Euler Hermes Economic Research

Country Report

Kuwait

High dependency on oil but large financial buffers

General Information

GDP	USD175.83bn (World ranking 56, World Bank 2014)
Population	3.48mn (World ranking 134, World Bank 2014)
Form of state	Constitutional Emirate
Head of government	HH Sheikh Al Ahmad Al Jaber Al Sabah
Next elections	2017, legislative

Strengths

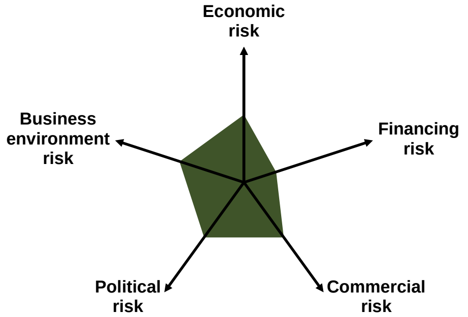
- World's seventh largest proven oil reserves.
- Strategic importance in troubled region and major non-NATO ally of the US.
- High income. Net creditor status.
- Strong oil and gas revenues generate large fiscal and current account surpluses during times of high oil prices and "excess" earnings are invested in foreign assets and/or used to supplement an oil account that is for the use of future generations.
- Low external obligations.
- Generally supportive business environment.

Weaknesses

- Combative political system that can slow reforms and policy implementation.
- Exposure to oil price and output cycles contributes to growth volatility.
- Industry is capital intensive and job creation is weak for a growing population, with social repercussions as the unemployed seek alternative means to vent their frustrations.
- High degree of public ownership and control of oil and gas sectors results in a generally weak private sector.
- Vulnerability of oil installations and foreign personnel to attacks by extremists and terrorists.
- Regional volatility and uncertainty.

Country Rating

BB1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Korea, Republic of	17%	1	14%	China
India	16%	2	10%	United States
Japan	13%	3	9%	United Arab Emirates
United States	12%	4	7%	Japan
China	11%	5	7%	Germany

By product (% of total)

Exports		Rank		Imports
Petroleum, petroleum products and	82%	1	16%	Road vehicles
Gas, natural and manufactured	5%	2	5%	Electrical machinery, apparatus and
Organic chemicals	3%	3	5%	Other industrial machinery and parts
Plastics in primary forms	2%	4	5%	Iron and steel
Road vehicles	1%	5	5%	Telecommunication and sound

Source: Unctad

Economic Overview

It's all about oil

Kuwait possesses the world's seventh largest proven oil reserves (6% of global resources) and, at current rates of extraction, its oil will last for another 89 years. Gas reserves have a life time of over 100 years. The oil sector dominates the economy (over 60% of GDP). The non-oil part of the economy is small and utilities, services, public administration and defence provide the main impetus to non-oil sector growth. In expenditure terms, net exports regularly provide a positive stimulus to overall growth (oil and gas account for almost 90% of export revenues). However, GDP growth is volatile, even relative to the Middle East region (see chart). In 2011 and 2012, with international benchmark oil prices over USD100/barrel, annual GDP growth was +9.6% and +6.6%, respectively. The impact of lower oil prices from Q4 2014 has been felt throughout the economy, including in terms of GDP growth.

To counter weak oil prices, Kuwait has adopted a similar policy to Saudi Arabia and has increased output (around 1.5mn barrels per day) in an attempt to maintain or increase market share. Asian markets account for approximately 60% of exports.

A period of relatively low GDP growth will be sustained by significant financial resources accumulated during times of higher oil prices. FX reserves provide around seven months of import cover and the country's Sovereign Wealth Fund (SWF) is estimated at around USD590bn.

Large fiscal surpluses have turned to deficits but will be supported by large financial assets

The state budget is usually projected on the basis of a very conservative oil price, so revenues almost invariably exceed official forecasts. Moreover, spending on capital projects is limited by the political system in which the government and parliament struggle to agree on policy implementation. As a result, official budget projections are not a reliable indicator of fiscal outcomes. In periods of high oil prices, Kuwait's large annual fiscal surpluses climb significantly upwards. Fiscal surpluses equivalent to an annual average +17.8% of GDP were registered in the period 2000-2014. Deficits of around -5% of GDP are likely in 2015 and 2016 but a General Reserve Fund, FX reserves and SWF (see above) will provide adequate support.

Public debt is low, at around 6% of GDP, and its management is unlikely to be a problem.

Uncertain policy response to the period of lower oil prices

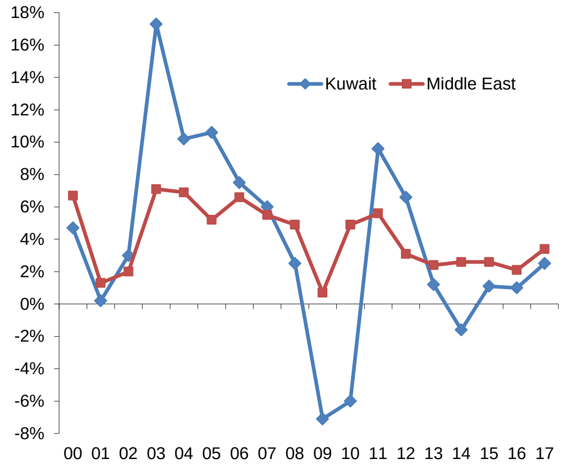
As with other GCC oil exporters, Kuwait is attempting to implement a reform programme to diversify the economy away from oil and improve fiscal revenue generation. However, a fractious political system, with frequent blocks on enactment of legislation, raises uncertainties relating to whether some reforms, including a proposed 10% corporate income tax and 5% value-added tax (from 2018) will come to fruition. Moreover, plans to reduce fiscal spending, particularly on public sector wages, are likely to prove difficult as labour unions and other work committee groups have already displayed opposition to change.

