Kuwait

Economics

Export Development Canada / Exportation et développement Canada

Economic

Credit Agencies

Moody's: A2

S&P: A+

Fitch: AA-

Nominal GDP (2005)

US$75.5bn

Population (2005):

2.9 million

Total Trade / GDP:

86%

Currency:

Kuwaiti dinar

Exchange regime:

Conventional peg

Merchandise imports from Canada: 2005

Cdn$105.6mn

Main sources of Foreign Exchange (excl. FDI):

Oil (2.69mn b/d)

Largest Merchandise Trading Partner:

Japan (21%)

South Korea (12%)

Main imports:

Consumer Goods (54%)

Risks to the Outlook

High oil prices; low debt load; solid fiscal & trade position.

Slow reform process, excessive reliance on oil revenues.

May 2006

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Market Spotlight: Performance has been solid in recent years due to higher oil and non-oil activities. GDP growth was strong and inflation low. Kuwait recorded large fiscal and external accounts surpluses. The stock price index more than tripled between 2003 and 2005. This economic success will be maintained in 2006 and 2007 driven by sustained high oil prices, a slight up tick in oil export volume, and rising FDI associated with oil field expansion plans. The outlook is strong, even if reforms are slow, due to projected strong world oil prices and future plans for the hydrocarbon sector. Kuwait has a US$22bn plan to expand oil capacity to 3mn b/d by 2008 and double the production of petrochemical products. The new legislation passed in 2003 that allows 100% foreign ownership will boost FDI in the years ahead.

Macroeconomic performance: Kuwait's economy strengthened further in 2004 and 2005 due to the buoyancy of world oil prices and strong non-oil activity. GDP growth averaged 7.5% a year. GDP per capita jumped to US$26,000 in 2005. Current oil production is about 2.69mn b/d. Kuwait's economy remains heavily dependant on its oil sector. Oil accounts for roughly 60% of GDP and 90-95% of government revenues. Current oil production capacity is estimated at 2.6-2.8mb/d, but plans are in the works to boost capacity to 3mn b/d in 2008 and eventually to 4mb/d. Given the expected buoyancy of the global oil market and Kuwait's plans to expand and diversify its hydrocarbon sector, GDP growth is expected to be at least 6.5% in 2006 and 5% in 2007.

Fiscal policy: Kuwait has enjoyed sizeable budgetary surpluses dating back to 1999. The budgetary surplus jumped to 40% of GDP in 2005 and is expected to be in the area of 43% of GDP in 2006. This is remarkable by international standards. This has been due to significantly higher oil prices combined with larger oil output (above quotas) resulting in much larger government revenues. Kuwait has the dilemma of how to "best manage" larger than expected oil windfalls. The IFIs have been encouraging Kuwait to rationalize subsidies and to improve the structure of the budget because the country would show a budgetary deficit of 35% of GDP if one excludes oil revenues. The surge in oil prices and in liquidity, which combined with speculation, has led to frenzy in the stock market and the WPI jumped by 67% in 2005. Profits in companies have been a reflection of capital gains on stock investments. Fortunately, the financial system (strong bank capitalization) is well equipped to withstand a reasonable correction.

The monetary policy: It has managed to maintain price stability. However, buoyant economic conditions have led to higher inflation of 4% in 2005. It is likely to be in the area of 3.5% in 2006 despite subsidies. Kuwait is expected to maintain the "peg" exchange regime for the dinar to the US dollar.

The external sector: The current account surplus will remain significant in 2006-07 along side a minimal external debt load. Kuwait also has fairly sizeable external financial assets estimated at US$100bn and providing also decent non-oil income stream. The external current account could move into deficit should oil prices drop below US$18-20/bbl. However, this is not anticipated in the foreseeable future.

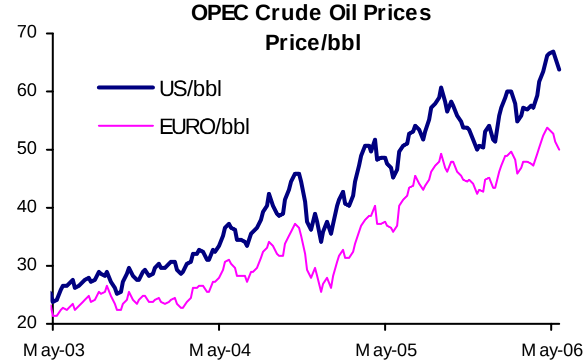
***OUTLOOK**: Medium- term growth prospects remain linked to international oil prices, which for the moment appear to favor Kuwait.*

