Fitch ratings downgrade Kuwait to 'AA-', outlook stable

Higher oil prices have relieved some immediate pressure

HONG KONG: Fitch Ratings has downgraded Kuwait's long-term foreign-currency Issuer Default Rating (IDR) to 'AA-', from 'AA'. The outlook is stable.

Key rating drivers

The downgrade reflects ongoing political constraints on decision-making that hinder addressing structural challenges related to heavy oil dependence, a generous welfare state and a large public sector. There has been a lack of meaningful underlying fiscal adjustment to recent oil-price shocks and the outlook for reforms remains weak, despite some positive political developments as part of a national dialogue. While we assume a debt law will be agreed in 2022, this has been under discussion since 2017, reflecting slow processes for decision-making in Kuwait.

A new cabinet was formed in December 2021, three months after the Amir convened a national dialogue to resolve the impasse between the government and National Assembly, Kuwait's parliament, which has prevented agreement on a new law to allow the government to issue debt. The national dialogue addressed some points of contention with the opposition, notably an amnesty agreement that saw the return from abroad of a number of opposition figures. The cabinet also includes three opposition MPs, whereas it did not before.

We assume that a debt law will be agreed in 2022, although some uncertainty remains. Even without a debt law, the government would still be able to meet its financing obligations. However, the difficulties in passing the law and institutional gridlock have forced the government to rely on stop-gap measures, which is unusual for Kuwait's rating level. The debt law needs to be presented to the parliamentary finance and economic committee, before going to parliament for further discussion and voting. Higher oil prices have relieved some immediate pressure, which could slow decision-making.

Political divisions remain, despite the national dialogue, and are likely to prevent broader reform of Kuwait's fiscal rigidities. More than 70% of government spending consists of sticky current spending, including salaries and subsidies, and about 80% of Kuwaiti nationals are employed in the public sector. We forecast a sharp rise in debt to around 50% of GDP over the medium term after the debt law is approved, from the current low level of 10% of GDP. Further periods of political paralysis also remain a risk. In November, the Amir, who took over the leadership in 2020, handed over some powers to his half-brother, the Crown Prince. While succession processes in Kuwait have generally been smooth, they can present a further headwind to decision-making.

Kuwait's IDRs also reflect the following key rating drivers: Kuwait remains committed to meeting its obligations, even in the absence of a debt law. The government will rely on the assets of the General Reserve Fund (GRF) - the government's treasury account - to meet gross financing needs until new financing arrangements are secured. The bulk of the GRF's liquid assets were drawn down during 2020-2021, necessitating the sale of illiquid assets to the Future Generation Fund (FGF), which contains the bulk of Kuwait's foreign assets. The GRF's current level of liquid assets is not disclosed, although the government has indicated that it more than covers the sovereign's $3.5 billion eurobond maturity in March and that the GRF still owns extensive illiquid assets that could be sold quickly to the FGF if necessary. This occurred in 2020-2021, when the FGF purchased close to $16 billion of GRF assets and a previous transfer of around $7 billion from the GRF to the FGF was reversed.

The government is also proposing an FGF contribution law to allow for dividend payments from the FGF to help finance budget deficits subject to an annual cap. The current law prevents the government from direct access to FGF assets. The contribution law would represent an important financing tool and would allow for a slower rise in government debt. Discussions on the contribution law are more fledgling than discussions over the debt law.

Kuwait's fiscal and external balance sheets remain among the strongest of Fitch-rated sovereigns, despite severe oil-prices swings since 2014 and intermittent political gridlock. We estimate Kuwait's sovereign net foreign asset position at more than 500% of GDP, the highest among all Fitch-rated sovereigns and 10x the 'AA' median. The bulk of the foreign assets are held in the FGF. Gross government debt/GDP is low and we expect it to fall to 10% of GDP in the fiscal year ending March 2022 (FY21), against a 'AA' median of 47%, although government debt is likely to rise to 50% of GDP over the medium term.

We forecast the general government budget deficit to narrow to 1.6% of GDP in FY21from 20.6% of GDP in FY20, largely due to higher oil prices. Attempts to control budget spending have also helped and we expect total spending to be less than budgeted. We forecast the budget deficit to widen to 2.4% of GDP in FY22 and 5.7% in FY23 as oil prices fall back, spending pressure continues and progress on fiscal reforms remains limited. We do not assume the implementation of a value added tax in the next few years.

Fitch's budget calculations include estimated investment interest income of the Kuwait Investment Authority, which is not officially disclosed. Our forecast budget deficit would be 10% of GDP (KD 4.3 billion) in FY21 under the government's reporting convention, which excludes the investment income from revenue, followed by deficits averaging 12% of GDP in FY22-FY23. This corresponds to the government's budget financing needs, as investment income relates to the FGF and is retained by the Kuwait Investment Authority.

