CREDIT OPINION
20 May 2024

Update

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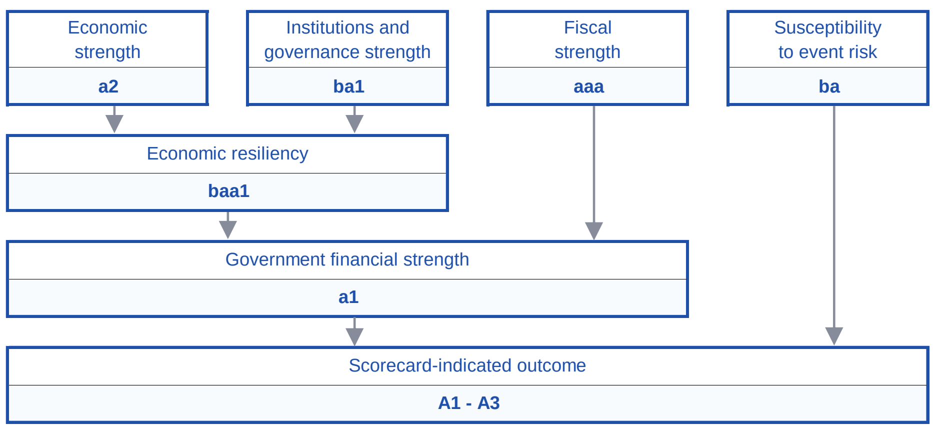
Government of Kuwait – A1 stable

Update following rating affirmation, outlook unchanged

Summary

The credit profile of Kuwait is underpinned by the country's very large fiscal buffers, vast hydrocarbon reserves at low production costs, and very high income levels. Balanced against these strengths are Kuwait's very high dependence on oil and exposure to long-term carbon transition risks and institutional impediments – which the sovereign is aiming to address – that have impaired its ability to address these challenges.

Exhibit 1
Kuwait's credit profile is determined by four factors



Source: Moody's Ratings

Credit strengths

» Very strong government balance sheet

» Substantial hydrocarbon endowment at low production costs

» Very high level of per-capita income

Credit challenges

» Very high reliance on the hydrocarbon sector and exposure to carbon transition risks

» Lack of progress in reforms due to institutional constraints

» Persistent regional geopolitical tensions

Rating outlook

The stable outlook reflects balanced risks to the ratings. Progress in economic and fiscal diversification away from hydrocarbons not currently factored into our baseline assumptions may reduce Kuwait's exposure to oil price fluctuations and long-term carbon transition. The recent dissolution of parliament and temporary suspension of related constitutional articles aimed at overcoming institutional constraints has the potential to accelerate reforms. By contrast, increasing global momentum towards carbon transition that significantly lowers the demand for and price of oil would likely weigh on Kuwait's credit metrics and weaken the credit profile in the absence of fiscal and economic reforms. Our baseline scenario assumes that there is no significant escalation of the geopolitical conflict in the Middle East region into a full-scale multifront conflict that involves Iran, which could have significant negative implications for sovereigns in the region depending on transmission channels, exposures and buffers.

Factors that could lead to an upgrade

The rating may be upgraded if prospects for fiscal and economic diversification away from oil were to significantly improve, in turn raising our assessment of the sovereign's resilience to longer-term carbon transition risks. Indications of greater policy effectiveness that increased the government's ability to respond to shocks, including through a more productive institutional framework over time, would also exert upward pressure on the rating.

Factors that could lead to a downgrade

The rating may be downgraded if the government's fiscal strength were likely to substantially weaken over the medium term, potentially in a scenario where the inability to implement reforms led to wide fiscal deficits as oil prices decline, and accompanied by markedly higher debt (should a new debt law be passed) and/or lower fiscal buffers. While unlikely in the near term, renewed government liquidity risk, particularly if assets in the General Reserve Fund (GRF) were to be significantly drawn down because of persistently wide fiscal deficits, would also exert downward pressure on the rating.