Economic Indicators

	00-04 avg.	2005	2006	2007
GDP (% growth, real)	6.3	8.5	7.1	5.4
Inflation (%, year-end)	1.1	3.9	3.5	3.0
Fiscal Balance (% of GDP)	19.5	40.5	43.0	42.0
Exports (US$ bn)	20.7	45.1	54.2	56.0
Imports (US$ bn)	-9.3	-13.5	-14.7	-15.9
Current Account (US$ bn)	9.7	32.2	42.3	42.9
Reserves (month of imports)	7.1	5.2	5.6	5.5
External Debt (US$ bn)*	11.0	12.6	12.4	12.8
Debt Service ratio	3.5	3.6	3.3	3.2
Currency (per US$, year-end)	3.4	3.4	3.4	3.4

Source: EIU, EDC Economics * including private sector

OPEC Crude Oil Prices Price/bbl



Source: Bloomberg, EDC Economics

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General Political Environment:
Kuwait is a constitutional hereditary monarchy in which political power is concentrated in the hands of the Emir and the ruling al-Sabah family.

A democratically-elected (male suffrage only) 50-member unicameral legislature has taken on an increasingly assertive role vis-à-vis the ruling family in recent years. Nevertheless, the balance of power rests firmly with the executive branch of government.

A succession crisis was triggered following the death on January 15, 2006 of Emir Jaber al-Ahmad al-Jaber al-Sabah. While the ailing Crown Prince Saad al-Abdullah al-Salem al-Sabah was swiftly proclaimed Kuwait's new Emir, his poor-health prompted discussions among the two branches of the ruling al-Sabah family on whether to replace him with Prime Minister Sabah. Although family consensus did finally emerge on the transfer, it was pre-empted by a vote within the National Assembly approving Prime Minister Sabah as Kuwait's new Emir. Among Gulf states, the Kuwaiti's Assembly decision to depose its hereditary leader was an important first and bodes well for the continued strengthening of Kuwait's democratic credentials over the long-term.

Following an unprecedented request by three liberal MPs to question the Kuwaiti Prime Minister and member of the ruling al-Sabah family on the issue of constituency reform, the Emir moved to dissolve the Assembly in late May 2006. New elections have been called for June 29. While the dissolution offers some short-term respite to the political mpasse which had gripped the Assembly and holds out a slim hope that the incoming Assembly may prove more accommodating than the last, the electoral reform issue has only been delayed as opposed to resolved.

Investment Environment:
Kuwait is increasingly adopting a more welcoming attitude towards increasing foreign direct investment. The implementing regulations of Kuwait's March 2001 Foreign Direct Investment Law were approved by the Kuwaiti cabinet in 2003. The law provides for a range of investment incentives, the right to freely repatriate profits, and affords guarantees against the expropriation of an investment without due compensation. There are no restrictions on current or capital account transactions and equity, dividend, interests and profits can all be freely transferred in or out of the country. The Kuwaiti cabinet also recently approved a draft law which cuts corporate tax rates from 55% to 15% for foreign entities operating in Kuwait.

Investors are often frustrated by the slow pace of the Kuwaiti legal system and a cumbersome bureaucracy.

Given the ongoing struggle between the National Assembly and the government over a number of issues including economic reform, foreign investors should expect more delays in the passage of the long-awaited multi-billion dollar Project Kuwait bill which promises to open up Kuwait's upstream oil sector to international oil firms.

Political Violence:
The Kuwaiti leadership remains weary of the spillover effects that could result from continued unrest in Iraq and/or Saudi Arabia.

A number of extremist cells are present in Kuwait and several extremist-related security incidents occurred in January 2005. There is no indication, however, that a sustained militant campaign is about to take root.

Kuwait is at risk for isolated terrorist attacks. While other pro-Western Gulf States are similarly at risk, a number of factors (location, presence of extremist cells, number of potential targets) contribute to Kuwait's more elevated risk of attack than its small Gulf neighbours.

Political

Political Structure
Constitutional Hereditary Monarchy

Head of State
Emir Sabah al-Ahmad al-Jaber al-Sabah

Crown Prince
Sheikh Nawwaf al-Ahmed al-Sabah

Prime minister (appointed by Emir)
Sheikh Nasser Muhammad al-Ahmad al-Sabah

Main Bodies

National Assembly: 50-member elected parliament

Major Parties
Illegal but unofficial political blocs exist in the Assembly estimated as follows: Islamists (Salafists and Muslim Brothers) 21, government supporters 14, liberals 3, and non-partisans, 12.

Elections
Legislative: July 5, 2003

Next elections
Legislative: June 29, 2006

Press Freedom Survey:
- 2005 Score: 58 (Partially Free)

freedomhouse.org

Control of Corruption Index:
- 2004 Score: +0.71

(-2.5: Worst; +2.5: Best)
worldbank.org

June 2006
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Political Outlook

Regime stability is expected to continue over the short to medium term.

Kuwait's short-term outlook is bright now that long-standing political uncertainty over the succession issue has come to an end. With a new Emir, Crown Prince and Prime Minister at the helm, the re-invigorated Kuwaiti leadership is expected to focus on addressing pressing issues of economic reform.