FitchRatings

Fitch Affirms Kuwait at 'AA'; Outlook Stable

Fitch Ratings-Hong Kong-11 April 2019: Fitch Ratings has affirmed Kuwait's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS
Kuwait's key credit strengths are its exceptionally strong fiscal and external metrics and, at around USD60/bbl, one of the lowest fiscal breakeven Brent oil prices among Fitch-rated oil exporters. These strengths are tempered by Kuwait's heavily oil-dependent economy, geopolitical risk, and weak indicators of governance and the business environment. A generous welfare state and the large economic role of the public sector present increasing challenges to public finances, given the robust growth of the Kuwaiti population.

We estimate that the foreign assets of the Kuwait Investment Authority (KIA) reached USD561 billion or 394% of GDP in 2018, accounting for the bulk of Kuwait's sovereign net foreign asset position of 479% of GDP (the highest of any Fitch-rated sovereign). Of the KIA total, the Reserve Fund for Future Generations (RFFG) accounted for almost USD500 billion and has continued to increase, due to investment income and the statutory annual transfer of 10% of government revenue. Meanwhile, the value of the General Reserve Fund (GRF), which holds the accumulated government surpluses after transfers to RFFG, is estimated to have fallen for the fifth year in a row as the government tapped the GRF for deficit financing and the repayment of domestic maturities.

We expect the general government to post a surplus of around KWD3.3 billion (7.9% of GDP) for the fiscal year ending March 2019 (FY18/19), supported by another double-digit increase in oil revenue. According to the government's usual reporting convention (not including KIA investment income in revenue and treating the RFFG transfer as expenditure), the deficit would be over KWD2.2 billion, which roughly corresponds to the financing need. We expect surpluses to moderate in line with our baseline assumption that the Brent price will average USD65/bbl in 2019 and USD62.5/bbl in 2020.

The government's authorisation to issue debt has expired and it is unable to borrow, even to refinance existing maturities, which currently have to be met out of the GRF. As a result, general government debt fell to KWD7.4 billion (around 17% of GDP) at the end of FY18/19, from KWD8.6 billion in the preceding fiscal year. Kuwait's existing eurobonds mature in 2022 and 2027. We understand that the debt law remains a legislative priority for the government and assume that it will get passed in time to enable debt issuance during FY19/20.

Tapping the RFFG would allow Kuwait to sustain current spending levels for decades, but it would require parliamentary approval and could be politically contentious. We estimate that the GRF could be depleted by 2021 in a hypothetical scenario where the government is unable to pass a new debt law, the RFFG transfer continues at the 10% level, there are no investment returns and medium-term deficits remain at the level of FY20/21. We estimate that Brent prices of over USD80/bbl would have to be sustained to eliminate the central government's drawdown of the GRF.

The government is making little progress on its reform programme aimed at boosting its underlying fiscal position, improving the business environment and boosting the role of the private sector as a provider of jobs for a young and growing population of Kuwaiti nationals. It is focusing its efforts on regulatory and administrative measures that do not require approval from parliament, which in turn is trying to minimise the immediate costs to its constituents of reform. The number of Kuwaiti nationals employed in the government rose by 5% in 2018, accounting for more than 80% of total Kuwaiti employment.

The demographic and populist pressures facing the government were highlighted by the parliament's recent passage of a law that allows Kuwaiti citizens to seek early retirement five years ahead of the official retirement age (55 years for men and 50 years for women). Early retirees will suffer a net 2% reduction in their pension, with pension payments by the Public Institution for Social Security (PIFSS) reduced by 5% but the government agreeing to pay 3% to the retirees through the PIFSS. Official estimates put the impact on the government budget at KWD20 million-KWD40 million per year (less than 0.1% of GDP). It is unclear how this scheme will affect the growing actuarial deficit of the PIFSS, the current size of which is unknown but which was estimated at more than 20% of GDP in 2013.

