

RAM

COUNTRY ASSESSMENT REPORT

JUNE 2011

MIDDLE EAST - THE STATE OF KUWAIT

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PUBLIC FINANCE RATINGS

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Kuwait at a Glance:¹

Population:

3.6 million (2010e)
Median age: 28.5 years

Nominal GDP:

KWD37.6 billion (2010e)
USD131.3 billion (2010e)

Nominal GDP per capita:

KWD10,435 (2010e)
USD36,412 (2010e)

Real GDP growth:

2004-2008 (average) 7.2%
2009 (5.2%)
2010e 2.0%

Unemployment rate:

1.6% (2010e)

Inflation rate (average consumer prices):

2004-2008 (average) 4.9%
2009 4.0%
2010e 4.1%

General government debt (% of GDP):

2008 : 10.0%
2009 : 12.9%
2010e: 10.5%

System of government:

Constitutional monarchy

Head of State:

Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah (since January 2006)

MIDDLE EAST

– The State of Kuwait

■ Summary

The State of Kuwait (“Kuwait” or “the State”) – an oil-rich Arab nation – is situated on the north-western shore of the Persian Gulf. Kuwait is bordered by Iraq to the north and Saudi Arabia to the south.

Positives

- A small but wealthy and open economy, with approximately 102 billion² barrels of crude-oil reserves (or roughly 9.5% of the world’s reserves).
- The Kuwaiti government has a strong financial position. Its net-asset position is underpinned by sizeable savings vis-à-vis a series of fiscal surpluses and assets accumulated in its sovereign wealth fund.

Negatives

- Geopolitical risk.
- Kuwait has a concentrated economy; dependence on the oil sector exposes it to the vagaries of external demand and fluctuating oil prices.

¹ Sources for *Kuwait at a Glance*: International Monetary Fund (“IMF”) World Economic Outlook (“WEO”) database (April 2011), CIA World Fact Book, CEIC Database.

² OPEC Annual Statistical Bulletin 2009.

Head of Government:
Prime Minister Sheikh
Nasser Al-Mohammed Al-
Sabah (since April 2007)

Parliamentary Elections:
Kuwait has only 1
parliamentary chamber.

The last parliamentary
elections were held in
May 2009, with 210
candidates vying for 50
seats.

■ Economic Structure & Performance

- The third-largest economy among the Gulf Cooperation Council (“GCC”) nations.
- An externally driven and rather concentrated economy; the oil and gas (“O&G”) sector features prominently in Kuwait’s economy.
- Possesses substantial oil and gas reserves.
- The public sector dominates the State’s economy; there are efforts to increase the private sector’s participation and raise the contributions of non-oil economic sectors.
- Population enjoys a high average income, but their wealth is mostly invested outside Kuwait.

Table 1: Selected key economic indicators of Kuwait

Details	2006	2007	2008	2009	2010 (e)
GDP, constant prices (KWD million)	17,372	18,146	19,048	18,060	18,415
GDP, current prices (KWD million)	29,470	32,581	39,991	31,500	37,631
GDP, current prices (USD million)	101,560	114,677	148,770	109,463	131,315
GDP per capita, constant prices (KWD)	5,458	5,482	5,533	5,108	5,106
GDP per capita, current prices (KWD)	9,259	9,842	11,616	8,909	10,435
GDP per capita, current prices (USD)	31,908	34,643	43,213	30,960	36,412
Government revenue (% of GDP)	67.3	69.7	59.8	65.5	59.7
Government expenditure (% of GDP)	31.8	29.9	39.9	41.9	42.3
Gross debt (% of GDP)	10.5	11.4	10.0	12.9	10.5
Current-account balance (% of GDP)	44.6	36.8	40.5	26.1	31.8
Unemployment rate (% of total labour force)	1.4	1.7	1.7	1.6	1.6

