



بنك الإمارات دبي الوطني
Emirates NBD

Credit Note

14 May 2018

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Kuwait Debt Update

Situated in the Arabian Peninsula, the State of Kuwait, is a small and relatively open economy with proven crude oil reserves. As at 2017, it had population of circa 4 million and estimated GDP of \$120 billion. Petroleum accounts for circa 57% of GDP and over 90% of government revenues.

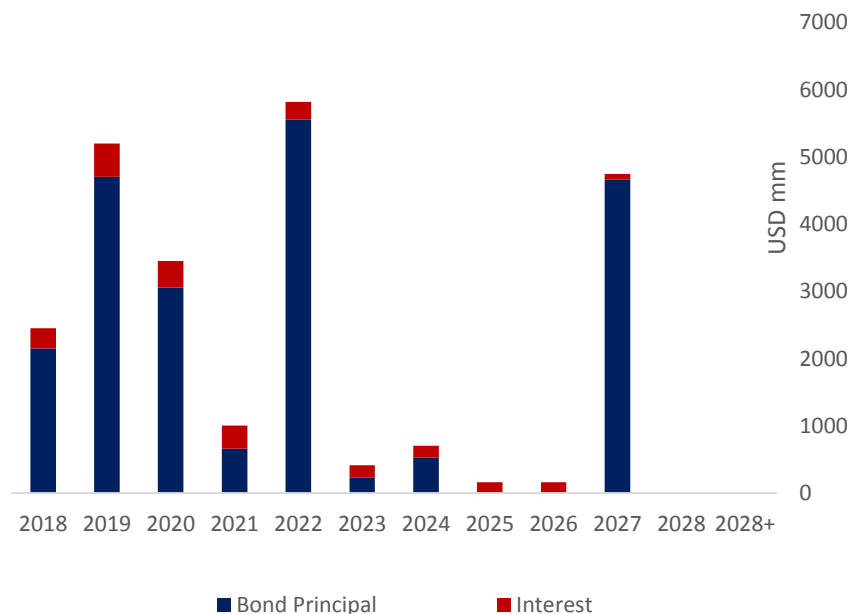
Kuwait is rated AA/stable, Aa2/stable and AA/stable by S&P, Moody's and Fitch respectively.

Kuwait Debt

Kuwait's government debt stands at US \$24.12 billion comprising of USD and local currency bonds. One key difference between Kuwait and other GCC sovereigns is that Kuwait has majority of its debt in the domestic local currency market instead of in hard currencies in international markets.

- Kuwait's current debt obligation is made of two USD bonds amounting to \$9.8 billion (including principal of \$8.0bn and interest of \$1.8bn) and 50 KWD denominated bond issues amounting to equivalent of \$14.3 bn.
- 100% of the debt is at fixed interest rate and is in the bullet format. Interest expense represents circa 10% of the total obligation.

Kuwait Sovereign Debt



Source: Bloomberg, Emirates NBD Research

Kuwait plans to tap international markets again this year after seeking parliament approval to raise debt ceiling to KWD 25 billion from KWD 10 billion and to increase bonds/ sukuk tenure from 10yr to 30yr.

One of the strongest factor supporting Kuwait's credit rating is the large size of FX assets at Kuwait Investment Authority, KIA, of over \$580 billion as at Dec 2017. Kuwait ranks the highest among all the sovereigns rated by S&P Global Ratings in terms of net general government assets. Though low oil prices caused the central government's budget to run in deficit, substantial investment income on KIA assets meant that overall government budgets have remained mostly in the green even during the times of low oil prices.

Kuwait issued its first sovereign international bond in 2017, and will likely continue to tap external bond markets to fund the central government budget deficits via debt. The preference for debt is driven by still relatively low interest rates compared with the return available on KIA's external assets.