Real GDP rose by 1.3% in 2018, evenly split between the oil and non-oil sectors. We expect a similar growth rate in 2019, driven by non-oil sector growth as the OPEC agreement and delays to refinery upgrades as part of the Clean Fuels Project (CFP) restrict oil sector growth. In 2020, we expect a pick-up in growth to 1.9% with the completion of the CFP and the 615,000 bbl/day Al-Zour refinery. Upside risks to growth would be the end of the OPEC agreement, currently constraining Kuwait's production at 2.73 million bbl/day (against capacity of around 3.15 million bbl/day), or a resolution of the dispute with Saudi Arabia over the Neutral Zone oilfields (which could mean a further 0.35 million bbl/day for Kuwait).

We expect non-oil growth of around 2.5% in 2019-2020 amid continued growth of government spending on wages and investment. The government's draft budget proposal for FY19/20 includes additional capital expenditure commitments of around 2.5% of non-oil GDP, after a similar increase in actual capital spending between FY17/18 and FY18/19. We expect a slight pick-up of private credit growth to 5% in 2019-2020, from around 4% in 2018 (mostly in the oil and retail sectors). The banking sector would be well placed to extend more credit, being adequately capitalised, liquid and profitable.

Relatively muted domestic growth prospects have contributed to Kuwait's track record of current account surpluses, stretching back more than two decades. As a result, we estimate that Kuwait's net international investment position was 527% of GDP in 2018, exceeding the sovereign net foreign asset position by around 50% of GDP. Kuwait's bank and non-bank private sectors are net external creditors and major investors in the rest of the region. We expect this trend to continue, with Kuwait's current account surplus averaging 10% of GDP in 2019-2020 in our forecast, above projected fiscal surpluses.

Kuwait's fiscal and external metrics are highly sensitive to changes in oil prices and production. We estimate that a USD10/bbl increase in the oil price above our baseline assumption would improve Kuwait's fiscal balance by 4-5% of GDP, with a slightly larger effect on the current account. An additional 100,000 bbl/day of oil production would impact the fiscal surplus by around 1.5% of GDP.

DATA LIMITATIONS
The KIA's assets are not officially reported by the government. We estimate these assets by compounding the government's transfers into the KIA, using assumptions about returns and asset allocations that are informed by discussions with the KIA. We benchmark government transfers into the KIA and KIA investment income against the balance of payments.

SOVEREIGN RATING MODEL (SRM) and QUALITATIVE OVERLAY (QO)
Fitch's proprietary SRM assigns Kuwait a score equivalent to a rating of 'AA' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

RATING SENSITIVITIES
The main factors that could individually or collectively lead to positive rating action are:
- Improvement in structural factors such as reduction in oil dependence, and a strengthening in governance, the business environment and the economic policy framework.

The main factors that could individually or collectively lead to negative rating action are:
- Erosion of fiscal and external positions, for example due to a sustained period of low oil prices or an inability to address structural drains on public finances.

KEY ASSUMPTIONS
We forecast that Brent crude will average USD65/bbl in 2019 and USD62.5/bbl in 2020.

We assume broad policy continuity and a smooth eventual transition of power from Kuwait's current Amir.

Fitch assumes that regional conflicts will not directly impact Kuwait or its ability to trade.

The full list of rating actions is as follows:

Long-Term Foreign-Currency IDR affirmed at 'AA'; Outlook Stable
Long-Term Local-Currency IDR affirmed at 'AA'; Outlook Stable
Short-Term Foreign-Currency IDR affirmed at 'F1+'
Short-Term Local-Currency IDR affirmed at 'F1+'
Country Ceiling affirmed at 'AA+'
Issue ratings on long-term senior unsecured foreign-currency bonds affirmed at 'AA'

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Applicable Criteria
Country Ceilings Criteria (pub. 19 Jul 2018)
Sovereign Rating Criteria (pub. 19 Jul 2018)

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Dodd-Frank Rating Information Disclosure Form
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