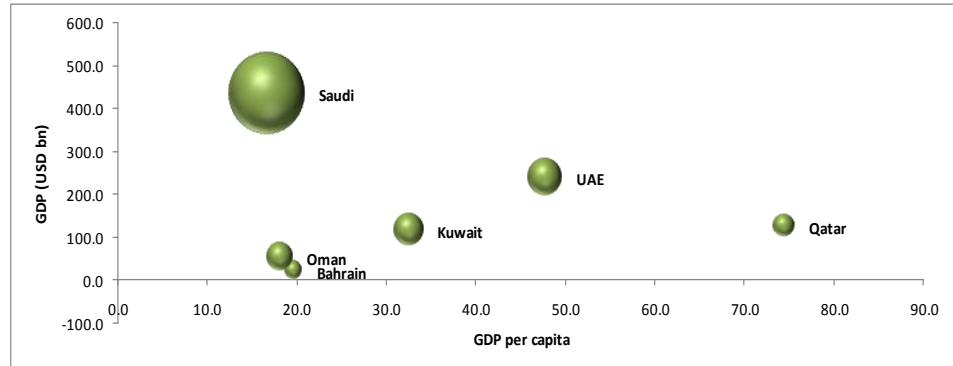
Source: IMF World Economic Outlook Database, April 2011.

Note: Numbers for 2010 are IMF estimates.

Third-largest economy among GCC nations

Kuwait has the third-largest economy among the GCC nations, with an estimated nominal GDP of USD131.3 billion (2010). It was also the third-wealthiest – as measured by GDP per capita - and third-most populous GCC member in 2010, accounting for an estimated 9% (or roughly 3.6 million) of the 41 million people currently residing in that region.

Chart 1: Estimated size and wealth of the 6 GCC nations in 2010

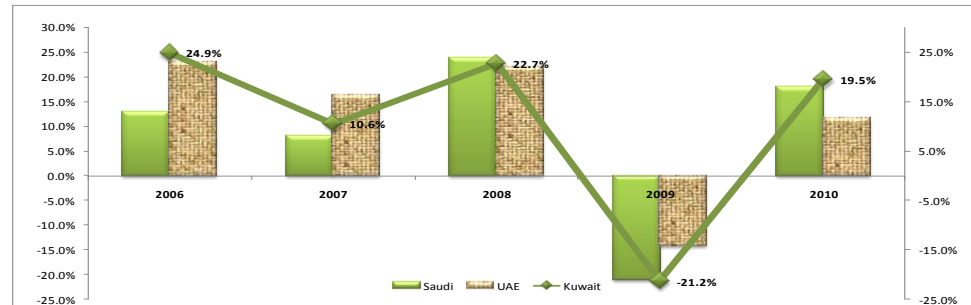


Source: IMF World Economic Outlook Database, April 2011.
 Note: The size of the circle denotes the size of the population.

Externally driven, rather concentrated economy

Kuwait’s economic performance largely correlates to the oil sector; oil and gas account for roughly 60% of the State’s GDP³. This, points to 2 observations: lack of economic diversity and vulnerability to volatile oil prices. This was apparent in 2009, when its nominal GDP contracted 21.2% – the first decline in 5 years – on the back of plummeting oil prices that had stemmed from the world economic turmoil.

Chart 2: Nominal GDP growth rates of the 3 biggest economies in the GCC



Source: IMF World Economic Outlook Database, April 2011.

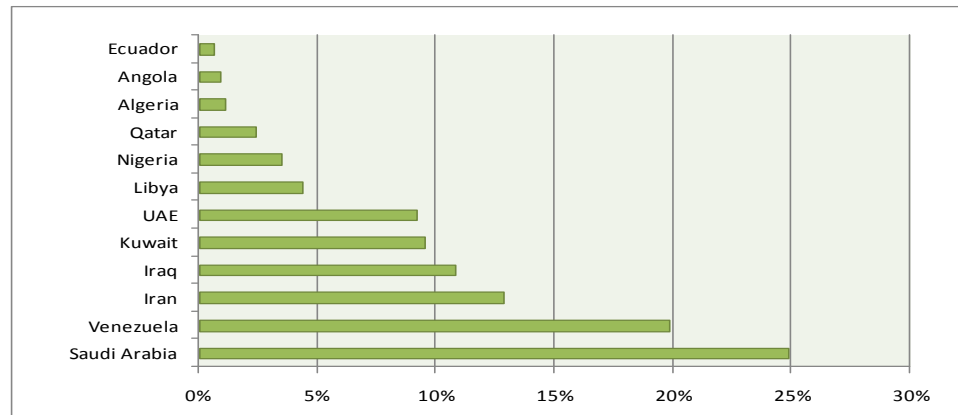
Substantial oil reserves to last another century