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	-1.6	1.1	1.0	2.5
Inflation (%, end-year)	3.0	3.0	3.2	3.2
Fiscal balance (% of GDP)	7.5	-5.1	-5.5	2.0
Public debt (% of GDP)	3.4	5.0	6.5	6.0
Current account (% of GDP)	33.0	5.6	4.0	8.0
External debt (% of GDP)	15.6	23.4	29.0	26.0

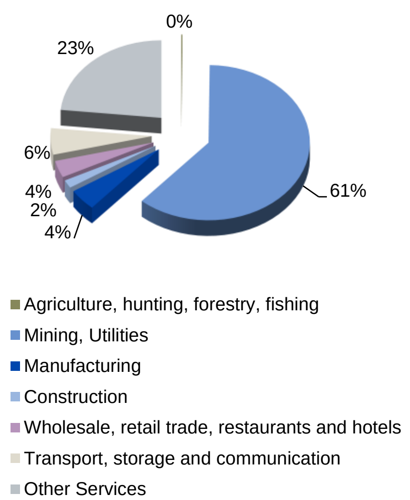
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

GDP breakdown



Sources: UN, National sources, Euler Hermes

Exchange rate system is unlikely to change in the short term

Unlike most exchange rate regimes of GCC countries, which are pegged to the USD, the Kuwaiti dinar (KWD) is pegged to an undisclosed basket of currencies. Nominally, the peg provides Kuwait with more flexibility in monetary policy. In practice, with the basket weighted heavily towards the USD, the KWD follows closely the movements of the former and the exchange rate is relatively stable. Despite speculation that GCC currencies will be revalued because of reduced oil earnings as a result of weak prices, Kuwait is unlikely to change its peg, partly because FX reserves and the SWF provide financial backing and partly because its exports are largely conducted in USD.

External accounts have deteriorated but will remain in surplus

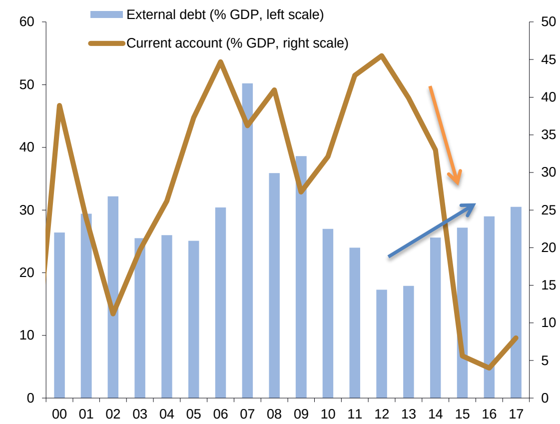
As with the fiscal accounts, surpluses in the current account of the balance of payments become magnified in times of high oil prices. In 2011 and 2012, the current account surplus was equivalent to over +40% of GDP. The surplus in merchandise trade in 2013 was around +USD90bn, which was equivalent to over 50% of GDP. With current weak oil prices, external accounts have deteriorated and we expect the trade surplus will fall to around +USD18.5bn in 2016 and the current account surplus will fall to around +4% of GDP.

FX reserves provide import cover of around seven months and external debt obligations are low

FX reserves ended 2015 at almost USD29bn and provided an import cover of seven months. However, usual large hard currency inflows are used to supplement sovereign wealth funds and buy foreign assets, so the nominal level of FX reserves indicates only a small part of the overall asset base of the country. The Sovereign Wealth Fund amounts to around USD590bn and net foreign assets are estimated at over USD400bn. Meeting trade payments is unlikely to be a problem over the forecast period to end-2017.

External debt is relatively low, at around 29% of GDP and 58% of export earnings. Moreover, servicing of current external obligations is comfortable, with a ratio of debt servicing/export earnings of 11%.

Current account and external debt (% of GDP)



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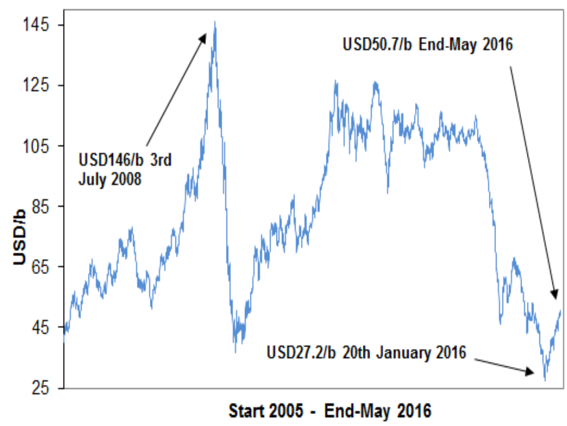
Oil Prices (Brent benchmark, USD/barrel)



Sources: FT, Euler Hermes

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