Kuwait USD bonds and sukuk

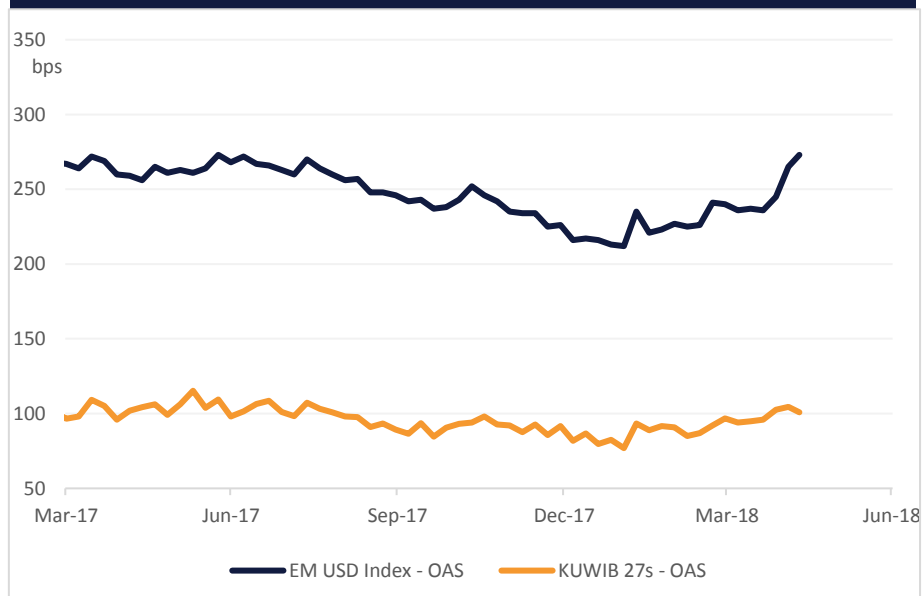
	Ticker	Cpn	Maturity	Amount \$mm	YTW %
Bonds					
	KUWIB	2.75	3/20/2022	3500	3.52
	KUWIB	3.50	3/20/2027	4500	3.99

Source: Bloomberg, Emirates NBD Research

Lately, emerging market bonds have been suffering from rising benchmark UST yields as well as widening credit spreads. In this environment, Kuwait bonds have outperformed their EM peers, mainly benefiting from their scarcity value as investors perceived the country's real need for new debt to be low. Also refinance risk is seen to be very low in view of Kuwait's large FX assets and availability of a vibrant LCY market as an alternate source of raising debt.

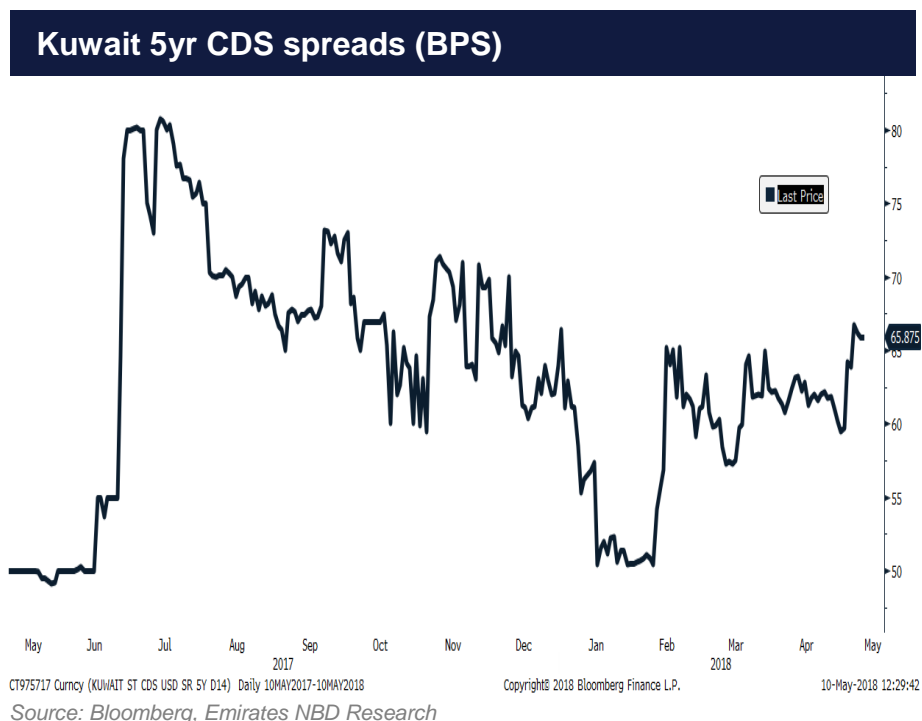
Nevertheless, Kuwait bonds still trade cheaper than those of similar rated Abu Dhabi government, largely due to relatively lower institutional strength and lower ability of the Kuwait's government to impose reforms and subsidies compared with that experienced by the Abu Dhabi government.