A founding member of the Organisation of the Petroleum Exporting Countries (“OPEC”), Kuwait has significant influence in the organisation owing to its large production capacity. The State has substantial proven oil reserves, which are officially⁴ estimated at 102 billion barrels. OPEC’s current production quota for Kuwait stands at 2.2 million barrels per day. At this rate, the State’s current reserves can carry it for another 100 years or so. Kuwait also has approximately 3 trillion cubic feet⁵ of natural gas reserves, with a current production capacity of

³ Data sourced from the IMF’s country report on Kuwait, published in July 2010.
⁴ OPEC Annual Statistical Bulletin, 2009.
⁵ US Energy Information Administration.

some 175 million cubic feet per day. Moving forward, the State targets to increase its production to 1 billion cubic feet per day by 2015. On the whole, the Kuwaiti economy is expected to be able to sustain its medium- to long-term economic growth, driven by rising global demand for petroleum products, which form the backbone of the State's economy.

Chart 3: OPEC's share of world oil reserves



Source: OPEC Annual Statistical Bulletin, 2009.

Reducing public sector's dominance while increasing contributions from non-oil economic sectors

The public sector is by far the largest employer in Kuwait; it employs the majority of Kuwaiti nationals and also dominates the State's oil sector. Kuwait's oil sector is entirely state-owned. The Kuwaiti authorities, recognising the public sector's dominance over the economy, are pushing for economic diversification. To this end, Kuwait's Parliament has approved a USD125 billion, 5-year long-term development plan (in January 2010), aimed at transforming the State into a major financial hub and trade centre by 2035. The Kuwaiti government plans to push project development through local and foreign companies while encouraging private-sector job creation⁶. A number of projects are already in the pipeline⁷, with expectations of greater contributions from the non-oil sectors of the economy. Nonetheless, these projects are on the Kuwaiti government's long-term agenda; RAM Ratings believes that it would be some time before this targeted economic shift can materialise.

⁶ The Kuwaiti Manpower Restructuring Programme targets the placement of 20,000 citizens in private-sector jobs over the next 2 years. The programme is designed to alleviate the financial burden of the State by encouraging Kuwaitis to join the private sector's workforce. National employment has been a key priority throughout the region for some time, and certainly since a 2003 World Bank report, which stated that the Middle East would need to create 100 million jobs by 2020 to deal with its increasingly younger population. The Manpower Restructuring Programme has successfully placed 70,000 citizens in private-sector positions over the last decade.

⁷ These projects include the estimated USD77 billion Silk City project, the USD25 billion project to enhance oil production and facilities, the USD14 billion Metro project, a major container harbour, a 25-km causeway and additional infrastructure projects.

High income population but wealth mostly invested outside Kuwait

The build-up of Kuwait's high-income economy can be seen from its steadily increasing GDP per capita. Despite this, very little progress has been made in terms of infrastructural changes and in diversifying the economy away from its dependence on oil. Kuwait ranks 60th out of 139 countries under the infrastructure pillar i.e. one of the 12 "pillars of competitiveness" in the Global Competitiveness Index ("GCI"). The State also falls into the middle tier under the "business sophistication pillar". This is clearly evident as its bickering parliament continues to stand in the way of Kuwait's economic and business development. As a result of these domestic uncertainties, a large part of its domestic savings - rather than being invested locally - ends up as wealth accumulated abroad. These investments reap benefits in the form of investment income and are an indirect diversification from the State's otherwise "oil only" income base.

■ **Government Finances**

- Kuwait continues to chart consistent fiscal surpluses.
- Light sovereign debt load.
- Rather narrow and concentrated income base.

