banks have built up provisions against weak loans and written off fully provisioned loans. Non-performing loans have declined as a result, to 7.3% in 2011 from 11.5% in 2009, but remain elevated.

Political dysfunction has reached a new stage and could weigh on the ratings if left unresolved as it affects government effectiveness. Against this, Fitch also notes that Kuwait has relatively open political institutions compared with GCC peers, which reduces the risk of major civil unrest.

A major geopolitical risk event, such as a confrontation between Iran and the international community could be a trigger for a downward movement in the ratings.

Success in diversifying the economy away from oil, and developing the private sector and Kuwaiti employment in the private sector would be rating positive.

For all of Fitch's Eurozone Crisis commentary go to http://www.fitchratings.com/web_content/pages/grs/eurozone

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The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, "Sovereign Rating Methodology" dated 16 August 2011 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Sovereign Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648978