Persistently high oil prices would lower financing needs, as budget outcomes are sensitive to changes in oil prices and production. We assume annual Brent crude prices of $70/barrel (bbl) in 2022 and $60/bbl in 2023 and expect Kuwait's average oil production to increase to 2.7 million bbl a day in FY22, in line with the OPEC+ taper, and 2.8 million bbl a day in FY23, from the current level of 2.5 million bbl a day. A $10/bbl change in the oil price impacts the budget by around 5.5% of GDP, all things being equal. A change of 100,000bbl a day of production affects the budget by about 1.7% of GDP.

ESG - Governance: Kuwait has an ESG Relevance Score of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Kuwait has a medium WBGI ranking at the 52nd percentile, reflecting low scores for voice and accountability, weak government effectiveness and middling scores across other governance indicators.

Rating sensitivities

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Structural Features: Depletion of the GRF in the absence of a new debt law, legislation permitting access to the FGF or other extraordinary measures to ensure that the government can continue to make good on its payment obligations, including but not limited to debt service.
- Public Finances: Significant deterioration in 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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Structural Features/Public Finances: Evidence that Kuwait's institutions and political system are able to tackle long-term fiscal challenges, for example, through actions to implement a clear deficit reduction plan that is resilient to lower oil prices, as well as adopting a transparent and sustainable government funding strategy.

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 IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final Long-Term Foreign-Currency IDR by applying its QO, relative to SRM data and output, as follows:

- Structural: -1 notch to reflect political constraints on enacting key economic and fiscal reforms, as illustrated by the difficulties in passing a debt law and the lack of progress on addressing structural public finance challenges stemming from heavy oil dependence, a generous welfare state and a large public sector.
- External Finances: -1 notch to offset the increase in the sovereign net foreign assets/GDP ratio feeding into the SRM, which has been driven in part by the sharp decline in nominal GDP in 2020 (as well as by buoyant global financial markets driving strong investment gains) and which should moderate as nominal GDP bounces back with higher oil prices.

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 Long-Term Foreign-Currency 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.

Best/worst case rating scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

References for substantially material source cited

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG considerations

Kuwait has an ESG Relevance Score of '5[+]' for Political Stability and Rights, as WBGIs have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Kuwait has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Kuwait has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption, as WBGIs have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Kuwait has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Kuwait has an ESG Relevance Score of '4' for Human Rights and Political Freedoms, as the Voice and Accountability pillar of the WBGIs is relevant to the rating and a rating driver. As Kuwait has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Kuwait has an ESG Relevance Score of '4[+]' for Creditor Rights, as willingness to service and repay debt is relevant to the rating and is a rating driver for Kuwait, as for all sovereigns. As Kuwait has track record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies).

Minimum wage in focus as Portugal heads to polls

LISBON: Like nearly one in four workers in Portugal, Fernanda Moreira, a food services worker at a hospital in a Lisbon suburb, earns the minimum wage. "We don't live, we survive," said the 40-year-old mother of a 12-year-old boy whose husband earns just a bit more than her.

"We learn to live with the essentials. It is frustrating and sad." Portugal's large and growing pool of workers like Moreira who earn the minimum wage-and the incumbent Socialist party's plans to raise it further-is a key issue in Sunday's snap election. Nearly 900,000 workers in Portugal earn the minimum wage, which was raised this year by 47 euros to 822 euros ($927) per month, still one of the lowest in western Europe.

Their numbers have doubled over the past decade, according to a study by economist Eugenio Rosa, who warns Portugal "is becoming a nation of minimum wages." Prime Minister Antonio Costa has vowed to raise the minimum wage above 1,000 euros a month by 2026 if he is re-elected. It stood at 589 euros when he took office in 2015.

"It is even possible to go beyond that," Costa said Monday during a radio interview. But the two hard-left parties that have propped up his minority government have slammed the proposed increase as too little while the main opposition centre-right PSD party argues it goes too far.

'Miserable wages'

The Communist party voted against Costa's proposed 2022 budget, prompting the early election, in part because it deemed this year's minimum wage hike too small. The PSD argues minimum wage increases should track growth in productivity and the economy. PSD leader Rui Rio points out that Portugal's GDP per capita has increased by an annual average of just 0.3 percent between 2001 and 2020, less than half the EU growth rate.