Table 2: Selected government finance indicators – Kuwait

Details (KWD billion)	2006	2007	2008	2009	2010 (e)	2011 (e)
Government revenue	19.84	22.72	23.91	20.64	22.48	28.64
Government expenditure	(9.38)	(9.76)	(15.97)	(13.21)	(15.90)	(17.79)
Government surplus / (deficits)	10.46	12.96	6.94	7.43	6.58	10.85

- 1) Government revenue consists of oil revenue and others.
- 2) Government expenditure consists of wages and salaries, goods and services, transport and equipment, construction and land acquisition, and miscellaneous items.
- 3) The numbers in the table above are for a calendar year and are sourced from the IMF.

Consistent surpluses in last 5 years; strong capacity to implement counter-cyclical fiscal stance

Kuwait's fiscal surplus is expected to augment to KWD10.85 billion in 2011, on the back of the recovering global economy. The State is expected to remain resilient as it: (i) has built up a buffer of reserves from past fiscal surpluses; (ii) is in a net-asset position; (iii) has one of the world's lowest ratios on government gross debts to GDP; and (iv) has a large sovereign wealth fund (estimated at USD202 billion) that it can tap. While expenditure is expected to increase this year, we opine that the growth in its revenue (driven by stronger oil prices and rising global demand) will more than offset this.

Low sovereign debt level

Kuwait's general sovereign gross debt mainly consists of treasury bills and bonds, which amounted to approximately KWD3.96 billion (or 10.5% of its GDP)

as at end-2010. The government's debt level has remained one of the lowest among the GCC countries and also the world. The State is further cushioned against debt increases by its 2 government reserve funds. These funds are currently managed by the Kuwait Investment Authority⁸ and are estimated to contain roughly USD202 billion⁹. This is equivalent to about 154.2% of the State's 2010 GDP estimate, and dwarfs its sovereign debt. It points to a very comfortable buffer for "emergencies" and underscores the fiscal muscle of the Kuwait government.

Rather narrow and concentrated income base

Oil revenue still contributes more than 80% of the Kuwaiti government's revenue. The State's income base remains highly vulnerable to the vagaries of external demand and fluctuations in the price of oil and efforts by the government to diversify and broaden its income base may take some time to bear fruit. Additionally, the political landscape of Kuwait (please refer to the section on political stability) makes it rather difficult for economic reforms to take place. Existing interest groups continue to block parliamentary approval for major changes in ownership rules and privatisation.

■ External Position

- Current-account balance expected to remain sizeable and in positive territory.
- Liquidity position envisaged to stay strong.
- Trade balance anticipated to be kept positive in 2011.

Table 3: Selected external position indicators – Kuwait

Details (USD billion)	2006	2007	2008(p)	2009 (e)	2010 (e)
Exports	56.5	62.6	87.0	50.5	61.3
Imports	(16.2)	(19.1)	(22.9)	(17.1)	(19.2)
Trade balance	40.3	43.5	64.1	33.4	42.1
International reserves	11.8	15.9	16.7	17.7	24.5
Current-account balance	45.3	42.2	60.2	28.7	33.8

Source: IMF country report – Kuwait

Current-account balance expected to remain positive

Kuwait's current-account, which captures trade, services and investments between Kuwait and the world, averaged about 41% of its GDP between 2006 and 2008; this mirrored the effects of lofty oil prices.

⁸ Kuwait's Sovereign Wealth Fund now contains roughly USD202 billion. The Kuwait Investment Authority ensures that the State transfers 10% of its oil revenue to the Reserve for Future Generations every year.

⁹As quoted by the Sovereign Wealth Fund Institute.

Lower prices and weaker demand for oil in 2009 exerted the opposite effect, although the country's current-account balance has remained positive, offset by reduced and cheaper imports¹⁰. For 2010, Kuwait's exports are estimated to have risen some 21%¹¹ on the back of higher prices and demand for the State's primary commodity.

Strong liquidity position

The current-account surpluses have largely been channelled into investments abroad, and to shore up the Kuwaiti central bank's official reserves. We estimate that the State's foreign reserves, including the Kuwait Investment Authority's estimated assets, are sufficient to support more than 140 months of imports, or 3.7 times its external debts.