Kuwait 3.50% 2027 bond: Z-spread (bps) vs EM Index OAS



Source: Bloomberg, Emirates NBD Research

In the more volatile credit default swap market, 5yr CDS spreads on Kuwait have generally widened in line with the wider market as a result of rising geopolitical tension in the GCC region.



2018 Budget

Kuwait government's own headline budget for FY 2017/18 reflected deficit of KWD 6.6 billion at the central government level. The actual deficit is likely to have been lower given that oil prices averaged higher during the year than the government's assumption of USD45/b for the budget. For 2018/19, the government budget reflects deficit of KWD 5 billion (revenue KWD 15bn, expenditure KWD 20 billion) with assumption of oil prices at \$50/b.

Kuwait's central government is required to transfer 10% of all revenues to the KIA Future Generation Fund. The above budget deficits are before the transfer of 10% of revenues to the fund. Our own estimates of Kuwait's budget deficits are much more optimistic in view of higher prevailing oil prices.

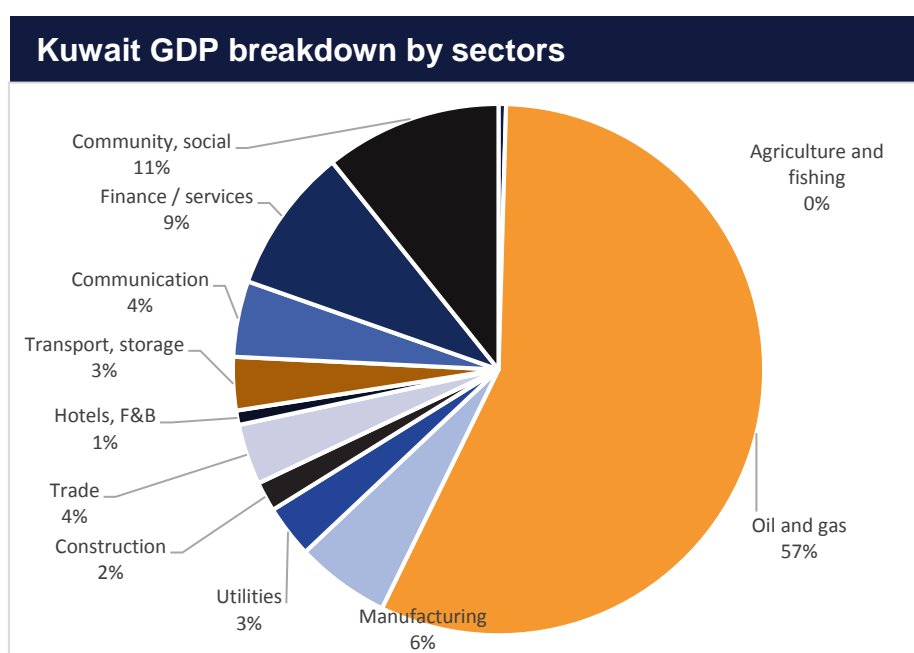
The central government's budget for 2019 reflects deficit of over 12% of GDP in 2018, however, at the general government level, it is expected to have fiscal surplus of circa 10% of GDP after including income on KIA investments. Looking ahead, the general government surplus is likely to increase to over 13% of GDP by FY 2021/22, though still below circa 30% recorded in 2009/2014.