Key indicators

Exhibit 2

Kuwait [1]	2018	2019	2020	2021	2022	2023	2024F	2025F
Real GDP (% change)	2.4	1.4	-5.3	1.7	6.1	-1.6	-1.9	3.8
Inflation rate (% change average)	0.6	1.1	2.1	3.4	4.0	3.6	3.2	3.0
Gen. gov. financial balance/GDP (%)[2]	-8.0	-14.4	-30.4	-6.5	11.4	-3.3	-3.8	-5.1
Gen. gov. primary balance/GDP (%)[3]	-7.6	-14.1	-30.1	-6.3	11.5	-3.2	-3.5	-4.9
Gen. gov. debt/GDP (%)[3]	13.7	9.8	10.7	4.4	2.9	2.8	2.9	2.8
Gen. gov. debt/revenues (%)[2]	27.8	24.1	33.5	10.2	5.7	6.8	6.4	6.6
Gen. gov. interest payment/revenues (%)[3]	0.8	0.8	1.1	0.6	0.2	0.2	0.5	0.5
Current account balance/GDP (%)	14.4	12.9	4.5	26.4	44.0	30.4	31.8	32.5
External debt/CA receipts (%)[4]	59.1	45.4	57.7	44.5	34.3	40.5	43.7	44.0
External vulnerability indicator (EVI) [5][6]	94.5	96.4	80.5	69.5	76.4	70.8	65.6	78.2

[1] Economic forecasts based on an assumed average price for the benchmark Brent crude oil of $83/b in 2023, $82.1/b in 2024 and $75.5/b in 2025. Our broad expectations are that prices will remain volatile within a range of $55-$75/b in the medium term.
[2] Central government; Revenues definition reported as post-transfer to Future Generations Fund; Fiscal years ending March 31, e.g. 2019 refers to fiscal year 2019/20
[3] Central government; Fiscal years ending March 31, e.g. 2019 refers to fiscal year 2019/20
[4] Current Account Receipts
[5] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves
[6] exchange reserves; Excludes sovereign wealth fund assets

Source: Moody's Ratings

Detailed credit considerations

We set Kuwait's **economic strength** at “a2”, above the initial score of “a3”, because the country's very substantial hydrocarbon endowment including on a per capita basis, and low production costs allow the mineral resource to be the long-term driver of incomes and wealth, which the scorecard metrics do not capture. However, given Kuwait's reliance on hydrocarbons, accelerating momentum in global carbon transition would exert negative pressure on its economy and government finances.

Kuwait has among the largest proven oil reserves-to-production ratio globally, sufficient to last around 90 years at the current rate of production, while production costs are among the lowest globally. These advantages give the country more time to adjust to carbon transition. That said, Kuwait's smaller economy compared to other hydrocarbon-exporting peers coupled with its greater reliance on the hydrocarbon sector result in economic growth and nominal GDP that tend to be more volatile than peers.

At “ba1”, our assessment of Kuwait's **institutions and governance strength** balances weaknesses in some aspects of its institutional framework and effectiveness against the ability of institutions to build large fiscal buffers during periods of high oil prices and tap these buffers to limit the deterioration in the government’s credit profile during periods of low oil prices. Lack of progress in reforms – such as the expansion of non-hydrocarbon revenue – and still limited economic diversification reveal underlying and persistent institutional constraints that the government is aiming to address through the recent dissolution of parliament and temporary suspension of related constitutional articles. The fractious relationship between the government and now-suspended parliament had led to relatively frequent changes in the cabinet and delays in policy design and approval.

Monetary policy management is credible and effective, with the dinar's peg to an undisclosed basket of currencies (but likely heavily weighted to the dollar) sustaining relatively low and stable inflation levels. Regulation by the Central Bank of Kuwait (CBK) is generally strong and prudent, and this is reflected in the financial stability of the banking system through periods of macroeconomic volatility.