Rio, an economist by training, says the government should focus instead on raising the medium wage since qualified graduates are being forced to choose between "miserable wages" at home and emigration. While the minimum wage has steadily risen, the medium wage has stagnated at 1,160 euros per month, reducing the gap between the two.

LISBON: A catering maid is pictured at her work site, a Portuguese custard tart coffee shop in Lisbon. Nearly 900,000 workers in Portugal earn the minimum wage, which was raised this year by 47 euros to 822 euros ($927) per month, still one of the lowest in western Europe. —AFP

"Companies have raised their minimum wages because they were forced to by law, but they left other salaries untouched," said Joao Duque, an economist at Lisbon's School of Economics and Management (ISEG). The government's strategy to achieve full employment has led to the development of an economy based on low wages centred on sectors like tourism and construction, he added. This has "encouraged the emigration of more qualified workers to countries where they are paid better, and the immigration of less qualified workers," Duque said.

'Not our recipe'

Portugal's unemployment rate fell to around six percent last year, its lowest level in two decades- a figure highlighted by the Socialists throughout the campaign. Labour Minister Ana Mendes Godinho said the "significant" rise in the minimum wage has boosted economic growth. "Austerity advocates claimed that freezing wages is the only way to become a competitive country. It's not our recipe," she told AFP.

The policy is popular with many low-wage voters ahead of Sunday's early election, with some polls suggesting the Socialists and the PSD are virtually tied. "We have never seen such a significant increase in the minimum wage," said Amelia Casquinha Fernandes, 60, who earns the minimum wage as a cleaner at Lisbon airport. —AFP

Samsung reports 53% jump in profit despite supply chain woes

SEOUL: South Korean tech giant Samsung Electronics said yesterday its operating profit rose 53.3 percent in the fourth quarter of 2021, as record sales helped overcome pandemic-induced supply chain challenges.

The world's biggest smartphone maker said its operating profit rose to 13.87 trillion won ($11.55 billion) for the October-December period in 2021, up from nine trillion won in the same quarter the previous year.

Thanks to high memory chip prices and strong consumer demand, Samsung had its highest annual sales of 279.6 trillion won in 2021, an 18 percent jump from a year earlier, the company said in a regulatory filing.

Samsung achieved "record sales thanks to competitive products, despite continuing uncertainty," the tech giant said in a statement, singling out solid demand for its premium smartphone lines. While the Covid-19 pandemic has wreaked havoc on the global economy, it has helped many tech companies boom.

Pandemic-driven working from home has boosted demand for devices powered by Samsung's chips, as well as home appliances such as televisions and washing machines. But LG Electronics, South Korea's second-largest appliance firm after Samsung, saw its operating profit shrink by 21.4 percent in the fourth quarter on-year to 677.7 billion won.

Growing demand

The world's biggest memory chip maker, Samsung Electronics has aggressively stepped up investment in its semiconductor business as the world battles chip shortages that have hit everything from cars and home appliances to smartphones and gaming consoles.

The global chip supply shortage is expected to persist well into the new year, analysts have said. "In the Memory Business, demand is expected to grow as enterprises ramp up IT investments while the Company will expand supply of high-performance products," Samsung said. In November Samsung announced a new microchip factory in Texas, a $17 billion investment. The plant is expected to be operational by the end of 2024.

Samsung is also investing in the development of advanced technologies such as artificial intelligence and robotics, as well as 5G and 6G communications.

SEOUL: The flags of South Korea (L) and Samsung are seen hoisted outside the company's Seocho building in Seoul yesterday. —AFP

Park Sung-soon, an analyst at Cape Investment & Securities, said that memory chip prices were likely to decline in the first half of 2022. "Samsung's profit is likely to dip for the January-June period. But we also expect chip prices to turn around in the second half, giving a boost to company profits," he said.

"We had forecast around a 10 percent fall in chip prices in the first months of 2022 but it appears now that the decline scope will be smaller with solid demands for PCs and improved supply chains." Consumer demand for high-end products, such as foldable phones, also helped to further boost profits around the holiday season.

Samsung said it expected the smartphone and premium television market to grow in the third year of the pandemic, though it anticipated sustained "uncertainties triggered by COVID 19 and supply and logistics issues". Operating profits generated from Samsung's semiconductor business accounted for over 63.7 percent of the Q4 total, illustrating the major role the division plays in the sprawling group.

Samsung's operating profit from the semiconductor division stood at 8.8 trillion won for the October-December period. Samsung Electronics is the flagship subsidiary of the giant Samsung group, by far the largest of the family-controlled empires known as chaebols that dominate business in South Korea. The conglomerate's overall turnover is equivalent to around one-fifth of South Korea's gross domestic product. —AFP