Progress on fiscal consolidation has been limited given the buffers available and the political will to maintain the social contract with its population by preserving the welfare state. Instead of cutting expenditures, the government plans to focus efforts on improving revenue collection, divesting underutilized assets such as land, and implementing its privatization program over the next five years. Plans for corporate tax have been shelved and VAT will probably only be implemented in 2019. To control expenditure, spending limits are expected to be introduced to cap expenditure at 2017/18 level.

Driven by higher oil receipts, our estimate for current account is to be in surplus by over 7% of GDP, however, rising interest payments and import of equipment for the infrastructure work may see it falling down in 2019 -2021.

General Government Debt / GDP currently is around 18% and is expected to increase to 40% of GDP by end 2021/22. Ratings could come under pressure if debt/GDP was to rise above 50% as all agencies are currently expecting only about 40% in worse case scenarios.

KIA assets are estimated to be close to 500% of GDP. Moody's estimate of KIA's assets is at \$597 billion and Fitch estimates it to be around \$580 billion. Circa 25% of KIA's assets are held in General Reserve Fund which is invested in cash and deposits. Fitch estimates KIA's income at KWD 5bn per annum.



Source: Haver Analytics, Emirates NBD Research

Other Credit Considerations

- In case of Kuwait, the main credit concerns are mostly non-financial. Its balance sheet strength and external position is likely to remain strong in the foreseeable future, however, undiversified government revenue sources and rising geopolitical tensions are of concerns.
- Oil production cuts under the OPEC agreement have weighed on Kuwait's GDP growth in 2017 which is likely to have contracted between 2% to 3%. Increasing oil production and increase in broad public spending on infrastructure under the Kuwait National Development Plan are likely to support growth in 2018. GDP growth in 2019-21 is expected to be over 3% as oil output rises to 3 million bpd by 2021 from around 2.7 million bpd currently.
- A record number of land grants under the government's housing program in 2016 will support residential construction activity in the coming years.
- PPP law came into force in 2015 and first project has been completed. Power plans and housing projects are expected to be launched in 2018 after being stalled in 2017.

- Foreign exposure of the Kuwait banking sector is not available. However, its banking sector is seen as stable with high capital adequacy ratios under Basel III standards. S&P's BICRA score for Kuwait is '4' on a scale off 1 to 10 with 1 being the strongest. Banks remain adequately capitalised, liquid, and profitable.
- Kuwait has more flexibility in its exchange rate than its GCC peers. KWD is pegged to an undisclosed basket of currencies, though still dominated by the USD. The benefit of this flexibility was evident in the recent past whereby the Central Bank of Kuwait decided to leave the key discount rate unchanged and lift only the deposit rates when the US Federal reserve raised rates.
- Kuwait's foreign policy is likely to continue to be aligned with the U.S. and Saudi Arabia, and we assume limited spillover to Kuwait from regional geopolitical conflicts.
- Kuwait's political system is characterized by a powerful cabinet appointed by the Emir and a democratically elected parliament, and the relationship between the two has been historically confrontational. However, decision-making ultimately rests in the hands of the Emir, who can dissolve the parliament as well as the cabinet. This limits institutional checks and balances.
- Kuwait has very low fiscal and external breakeven oil prices, which limit the deterioration in fiscal and current account balances. In addition, Kuwait has extraordinarily large hydrocarbon reserves at very low production costs.
- High per capita income of over \$90k, provide significant economic buffer in terms of social stability.

