Friday Times

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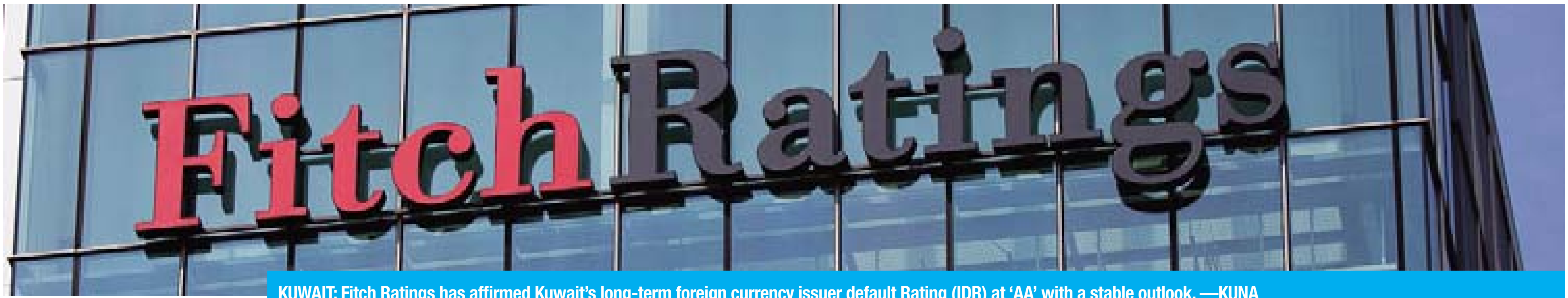

KUWAIT: Fitch Ratings has affirmed Kuwait's long-term foreign currency issuer default Rating (IDR) at 'AA' with a stable outlook. —KUNA

Fitch affirms Kuwait rating at 'AA'

Outlook stable, key credit strengths exceptionally strong

KUWAIT: Fitch Ratings has affirmed Kuwait's long-term foreign currency issuer default Rating (IDR) at "AA" with a stable outlook. Kuwait's key credit strengths are its exceptionally strong fiscal and external metrics and, at around $60/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, 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 $561 billion or 394 percent of GDP in 2018, accounting for the bulk of Kuwait's sovereign net foreign asset position of 479 percent of GDP (the highest of any Fitch-rated sovereign). Of the KIA total, the Reserve Fund for Future Generations (RFFG) accounted for almost $500 billion and has continued to increase, due to investment income and the statutory annual transfer of 10 percent of government revenue.

Meanwhile, 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 KD 3.3 billion (7.9 percent 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 KD 2.2 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 $65/bbl in 2019 and $62.5/bbl in 2020." The government's authorization 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 KD 7.4 billion (around 17 percent of GDP) at the end of FY18/19, from KD 8.6 billion in the preceding fiscal year.

Eurobonds

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 percent level, there are no investment returns and medium-term deficits remain at the level of FY20/21. We estimate that Brent prices of over $80/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 program 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 minimize the immediate costs to its constituents of reform. The number of Kuwaiti nationals employed in the government rose by 5 percent in 2018, accounting for more than 80 percent 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 percent reduction in their pension, with pension payments by the Public Institution for Social Security (PIFSS) reduced by 5 percent but the government is agreeing to pay 3 percent to the retirees through the PIFSS. Official estimates put the impact on the government budget at KD 20 million-KD 40 million per year (less than 0.1 percent 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 percent of GDP in 2013.

Real GDP

Real GDP rose by 1.3 percent 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 percent 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).

Fitch forecast non-oil growth of around 2.5 percent 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 percent 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 percent in 2019-2020, from around 4 percent in 2018 (mostly in the oil and retail sectors). The banking sector would be well placed to extend more credit, being adequately capitalized, 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 percent of GDP in 2018, exceeding the sovereign net foreign asset position by around 50 percent of GDP. Kuwait's bank and non-bank private sectors are net external creditors and major investors in the rest of the region, Fitch said, predicting that this trend would continue, with Kuwait's current account surplus averaging 10 percent 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 $10/bbl increase in the oil price above our baseline assumption would improve Kuwait's fiscal balance by 4-5 percent of GDP, with a slightly larger effect on the current account. —KUNA