Our assessment of Kuwait's **fiscal strength** at “aaa” takes into account the government's very low debt burden and the extraordinarily large fiscal buffers, which help cushion high revenue volatility with more than 90% of revenue derived from oil. The government's very strong balance sheet is derived from the very large fiscal surpluses it had in the past when oil prices and/or production were higher compared to current levels. We estimate that government financial assets, which are dominated by those managed by the Kuwait Investment Authority (KIA) in the Future Generations Fund, amounted to more than 400% of GDP at the end of 2022.

Meanwhile, the government's debt burden is extraordinarily low in part because it has been unable to raise new debt since the public debt law expired in 2017. Assuming that a new law allowing the government to incur new debt will eventually be passed, its debt burden will gradually rise as fiscal deficits return over the medium term in the absence of diversification reforms when oil prices decline to our medium-term range of $55-75/barrel. However, we expect the government's debt burden to remain low and its net asset position to remain very large for the foreseeable future.

Kuwait's “ba” **susceptibility of event risk** is driven by political risk. We assess Kuwait’s **political risk** to be “ba” driven by both domestic political and geopolitical risks. Domestic politics are a key credit challenge, as it has led to parliamentary frictions that impede reforms and weigh on the ability of institutions to effectively adapt to shocks and address long-term environmental risks. The sovereign is targeting constitutional reforms to address this challenge, but how effective the reforms will be – to what extent domestic politics becomes less of an institutional constraint – is highly uncertain at this stage.

Geopolitical risks stem from Kuwait’s geographical location, similar to most other Gulf Cooperation Council (GCC) sovereigns. In particular, long-standing tensions between the GCC and Iran, notwithstanding some recent improvements, and the risk of a closure of the Strait of Hormuz represent a low probability, high impact risk to Kuwait, given that all of its oil is exported via the strait. The country's neutral stance in regional conflicts partly mitigates this risk. Our geopolitical risk assessment also incorporates the possibility of military escalations across the broader Middle East region, including in relation to the unresolved issue of the Palestinian statehood and the ongoing civil strife and instability in some countries.

Our assessment of the “baa” **government liquidity risk** balances our expectation that liquidity needs will be limited in the current oil price environment, against longer term liquidity challenges that may arise from wider fiscal deficits in the absence of fiscal reforms and constrained access to borrowing (without legislation change). Even without legislative changes that provide access to borrowing, the GRF's ample resources limit liquidity risk.

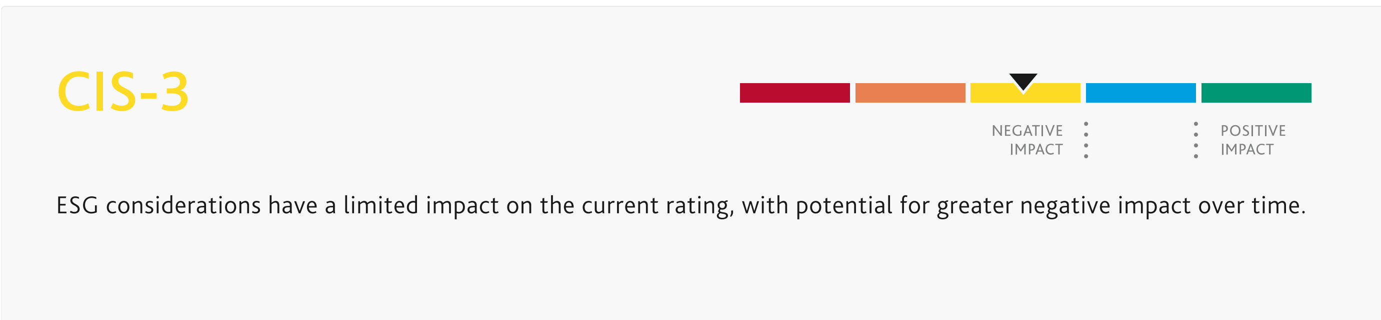
Our “a” assessment of Kuwait's **banking sector risk** reflects the limited contagion posed by the sector to the government's balance sheet and credit profile, despite its large size. This is supported by the track record of financial stability, while banks remain highly capitalised and liquid, with strong provisioning coverage of non-performing loans.

