Forbes Middle East

Kuwait Bonds With International Investor

Kuwait's debut international bond received a warm welcome from the market, but it's unlikely to lead to a lot more debt issuance from the country in the near-term.

Kuwait made a splash with its debut in the international bond market in mid-March, raising $8 billion from regional and international investors following a five-day roadshow in London and three cities in the United States. Demand was high, with more than 778 orders totalling $29 billion, according to officials.

The success of the issue was a sign of the vibrancy of the Gulf bond market as well as the strength of the Kuwaiti government's financial position, even at a time of lower oil prices. Kuwait has one of the strongest credit ratings in the GCC, alongside Qatar and Abu Dhabi, and Finance Minister Anas Al- Saleh said the reaction to its debut bond "highlights the state of Kuwait's strong credit standing amongst its international peers".

The issue is likely to account for almost a quarter of all GCC bond issuance this year. Moody's Investors Service says it expects around $32.5 billion to be raised through international bond sales over the course of 2017. The figure is slightly lower than the $38.9 billion raised by GCC governments in 2016, due to higher anticipated oil revenues this year and cuts to government spending programs across the region. Even so, all GCC governments have been getting in on the act. Other recent issues include the $5 billion raised by Oman at the beginning of March and a $9 billion sharia-compliant bond (sukuk) launched by Saudi Arabia in April. Order books for new issues are often three or four times oversubscribed.

Matching the 'gold standard'

Kuwait's bond should cover most, if not quite all, of the government's financing needs in the short-term. Khatija Haque, head of Middle East and North Africa (MENA) research at Dubai-based Emirates NBD, says Kuwait's bond "should finance more than 80% of the 2017/2018 budget deficit, with the remainder covered by drawing down reserves".

The issuance was divided into two tranches. A $3.5 billion, five-year tranche was priced with a yield of 2.887% or 75 basis points (bp) over U.S. Treasuries, while a $4.5 billion, ten-year portion carried a yield of 3.617%, giving a spread of 100bp over U.S. Treasuries. Those spreads are lower than most in the GCC and close to those of Abu Dhabi's which, according to National Bank of Kuwait, "until now had been considered the 'gold standard' in the GCC".

In geographic terms, the allocation of the five-year bonds was led by European investors, who took up 46% of the total, followed by those from the MENA region (26%), the Americas (24%) and Asia (4%). A majority (51%) of the ten-year debt was sold to American investors, followed by those from MENA (26%), European (19%) and Asia (4%).

Kuwait may return to the market with further issuances, although there is no real rush. The government is in an enviable position compared to most of its Gulf neighbors. Its fiscal breakeven price for oil is one of the lowest in the region, at an estimated $46 a barrel, according to Fitch Ratings, and it has large savings and low debt. And while the budget has recently slipped into the red, the government is expected to start posting a surplus again before long, which will further reduce the need to raise debt.

“Given the success of the previous bond sale, the Kuwaiti authorities may be tempted to return to the international bond market, but with the country’s budget and current account positions set to return to surplus, future bond sales are likely to be much smaller in scale,” says Jason Tuvey, Middle East economist at the London-based consultancy Capital Economics. “Indeed, higher oil prices and the progress already made with fiscal austerity mean that bond issuance across the whole of the GCC is likely to slow.”

A further factor which could reduce the need for debt issuance comes from the domestic political scene which, at the best of times, is prone to bouts of turmoil and disagreement between the National Assembly and the government. Signs of parliamentary opposition have been growing in recent weeks, with a number of MPs calling for a grilling of the Prime Minister Jaber Al-Mubarak Al-Hamad Al-Sabah over his handling of corruption allegations, the revocation of some Kuwaitis’ citizenship and government spending plans, among other issues. In the past, such calls have led to parliament being dissolved or the government resigning. In either case, the chances of significant spending programs going ahead in the near-term are diminished, which will also reduce the need for the state to raise more funds.

Maintaining a market presence

But bonds can have a purpose beyond simply plugging budget deficits and underpinning project spending. Establishing a sovereign benchmark yield curve can help other local issuers tap into international capital markets and, for that reason alone, Kuwait may decide it is worth maintaining a presence in the market.

Steffen Dyck, senior credit officer at Moody’s Investors Service, says there is unlikely to be any more large issues from Kuwait in the near term, although he says the government might look into tapping the sukuk market, in the wake of the recent Saudi issuance.
“We wouldn’t expect a lot more [bond issuance],” he says. “If you look at where the deficit might go with oil prices higher, then there is less need for financing. But I think Kuwait would want to maintain a presence in the market, providing an international benchmark for other sectors. Would they need it? Probably not. But they would probably want to maintain at least a 10-year presence.”

Indeed, the government has given some broad hints that it is thinking along these lines. Al-Saleh told local media that the government “will continue to be present in the international debt market, but in a prudent, rational way,” when speaking on the sidelines of the Kuwait Financial Forum in early April. He has also said the government is considering issuing 30-year bonds and setting a ceiling of KD20 billion ($62 billion) on its debt program over the next five years

Part of that figure will be taken up with domestic debt issuance. Currently, the government’s domestic debt stands at KD3.8 billion ($12.5 billion), or around 10% of GDP, but there is demand for more from the country’s banks which have deposits they need to invest.

Overall, Kuwait’s approach in this area has matured greatly in recent years, something that is characterized by the establishment of a debt management committee in 2016, which is led by the undersecretary at the Ministry of Finance and includes representatives from the Central Bank of Kuwait and the country's sovereign wealth fund, the Kuwait Investment Authority. A debt management unit is also being set up at the finance ministry to support the committee's work, helped with technical assistance from the International Monetary Fund. If and when Kuwait does decide to return to the international debt markets with another big issue, it will at least be well placed.

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