Trade balance seen to stay positive this year

Oil exports typically account for the bulk of Kuwait's annual export receipts, with some 90% of its total exports derived from the petroleum sector. The uncertainties plaguing Middle Eastern countries have lifted the price of crude oil past USD100 per barrel, from just over USD70 in August 2010. Against this backdrop, we opine that Kuwait's trade balance will remain positive this year, on the back of burgeoning demand for and rising exports of the State's primary commodity.

■ Political Stability

Kuwait is a constitutional monarchy. The Emir, Kuwait's head of state, has substantial influence over its direction (as allowed by its constitution). The Emir is traditionally a descendant of the Al-Sabah family. The incumbent, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, has been the Emir since January 2006.

Heightened geopolitical risk amid political unrest in Middle East

Since early this year, the political situation in the Middle East has been volatile. However, we opine that the regional political turmoil is unlikely to have a significant impact on Kuwait's economic outlook. Despite its relatively large *Shia* Muslim minority, the small and sporadic protests in the State have been contained; there has been no apparent disruption to its economy.

Slowly but surely changing political landscape

In May 2010, the Kuwaiti National Assembly passed a broad and historic privatisation bill¹² ("the Bill"). This had signalled the culmination of an era when the gathering momentum for change had brought about a rare and welcome level

¹⁰ About 36% of Kuwait's imports comprise consumer goods (mainly durables (30%), excluding motor vehicles) and food (28%).

¹¹ IMF country report – Kuwait, July 2010.

¹² This bill was first proposed about 18 years ago. A method of diversification, it practically opens public services and state-owned companies to private ownership including foreign companies.

of leadership from parliamentarians, along with an unusual degree of cooperation between the legislative and executive branches of government. In March 2011, however, the Kuwaiti cabinet resigned. Elections – which are meant to be held once every 4 years, are expected to take place in the middle of this year. Despite this, the Bill will remain in force. Nonetheless, its implementation and execution could prove rather challenging. While differences between the 2 branches of government may point to an environment of “check and balance” and prolonged disagreements, the strength of Kuwait’s ultimate ruler – the Emir - is expected to provide some stability to the overall landscape¹³.

Kuwait remains vulnerable, but perceived to enjoy strong international support

Threats to Kuwait’s external security are heightened by the State’s proximity to Iran. Kuwait’s vulnerability in the event of any potential conflict stems from its large hydrocarbon industry, which could make it a target for international retaliation. On the flip side, Kuwait’s cordial relationship with the other GCC nations and its links with the United States help cushion the risk of external and internal threats to some extent. The support that Kuwait enjoys from these countries is not expected to wane given the strategic importance of the State’s economy.

➤ **Institutional Environment**

We have compared Kuwait’s rankings on several international benchmarks, i.e. the GCI, the World Governance Indicators (“WGI”) and the Ease of Doing Business Index, to gauge the State’s institutional environment. Overall, Kuwait currently lags behind its GCC peers in these benchmarks. The State has a particularly poor score in terms of “regulatory quality” under the WGI (2009); this indicator measures the ability of a government to formulate and implement sound policies and regulations that permit and promote private-sector development. In contrast, positive assessments under “rule of law” and “control of corruption” suggest that Kuwait has an adequate platform on which it can build.

Meanwhile, the State climbed up to 35 for the period of 2010/2011 in the Global Competitiveness Index (it had previously occupied the 39th position out of 139 major and emerging economies for the period 2009/2010). Kuwait’s strength is attributable to its “macroeconomic stability” (ranked 2nd out of 139 countries), which is seen to stem from its government’s fiscal clout.

¹³ The Emir has the authority to decide whether to accept the resignation of the cabinet, or to dissolve the National Assembly (i.e. the parliament) and call for fresh elections. Unlike the National Assembly, where members are selected through elections, the Kuwait Cabinet comprises Ministers who are appointed (with approval from the Emir) by the Prime Minister (who is selected by the Emir). The national assembly may, however, force the resignation of a Minister by filing a motion (i.e. request for the Minister to be questioned in parliament) and/or calling for a vote of no-confidence against him/her.

When comparing its position against the 11 other “pillars of competitiveness”¹⁴, however, the State generally falls among the lower half of the 6 GCC countries.

¹⁴ As defined in the Global Competitiveness Report, Kuwait is ranked 35th out of 139 major and emerging economies.

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