We assess Kuwait's **external vulnerability risk** to be “aa”. Sizeable foreign-exchange reserves held by CBK and the very large stock of foreign assets held by KIA significantly contain external risks. We expect Kuwait to run large current account surpluses for the foreseeable future under our current oil price assumptions.

ESG considerations

Kuwait's ESG credit impact score is CIS-3

Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Kuwait's ESG credit impact score of **CIS-3** indicates that ESG considerations are having some impact on the rating, with greater potential for future negative impact over time given the country's ESG risk exposures. Kuwait is negatively exposed to environmental risks, particularly long-term global carbon transition, and social risks to a lesser extent. Institutional challenges constrain the government's ability to respond to shocks.

Exhibit 4
ESG issuer profile scores

Source: Moody's Ratings

Environmental

Kuwait's exposure to environmental risks (**E-4** issuer profile score) primarily stems from carbon transition as the economy and government finances are highly susceptible to a global transition away from hydrocarbon fuels over the longer term, although low oil production costs provide a degree of insulation to this long-term risk. While less pertinent than carbon transition, Kuwait is also susceptible to water management risks as it is one of the world's ten most arid states, although the use of desalination plants reduces water supply challenges.

Social

The exposure to social risks (**S-3** issuer profile score) is driven mainly by the country's young demographics, which will drive rapid growth in the labour force over the coming decades. The challenge in keeping unemployment low among citizens is more relevant in

Kuwait than some of its regional peers because its private sector is relatively underdeveloped. However, the country's financial wealth places it in a position of comparative strength to manage the social challenges.

Governance

The influence of governance (**G-3** issuer profile score) in Kuwait largely reflects underlying and persistent challenges in the institutional framework, exemplified by the fractious relationship between the government and parliament, that have impeded effective policy formation and constrained the sovereign's ability to implement longer term reforms and respond to shocks. The sovereign is aiming to raise policy effectiveness through the temporary suspension of parliament and eventual constitutional reform, albeit with a risk of undermining the credibility of the country's institutional and governance framework if not used effectively.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

Temporary suspension of parliament offers opportunity for reforms

On 10 May 2024, Kuwait's Amir Sheikh Mishal Al-Ahmad Al-Jaber Al-Sabah announced the dissolution of parliament and the temporary suspension of related constitution articles for up to four years. During this period of suspension, the Amir and the government cabinet (comprising the prime minister and other ministers) will hold legislative powers. The dissolution of parliament and the suspension of the constitution are not new to Kuwait, as there were precedents in 1976-81 and 1986-92.

Fractious relations between the government and now-suspended parliament have hampered Kuwait's ability to implement structural reforms and promote the diversification of the economy. The fragmentation of views across members of parliament and lack of political parties and stable coalitions had resulted in regular gridlocks on policy initiatives and relatively frequent changes in the cabinet, affecting Kuwait's ability to design and implement long-term credit-enhancing policies.

We believe the government's key policy priorities include the implementation of economic and fiscal reforms to address longer-term carbon transition risks and constitutional reform aimed at addressing the underlying institutional constraints to effective governance. While the temporary suspension of parliament provides a window for the government to adopt credit-enhancing reforms, how effective it will be is highly uncertain at this stage.

Real GDP will contract further in 2024 driven by ongoing oil production cuts

We expect real GDP to contract by around 2% in 2024, similar to the contraction of 1.6% in 2023. Ongoing oil production cuts agreed with the Organisation of Petroleum Exporting Countries and other partners (together OPEC+) since November 2022 and further voluntary cuts from May 2023 in coordination with Saudi Arabia (A1 positive), Oman (Ba1 stable) and the United Arab Emirates (Aa2 stable) will weigh on headline growth. Kuwait had agreed to oil production cuts of 135,000 barrels per day beginning November 2022, with further voluntary cuts of 128,000 barrels per day from May 2023 and additional voluntary cuts of 135,000 barrels per day from January 2024, which will last through the end of June 2024. We currently assume that all voluntary cuts will remain in place through the end of 2024 given subdued global demand, which we estimate will lead to a cumulative decline in production levels of around 7% year-on-year in 2024 compared to 2023 levels.