Kuwait Economic Data				
KWDbn	2015	2016	2017	2018
Nominal GDP	34.5	33.5	36.4	41.2
Revenue	13.6	13.1	16.4	19.3
Expenditure	18.2	17.7	18.5	20.0
Budget Deficit KWD bn	-4.6	-4.6	-2.1	-0.7
Budget Balance (% GDP)	-13.4	-13.8	-5.8	-1.6
CA balance % GDP	3.5	-4.5	6.3	7.8
Oil Revenue % Total	88.6	89.2	90.9	

Source: Haver Analytics, Emirates NBD

Credit Ratings

S&P affirmed Kuwait's rating at AA/stable recently citing its strong balance sheet and external position. The rating could be upgraded if political reforms enhanced institutional effectiveness and improved long-term economic diversification, or if prospects for the oil sector improved significantly, though such scenarios are unlikely

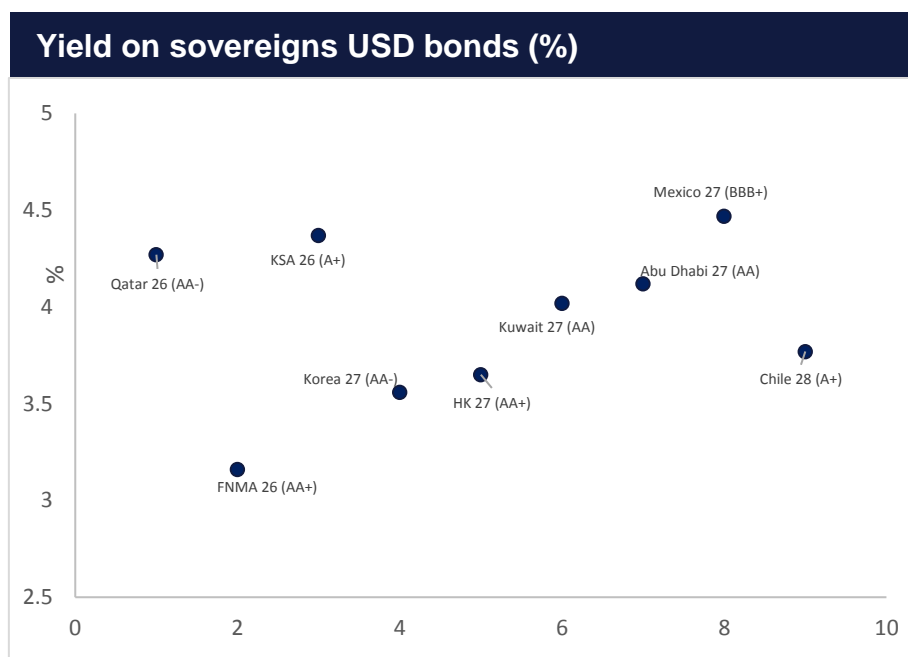
over the forecast horizon. Kuwait derives about 57% of GDP, more than 90% of exports, and about 90% of fiscal receipts from hydrocarbon products.

Moody's affirmed Kuwait's rating at Aa2/stable in mid-2017 and has kept it unchanged ever since. Given Kuwait's strong financial position, from Moody's perspective the pressure on the rating may arise due to institutional weakness falling below the level appropriate for a Aa2 rating. The coming years will provide insights into the capacity of Kuwait's government to articulate and implement a credible policy strategy which has previously remained untested.

Fitch affirmed Kuwait's rating at AA/stable earlier this month citing Kuwait's exceptionally strong fiscal and external metrics and low fiscal breakeven oil price of only \$56 / b. Fitch expects Kuwait government surplus to be about 2.4% of GDP for FY17/18, 0.7% of GDP in FY18/19 and FY19/20. Kuwait's non-oil growth seen at about 3.5% in 2018-2019.

Relative Value

Given Kuwait's very high credit rating and based on the current trading prices, Kuwait bonds appear attractive on relative value.



Source: Bloomberg, Emirates NBD Research

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