FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Kuwait at 'AA-'; Outlook Stable

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Fitch Ratings - Hong Kong - 18 Jan 2023: 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

Credit Fundamentals: Kuwait's key credit strengths are its exceptionally strong fiscal and external balance sheets, while key weaknesses include frequent institutional gridlock and political constraints on reforms that would address fiscal and structural challenges stemming from heavy oil dependence, a generous welfare state and a large public sector. Governance indicators are well below the 'AA' median. There has been a lack of meaningful underlying fiscal adjustment to recent oil price shocks and the outlook for reforms remains weak.

Exceptionally Strong Balance Sheet: Kuwait's fiscal and external balance sheets remain among the strongest of Fitch-rated sovereigns, despite severe oil price swings since 2014. We forecast Kuwait's sovereign net foreign asset position will average 470% of GDP in 2022-2024, the highest among all Fitch-rated sovereigns and more than 10x the 'AA' median. The bulk of the foreign assets are held in the Future Generations Fund (FGF), managed by the Kuwait Investment Authority (KIA), which also manages the assets of the General Reserve Fund (GRF), the government's treasury account.

Gross government debt/GDP is low and we expect it to fall below 10% of GDP in the fiscal year ending March 2023 (FY22) against a 'AA' median of 49%. However, assuming the passage of a debt law, limited fiscal reform and lower oil prices, we forecast government debt will double to 20% of GDP in FY24 and rise further in subsequent years.

Political Constraints Will Persist: Kuwait held an election for the national assembly in September 2022, the ninth general election in 16 years. A government was formed in mid-October. The frequency of elections reflects ongoing friction between the national assembly and the government. The new government and parliament could allow for some policy advances. However, political divisions are likely to persist, as are populist demands from parliament, preventing reform of fiscal rigidities.

Structural Fiscal Challenge: 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. The fiscal break-even oil price (excluding investment income) will remain high (at around USD80/bbl) and the non-oil primary deficit/non-oil GDP is extremely weak at more than 80%, significantly worse than regional peers.

Debt Law High on Agenda: Kuwait has been unable to issue debt since 2017, owing to the lack of an updated debt law. The new government has said that a debt law remains a priority and we assume that it will be agreed during FY23, but a high level of uncertainty remains. The government would still be able to meet its limited debt service obligations in coming years given the assets at its disposal, even if a debt law is not passed. However, the difficulties in passing the law forced the government to rely on stop-gap measures, unusual for Kuwait's rating level, to replenish the liquid assets of the GRF. The government cannot directly access the assets of the FGF without parliamentary approval - this has only happened once, during the invasion of Kuwait by Iraq.

Budget Surpluses Will Fade: We forecast a budget surplus of 12.2% of GDP in FY22, due to higher oil prices (USD95/bbl) and production. We forecast lower oil revenue in FY23 and FY24, assuming average oil prices of USD79/bbl and USD61/bbl in those years and broadly stable output levels (around 2.7 million b/d). This will drive a narrowing of the budget surplus to 5.9% of GDP in FY23 and a return to deficit in FY24. Our forecasts assume a marginal decline in nominal government spending to below KD23 billion, helped by an automatic decline in fuel subsidies and spending restraint across some budget lines in the context of lower oil prices.

Fitch's budget calculations include an estimate for investment interest income of the KIA, which is not officially disclosed. Under the government's reporting convention, which

excludes investment income, our forecasts would translate into budget deficits/GDP of 2% and close to 10% in FY23 and FY24 respectively. Combined with debt service of less than 1% of GDP, this corresponds to the government's fiscal financing need. In FY24 we assume this will be met via 6% of GDP in net domestic and foreign borrowing and around 4% of GDP in drawdowns from GRF assets. If a debt law Is not passed this would imply higher drawdowns from GRF assets.

Oil Dependence: Budget outcomes are highly sensitive to changes in oil price and production. A USD10/bbl change in our oil price assumption for 2023 would affect the budget by around 4% of GDP, other things equal. A change of 100,000 bbl/day of production affects the budget by around 1.5% of GDP.

ESG - Governance: Kuwait has an ESG Relevance Score (RS) 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 51st 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: Signs of greater pressure on GRF liquidity 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 and External 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 (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

- Structural: -1 notch, to reflect 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.

- Public Finances: We have introduced a -1 notch to reflect our expectation that the budget deficit will widen and debt will rise as the impact of cyclically strong global oil prices fades and to reflect significant fiscal rigidities, including structurally large and difficult-to-reform subsidy and wage expenditure, which we expect will drive wider budget deficits over the medium-to-long term. The fiscal break-even oil price (excluding investment income) will remain high (at around USD80/bbl) and the non-oil primary deficit/non-oil GDP is extremely weak at more than 80%, significantly worse than regional peers.

We have removed the previous -1 notch on external finances because the upward impact on the SNFA/GDP indicator from the sharp decline in nominal GDP in 2020 has faded and the number feeding into the SRM is now broadly in line with Fitch's forecasts.

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.

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 AS KEY DRIVER OF RATING

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

The KIA's assets are not officially reported by the government. Fitch estimates 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. Fitch benchmarks government transfers into the KIA and KIA investment income against the balance of payments. Fitch has sufficient confidence in these estimates to maintain the rating.

ESG CONSIDERATIONS

Kuwait has an ESG Relevance Score of '5'[+] for Political Stability and Rights as World Bank Governance Indicators 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 World Bank Governance Indicators 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 World Bank Governance Indicators 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, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Kuwait	LT IDR Affirmed	AA- Rating Outlook Stable		AA- Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR Affirmed	AA- Rating Outlook Stable		AA- Rating Outlook Stable
	LC ST IDR	F1+	Affirmed	F1+
	Country Ceiling	AA+	Affirmed	AA+
senior unsecured	LT	AA-	Affirmed	AA-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 12 Jul 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.3 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.13.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Kuwait	EU Endorsed, UK Endorsed

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