By contrast, we forecast that the non-hydrocarbon sector will grow by around 2-3% in real GDP terms in 2024, driven by the implementation of large projects such as the Mubarak Al Kabeer port and the airport expansion (new Terminal 2). This compares to our estimate of near zero non-hydrocarbon real GDP growth in 2023 that was due to sluggish wholesale and retail trade and manufacturing activity.

Beyond 2024, we expect Kuwait's real GDP to grow by 3.5-4.0% in 2025 as we anticipate some unwinding of the 2024 voluntary cuts in 2025 in line with global growth. Non-hydrocarbon economic activity may also pick up if the government is able to take advantage of the window of temporary parliamentary suspension to implement reforms and accelerate the implementation of diversification projects.

Kuwait returned to a fiscal deficit in fiscal 2023 and we expect the fiscal balance to remain in deficit

We estimate that Kuwait recorded a fiscal deficit of 3.3% of GDP in fiscal 2023 (ending March 2024), compared to the large fiscal surplus of over 10% recorded in 2022, on the back of lower oil prices and production. Given the additional voluntary oil production cuts since January 2024 and based on spending projections in the draft budget for fiscal 2024, we expect Kuwait's fiscal deficit to widen to around 4% of GDP in 2024.

We do not currently expect the government to incur any new debt in fiscal 2024, as there is no legislation in place allowing debt issuance. However, even if the government is able to pass legislation during the temporary suspension of parliament, we expect Kuwait's government debt burden to remain very low for the foreseeable future. Kuwait's debt burden has been declining since the public debt law expired in 2017, falling to below 3% of GDP as of the end of 2023.

Moody's rating methodology and scorecard factors: Kuwait - A1 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				**a3**	**a2**	**50%**
Growth dynamics	Average real GDP growth (%)	2018-2027F	1.3	b2		25%
	MAD Volatility in Real GDP Growth (%)	2013-2022	1.0	baa2		10%
Scale of the economy	Nominal GDP ($ billion)	2022	182.8	baa1		30%
National income	GDP per capita (PPP, Intl$)	2022	53,170.9	aaa		35%
Adjustment to factor 1	*# notches*				1	max ±9
Factor 2: Institutions and governance strength				**ba1**	**ba1**	**50%**
Quality of institutions	Quality of legislative and executive institutions			b		20%
	Strength of civil society and the judiciary			ba		20%
Policy effectiveness	Fiscal policy effectiveness			ba		30%
	Monetary and macroeconomic policy effectiveness			a		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				**baa2**	**baa1**	
Factor 3: Fiscal strength				**aaa**	**aaa**	
Debt burden	General government debt/GDP (%)	2022	2.9	aaa		25%
	General government debt/revenue (%)	2022	5.7	aaa		25%
Debt affordability	General government interest payments/revenue (%)	2022	0.2	aaa		25%
	General government interest payments/GDP (%)	2022	0.1	aaa		25%
Specified adjustments	*Total of specified adjustment (# notches)*			4	4	max ±6
	Debt Trend - Historical Change in Debt Burden	2014-2022	-0.5	0	0	
	Debt Trend - Expected Change in Debt Burden	2022-2024F	-0.1	0	0	
	General Government Foreign Currency Debt/ GDP	2022	2.5	0	0	
	Other non-financial public sector debt/GDP	2022	0.8	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2022	425.6	4	4	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				**a1**	**a1**	
Factor 4: Susceptibility to event risk				**ba**	**ba**	Min
Political risk				ba		
	Domestic political risk and geopolitical risk			ba		
Government liquidity risk				baa	baa	
	Ease of access to funding			baa		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	baa2	baa2		
	Total domestic bank assets/GDP	2022	190.5	180-230		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				aa	aa	
	External vulnerability risk			aa		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**A1 - A3**	**A1 - A3**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

REPORT NUMBER 1403701